BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Capital Adequacy Framework (Capital Components)

Applicable to:
1. Licensed banks
2. Licensed investment banks
3. Financial holding companies

Issued on: 9 December 2020

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PART A OVERVIEW

1 Introduction

1.1 Regulatory capital requirements seek to ensure that risk exposures of a financial institution are backed by an adequate amount of high quality capital which absorbs losses on a going concern basis. This ensures the continuing ability of a financial institution to meet its obligations as they fall due while also maintaining the confidence of customers, depositors, creditors and other stakeholders in their dealings with the institution. Capital requirements also seek to further protect depositors and other senior creditors in a gone concern situation by promoting an additional cushion of assets that may be used to meet claims in liquidation.

Policy objective

1.2 The Capital Adequacy Framework sets out the approach for computing regulatory capital adequacy ratios, as well as the levels of those ratios at which a financial institution is required to operate. The framework has been developed based on internationally-agreed standards on capital adequacy promulgated by the Basel Committee on Banking Supervision (BCBS).

Scope of policy

1.3 This policy document sets out the general requirements concerning regulatory capital adequacy, and the components of eligible regulatory capital. It shall be read together with the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets)* which details out the requirements for computing risk-weighted assets and other relevant legal instruments and policy documents that have been issued by the Bank.

2 Applicability

2.1 This policy document is applicable to financial institutions as defined in paragraph 5.2.

3 Legal provisions

3.1 This policy document is specified pursuant to section 47 (2), section 51, section 115, section 143 (2), and section 266 of the Financial Services Act 2013 (FSA).

4 Effective date

4.1 This policy document comes into effect–

(a) on 9 December 2020 for a banking institution, subject to the transitional arrangements as set out in paragraphs 38 and 39; and

(b) on 9 December 2020 for a financial holding company, subject to the transitional arrangements as set out in paragraph 39.

5 Interpretation

5.1 The terms and expression used in this policy document shall have the same meanings assigned to them in the FSA, unless otherwise defined in this policy document.

5.2 For the purpose of this policy document–

"S" denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement actions;

"G" denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted;

"banking institution" means a licensed bank or a licensed investment bank, as the case may be;

"financial group" refers to a licensed bank and its subsidiaries, a licensed investment bank and its subsidiaries, or a financial holding company and its subsidiaries, as the case may be;

"financial holding company" refers to a financial holding company approved pursuant to section 112(3) of the FSA and holds investment directly or indirectly in corporations that are engaged predominantly in banking business;

"financial institution" means a banking institution or financial holding company, as the case may be;

"financial subsidiary/entity" refers to any entity, whether incorporated in or outside Malaysia, engaged substantively in, or acquiring holdings in other entities engaged substantively in, any of the following activities: banking, provision of credit, securities broking, fund management, asset management, leasing and factoring and similar activities that are ancillary to the conduct of these activities;

"general provision" refers to (i) loss allowance measured at an amount equal to 12-month and lifetime expected credit losses[1]; and (ii) regulatory reserves[2], to the extent they are ascribed to non-credit-impaired exposures.

[1] Refer to MFRS 9 *Financial Instruments*. For the avoidance of doubt, these provisions are also commonly known as Stage 1 and Stage 2 provisions respectively.

[2] Refer to the policy document on *Financial Reporting*.

6 Related legal instruments and policy documents

6.1 This policy document must be read together with other relevant instruments and policy documents that have been issued by the Bank, in particular–

(a) Policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets)* issued on 3 May 2019;

(b) Policy document on *Capital Adequacy Framework for Islamic Banks (Capital Components)* issued on 9 December 2020;

(c) Policy document on *Domestic Systemically Important Banks Framework* issued on 5 February 2020;

(d) Policy document on *Financial Reporting* issued on 27 September 2019;

(e) Policy document on *Guidelines on Skim Perbankan Islam* issued on 2 November 2012;

(f) Policy document on *Investment Account* issued on 17 January 2018;

(g) Policy document on *Risk Weighted Capital Adequacy Framework (Basel II) – Disclosure Requirements (Pillar 3)* issued on 7 August 2010; and

(h) Policy document on *STATsmart Reporting Requirements on Data Submission for Reporting Entities* issued on 29 March 2019.

7 Policy document superseded

7.1 This policy document supersedes the policy document on *Capital Adequacy Framework (Capital Components)* issued on 5 February 2020.

PART B GENERAL REQUIREMENTS

8 Level of application

S 8.1 A banking institution shall comply with the capital adequacy requirements in this policy document at the following levels:

(a) entity level[3], referring to the global operations of the banking institution (i.e. including its overseas branch operations) on a stand-alone basis, and including its Labuan banking subsidiary; and

(b) consolidated level, which includes entities covered under the entity level requirement, and the consolidation[4] of all financial and non-financial subsidiaries, except insurance/takaful subsidiaries which shall be deducted in the calculation of Common Equity Tier 1 Capital[5].

S 8.2 A financial holding company shall comply with the capital adequacy requirements in this policy document at the consolidated level in accordance with paragraph 8.1(b).

S 8.3 Where consolidation of the subsidiaries required under paragraphs 8.1(b) and 8.2 is not feasible[6], a financial institution shall seek the Bank's approval to–

(a) in the case of a financial subsidiary, deduct such investments in accordance with paragraph 31.2; and

(b) in the case of a non-financial subsidiary, apply a risk weight of 1250% to such investments in accordance with paragraphs 2.44, 3.4 and 3.195 of the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets)*.

S 8.4 In addition to paragraph 8.1(a), a banking institution carrying on *Skim Perbankan Islam*[7] (hereafter referred to as an "SPI"), shall comply with the requirements under the policy document on *Capital Adequacy Framework for Islamic Banks (Capital Components)* at the level of the SPI, as if it were a stand-alone Islamic bank.

S 8.5 A summary of the general treatment referred to in paragraphs 8.1 to 8.4, as well as that applicable for other equity investments, is set out in Appendix 1.

