



Bank of Papua New Guinea

**LIFE INSURANCE PRUDENTIAL STANDARD (LIPS 10/2016): RISK
MANAGEMENT**

Issued under Section 48 of the *Life Insurance Act* 2000

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OVERVIEW

This prudential standard requires Life Insurance Companies (LICs) regulated by the Central Bank of Papua New Guinea (BPNG) to have systems for identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating material risks that may affect its ability, or the ability of the group it heads, to meet its obligations to policy holders. These systems, together with the structures, policies, processes and people supporting them, comprise the institution's Risk Management Framework (RMF).

The Board of Directors are ultimately responsible for having a RMF that is appropriate to the size, business mix and complexity of the institution or group it heads. The RMF must also be consistent with the institution's strategic objectives and business plan.

Part I: PRELIMINARY**1. Short Title**

LIPS 10/2016 Risk Management

2. Authorisation

The BPNG, acting under Section 48 of the *Life Insurance Act 2000* ("Act") and all other powers enabling it, determines this prudential standard.

3. Application

- a) This prudential standard applies to all Licence Holders licensed under the Act unless the context indicates otherwise.
- b) This prudential standard does not apply to Life Insurance Brokers licensed under the Act.
- c) This prudential standard applies to all Officers as defined under Section 3 of the Act unless the context indicates otherwise, the term director, chief executive or a manager is specifically used.

4. Definitions

- a) In this prudential standard, unless the contrary intention appears, capitalised terms that are defined in the Act have the same meaning when appearing in this Standard. The following definitions also apply.
 - i) A Group is a reference to a group comprising the licensed service provider and all connected entities and all related bodies corporate to the licensed service provider;
 - ii) Material risk refers to all internal and external sources of inherent risk that could have a material impact on the Licence Holder's business operations or the interests of policy holders to the test of whether a relationship or business is material, which will be based on the nature, circumstances and activities of a director, having regard to his/her independence. Materiality will be considered from the perspective of the Licence Holder, the persons or organisations with which the director has an affiliation and from the perspective of the director;
 - iii) Risk Management Framework refers to the totality of systems, structures, policies, processes and people within a Licence Holder's business operations that identify, assess, manage, mitigate and monitor all internal and external sources of inherent risk that could have a material impact on the Licence Holder's business operations or the interests of policy holders; and
 - iv) Risk Management Strategy (RMS) means the strategic document that describes the Licence Holder's strategy for managing risk and the key elements of the RMF that gives effect to this strategy.

Part II: STATEMENT OF POLICY**5. Purpose**

- a) This prudential standard prescribes requirements for all Licence Holders to have systems for identifying, assessing, managing, mitigating and monitoring material risks that may affect its ability to meet its obligations to its policy holders.
- b) These systems, together with the structures, policies, processes and people supporting them, comprise the Licence Holder's RMF.
- c) The ultimate responsibility for the sound and prudent management of risk rests with the Board of Directors of the Licence Holder, which is ultimately responsible for having a RMF that is appropriate to the size, business mix and complexity of the Licence Holder's business operations. This enables the Licence Holder to implement risk management approaches that appropriately manage different types of risk.

6. Scope

All Licence Holders must comply with this prudential standard.

7. Responsibility

It is the responsibility of the Board of Directors of all Licence Holders to comply with this prudential standard.

Part III: PRINCIPLES AND PRUDENTIAL REQUIREMENTS**8. Risk Management Framework**

- a) The Board of a Licence Holder (the Board) must develop, document and maintain a RMF.
- b) In developing the RMF, the Board must take into account the size, complexity and risk profile of the business.
- c) The RMF must include, as a minimum, the requirements in paragraphs 9 to 20.

9. Responsibility for Risk Management

- a) The RMF must provide that the Board is responsible for the RMF of the Licence Holder.
- b) The Board may delegate functions to a Committee or to Management, but the Board cannot delegate ultimate responsibility for the RMF.
- c) All delegations of authority must be documented and approved by the Board.
- d) The Board must ensure that it receives regular reports on the exercise of delegated authority.
- e) The Board must put in place mechanisms to monitor the exercise of delegated authority.
- f) The Board cannot abrogate its responsibility for functions delegated to a Committee or to Management.

