
The Transition to RBC 2 for Malaysian General Insurers – Charting a Course to Success

# AVOIDING DANGERS AND SEEKING OPPORTUNITIES FOR PROFITABLE AND EFFICIENT CAPITAL DEPLOYMENT

Solvency regulations for insurance companies across Asia continue to evolve. Over the past 5 years, regulators in Hong Kong, China, Korea, Japan and Singapore have updated their solvency approaches, becoming increasingly risk sensitive. Malaysia is no exception to this trend. With the publication of the exposure draft for RBC 2, Bank Negara Malaysia (BNM) is seeking to drive greater alignment of solvency requirements with risk exposures.

RBC 2 is scheduled for implementation in 2027. Engaging with the proposed changes now will pay dividends and help shape its final implementation. The time is now to start preparing for the impacts of this change by shaping your business strategies—underwriting, distribution, reinsurance, investment, capital and financing, and M&A—to achieve maximum capital efficiency.

## RBC 2's Proposed Changes

RBC 2 adopts concepts from the Insurance Capital Standards (ICS) framework,[1] introducing several enhancements aimed at improving the risk sensitivity of capital requirements, contributing to the sustainability of the industry.

Changes to both sides of the solvency calculation are on the table in the exposure draft, with capital requirements being the most significant.

**Table 1:** Summary of Main Changes in the Draft RBC 2 Proposal

| Type of Change | Change Component | Description and Likely Impact on Capital Adequacy Ratio | | Key Points |
|---|---|---|---|---|
| **New Risk Category** | Catastrophe Risk | Mandatory flood risk | ↓ | Modelled vs. factor bases |
| | | Factors for other material perils | ↓ | Materiality considerations |
| **Changes in Risk Charges** | Operational Risk | 1% of total assets to 2.75% of GWP or insurance liabilities[2] | ↓ | Likely to represent an increase for most, if not all, companies |
| | Insurance Risk | Premium and reserve risk charges | ↓ | Most risk charges are increasing |
| | | | ↑ | Medical/Health are exceptions |
| | Market Risk | Increasing equity/property risk charges | ↓ | |
| | | Stress factors for interest rate risk charges | ↓ | |
| | | Non-default spread risk charge added | ↓ | |
| | | Asset concentration risk charge is changed | ↓ | Reduction of counterparty limits will increase concentration |
| **Structural Changes** | Diversification Effects | Diversification credit given but limited within general insurance risk | ↑ | Highly dependent on risk mix<br>Opportunity if current mix is not optimised |
| **Quantitative Change** | BNM Intervention Level | Reduced from 130% to 100% | ↑ | Does not improve the actual ratio optics |

[1] As set out by the International Association of Insurance Supervisors
[2] Central estimate of gross insurance liabilities

## Catastrophe Risk

A significant change in RBC 2 for general insurers and general takafuls (GIGT) is the introduction of a catastrophe risk charge. This new requirement reflects the increasing frequency and severity of such occurrences, driven by factors such as climate change and urbanisation.

Flood risk is singled out for specific treatment in the exposure draft, pointing to the growing impact of flood losses in Malaysia. The flood event in 2021-2022 caused an estimated USD 700 million (MYR 2.5 billion) in insured losses. While extreme, floods have increased in frequency and severity in the last 30 years.