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3 Also referred to as the "solo" or "stand-alone" level.
4 In accordance with the Malaysian Financial Reporting Standards (MFRS).
5 In accordance with paragraph 31.2.
6 For example, where non-consolidation for regulatory capital purposes is otherwise required by law.
7 In accordance with section 15 of the FSA and *Guidelines on Skim Perbankan Islam.*

9 Capital adequacy ratios

S 9.1 A financial institution shall calculate its Common Equity Tier 1 (CET1) Capital, Tier 1 Capital and Total Capital Ratios in the following manner:

(a)

$$\text{CET1 Capital Ratio} = \frac{\text{CET1 Capital}}{\text{Total RWA}}$$

(b)

$$\text{Tier 1 Capital Ratio} = \frac{\text{Tier 1 Capital}}{\text{Total RWA}}$$

(c)

$$\text{Total Capital Ratio} = \frac{\text{Total Capital}}{\text{Total RWA}}$$

S 9.2 For the purpose of paragraph 9.1–

(a) the numerators of the capital adequacy ratios are defined in accordance with the following:

(i) CET1 Capital as defined in paragraph 12.1;

(ii) Tier 1 Capital shall be the sum of CET1 Capital and Additional Tier 1 Capital as defined in paragraph 13.1; and

(iii) Total Capital shall be the sum of Tier 1 Capital and Tier 2 Capital as defined in paragraph 14.1;

(b) total risk-weighted assets (RWA) shall be calculated as the sum of credit RWA, market RWA, operational RWA, and large exposure risk requirements as determined in accordance with the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets)*;

(c) where applicable, the sum of the credit and market RWA in paragraph 9.2(b) shall be further adjusted for investment accounts which are recognised as a risk absorbent in accordance with the requirements as set out in the policy document on *Investment Account*[8]; and

(d) any exposures which are deducted in the calculation of CET1 Capital, Tier 1 Capital, and Total Capital shall not be subject to any further capital charges in the computation of RWA.

S 9.3 In calculating the capital adequacy ratios at the consolidated level, a financial institution shall apply the Bank's rules for calculating RWA for an overseas subsidiary's risk exposures and not the capital rules of the host authority.

[8] For the avoidance of doubt, any committed but unfunded investment accounts (where actual cash has yet to be received from the Investment Account Holder) shall not qualify as risk absorbent.

10 Minimum capital adequacy requirements

S 10.1 A financial institution shall hold and maintain, at all times, the following minimum capital adequacy ratios:

CET1 Capital Ratio	Tier 1 Capital Ratio	Total Capital Ratio
4.5%	6.0%	8.0%

S 10.2 Notwithstanding paragraph 10.1, where the Bank specifies in writing a higher minimum capital adequacy ratio for a financial institution after having regard to the specific risk profile of the financial institution, the financial institution shall hold and maintain such higher minimum capital adequacy ratio.

11 Capital buffer requirements

S 11.1 A financial institution shall hold and maintain capital buffers, as specified by the Bank, in the form of CET1 Capital above the minimum CET1 Capital, Tier 1 Capital and Total Capital adequacy levels set out in paragraph 10.1 or 10.2 respectively[9]. The capital buffers shall comprise the sum of the following:

(a) a Capital Conservation Buffer (CCB) [10] of 2.5%;

(b) a Countercyclical Capital Buffer (CCyB) [11], determined as the weighted average of the prevailing CCyB rates applied in the jurisdictions in which a financial institution has credit exposures; and

(c) a Higher Loss Absorbency (HLA) requirement for a financial institution that is designated as a domestic systemically important bank (D-SIB)[12].

[9] For the avoidance of doubt, a financial institution's CET1 Capital shall first be used to meet the minimum ratios before the remainder can count towards its capital buffers. For example, a financial institution with 8% CET1 Capital Ratio and which does not have any Additional Tier 1 or Tier 2 capital instruments would meet all minimum capital adequacy requirements but would not meet the capital buffer requirements.

[10] The CCB is intended to encourage the build-up of capital buffers by individual banking institutions during normal times that can be drawn down during stress periods.

[11] The CCyB is intended to protect the banking sector as a whole from the build-up of systemic risk during an economic upswing when aggregate credit growth tends to be excessive.

[12] Refer to the policy document on *Domestic Systemically Important Banks Framework.*

S 11.2 For the purpose of paragraph 11.1(b)–

(a) the CCyB to be maintained by a financial institution shall be calculated as follows:

$$\frac{\sum_c (RWA_c \times CCyB_c)}{\sum_c RWA_c}$$

where–

RWA_c the sum of the following private sector credit exposures:

(a) RWA in respect of the private sector credit exposures[13] in the banking book in jurisdiction *c*; and

(b) RWA equivalent for trading book capital charges for specific risk, incremental risk charges (i.e. default and migration risks) and securitisation[13] in jurisdiction *c*;

$CCyB_c$ the prevailing CCyB rate applied in jurisdiction *c*;

c jurisdictions in which a financial institution has private sector credit exposures;

(b) in determining the jurisdiction to which a private sector credit exposure relates, a financial institution shall use an ultimate risk basis where possible[14];

(c) a financial institution shall calculate the CCyB based on the prevailing CCyB rate at the date from which the rate applies, as announced by the relevant national authority;

(d) where the prevailing CCyB rate applied in a jurisdiction outside Malaysia is more than 2.5%, the CCyB rate for that jurisdiction is capped at 2.5% for the purpose of calculating the financial institution's CCyB, unless specified otherwise by the Bank; and

(e) if the national authority in a jurisdiction outside Malaysia has yet to announce the CCyB rate, the rate applicable for that jurisdiction is deemed to be 0%.

S 11.3 For exposures in Malaysia and for the purpose of paragraph 11.2(d), the Bank will communicate any decision on the CCyB rate by up to 12 months before the date from which the rate applies. Any decision to reduce the CCyB rate shall take effect immediately.

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[13] This excludes exposures to sovereigns, central banks, non-federal public sector entities, multilateral development banks and banking institutions as defined in the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets)*. However, this shall include exposures to non-bank financial entities and public sector entities that are risk-weighted based on their external ratings similar to corporates.

[14] For allocation of exposures to a multinational company, a financial institution shall, to the best of the financial institution's knowledge and information, determine where the risk ultimately lies and not allocate exposures solely on the basis of where the exposure is booked.

11.4 In considering an application by a financial institution to declare or pay any dividend on its shares in accordance with section 51(2) of the FSA[15], the Bank shall have regard to, *inter alia* the level of capital buffers maintained by the financial institution.

[15] And share buybacks, in the case of a banking institution.

PART C COMPONENTS OF CAPITAL

12 Common Equity Tier 1 Capital

S 12.1 CET1 Capital shall consist of the following[16]:

(a) ordinary shares issued by the financial institution that meet the criteria specified in paragraph 15.1;
(b) share premium resulting from the issue of ordinary shares;
(c) retained earnings net of any interim and/or final dividend declared[17] and any interim losses. Any quarterly interim profits may be included in CET1 Capital, subject to a review/audit by the financial institution's external auditors[18];
(d) other disclosed reserves[19];
(e) qualifying minority interest, as determined in paragraph 18.2; and
(f) regulatory adjustments applied in the calculation of CET1 Capital, as determined in Part E.

13 Additional Tier 1 Capital

S 13.1 Additional Tier 1 Capital shall consist of the following:

(a) Additional Tier 1 capital instruments issued by the financial institution[20] that meet the criteria specified in paragraph 16.1, and are not included in CET1 Capital;
(b) share premium resulting from the issue of instruments referred to in paragraph 13.1(a)[21];
(c) qualifying CET1 and Additional Tier 1 capital instruments issued by consolidated subsidiaries of the financial institution and held by third parties, as determined in paragraph 18.4; and
(d) regulatory adjustments applied in the calculation of Additional Tier 1 Capital, as determined in Part E.

