



**Insurance Development and
Regulatory Authority**

Risk- Based Supervision Framework

21th April 2024

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Insurance Development and Regulatory Authority

Risk- Based Supervision Framework

1. Introduction

Risk Based Supervision(RBS) is a regulatory approach that focuses on the risk profile of each insurer. The RBS approach enables insurers and regulators to manage risks effectively, maintain their financial stability, and protect policyholders. This Supervision Framework describes the objectives, principles and approach adopted by Insurance Development and Regulatory Authority (IDRA) to support its risk-based supervision of the regulated insurers. This framework applies to the insurance and reinsurance companies regulated by IDRA. The document will help the (re)insurers understand what is required of them as well as what they can expect from the supervisors during the supervision process.

2. Objectives

The Insurance Act, 2010 sets out following objectives for Insurance Development and Regulatory Authority:

- contribute to improved management practices and regulation of the insurance sector enhancing confidence in the insurance industry;
- ensure quality and reliable service to public through healthy competition within insurance industry, and
- regulate insurance industry in an effective manner for ensuring protection of rights of insured.

To achieve its objectives, IDRA aims to ensure protection of the interests of the current and future policyholders (i.e., insured) through prudential supervision; transparent and fair treatment of customers (conduct supervision) delivered through the safety and soundness of the regulated (re)insurance companies and stability of the Bangladesh Insurance Sector.

In addition, IDRA also has the mandate to develop the market which includes insurance literacy programs, insurance related training, insurance market expansion and development of specific insurance sectors (e.g., microinsurance and agricultural insurance).

3. Principles

The six key principles followed by IDRA in its RBS approach that shall be applied to all insurers:

- 1) Judgment-based: IDRA shall rely on the judgment of the IDRA which will be supported by the relevant data, observations and analyses, and through engagement with the board and senior management of the insurers.
- 2) Forward looking: IDRA shall assess the insurers against current risks as well as future emerging risks so that early timely intervention can take place.
- 3) Focus on key risks: IDRA shall focus on material risks arising from the activities of the insurers that could have a detrimental impact on the policyholder protection; IDRA will focus its resources and activities to areas of greatest risks.
- 4) Assessment of the whole institution: IDRA shall adopt a holistic approach to assess the composite risk (i.e., risk profile) of an insurer. To perform this task, reliance shall be placed on the total balance sheet approach with the assessment of inherent risks and the mitigation and oversight of

these material inherent risks.

- 5) Principle of Proportionality: IDRA shall apply 'Principles of Proportionality' in its approach to supervision. Application of proportionality shall be based on the impact, size and complexity of the insurer and the level of risks posed by such insurer to policyholders, the insurance sector or the financial system as a whole. This principle gives the supervisor the flexibility to tailor its intensity of supervision or the application of the supervisory requirements on insurers in order to achieve IDRA's objectives. Insurers with high risk profile will be subject to more intensive supervision in comparison to insurers with low risk profile.
- 6) Outcome focused: Supervisory work focuses on material risks of business activities that could pose threat to the achieving the key supervisory outcome of policyholder protection.

4. Risk Based Supervision Process:

- Pillars of Risk-Based Supervision

CAPITAL REQUIREMENTS	REPORTING REQUIREMENTS	GOVERNANCE
<ul style="list-style-type: none"> • Specifies the approach for valuation of assets and liabilities. These can be compatible with IFRS/local GAAP or could be done on market-consistent basis • Specifies the standard formula/framework to be used for estimating the required solvency capital - RBC 	<ul style="list-style-type: none"> • Focuses on disclosures that an (re)insurer needs to make for public and the supervisor • The requirements vary from country to country, however, it broadly covers following themes <ul style="list-style-type: none"> ▪ Solvency & Financial Condition Report ▪ Solvency Calculation ▪ Technical Provisions Estimation ▪ Assets Valuation ▪ Own Funds 	<ul style="list-style-type: none"> • Governance pillars requires companies to demonstrate that they have an operational system for managing and overseeing their risks. • Clear, robust and well document system of governance • Clearly documented processes, procedures and policies • Internal Audit Function

4.1 Pillar 1: Quantitative requirements

4.1.1 Technical Provisions

Insurance companies will be required to calculate and report Technical Provisions, which is a valuation process for actuarial liabilities, including margins for adverse deviations. In life insurance business, reasonable actuarial assumptions based on past experience and expectations for future will be taken into considerations. In the case of short-term insurance, technical reserves will consist of unearned premium reserve, case reserves and Incurred But Not Reported (IBNR) reserves. Non-life insurance companies will also be required to estimate their IBNR and IBNR reserves.