10. Risk Appetite Statement (RAS)

- a) The Board must consider and approve a RAS that covers the Licence Holder's business operations and each category of material risk.
- b) The RAS must, at a minimum, articulate:
 - i) The degree of risk that the Licence Holder is prepared to accept in pursuit of its strategic objectives, giving consideration to the interests of the policy holders (risk appetite);
 - ii) For each material risk, the maximum level of risk that the Licence Holder is willing to operate within; expressed as a risk limit that, where possible, is based on a measurable limit of the risk remaining, after taking into account the mitigants for the risk where appropriate (risk tolerance);
 - iii) The process for ensuring that risk tolerances are set at an appropriate level, based on an estimation of the impact on the interests of policy holders in the event that a risk tolerance is breached and the likelihood that each material risk is realised;
 - iv) The process for monitoring compliance with each risk tolerance and taking appropriate action in the event of a breach of the risk tolerance; and
 - v) The timing and process for review of the risk appetite and risk tolerances and the triggers which would result in a more frequent or immediate review of the risk appetite.

11. Material Risk

- a) The Board must, at a minimum, ensure that its RMF covers all material risks, both financial and non-financial, of the Licence Holder's operations, having regard to the size and complexity of those operations.
 - b) The Board must assess the materiality of each risk with reference to its operations as a whole and the impact of the risk on the obligations of the Licence Holder to the policy holders.
 - c) The RMF must, at a minimum, cover where applicable:
 - i) Governance risk;
 - ii) Investment risk including: currency risk; asset concentration risk; and counter-party risk;
 - iii) Liquidity risk;
 - iv) Operational risk;
 - v) Strategic risks that arise out of the Licence Holder's strategic and business plans;
 - vi) Business continuity risk;
 - vii) Insurance risk; and
 - viii) Any other risks that may have a material impact on the Licence Holder's business operations.
 - d) The Board must ensure that the outsourcing risks and controls are taken into account as part of its overall RMF.
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12. Material Contagion Risk

Where a Licence Holder is engaged in other business activities in addition to life insurance, its RMF must cover all material contagion risks that any non-life insurance business might have on the life insurance business.

13. Risk Management Strategy (RMS)

- a) The Board must ensure that the RMF requires the Board to develop and maintain a RMS.
- b) At a minimum, the RMS must describe:
 - i) Each material risk identified under paragraphs 11 and 12 and the Licence Holder's approach to managing these risks;
 - ii) The policies and procedures dealing with the following risk management matters, including the date when each policy or procedure was last revised, the next date that it is due for review and who is responsible for the review:
 - (1) Processes for identifying and assessing material risks and controls;
 - (2) Processes for establishing, implementing and testing mitigation strategies and control mechanisms for material risks;
 - (3) Processes for monitoring, communicating and reporting risk issues, including escalation procedures for the reporting of material events and incidents;
 - (4) Mechanisms in place for monitoring and ensuring on-going compliance with all licensing requirements;
 - (5) Processes for ensuring continued alignment between the RMF and the business plan;
 - (6) Roles and responsibilities of the risk management function;
 - (7) Relationships between the Board, Board Committees and senior management with respect to the RMF;
 - (8) Those with managerial responsibility for the RMF, and their roles and responsibilities;
 - (9) Approaches to ensuring all persons within the Licence Holder's business operations have awareness of the RMF and for instilling an appropriate risk culture across the Licence Holder's business operations; and
 - (10) Processes by which the RMF is reviewed and the intended coverage and timing for these reviews.
- c) The RMS should be communicated to all employees of the Licence Holder.

14. Review of the Risk Management Framework

- a) The Board must ensure that the appropriateness, effectiveness and adequacy of its RMF are subject to a comprehensive independent review by appropriately trained and competent persons at least every three (3) years at a minimum.
 - b) The scope of the comprehensive independent review of the RMF must have regard to the size and complexity of the operations, the extent of any change to those operations
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or its risk appetite and any changes to the external environment in which the Licence Holder operates.