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16 For the purpose of paragraph 8.4, CET1 Capital of an SPI shall consist of an allocation of the banking institution's CET1 Capital and CET1 Capital generated by the SPI (collectively known as Islamic Banking Fund), and regulatory adjustments applied in the calculation of CET1 Capital.

17 In accordance with applicable MFRS.

18 Quarterly financial statements shall be reviewed in a timely manner by the financial institution's approved external auditors, and no qualified opinion has been made on any of the financial institution's quarterly financial statements in the preceding 12 months.

19 Disclosed reserves including other accumulated comprehensive income, but excluding share premium.

20 For the purpose of paragraph 8.4, allocation of a banking institution's Additional Tier 1 capital instruments, if any, which is not issued specifically for the purpose of the SPI shall not be recognised as regulatory capital for the SPI.

21 Share premium that is not eligible for inclusion in CET1 Capital will only be permitted to be included in Additional Tier 1 Capital if the shares giving rise to the stock surplus are permitted to be included in Additional Tier 1 Capital.

14 Tier 2 Capital

S 14.1 Tier 2 Capital shall consist of the following:

(a) Tier 2 capital instruments issued by the financial institution[22] that meet the criteria specified in paragraph 17.1, and are not included in Tier 1 Capital;

(b) share premium resulting from the issue of instruments referred to in paragraph 14.1(a)[23];

(c) qualifying CET1, Additional Tier 1 and Tier 2 capital instruments issued by consolidated subsidiaries of the financial institution and held by third parties, as determined in paragraph 18.6;

(d) loss provisions[24]–

(i) surplus eligible provisions[25] over expected losses[26], subject to a maximum of 0.6% of total credit RWA determined under the Internal Ratings-Based approach for credit risk; and

(ii) general provisions subject to a maximum of 1.25% of total credit RWA determined under the Standardised Approach for credit risk; and

(e) regulatory adjustments applied in the calculation of Tier 2 Capital, as determined in Part E.

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22 For the purpose of paragraph 8.4, allocation of a banking institution's Tier 2 capital instruments, if any, which is not issued specifically for the purpose of the SPI, shall not be recognised as regulatory capital for the SPI.

23 Share premium that is not eligible for inclusion in Tier 1 Capital will only be permitted to be included in Tier 2 Capital if the shares giving rise to the stock surplus are permitted to be included in Tier 2 Capital.

24 The provisions shall be gross of tax effects.

25 In accordance with paragraphs 3.227 to 3.229 of the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets)*.

26 In accordance with paragraphs 3.216 to 3.226 of the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets).*

PART D CRITERIA FOR INCLUSION IN CAPITAL

15 Ordinary shares

S 15.1 An ordinary share shall qualify as a CET1 capital instrument if it meets all the following criteria:

(a) it is directly issued and paid-up;

(b) it represents the most subordinated claim in liquidation of the financial institution;

(c) ordinary shares absorb the first and proportionately greatest share of any losses as they occur[27], and each ordinary share absorbs losses on a going concern basis proportionately and *pari passu* with all ordinary shares;

(d) the paid-up amount is neither secured nor covered by a guarantee of the financial institution or an affiliated entity[28] or subject to any other arrangement that legally or economically enhances the seniority of the claim;

(e) principal is perpetual and never repaid outside of liquidation[29];

(f) shareholders are entitled to a claim on the residual assets that is proportional with their respective share of issued capital, after all senior claims have been repaid in liquidation (i.e. has an unlimited and variable claim, not a fixed or capped claim);

(g) distributions are paid out of distributable items (including retained earnings), with the level of distributions not in any way tied or linked to the amount paid up at issuance and is not subject to a contractual cap, except to the extent that the financial institution is unable to pay distributions that exceed the level of distributable items;

(h) there are no circumstances under which distributions are obligatory, and non-payment is therefore not an event of default;

(i) distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made, thereby precluding any preferential distributions, including in respect of other ordinary shares;

(j) the paid-up amount is recognised as equity capital for determining balance sheet insolvency;

(k) the paid-up amount is classified as equity under the Malaysian Financial Reporting Standards (MFRS);

(l) ordinary shares are clearly and separately disclosed on the financial institution's balance sheet;

(m) the financial institution does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the

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27 For the avoidance of doubt, the requirement for a permanent write-off feature in capital instruments as set out in paragraph 34.1(b) does not negate this criterion being met by ordinary shares.

28 An affiliate is defined as a company that controls, or is controlled by, or is under common control with, the financial institution. Control of a company is defined as (i) ownership, control, or holding with power to vote 20% or more of a class of voting securities of the company; or (ii) consolidation of the company for financial reporting purposes.

29 Except for discretionary repurchases or other means of capital reduction arrangements allowable under relevant law and regulations. Repayment of principal shall also be subject to the prior written approval of the Bank.

statutory contractual terms provide any feature which might give rise to such an expectation;

(n) the purchase of the ordinary share is not directly or indirectly funded by the financial institution;

(o) the ordinary share is not purchased by the financial institution or its affiliated party over which it exercises control or significant influence; and

(p) the ordinary share is only issued with the approval of the shareholders of the financial institution, either given directly by shareholders or, if permitted by law, given by the board of directors or by other persons duly authorised by the shareholders.

S 15.2 In instances where a financial institution issues different classes of ordinary shares with different levels of voting rights (including non-voting shares), all classes of ordinary shares must be identical in all respects except the level of voting rights in order to qualify as a CET1 capital instrument.

S 15.3 For the purpose of paragraph 15.1(a), where an instrument is paid-up by way of issuance of shares and not by cash (e.g. payment for take-over of another company in the form of ordinary shares), a financial institution is required to obtain the prior written approval of the Bank to include the shares issued as regulatory capital.

16 Additional Tier 1 capital instruments

S 16.1 An instrument shall qualify as an Additional Tier 1 capital instrument if it meets all the following criteria:

(a) the instrument is issued and paid-up;

(b) the instrument is subordinated to depositors, general creditors and other holders of subordinated debt of the financial institution;

(c) the instrument is neither secured nor covered by a guarantee of the financial institution or an affiliated entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors, general creditors and other holders of subordinated debt of the financial institution;

(d) the instrument is perpetual, and shall therefore not have a maturity date, step-up features or other incentives for the financial institution to redeem the instrument[30];

(e) the instrument may be callable at the initiative of the financial institution only after a minimum of five years, subject to the following conditions:

(i) the exercise of a call option must receive the prior written approval of the Bank;

(ii) the financial institution must not do anything which creates an expectation that the call will be exercised; and

[30] Other incentives to redeem include a call option combined with a requirement or an investor option to convert the instrument into shares if the call is not exercised, or a call option combined with a change in the reference rate where the credit spread over the second reference rate is greater than the initial payment rate less the swap rate. For the avoidance of doubt, conversion from a fixed rate to a floating rate, or vice versa, in combination with a call option without any increase in credit spread will not in itself be viewed as an incentive to redeem.