4.1.2 Solvency Capital Requirements

As commercial enterprises offering products and services to the public, an insurance company needs to have capital over and above its actuarial and technical reserves, this additional capital requirement is also called Solvency Capital requirements. IDRA will introduce a simplified solvency regime in the short run, followed by introduction of risk-based solvency capital. After successful implementation of the simplified solvency margin regulation, IDRA will focus on the introduction of a Risk Based Capital Framework. The introduction of Risk-Based Capital provides a unique opportunity that will help the industry develop technical capacity as it incentivizing companies to manage themselves better and develop in-house capacity. Considering the above,



IDRA will commence with a phased introduction of risk-Based Capital for the Bangladesh insurance industry.

4.2 Pillar 2: Reporting Requirements

Supervisory review and reporting is an important control mechanism to ensure that the IDRA is aware of the systemic risks as well as the individual institution risks. This will enable communication with the supervised insurers and promote cooperation, allowing for the early detection of risks and encouraging insurers to discuss emerging issues and troubling matters with the IDRA. IDRA must be aware of the strengths and weaknesses of the supervised institutions and be able to help the institutions that are in higher risk categories return to lower risk categories within a reasonable amount of time.

Policyholders should be able to bring their complaints to the supervisor authority, or to an Ombudsman, after having exhausted avenues of redress with the institution. Tracking complaints and how they are handled can be a powerful early warning signal for supervisory authorities but can also make the insurers themselves more consumer oriented.

4.3 Pillar 3 – Governance

Qualitative requirements include internal controls by the insurers themselves and supervisory review by the IDRA. These requirements are particularly important as they are more forward looking than the quantitative requirements, which inevitably are based in past financial results, although dynamic solvency testing attempts to be more forward looking. Good internal controls will minimize the probability of things going wrong and will indicate that the Board and management are aware of the internal and external circumstances of the institution.

4.4 RBS Process:

4.4.1 Risk profiling of Insurers

The central plan for RBS is to create an accurate risk profile of each Insurer. The risk profile will be a document, that describes various financial and non-financial risks faced by an insurance institution. The risk assessment entails the identification of financial activities in which an insurer has chosen to engage and the determination of the types and quantities of risks to which these activities expose the insurer. The type of risk that an insurer faces individually or in combination include, but are not limited to, underwriting, reserving, credit, market, liquidity, operational, legal and reputational risks.

The risk profile will be designed to provide a systematic assessment from the supervisor's perspective of the adequacy and effectiveness of the insurer's organization, management and controls. The main risk-profiling devices to be used in the short-term are the CARMELS & ICP rating framework, off-site supervision, which over time will be derived from off-site returns, and other information. CARMELS rating will be the core of risk profile compilation, but successive ratings will be used to reflect trends in contrast to being used as a static annual indicator of risk.

The key components of the risk profile document would be the following:

- 4.4.1.1 CARMELS & ICP rating with trends
- 4.4.1.2 Narrative description of key risk features captured under each ORSA assessment
- 4.4.1.3 Solvency capital margin and Dynamic capital stress testing



4.4.1.4 Monitorable action plan and Insurer's progress to date

IDRA will undertake a formal assessment of the risk profile of each Insurer on a regular basis. The period between assessments will vary depending on the materiality of the risk profile of an Insurer, with an average period of one year. However, more frequent assessments will be conducted for higher risk Insurers and less frequent assessment for lower risk Insurers.

4.4.2 Supervisory cycle

The supervisory process will commence with the preparation of the Insurer risk profile (based on data furnished by insurers to IDRA, as well as data from other sources). The supervision cycle will vary according to risk profile of each insurer, with the underlying principle that higher the risk the shorter the cycle. The supervision cycle will remain at 12 months in the short-term and eventually be extended beyond 12 months for low-risk insurers at a suitable stage. In cases where shorter supervisory cycle is necessary, the cycle could be less than 12 months.