- c) The review of the RMF must, at a minimum, include a review of:
 - i) Whether the RMF remains appropriate for the Licence Holder's business operations;
 - ii) The specific resources utilised, at a minimum, to undertake the risk management activities required by this prudential standard;
 - iii) The Risk Appetite Statement;
 - iv) The RMS, to ensure that it accurately documents the Licence Holder's RMF and the Licence Holder's strategy for managing risk;
 - v) All risk management policies and procedures; and
 - vi) All risk management and internal control systems.
- d) The RMF must be reviewed by the Board at least annually for each year during which a comprehensive independent review does not take place, and the scope of the Board review must, at a minimum, be to assess the appropriateness, effectiveness and adequacy of the RMF.
- e) The RMF should also document the triggers which would result in a more frequent or immediate review of the RMF.
- f) A copy of the Board-approved RMF must be submitted to BPNG including approved revised versions.

15. Risk Management Framework Audit Procedures and Arrangements

The Board must implement satisfactory internal audit procedures and external audit arrangements to ensure compliance with the RMF and enable the Board to attest that the risk management and internal control systems in place are operating effectively and are adequate.

16. Risk Management Function

- a) A Licence Holder must have a designated risk management function that, at a minimum:
 - i) Is responsible for assisting the Board, Board Committees and Senior Management to develop and maintain the RMF;
 - ii) Is appropriate to the size, business mix and complexity of the Licence Holder's business operations and is operationally independent from the business units of the Licence Holder;
 - iii) Is resourced with staff who have clearly defined roles and responsibilities and who possess appropriate experience and qualifications to exercise those responsibilities;
 - iv) Has access to all aspects of the Licence Holder's business operations that have the potential to generate material risk;
 - v) Has the necessary authority and reporting structure to the Board, Board Committees and Senior Management to conduct its risk management activities in an effective and independent manner; and
 - vi) Is required to notify the Board immediately when it becomes aware of any material deviation from, or material breach of, the RMF.

17. Licence Holder that is part of a Corporate Group

- a) Where a Licence Holder is part of a corporate group, and utilises the RMF of the group, the Board must approve the use of the RMF of the group and must ensure that the RMF of the group gives appropriate regard to the Licence Holder's operations and its specific requirements.
- b) A Licence Holder that is part of a corporate group may rely on a risk management function located in another entity in the group where the risk management function satisfies the criteria set out in paragraph 16 in respect of the Licence Holder's business operations.

18. External Service Provider of Risk Management Function

A Licence Holder may engage the services of an external service provider to perform all or part of the risk management function where the Licence Holder can demonstrate to BPNG that the external risk management function meets the requirements in paragraph 16.

19. Risk Management Declaration

- a) The Board must, on an annual basis, provide to BPNG with a declaration on risk management (Risk Management Declaration) signed by the Chairman and two directors that satisfies the requirements prescribed by BPNG.
- b) The Board must ensure that the outsourcing risks and controls are taken into account as part of its overall RMF when completing the Risk Management Declaration which the Board is required to provide to BPNG.
- c) If the Board qualifies the Risk Management Declaration, the qualified declaration must include a description of any material deviation from the Licence Holder's RMF and the steps taken, or proposed to be taken, to remedy those deviations.

20. Notification Requirements

- a) The Board must notify BPNG within five (5) working days when it:
 - i) Becomes aware of a significant breach of, or material deviation from, the RMF;
or
 - ii) Discovers that the RMF did not adequately address a material risk.

Part IV: CORRECTIVE MEASURES**21. Remedial Measures and Sanctions**

- a) If a Licence Holder fails to comply with this prudential standard, the BPNG may impose or vary conditions on the licence to ensure compliance or, if necessary, suspend or revoke the licence.
- b) Any Licence Holder which experiences difficulty in complying with the prudential standard should advise the BPNG forthwith in writing.

Part V: EFFECTIVE DATE**22. Commencement and Transitional Arrangements**

The effective date of this prudential standard shall be 1 January 2017 with full compliance required by 1 January 2018.

23. Questions and Enquiries

Questions and enquiries relating to this prudential standard should be addressed to:

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