(iii) the call option must not be exercised unless–

(A) the called instrument is replaced with capital of the same or better quality, and the replacement of this capital is done at conditions which are sustainable for the income capacity of the financial institution[31]; or

(B) the financial institution demonstrates to the satisfaction of the Bank that its capital position is and can be sustained well above the minimum capital adequacy requirements and capital buffer requirements, as outlined in paragraphs 10 and 11 respectively, after the call option is exercised;

(f) any repayment of principal[32], other than through the exercise of a call option, (e.g. through repurchase) must be with the prior written approval of the Bank and the financial institution shall not assume or create market expectations that approval will be given;

(g) dividends/coupons must be paid out of distributable items, and such distributions must meet the following conditions:

(i) distributions/payments shall be at the full discretion of the financial institution at all times[33,34];

(ii) cancellation of discretionary payments must not constitute an event of default;

(iii) the financial institution must have full access to cancelled payments to meet obligations as they fall due[35]; and

(iv) cancellation of distributions/payments must not impose restrictions on the financial institution except in relation to distributions to ordinary shareholders;

(h) the instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the credit standing of the financial institution or any of its affiliated entities;

(i) the instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of national insolvency law governing the provisions of the instrument;

(j) the provisions governing the instrument require the instrument to be written-off[36], or the instrument to be converted into ordinary shares, if the consolidated or entity level CET1 Capital Ratio of the financial institution[37] falls below a pre-specified level, which shall be no lower than 5.125%. The aggregate amount to be written-off or converted into ordinary shares for all these instruments, on breaching the trigger level, must at least be the amount needed to immediately restore the consolidated and entity

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31 Replacement issues may be concurrent with, but not after the instrument is called.

32 Repayments due to tax or regulatory events are permitted subject to the assessment by the Bank that the financial institution was not in a position to anticipate the event at issuance.

33 Features such as “dividend pushers” are prohibited. An instrument with a dividend pusher obliges the issuing financial institution to make a dividend/coupon payment on the instrument if it has made a payment on another (typically more junior) capital instrument or share.

34 Any waived distributions/payments are non-cumulative i.e. are not required to, and must not, be made up by the financial institution at a later date.

35 Any structuring of bonus payment to make up for unpaid dividends is also prohibited.

36 Subject to paragraph 34.3.

37 As disclosed in its published financial reports/statements or in Pillar 3 disclosures.

level CET1 Capital Ratio of the financial institution to 5.75%[38]. If this is not possible, then the full principal value of the instrument must be written-off or converted into ordinary shares;

(k) the instrument cannot have any features that hinder recapitalisation, such as provisions that require the financial institution to compensate investors if a new instrument is issued at a lower price during a specified time frame;

(l) if the instrument is issued out of a special purpose vehicle (SPV), proceeds must be immediately available without limitation to the financial institution in a form which meets or exceeds all of the other criteria for inclusion in Additional Tier 1 Capital[39];

(m) the provisions governing the issuance of the capital instrument require the instrument to be written-off[36], or the instrument to be converted into ordinary shares upon the occurrence of a trigger event, which shall be determined by the requirements set out in paragraphs 33.1 to 33.3. The amount to be written-off or converted into ordinary shares must be the full principal value of the instrument;

(n) the purchase of the instruments is not directly or indirectly funded by the financial institution;

(o) the instrument is not purchased by the financial institution or its affiliated party over which it exercises control or significant influence; and

(p) for an SPI and an Islamic banking subsidiary[40], the instrument issued shall be structured using unrestricted non-exchange-based contracts (e.g. *Musharakah, Mudarabah, or Wakalah*), in addition to meeting other Shariah requirements.

S 16.2 Where Additional Tier 1 capital instruments issued by a fully consolidated subsidiary are included as regulatory capital in the consolidated capital of a financial institution, the provisions governing the instruments shall fulfil all the criteria for inclusion in Additional Tier 1 capital as set out in paragraph 16.1, and the instruments shall be written-off or converted into ordinary shares when–

(a) the consolidated CET1 Capital Ratio of the financial institution falls below a pre-specified level, which shall be no lower than 5.125%; and

(b) a trigger event as specified in paragraphs 33.1 to 33.3 takes place in relation to the financial group (i.e. financial institution and its subsidiaries).

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38 Accordingly, for the purpose of paragraph 8.4, if the consolidated or entity or SPI level CET1 Capital Ratio of an institution falls below 5.125%, the aggregate amount to be converted into ordinary shares must at least be the amount needed to immediately restore the consolidated, entity, and SPI level CET1 Capital Ratio of the institution to 5.75%.

39 For the avoidance of doubt, a capital instrument, issued out of an SPV must satisfy the requirements in paragraph 18.7 to qualify as Additional Tier 1 Capital or Tier 2 Capital as applicable.

40 Licensed under section 10 of the Islamic Financial Services Act 2013.

17 Tier 2 capital instruments

S 17.1 An instrument shall qualify as a Tier 2 capital instrument if it meets all the following criteria:

(a) the instrument is issued and paid-up;

(b) the instrument is subordinated to depositors and general creditors of the financial institution;

(c) the instrument is neither secured nor covered by a guarantee of the financial institution or an affiliated entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general creditors of the financial institution;

(d) the instrument has an original maturity of at least five years, and there are no step-up features or other incentives for the financial institution to redeem the instrument;

(e) the instrument may be callable at the initiative of the financial institution only after a minimum of five years, subject to the following conditions:

(i) the exercise of a call option must receive prior written approval of the Bank;

(ii) the financial institution must not do anything which creates an expectation that the call will be exercised[41]; and

(iii) the call option must not be exercised unless–

(A) the called instrument is replaced with capital of the same or better quality, and the replacement of this capital is done at conditions which are sustainable for the income capacity of the financial institution[42]; or

(B) the financial institution demonstrates that its capital position is well above the minimum capital adequacy requirements and capital buffer requirements, as outlined in paragraphs 10 and 11 respectively, after the call option is exercised;

(f) any repayment of principal, other than through the exercise of a call option, (e.g. through repurchase) must be with the prior written approval of the Bank and the financial institution shall not assume or create market expectations that approval will be given;

(g) the holder of the capital instrument must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy or liquidation;

(h) the instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the credit standing of the financial institution or any of its affiliated entities;

(i) if the instrument is issued out of an SPV, proceeds must be immediately available without limitation to the financial institution in a form which meets or exceeds all of the other criteria for inclusion in Tier 2 Capital[39];

(j) the provisions governing the issuance of the capital instrument require the instrument to be written-off[36], or the instrument to be converted into

[41] An option to call the instrument after five years but prior to the start of, or during, the period in which the instrument will be gradually derecognised will not be viewed as an incentive to redeem as long as the financial institution does not do anything that creates an expectation that the call will be exercised at that point.