4.4.3 Supervisory programme

IDRA will prepare an insurer specific supervisory programme which will set out the detailed work plan for each insurer. The scope and objectives of the inspection programme will be derived from analysis of the insurer's risk profile. The supervisory programme will be tailored to individual insurers and will focus on the highest risk areas as well as specify the need for further investigation in identified problem areas. The supervisory programme will be prepared by IDRA at the beginning of the supervisory cycle and will be flexible enough to permit amendments warranted by subsequent major developments. The supervisory programme will also identify the package of supervisory tools that may be deployed including::

- 4.4.3.1 greater off-site surveillance
- 4.4.3.2 targeted on-site inspection
- 4.4.3.3 structured meetings with insurers
- 4.4.3.4 commissioned external audits
- 4.4.3.5 specific supervisory directions

On-site inspection will largely be targeted to specific areas unless a full scope inspection is warranted as per the insurer-specific supervisory programme. A monitorable action plan (MAP) to mitigate risks to supervisory objectives posed by individual insurers will be developed for follow-up. Variable supervisory cycles and variable frequency of inspections characterize the supervisory process under RBS.

4.4.4 Inspection process

The risk assessment of individual insurers will be performed by IDRA in advance of on-site supervisory activities. The risk assessment process will highlight both the strengths and vulnerabilities of an institution and provide a foundation from which IDRA will determine the procedures to be conducted during the on-site inspection. The inspection will target identified high-risk areas from the supervisory perspective and focus on the effectiveness of mechanisms in capturing, measuring, monitoring and controlling various risks. The inspection procedure will continue to include transaction testing and evaluation the extent of which will depend on the materiality of an activity and the integrity of the risk management system and the control process.

4.4.5 Review, evaluation and follow-up



An evaluation will be undertaken to ensure that the supervisory programme has been completed and effective in improving the risk profile of the insurer concerned. If need be, IDRA will employ further tools, including additional inspection visits. The findings of inspection and other supervisory information on records will be used by IDRA to produce a comprehensive document of supervisory risks and the insurer's assigned ratings for follow-up of supervisory concerns. The risk profile document of the insurer will be updated accordingly in light of new information.

4.4.6 Monitorable Action Plan (MAP):

The aim of supervisory follow-up is to ensure that insurers take corrective action in time to remedy or mitigate any significant risks that have been identified during the supervisory process. The major supervisory tool in this respect is the MAP. MAPs will in many cases include directions to insurers on actions to be taken. The remedial actions are outlined, will be tied explicitly to the areas of high risks identified in the risk profiling as well as the supervisory process. These remedial actions are expected to lead to improvements in the systems and controls environment at the insurer. Key individuals at the insurance company will be accountable for each of the action points. If the actions and timetable set out in the MAP are not met, IDRA shall consider issuing further directions to the insurers, which may include imposing sanctions and penalties.

4.5 Supervisor Level Preparations

4.5.1 Supervisory organization

IDRA will appoint an internal Central Point of Contact for insurers. Under the RBS, there is a need for a focal point for all contacts by insurers, in respect of matters relating to regulatory/supervisory issues. This focal point will be the main conduit for information and communication between the insurers and IDRA.

4.5.2 Enforcement process and incentive framework

While the aim of supervisory follow-up is to ensure that insurers take corrective action to mitigate significant risks, the persistence of deficiencies would pose a risk to IDRA's supervisory objectives. A system of incentives and disincentives will be implemented under the RBS to better attain these objectives. Insurers with a strong compliance record and good risk management and control system may benefit from a longer supervisory cycle and lesser supervisory interventions. Insurers, that fail to show improvement in response to the MAP, would be subject to a more frequent supervisory examination and higher supervisory intervention including directions, sanctions and penalties.

4.5.3 Change management implications

Change management is a key element in ensuring that the transition to RBS takes place in an orderly and effective manner. Insurers should have clearly defined standards of corporate governance and documented policies and practices in place so as to clearly demarcate the lines of responsibility and accountability. Insurers will have to address several organizational issues to realign themselves to meet the requirements of RBS.

4.6 Insurer level preparations

4.6.1 Adoption of Risk focused Internal Audit

Internal Audit is an independent activity designed to improve the insurer's operations. The internal audit function is a part of the ongoing monitoring of the system of internal control and assists the staff in the effective discharge of their responsibilities. The success of the internal audit function depends largely on the extent of reliance the insurer management would place in guiding the insurer's operations. The Internal Audit Department will therefore have to be independent from the internal control process and be given an appropriate standing within the insurance entity to carry out its assignments with objectivity and impartiality.