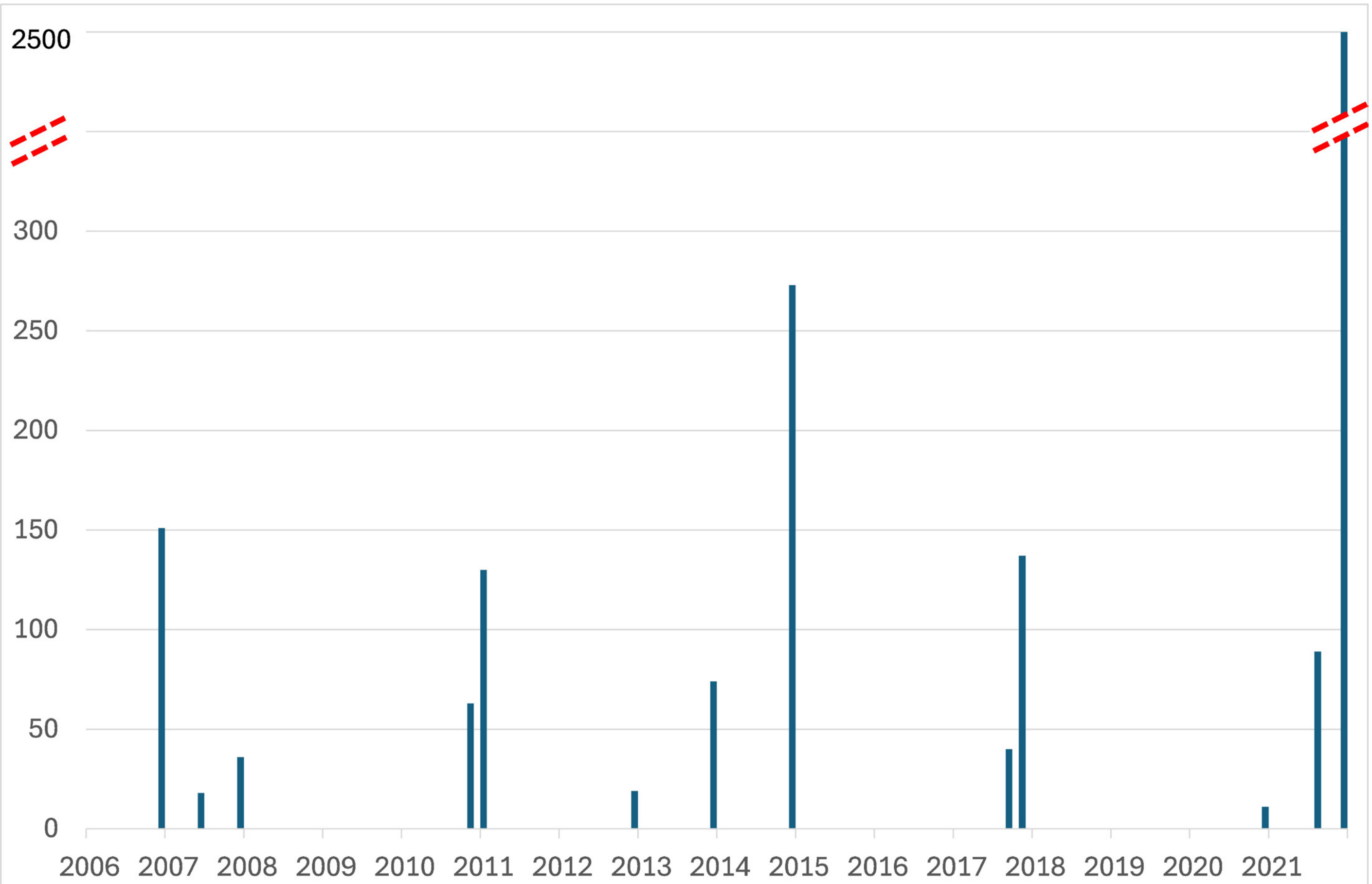


**Figure 1:** Flood events in Malaysia 2006-2021
(estimated insured losses in MYR millions; sources: Malaysian Re, Swiss Re, Guy Carpenter)

Two approaches are permitted for the calculation of the flood risk charge: a modelled 1-in-200-year return period (net of reinsurance) or a factor-based approach. The factor-based approach is challenging for companies, as it applies to entire business classes irrespective of flood coverage, omits reinsurance benefits, and benchmarking suggests significant mismatches between modelled results.

Catastrophe risk charges for other perils and territories are based on a factor approach. Geographical dispersion (i.e., high-risk vs. low-risk areas) and reinsurance benefits are not considered in this approach. Further, materiality is not defined within the exposure draft leaving uncertainty on the behalf of reporting companies.

## Other Risks

Other risk charges impacting companies are expected to be:

- Asset risk charge increases for less liquid and higher risk investments.
- Asset concentration risk charges are changing.
- Increasing insurance risk charges. Property will also be subject to catastrophe risk charges.
- Increasing operational risk charges.

## Diversification

The introduction of diversification is an opportunity to offset from increased risk charges and aligns more closely with capital standards used internationally. However, diversification is still limited within insurance risk, dampening its potential. Diversification across different risks will provide some benefit and give additional revenue-generating opportunities.

## Total Capital Available

Changes to total capital available should not be ignored. One significant change is that recoveries on cessions to non-qualifying reinsurers[3] must be deducted from capital available. Companies that are part of a bigger group and have ceded a substantial portion of their business to the regional office or headquarters to manage the local capital requirements will need to reconsider their approach.

## The Overall Impact

The overall effect of the RBC 2 change will vary substantially among insurers. Individual risk charges are generally rising, and diversification benefits may provide an offset. Insurers with a less-diversified risk mix, and those with a high catastrophe-risk element, are likely to see a reduction in capital adequacy ratios.

Insurers will need to gauge the expected impact based on their circumstances. Where there is pressure on solvency levels, insurers should look to adjust strategies to mitigate those impacts and put the business on a sustainable foundation for the future. For others, the transition may present opportunities for growth, particularly in business areas that provide diversification benefits against an existing portfolio.

## Time to Act

The transition to RBC 2 represents a significant evolution in the regulatory framework for the Malaysian insurance sector and seeks to align risk and regulator more closely in addition to improved decision making and planning. Now is the time to start preparing. Insurers can get ahead of the curve by refining risk-management practices, reassessing capital requirements and developing robust strategies to address challenges and maximise opportunities. There are many options available to manage risk and capital, and insurers that can make the right choices at the right time will be well-placed to prosper in the new environment.

*Guy Carpenter's Capital Advisory practice is ready to assist clients and others with this transition. We have the capability to analyse capital impacts and advise on business strategies. We have in-depth knowledge of catastrophe risk, including Malaysian flood. And we have the capability to execute on the full playbook of solutions.*

[3] Reinsurers not licenced in Malaysia or Labuan FT

## About Guy Carpenter

Guy Carpenter, a business of Marsh McLennan (NYSE: MMC), is a leading global risk advisory and reinsurance specialist and broker. Marsh McLennan is a global leader in risk, strategy and people, advising clients in 130 countries across four businesses: Marsh, Guy Carpenter, Mercer and Oliver Wyman. With annual revenue of $24 billion and more than 90,000 colleagues, Marsh McLennan helps build the confidence to thrive through the power of perspective. For more information, visit guycarp.com, or follow on LinkedIn and X.