[42] Replacement issues may be concurrent with, but not after the instrument is called.

ordinary shares upon the occurrence of a trigger event, which shall be determined by the requirements set out in paragraphs 33.1 to 33.3. The amount to be written-off or converted into ordinary shares must be the full principal value of the instrument;

(k) the purchase of the instruments is not directly or indirectly funded by the financial institution; and

(l) the instrument is not purchased by the financial institution or its affiliated party over which it exercises control or significant influence.

S 17.2 Where Tier 2 capital instruments issued by a fully consolidated subsidiary are included as regulatory capital in the consolidated capital of a financial institution, the provisions governing the instruments shall fulfil all the criteria for inclusion in Tier 2 Capital as set out in paragraph 17.1 and the instruments shall be written-off or converted into ordinary shares when a trigger event as specified in paragraphs 33.1 to 33.3 takes place in relation to the financial group.

S 17.3 In the final four years of its contractual maturity, a financial institution shall gradually derecognise the instrument from Tier 2 Capital on a straight line basis as follows:

Years to maturity (x)	Amount recognised in Tier 2 Capital
$x > 4$	100%
$3 < x \leq 4$	80%
$2 < x \leq 3$	60%
$1 < x \leq 2$	40%
$x \leq 1$	20%

18 Minority interest and capital instruments issued out of consolidated subsidiaries and held by third parties

S 18.1 Where the minority interest arising from the issue of ordinary shares by a fully consolidated banking subsidiary[43,44] of a financial institution is recognised in consolidated CET1 Capital of the financial institution, the ordinary shares giving rise to the minority interest shall meet the criteria for inclusion in CET1 Capital[45].

[43] A banking subsidiary in this paragraph shall mean to only include a deposit-taking entity that is subject to minimum prudential standards and level of supervision by an authority that subscribes to the *Core Principles for Effective Banking Supervision* promulgated by the BCBS. For the avoidance of doubt, this excludes the inclusion of any capital issued to third parties by non-banking subsidiaries, such as leasing, factoring or fund management companies.

[44] Where a fully-consolidated subsidiary of a financial institution has its own subsidiaries, the calculation of regulatory capital attributable to third parties shall be undertaken in respect of that subsidiary and its subsidiaries as a consolidated group.

[45] For the purpose of this paragraph, any reference to the term “financial institution” in paragraph 15 shall mean to refer to any “fully-consolidated banking subsidiary of the financial institution”.

S 18.2 For the purpose of paragraph 18.1, the amount of minority interest that will be recognised in consolidated CET1 Capital in paragraph 12.1(e) shall be calculated as follows:

$$A - (B \times C)$$

where–

A total qualifying minority interest[46]

B surplus CET1 Capital of the subsidiary, calculated as CET1 Capital of the subsidiary[47] minus the lower of the following:

I. 7.0%[48] of the subsidiary's total RWA calculated at the entity level; or

II. 7.0% of the portion of the financial institution's consolidated RWA relating to that subsidiary

C percentage of CET1 Capital of the subsidiary held by minority shareholders

S 18.3 Where Tier 1 capital instruments issued by a fully consolidated subsidiary[44,49] of a financial institution and held by third parties are recognised in consolidated Tier 1 Capital of the financial institution, the instruments shall meet the criteria for inclusion in CET1 Capital or Additional Tier 1 Capital[50,51].

S 18.4 For the purpose of paragraph 18.3, the amount of such capital that will be recognised in consolidated Tier 1 Capital shall be calculated as follows:

$$A - (B \times C)$$

where–

A total qualifying Tier 1 capital instruments (i.e. CET1 and Additional Tier 1) of the subsidiary issued to third parties[46]

B surplus Tier 1 Capital of the subsidiary, calculated as Tier 1 Capital of the subsidiary[47] minus the lower of the following:

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46 Including associated reserves, but prior to the application of regulatory adjustments.

47 Including associated reserves and regulatory adjustments.

48 Corresponding to the minimum CET1 capital requirement of 4.5% plus the capital conservation buffer of 2.5%.

49 For the avoidance of doubt, this includes both banking and non-banking subsidiaries, but excludes insurance/takaful subsidiaries and other subsidiaries which are not consolidated for regulatory purposes.

50 For the purpose of this paragraph, any reference to the term "financial institution" in paragraphs 15 and 16 shall mean to refer to any "fully-consolidated subsidiary of the financial institution". For example, the early redemption of an instrument by a subsidiary shall be subject to the Bank's approval, in addition to that of the relevant host authority.

51 A financial institution may recognise Shariah-compliant capital instruments issued by subsidiaries in other jurisdictions based on the Shariah views in the respective jurisdictions, unless specifically disallowed by the Bank.

I. 8.5%[52] of the subsidiary's total RWA calculated at the entity level; or
II. 8.5% of the portion of the financial institution's consolidated RWA relating to that subsidiary

C percentage of Tier 1 Capital of the subsidiary held by third parties

The capital that will be recognised in consolidated Additional Tier 1 Capital in paragraph 13.1(c) shall exclude amounts recognised in consolidated CET1 Capital as calculated in paragraph 18.2.

S 18.5 Where total capital instruments issued by a fully consolidated subsidiary[44,49] of a financial institution and held by third parties are recognised in consolidated Total Capital of the financial institution, the instruments shall meet the criteria for inclusion in CET1 Capital, Additional Tier 1 Capital or Tier 2 Capital[51,53].

S 18.6 For the purpose of paragraph 18.5, the amount of such capital that will be recognised in consolidated Total Capital shall be calculated as follows:

$$A - (B \times C)$$

where–

A total qualifying capital instruments (i.e. CET1, Additional Tier 1 and Tier 2) of the subsidiary issued to third parties[46]

B surplus Total Capital of the subsidiary, calculated as Total Capital of the subsidiary[47] minus the lower of the following:
I. 10.5%[54] of the subsidiary's total RWA calculated at the entity level; or
II. 10.5% of the portion of the financial institution's consolidated RWA relating to that subsidiary

C percentage of Total Capital of the subsidiary held by third parties

The capital that will be recognised in consolidated Tier 2 Capital in paragraph 14.1(c) shall exclude amounts recognised in consolidated CET1 Capital as calculated in paragraph 18.2 and amounts recognised in consolidated Additional Tier 1 Capital as calculated in paragraph 18.4.

S 18.7 Where the capital instruments issued to third parties out of an SPV are included in the entity and consolidated level Additional Tier 1 Capital or Tier 2 Capital of the financial institution[55]–

[52] Corresponding to the minimum Tier 1 capital requirement of 6% plus the capital conservation buffer of 2.5%.
[53] For the purpose of this paragraph, any reference to the term "financial institution" in paragraphs 15, 16 and 17 shall mean to refer to any "fully-consolidated subsidiary of the financial institution".
[54] Corresponding to the minimum Total Capital requirement of 8% plus the capital conservation buffer of 2.5%.
[55] For the avoidance of doubt, an Additional Tier 1 or Tier 2 capital instrument issued out of an SPV pursuant to this paragraph is not subject to the treatment set out in paragraphs 18.4 and 18.6.