The Internal Audit Department should therefore be provided with appropriate resources and staff to achieve its objectives. The internal audit would have to capture in a larger way the application and effectiveness of risk management procedures and risk assessment methodology and critical evaluation of the adequacy and effectiveness of the internal control systems. The internal audit department will have to pay special attention to auditing the insurance activities in all the places through which the activities are undertaken. The precise scope of the work of internal audit department must be determined by each insurer but as a minimum, the following task must be include: review and report on the control environment as a whole, the process by which risks are identified, analyzed and managed, the line of controls over key processes, the reliability and integrity of corporate management function, safeguarding of assets and compliance with rules and regulations.

4.6.2 Strengthening of Management Information System and Information Technology

A principal foundation for RBS is the availability of detailed and accurate data. Under RBS the monitoring needs of IDRA will differ based on the risk profile of an insurer and accordingly IDRA may require insurers to provide information in addition to the data now being provided. Consequently, insurers will be required to devise a policy for backup and storage of various databases on regular intervals. The policy should specify details like frequency of backups, media to be used, off-site storage areas, departments and officials (Data Managers) responsible for these actions. The accuracy, completeness and the timeliness of data are very important and need to be ensured by insurers through upgrades of their management information and information technology systems. The Data Manager's role shall be created in order to ensure that the data has integrity, is stored in the correct place, and is comprehensive and timely. The Data Managers will be responsible for specific databases. Insurers will have to review the present status of the management information and information technology systems and initiate necessary measures to ensure that IDRA data needs as well as supervisory reporting systems are streamlined.

4.6.3 Employee Training

Operational risk in companies is significantly influenced by unskilled and untrained labor. As a result, selecting and developing a core group of officials becomes more important as RBS is launched and developed. The insurer's top management shall also be well informed about the benefits that the company might receive through prudent risk management, in addition to the specifics of RBS.

The insurers and IDRA are equal partners in this endeavor to ensure that the RBS process is implemented smoothly in order to maintain the health and vitality of insurance sector.

5. Oversight Functions:

An Insurer's Oversight Functions are responsible for providing independent, enterprise-wide oversight to operational management for each significant activity. IDRA's assessment includes the following six Oversight Functions:



- Actuarial
- Compliance
- Risk Management
- Internal Audit
- Senior Management
- Board

The presence and nature of these functions vary based on the size, complexity, and risk profile of an Insurer and the inherent risks in its significant activities. Where an Insurer lacks a critical Oversight Function and has engaged external expertise to perform that function, IDRA expects an Insurer to maintain accountability for that function (i.e., Insurers can outsource the function's responsibility but not the accountability and ownership of risks).

Where an Insurer lacks some of the other Oversight Functions, they are not sufficiently independent, or they do not have enterprise-wide responsibility, IDRA expects other functions to provide the independent oversight, considering the principle of proportionality.

Oversight Functions are expected to have sufficient stature, authority, and independence from operational management, with unfettered access and a functional reporting line to the Board or the appropriate Board committee.

Controls and oversight assessments, including corporate governance assessments, are based on an evaluation of an Insurer's current practices for controls and oversight related to the Insurer's significant activities.

6. Other Considerations

Factors to consider while meeting the objectives:

- The Board of the insurer has the ultimate responsibility, and the senior management has a crucial role in maintaining adequate risk oversight of an insurer's business activities. To that effect, the Board is required to possess adequate knowledge, skills, experience and the ability to delegate authorities to the right personnel to perform day to day operations of the company. Key personnel within an insurance company shall have relevant qualifications, skills and experience to perform the required duties.
- IDRA shall intervene early to resolve issues of problematic insurers (or heightened risk insurers) in the market.
- Insurers are expected to meet all of the governing regulatory requirements. Insurers need to demonstrate they have processes and controls to comply with the regulations and for the insurers to notify the regulator if they are non-compliant.
- IDRA aims to follow international best practice in its supervisory approach, where possible, while giving consideration to the current features of the Bangladesh insurance market.

- IDRA shall rely on the works of other professionals, in particular, auditors and actuaries as such reliance is based on the understanding that these professionals will follow proper standards and practices set out by their professions. If IDRA believes that particular auditors or actuaries have in fact, not followed applicable standards and practices, then the IDRA may revise the risk profile of the institution accordingly.

7. Risk Assessment Framework

IDRA will follow the following risk assessment framework in conducting its risk-based supervision.