(a) the SPV must be domiciled in Malaysia[56];
(b) the SPV must be controlled[57] and managed by the financial institution, and would, in accordance with MFRS, be fully consolidated;
(c) the SPV must be set up for the sole purpose of the capital issuance for the financial institution[58] and does not conduct any other business or activity;
(d) the SPV must not have external creditors at any time[59];
(e) the entire proceeds from the capital issuance through the SPV[60] must be immediately available without limitation to the financial institution in a form which meets or exceeds all of the criteria for inclusion in Additional Tier 1 or Tier 2 Capital, as applicable; and
(f) the provisions governing the issuance of the instruments issued by the SPV and the financial institution must substantially be the same (e.g. maturity), and accordingly, the capital instrument issued by the SPV must meet all the relevant criteria (as required in paragraph 16.1 for Additional Tier 1 Capital and paragraph 17.1 for Tier 2 Capital) for inclusion as if the financial institution itself were to issue the instrument[61,62].

S 18.8 Where the capital instruments are issued to third parties through an SPV via a fully consolidated subsidiary of the financial institution[63] and included in the financial institution's consolidated Additional Tier 1 Capital or Tier 2 Capital in accordance with the treatment outlined in paragraphs 18.4 and 18.6, such capital instruments shall be subject to the requirements in paragraph 18.7 as if the subsidiary itself had issued the capital instruments directly to the third parties.

G 18.9 An illustration of the treatment for minority interest and capital instruments issued out of consolidated subsidiaries and held by third parties is provided in Appendix 2.

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56 Including Labuan.
57 Use of an independent SPV is allowed in structures that require the use of such SPVs, which includes the issuance of Islamic capital instruments structured using the exchange-based contracts (e.g. *Murabahah* or *Ijarah*).
58 In addition, an SPV may be established to issue tranches of one instrument where the only change in the terms and conditions of the tranches is a variation in distribution or payments to be made on the instrument. An SPV must not issue different forms of an instrument even if they belong to the same category of capital instruments.
59 Nonetheless, this does not preclude miscellaneous creditors (e.g. tax authorities, administrators) to the extent that they are *de minimis*.
60 This does not preclude the use of the proceeds to fund assets that relate to the operation of the SPV to the extent that they are *de minimis*.
61 For example, if an SPV issues a Tier 2 capital instrument to investors and upstreams the proceeds by investing in a Tier 1 capital instrument issued by the financial institution, the transaction will be recognised in Tier 2 Capital.
62 In the case of issuance of Islamic capital instruments structured using the exchange-based contracts through an SPV (e.g. *Murabahah* or *Ijarah*) or any other indirect structures (e.g. Commodity *Murabahah*), the contracts between the financial institution and the SPV or any parties involved shall be structured in a manner which in combination meets or exceeds the criteria for inclusion in capital. For example, any purchase undertaking shall be designed in a manner that does not legally or economically enhance the seniority of capital issued.
63 The SPV must be controlled and managed by the fully consolidated subsidiary except as mentioned in footnote 57.

PART E REGULATORY ADJUSTMENTS

19 Goodwill and other intangibles

S 19.1 Goodwill, including any goodwill included in the valuation of significant capital investments in unconsolidated entities, and all other intangibles[64] must be deducted in the calculation of CET1 Capital. The full amount shall be deducted net of any associated deferred tax liability that would be extinguished if the intangible asset becomes impaired or is derecognised under the relevant MFRS.

S 19.2 Bargain purchase gains (also commonly known as negative goodwill) shall not be recognised in the calculation of CET1 Capital.

20 Deferred tax assets and liabilities

S 20.1 Deferred tax assets (DTAs) that rely on the future profitability of the financial institution to be realised shall be deducted in the calculation of CET1 Capital[65]. In this regard, a DTA may be netted against its associated deferred tax liability (DTL) only if the DTA and DTL relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority. DTLs permitted to be netted against DTAs shall exclude amounts that have been netted against the deduction of goodwill, intangibles and defined benefit pension assets.

S 20.2 Net DTLs shall not be added back in the calculation of CET1 Capital.

21 Property revaluation gains/losses

S 21.1 The amount of cumulative unrealised gains arising from the changes in the fair value or revaluation of land and buildings[66] shall be treated as follows:

(a) cumulative unrealised gains shall be deducted in the calculation of CET1 Capital; and

(b) 45% of the cumulative unrealised gains shall be added back in the calculation of Tier 2 Capital[67].

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[64] As defined under the relevant MFRS. This shall include mortgage servicing rights, if any, but exclude right-of-use (ROU) assets, where the underlying asset being leased is a tangible asset.

[65] An overinstallment of tax or current year tax losses carried back to prior years may give rise to a claim or receivable from the government or local tax authority. Such amounts are typically classified as current tax assets for accounting purposes. As the recovery of such a claim or receivable does not rely on the future profitability of the financial institution, it shall be assigned the relevant sovereign risk weighting.

[66] Referring to the revaluation gains of properties that are subject to the *Revaluation Model* under MFRS 116 *Property, Plant and Equipment,* and the *Fair Value Model* under MFRS 140 *Investment Property*. In addition, any recognition of revaluation gains of property in the retained earnings arising from the application of MFRS 1 *First-Time Adoption of Malaysian Financial Reporting Standards* is also subject to this treatment.

[67] For the avoidance of doubt, any impairment charge or accumulated amortisation/depreciation against any land and buildings is not netted against unrealised gains from any other land and buildings.

S 21.2 The amount of cumulative unrealised losses arising from the changes in fair value or revaluation of land and buildings shall be fully recognised in the calculation of CET1 Capital.

S 21.3 For the purpose of recognition of cumulative unrealised gains in Tier 2 Capital in accordance with paragraph 21.1(b), the valuation of land and buildings shall be certified by an independent professional valuer at least once every three years[68] or where there is evidence that the value has been or is likely to be substantially impaired.

22 Cumulative gains/losses of financial instruments measured at fair value through other comprehensive income or designated at fair value

S 22.1 55% of cumulative unrealised gains arising from changes in the fair value of financial instruments measured at fair value through other comprehensive income, other than loans/financing and receivables, shall be deducted in the calculation of CET1 Capital.

S 22.2 For loans/financing and receivables measured at fair value through other comprehensive income or designated at fair value, the amount of unrealised gains arising from changes in the fair value shall be fully deducted in the calculation of CET1 Capital.

S 22.3 The amount of cumulative unrealised losses arising from the changes in fair value of financial instruments, including loans/financing and receivables, shall be fully recognised in the calculation of CET1 Capital.

23 Cash flow hedge reserve

S 23.1 The amount of the cash flow hedge reserve[69] that relates to the hedging of items that are not fair valued on the balance sheet (including projected cash flows) shall be derecognised in the calculation of CET1 Capital. In this regard, positive amounts shall be deducted and negative amounts shall be added back in the calculation of CET1 Capital.

24 Regulatory reserve

S 24.1 The amount of regulatory reserve maintained in accordance with paragraph 10.5 of the policy document on *Financial Reporting* shall be deducted in the calculation of CET1 Capital[70].

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[68] For the avoidance of doubt, recognition of revaluation gains of property in the retained earnings arising from the application of MFRS 1 *First-Time Adoption of Malaysian Financial Reporting Standards* is only subject to a one-off certification by an independent professional valuer.

[69] This treatment specifically identifies and removes the element of the cash flow hedge reserve that gives rise to artificial volatility in common equity, as the reserve only reflects the fair value of the derivative and not the changes in the fair value of the hedged future cash flow.

[70] Recognition of regulatory reserve in Tier 2 Capital is set out in paragraph 14.1(d)(ii).

25 Shortfall of eligible provisions to expected losses

S 25.1 Where the financial institution has adopted the Internal Ratings-Based approach for credit risk, any shortfall of eligible provisions[71] to expected losses[72] shall be deducted in the calculation of CET1 Capital. The full amount shall be deducted and shall not be reduced by any tax effects that could be expected to occur if provisions were to rise to the level of expected losses.

26 Valuation adjustments

S 26.1 The amount arising from the valuation adjustments computed in accordance with paragraphs 5.19 and 5.20 of the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets)* that exceed the valuation adjustments made under MFRS shall be deducted in the calculation of CET1 Capital.

27 Increases in equity capital resulting from a securitisation transaction

S 27.1 Any increase in equity capital resulting from a securitisation transaction, such as that associated with expected future margin income resulting in a gain-on-sale, shall be deducted in the calculation of CET1 Capital.

28 Cumulative gains/losses due to changes in own credit risk on fair valued liabilities

S 28.1 All unrealised fair value gains and losses on financial liabilities that are due to changes in the financial institution's own credit risk shall be derecognised in the calculation of CET1 Capital. In this regard, positive amounts shall be deducted and negative amounts shall be added back in the calculation of CET1 Capital.

S 28.2 In addition, all accounting valuation adjustments on derivatives liabilities that are due to changes in the financial institution's own credit risk shall be derecognised in the calculation of CET1 Capital. The offsetting between valuation adjustments that are due to changes in the financial institution's own credit risk and those arising from the counterparties' credit risk is not allowed.

29 Defined benefit pension fund assets and liabilities

S 29.1 For each defined benefit pension fund that is an asset on the balance sheet, the asset shall be deducted in the calculation of CET1 Capital net of any associated deferred tax liability which would be extinguished if the asset becomes impaired or derecognised under MFRS. The amount of defined benefit pension fund

[71] In accordance with paragraphs 3.227 to 3.229 of the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets)*.

[72] In accordance with paragraphs 3.216 to 3.226 of the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets).*

liabilities, as included on the balance sheet, shall be fully recognised in the calculation of CET1 Capital.

S 29.2 A financial institution shall seek a prior written approval of the Bank before the assets in the fund to which the financial institution has unrestricted and unfettered access can be used to offset the deduction.

S 29.3 For the purpose of paragraph 29.2, such offsetting assets shall be risk-weighted as if they were owned directly by the financial institution[73].

30 Investments in own capital instruments

S 30.1 All direct, indirect[74] and synthetic[75] holdings of a financial institution's own capital instruments[76] in the trading and banking book[77], including any own capital instruments which the financial institution is contractually obliged to purchase and any other financing[78] provided for the purpose of purchasing own capital instruments, shall be deducted in the calculation of capital. In applying the deductions, financial institutions must deduct the investment from the same component of capital for which it would qualify[79].

S 30.2 In instances where a financial institution has an indirect exposure to its own capital instrument (e.g. through an investment in a collective investment scheme or holdings of an index security), the financial institution shall look through the holdings to determine their underlying holdings of capital[80].

S 30.3 For the purpose of paragraph 30.1, where gross long positions are netted against gross short positions in the same underlying exposure, such offsetting is only

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[73] This treatment addresses the concern that assets arising from pension funds may not be capable of being withdrawn and used for the protection of depositors and other creditors of a financial institution. The concern is that their only value stems from a reduction in future payments into the fund. The treatment allows for financial institutions to reduce the deduction of the assets if they are able to address these concerns and show that the assets be easily and promptly withdrawn from the fund.

[74] Indirect holdings are exposures or parts of exposures that, if a direct holding loses its value, will result in a loss to the financial institution substantially equivalent to the loss in value of the direct holding. An indirect holding may arise when the financial institution invests in an unconsolidated intermediate entity that has an exposure to the capital of the financial institution itself.

[75] A synthetic holding may arise when a financial institution invests in an instrument where the value of the instrument is directly linked to the value of the capital of the financial institution itself.

[76] Including treasury stock.

[77] With the exposure amount in trading and banking book determined in accordance with the definition of exposures under the respective credit or market risk rules. For the avoidance of doubt, the exposure amount for derivatives shall refer to the delta equivalent position and not the notional value of the financial instrument.

[78] Both funded and unfunded (e.g. guarantees) exposures.

[79] Unless already derecognised under the relevant MFRS.

[80] If the financial institution finds it operationally impractical to look through the holdings of an index security, the financial institution may, with the prior written approval of the Bank, use a conservative estimate. The methodology for the estimate shall demonstrate that in no case will the actual exposure be higher than the estimated exposure, and the estimation should be updated at least annually to reflect the best estimates of the exposure. The full value shall be deducted in instances where this requirement cannot be met.

allowed when the short positions involve no counterparty risk[81]. In the case of an index security, where a gross long position is netted against a short position, both positions must be in the same underlying index. In such an instance, the short position may involve counterparty risk, which will be subject to the relevant counterparty credit risk charge as calculated in accordance with Appendix VIII of the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets)*.

31 Investments in the capital of unconsolidated financial and insurance/ takaful entities

S 31.1 Investments in the capital instruments of unconsolidated financial[82, 83] and insurance/takaful entities shall–

(a) include direct, indirect[84] and synthetic[85] holdings of capital instruments. A financial institution shall look through indirect exposures (e.g. through an investment in a collective investment scheme or holdings of an index security) to determine its underlying holdings of capital[80];

(b) refer to the net long positions[81] in both the banking book and trading book[77]. In this regard, the gross long position can be offset against the short position in the same underlying exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year[86];

(c) include underwriting positions held longer than five working days after the issuance date of the capital instruments[87]; and

(d) with the prior written approval of the Bank and subject to conditions that the Bank may specify (including the period of exclusion), exclude certain investments where these have been made in the context of resolving or providing financial assistance to reorganise a distressed institution.