7.1 Categorization (Impact Rating) of Insurers

- Group insurers into 4 categories depending on their level of significance of having an adverse impact on IDRA achieving its supervisory objectives (i.e., prudential, market conduct and market development).
- The implication of impact rating of insurers into different categories at an initial stage will determine the level of supervision required and help prioritize the baseline level of supervisory resources, i.e., higher intensity of supervision and hence, a larger resource allocation to insurers that pose greater risks.
- Categories used are: (1) Very Significant Impact; (2) Significant Impact; (3) Moderate Impact; and 4) Minimal Impact.

Very Significant Impact	Insurer poses very significant risks to the interests of a large number of policyholders, the insurance sector and the financial system as a whole.
Significant Impact	Insurer poses significant risks to the interests of a large number of policyholders and the insurance sector.
Moderate Impact	Insurer poses some risks to the interests of a large number of policyholders or the insurance sector.
Minimal Impact	Insurer poses some risks to the interests of a certain group of policyholders.

- IDRA shall consider both qualitative factors and quantitative measures to allocate insurers into different impact rating categories. The criteria used for categorization are as follows:

No	Criteria	Assessment of
1	Size	Insurer's relative scale of activities and importance in the insurance industry (e.g., number of insured; market share by premium volume; gross technical provision)
2	Substitutability	Ability or feasibility of other entities to provide substitutions for an insurer's products or functions or services without causing significant disruptions in the market.
3	Complexity	Complex nature of an insurer's structure and business model.

- The impact rating assessment shall take place at the beginning of each risk-based supervision cycle.
- Supervision cycle is defined to be three years. However, risk-based supervision is considered to be a continuous process and hence, the statutory 3-year supervision cycle effectively means that every institution gets an examination at least once every three years.
- The impact rating for an insurer shall not be affected by the priority rating assigned to that insurer at the end of the previous risk-based supervision cycle.

7.2 Risk Context

- External Risks: assessment of external risks facing the insurers will consider both macroeconomic risks and sector-wide (meso-economic) risks.
- Business Risks: assessment of the risks arising from significant business activities (i.e. line of business, unit or process) conducted by the insurer in order to achieve its business strategy. This will analyze business model, risk appetite, peer comparisons etc.

7.3 Significant Activities

An Insurer's significant activities ("activities") shall be identified at the start of the assessment process. A significant activity can be a line of business, business unit, or enterprise-wide process that is fundamental to an Insurer's business model and its ability to meet its overall business objectives. The identification and assessment of significant activities and their relative importance or materiality require the use of supervisory judgment which is informed by knowledge of an Insurer's external environment, sector, and business profile. To understand the business profile of an Insurer, supervisors use various sources including organization charts, strategic business plans, capital allocations, internal audit reports, and internal/external reporting.

7.4 Inherent Risk

- Inherent Risk refers to the natural level of risk (i.e. exposure to loss), defined as a probability of material loss, arising from the activities pursued by the insurer to meet its business objectives. Material loss shall be determined based on the size, nature and risk profile of the insurer.
- The inherent risks are also considered as "Gross Risks" as they reflect the level of risks before being controlled or mitigated by risk management strategies (i.e., before the application of management actions to mitigate/ manage/ avoid risks). The inherent risks will not be affected by the size of the activities.
- Key inherent risks are identified for each significant activity.
- The key gross inherent risks are grouped into 9 categories:
 1. Insurance Risk
 2. Market Risk
 3. Credit Risk
 4. Operational Risk
 5. Strategic Risk
 6. Compliance Risk (Legal and Regulatory)
 7. Conduct Risk
 8. Reputational Risk
 9. Money Laundering & Financing of Terrorism
 10. Climate Risk
- The definition of each inherent risk is provided in Appendix A.
- The level of each Gross Inherent Risk is assessed as Low, Medium Low, Medium High and High based on IDRA's judgement.



Gross Inherent Risk Rating	Interpretation
High	In the absence of substantial and urgent remediation, there is a very high probability of loss that will impair capital leading to potential damage to policyholders within twelve months.
Medium High	In the absence of remediation, there is a significant probability of loss that will impair capital, possibly leading to damage to policyholders in the foreseeable future.
Medium Low	There is some need for action in a limited number of areas but the likelihood of losses leading to damage to policyholders is small.
Low	No significant remediation is required and losses leading to damage to policyholders are very unlikely.

- The reference to the remediation in the above table reflects the mitigating actions (i.e., risk management actions) that the insurer needs to take to reduce the impact from the inherent risk. It does not refer to actions taken by the insurer to reduce the inherent risk itself.
- The gross inherent risk assessment includes the direction of the inherent risk: Increasing/ Stable/ Decreasing. This will reflect the change in the view of the prospective assessment of gross inherent risks.

7.5 Governance and Oversight

- This assesses the ability of the insurer to manage and control inherent risks appropriately.
- The assessment is carried out for two control levels: Operational Management and Oversight Functions.
- Operational Management: this will assess the ability of the 1st line (frontline) staff to apply proper controls and processes to manage or mitigate inherent risks arising from carrying out its day-to-day activities and ensure the alignment with the insurer's risk appetite and risk policies.
- Oversight Functions: this will assess the performance ability of the oversight functions (Board, Senior Management, Risk Management, Compliance and Internal Audit) to perform appropriate mitigation and oversight of the key activities and the risks arising from those activities.
- The evaluation is based on the assessment of:
 - a) the characteristics or attributes of operational management and oversight functions to ensure they are appropriate for the given nature, complexity and risk profile of the insurer's business (this evaluation examines the underlying structures, frameworks, policies and practices); and
 - b) the effectiveness of the performance of operational management loss mitigation and oversight functions.
- For each significant activity, operational management and oversight functions are assessed by IDRA as Strong, Effective, Need Improvement or Weak.



Rating	Interpretation (comparison against the given nature, complexity and risk profile of the insurer's business)
Strong	The characteristics of the function exceeds expectation against what is considered necessary by IDRA. The function has consistently demonstrated highly effective performance. The function's characteristics and performance are superior to sound industry practices.
Effective	The characteristics of the function meet expectation against what is considered necessary by IDRA. The function's performance has been effective. The function's characteristics and performance meet sound industry practices.
Need Improvement	The characteristics of the function generally meet expectations against what is considered necessary but requires improvements to some significant areas. The function's performance has generally been effective, but there are some significant areas where effectiveness needs to be improved. The areas needing improvement are not serious enough to cause supervisory concerns if addressed in a timely manner. The function's characteristics and/or performance do not consistently meet sound industry practices.
Weak	The characteristics of the function do not meet expectations against what is considered necessary by IDRA or the function's performance has demonstrated serious instances which require immediate actions to improve effectiveness. The function's characteristics and/or performance regularly or repeatedly fail to meet sound industry practices.

- The assessment also includes the direction of the quality of the operational management and oversight functions: Improving/ Stable/ Deteriorating. This will reflect the change in the view of the prospective assessment of the operational management and oversight functions.
- Sound industry practice and the effectiveness are defined by IDRA on the basis of international best practice while giving consideration to the current features of the Bangladesh insurance market.

7.6 Net Risk

- The level of Net Risk for each significant activity is assessed following consideration of the effective control mechanism and of oversight and governance in managing and mitigating inherent risks arising from the insurer's activities.
- The overall Net Risk shall be determined based on the relative importance or materiality of the significant activities.
- The level of Net Risk for each significant activity as well as for the overall Net Risk derived will be rated as: Low, Medium Low, Medium High and High.

Net Risk/ Overall Net Risk Rating	Interpretation
High	In the absence of substantial and urgent remediation, there is a very high probability of loss that will impair capital leading to potential damage to policyholders within twelve months.
Medium High	In the absence of remediation, there is a significant probability of loss that will impair capital, possibly leading to damage to policyholders in the foreseeable future.

Medium Low	There is some need for action in a limited number of areas but the likelihood of losses leading to damage to policyholders is small.
Low	No significant remediation is required and losses leading to damage to policyholders are very unlikely.

- The Net Risks and the Overall Net Risk assessments also include the direction: Increasing/ Stable/ Decreasing. This will reflect the change in the view of the prospective assessment of net risks and the overall net risk.

7.7 Financial Resources

- The three key aspects of financial resources that shall be considered are: Capital, Earnings and Liquidity.
- This aims to assess whether the insurer has adequate financial resources to absorb losses if the risks to the insurers materialize either during normal or stressed conditions.
- With regards to capital assessment, considerations are given to:
 - a) Capital Adequacy with consideration for insurer's risk profile and risk appetite, and in terms of: i) the quality of capital (i.e., its ability to absorb losses during normal and stressed scenarios); ii) transferability of capital (i.e., capital from one fund can be used to absorb losses from another fund); iii) company's ability to raise capital in the capital market; and iv) capital support from the parent companies towards foreign ventures and/or to subsidiaries of foreign companies.
 - b) Capital Management Policies and Practices: this assesses whether the insurer has appropriate policies and practices in place that reflect the nature, size and risk profile of the insurer.
 - c) Insurer are required to meet regulatory capital requirement at all times.
 - d) Consideration will also be given to differences between regulatory capital requirement and economic capital requirement.
- Liquidity resources are assessed with regards to the ability of the insurer to meet its cash flows requirement under normal and stressed scenarios. Liquidity assessment will also be based on: a) Liquidity Adequacy, and b) Liquidity Management Policies and Practices.
- Earnings assessment will be based on quantity, quality and volatility of the earnings.
- The level of capital, earnings and liquidity will be rated as Strong, Acceptable, Need Improvement and Weak.

Rating		Interpretation (for a given nature, size and risk profile of the insurer)
Strong	Capital	Capital adequacy is strong and is above expectation and will have positive trend over next 12 months. Capital management policies and practices put in place are appropriate, and have been and remains to be effective.
	Liquidity	Liquidity adequacy is strong and will remain consistently above the level required by IDRA. The insurer has proper and appropriate policies and practices as well as effective liquidity management.
	Earnings	Insurer have had consistent earnings performance and it has significantly contributed to long term viability of the company. There is no reliance on



		non-recurring sources of income to enhance earnings. Earnings outlook for the next 12 months continues to be positive.
Acceptable	Capital	Capital adequacy is appropriate and meets expectation and do not have concerns over adequacy level over next 12 months. Capital management policies and practices put in place are appropriate and have been and remains to be effective.
	Liquidity	Level of liquidity is adequate and will consistently meet the level required by IDRA. The insurer has appropriate and effective liquidity management policies and practices.
	Earnings	Insurer have had satisfactory earnings performance, producing returns needed to ensure its long-term viability. Insurer do not rely on non-recurring sources of income to enhance earnings. Although there is some exposure to earnings volatility, the outlook for the next 12 months remains positive.
Need Improvement	Capital	Capital Adequacy is appropriate most of the time while meeting the minimum regulatory capital requirements at all times. However, the level of capital adequacy is uncertain over next 12 months. Capital management policies and practices put in place are appropriate but ineffective.
	Liquidity	Level of liquidity is not always adequate, although meeting the minimum level set by IDRA. The insurer has appropriate liquidity management policies and practices but are not effective.
	Earnings	Insurer have had inconsistent earnings performance, with returns that may, at times, be inadequate to ensure its long-term viability. Insurer may occasionally depend on nonrecurring sources of income to show a profit. The earnings outlook for the next 12 months is uncertain.
Weak	Capital	Capital adequacy is not appropriate, marginally meeting minimum regulatory capital requirements and the level of capital adequacy likely to deteriorate over next 12 months. Capital management policies and practices put in place are not appropriate.
	Liquidity	Level of liquidity is not adequate and does not meet the minimum level set by IDRA. The insurer does not have appropriate liquidity management policies and practices.
	Earnings	Insurer has consistently recorded operating losses or earnings that are insufficient to ensure its long-term viability. It may be heavily dependent on non-recurring sources of income to show a profit. Negative earnings outlook for the next 12 months is expected.

- The assessments also include the direction of the quality of capital, earnings and liquidity: Improving/ Stable/ Deteriorating. This will reflect the change in the view of the prospective assessment of the quality of the capital, earnings and liquidity.

7.8 Composite Risk

- Insurer's composite risk (i.e., overall risk profile) is determined by assessing whether there is an adequate level of financial resource available for the given level of overall Net Risk. No amount of

capital can be considered as a substitute for poor risk management practices of the insurer. A higher level of capital will only be viewed as a temporary measure while the risk management practices are being improved.

- The Composite Risk rating will determine Priority Rating for the insurer and this will guide the level of intensity of supervisory intervention.
- The composite risk is categorized into four Rating: Low, Medium Low, Medium High and High.

Composite Risk Rating	Interpretation
High	In the absence of substantial and urgent remediation, there is a very high probability of loss that will impair capital leading to potential damage to policyholders within twelve months.
Medium High	In the absence of remediation, there is a significant probability of loss that will impair capital, possibly leading to damage to policyholders in the foreseeable future.
Medium Low	There is some need for action in a limited number of areas but the likelihood of losses leading to damage to policyholders is small.
Low	No significant remediation is required and losses leading to damage to policyholders are very unlikely.

- The Composite Risk assessment will also include the direction of the composite risk: Increasing/ Stable/ Decreasing. This will reflect the change in the view of the prospective assessment of the Composite Risk.

8. Risk Matrix

- Once the Composite Risk Rating has been determined, Priority Rating for each insurer is derived . The insurer will be notified of any regulatory concerns that will require remediation. As the Composite Risk Rating and Priority Rating are primarily developed as supervisory tools, and if disclosed out of context can be misused or have potential negative impact on an insurer, both information will be kept confidential by the supervisors. (Note: The insurer is also required to keep its Composite Risk Rating confidential; it may not be used in any marketing material or disclosed outside the organization without the written consent of IDRA)
- The Risk Matrix summarizes the outcome of all the assessments carried out under Step 2 of the Risk Assessment Framework. This provides an overall conclusion made by IDRA regarding the holistic risk assessment and hence, the overall risk profile of an insurer.
- The final decision shall be backed by IDRA's detailed documentation of the analysis including the rationale or expert judgements for coming up with conclusions for various steps.
- The template of a Risk Matrix for an insurer is shown in Appendix B.

9. Supervisory Intervention

IDRA has been given the power by the Insurance Act, 2010 to take timely and corrective measures ("supervisory intervention") against the insurers who fail to comply with sound business practices or

regulatory requirements. The assigned Priority Rating of an insurer will guide the level of intensity of supervisory intervention that will be required.

The Insurance Act, 2010 provides the basis for which a number of corrective measures that IDRA can take against insurers either as an early warning mechanism or in an extreme scenario, resolution action.

The table below shows the alignment between the Composite Risk Rating and Priority Rating:

Composite Risk Rating	Priority Rating
Low	Priority Rating 1: Routine Supervision
Medium Low	Priority Rating 1: Routine Supervision
	Priority Rating 2: Emerging Risk
Medium High	Priority Rating 2: Emerging Risk
	Priority Rating 3: Escalated Action
High	Priority Rating 3: Escalated Action
	Priority Rating 4: Formal Remediation
	Priority Rating 5: Resolution/ Liquidation

The Guide to Supervisory Intervention Framework provides details of the circumstances that could potentially lead an insurer to a different priority rating and the types of intervention that an insurer can expect from IDRA. Supervisory resource allocation will increase for the highest priority rated insurers.

10. Effective date and future review:

This Framework is effective from now and it will be reviewed in every two years interval.

Mohammad Jainul Bari
Chairman

Insurance Development and Regulatory Authority

Appendix A: Definition of Inherent Risks

The table below provides description of gross inherent risks.

No	Gross Inherent Risk	Definition
1	Insurance Risk	<p>Life insurance risk is the risk of financial loss or adverse change in the value of insurance liabilities resulting from changes in the level, trend or volatility of the risk drivers/ biometric/ decrement rates. The risk drivers covered under life insurance category are: mortality, longevity, morbidity, expenses, lapses and catastrophe risks.</p> <p>Non-life insurance risk is the risk of loss resulting from inadequate pricing, making wrong judgments in the selection, approval and retention of risks to be insured or under-estimation of insurance policy liabilities. The risk drivers covered under non-life insurance category are: claims, reserving and catastrophe risks.</p>
2	Market Risk	Market risk is the risk of adverse financial impact resulting from fluctuations in the level or volatility of prices of financial instruments and other financial market factors including interest rates, equity price, property price, foreign exchange rates.
3	Credit Risk	Credit risk is defined as the potential loss arising from a borrower or counterparty failing to meet its obligations in accordance with the agreed terms.
4	Operational Risk	Operational risk is the risk of loss to the insurer due to failure of people, processes or systems.
5	Strategic Risk	Strategic risk is the risk of loss to the insurer from potential failures or errors in strategic planning and/or implementation, either due to internal or external events, leading to the insurer not achieving its core objectives.
6	Compliance Risk (Legal and Regulatory)	Compliance risk is the risk of loss to the insurer due to failing to comply with the legal and regulatory requirements.
7	Conduct Risk	The conduct risk is the risk of loss or poor outcome or unfair treatment towards the current and future policyholders or adverse consequence to the insurance market due to improper business conduct or business malpractice or unwillingness to comply with regulatory market conduct requirements by the insurer and/or its representatives.
8	Money Laundering & Financing of Terrorism	The risk that illegal funds and assets are converted into legitimate funds and assets using insurer as the vehicle.
9	Climate Risk	Climate risk means the risks posed by the exposure of an insurer to physical, transition and/or liability risks caused by or related to climate change.