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81 This includes netting positions in cash instruments and derivatives over the same underlying exposures.

82 These refer to investments in entities outside the scope of regulatory consolidation, namely those that have not been consolidated at all or have not been consolidated in such a way as to result in their assets being included in the calculation of risk-weighted assets. For the avoidance of doubt, this shall only include investments in financial and insurance/takaful subsidiaries for entity level reporting.

83 For the purpose of paragraphs 31.1 to 31.4, this shall include financial entities and their holding companies.

84 An indirect holding may arise when a financial institution invests in an unconsolidated intermediate entity that has an exposure to the capital of an unconsolidated financial or insurance/takaful entity and thus gains an exposure to the capital of that financial or insurance/takaful entity.

85 A synthetic holding may arise when a financial institution invests in an instrument where the value of the instrument is directly linked to the value of the capital of an unconsolidated financial or insurance/takaful entity.

86 Any counterparty credit risk associated with short positions used to offset long positions shall remain included in the calculation of RWA.

87 For the avoidance of doubt, underwriting positions held for five working days or less (including pre-issuance underwriting obligations and undrawn amount of an underwriting facility) shall be risk-weighted.

S 31.2 The investments in the capital instruments of unconsolidated financial and insurance/takaful entities, as described in paragraph 31.1, shall be deducted in the calculation of capital as follows:

(a) where the financial institution owns more than 10% of the issued ordinary share capital of a non-affiliated issuing entity, the entire amount of investments in capital instruments;

(b) where the issuing entity is an affiliate of the financial institution[28], the entire amount of investments in capital instruments; and

(c) where the financial institution does not own more than 10%[88] of the issued ordinary share capital of a non-affiliated issuing entity, the amount of all capital instruments held in excess of 10% of the financial institution's common equity[89].

In addition, the Bank will also require that all reciprocal cross holdings of capital instruments that are designed to artificially inflate the capital position of a financial institution be deducted.

S 31.3 In applying the deductions in paragraph 31.2, a financial institution shall apply the corresponding deduction approach by deducting an investment from the same component of capital for which the capital would qualify if it was issued by the financial institution itself. In applying the corresponding deduction approach, if the capital instrument of the entity in which the financial institution has invested in does not meet the criteria for inclusion in CET1 Capital, Additional Tier 1 Capital, or Tier 2 Capital of the financial institution, the capital is to be considered as an ordinary share for purposes of this regulatory adjustment[90] and thus deducted in the calculation of CET1 Capital.

S 31.4 The amount of capital holdings which is not deducted in paragraph 31.2(c) shall continue to be risk-weighted[91]. For the application of risk weighting, the amount of the holdings must be allocated on a pro-rata basis between those held below and those held above the threshold.

32 Other regulatory adjustments

S 32.1 In applying the regulatory adjustments against a particular tier of capital and if the financial institution does not have enough of that tier of capital to satisfy the deduction, any shortfall shall be deducted in the calculation of the next higher tier of capital[92].

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88 This includes the scenario where the financial institution does not own any issued ordinary share capital of the issuing entity.

89 The common equity for purposes of calculating the 10% threshold shall be calculated after applying the regulatory adjustments set out in paragraphs 19 to 30 to the sum of items set out in paragraphs 12.1(a) to (e).

90 An investment in an instrument issued by a regulated financial entity is not required to be deducted if that instrument is not deemed as its regulatory capital under the rules of the relevant authority.

91 Instruments in the trading book shall be treated in accordance with the market risk rules and instruments in the banking book shall be treated in accordance with the credit risk rules.

92 For example, if a financial institution does not have enough Additional Tier 1 Capital to meet the deductions, the shortfall will be deducted in the calculation of CET1 Capital.

S 32.2 Where the Bank specifies in writing a specific regulatory adjustment in this framework in respect of a financial institution after having regard to the specific risk profile of the financial institution, the financial institution shall comply with such adjustment.

PART F OTHER REQUIREMENTS

33 Requirements to ensure loss absorbency at the point of non-viability

S 33.1 The provisions governing the issuance of an Additional Tier 1 or Tier 2 capital instrument shall contain clauses that require the instrument to be written-off, or the instrument to be converted into ordinary shares, upon the occurrence of a trigger event, which shall be the earlier of the following:

(a) a Relevant Malaysian Authority notifies the financial institution in writing that the Relevant Malaysian Authority is of the opinion that a write-off or conversion is necessary, without which the financial institution or financial group[93], as the case may be, would cease to be viable; or

(b) the Relevant Malaysian Authority publicly announces that a decision has been made by the Bank, the Malaysia Deposit Insurance Corporation (PIDM), or any other federal or state government in Malaysia, to provide a capital injection or equivalent support to a financial institution, without which the financial institution or financial group[93], as the case may be, would cease to be viable.

G 33.2 For the purpose of paragraph 33.1, "Relevant Malaysian Authority" refers to the following:

(a) the Bank, jointly with PIDM, where a financial institution is a *member institution*, as prescribed under the Malaysia Deposit Insurance Corporation Act 2011[94]; or

(b) the Bank, where a financial institution is not a *member institution*.

G 33.3 In assessing whether a financial institution or financial group, as the case may be, would cease to be viable in accordance with paragraph 33.1, the Relevant Malaysian Authority may consider, among others, whether any of the following circumstances exist[95]:

(a) the financial institution fails to follow any directive of compliance issued by the Bank, which is necessary to preserve or restore its or the group's financial soundness;

(b) the financial institution fails to meet all or any of its financial obligations as they fall due, that may significantly impair its ability to meet regulatory capital requirements on a continuing basis;

(c) the capital of the financial institution or financial group has reached a level or is eroding in a manner that may detrimentally affect depositors, creditors or the public, and the financial institution or financial group is unable to recapitalise on its own;

(d) the financial institution's assets are insufficient to provide protection to depositors and creditors; or

[93] For the avoidance of doubt, since a financial holding company is a non-operating entity, capital instruments issued by the financial holding company must include a trigger event referenced to the financial group (i.e. financial holding company and its subsidiaries).

[94] As defined in section 2 of the Malaysia Deposit Insurance Corporation Act 2011.

[95] The circumstances may be mutually exclusive and should not be viewed as an exhaustive list.

(e) any other state of affairs exist in respect of the financial institution or financial group that would put the interest of depositors or creditors at risk, including the loss of confidence of depositors and the public.

The Relevant Malaysian Authority has the full discretion to decide not to require a write-off or conversion when the financial institution or financial group has ceased, or is about to cease, to be viable or when a capital injection or equivalent support has been provided. Even if the option is not exercised, holders of the financial institution's Additional Tier 1 and Tier 2 capital instruments may still be exposed to losses from the resolution of the financial institution or financial group.

34 Write-off or conversion mechanisms for achieving principal loss absorption and/or loss absorbency at the point of non-viability

S 34.1 In respect of the requirement in paragraphs 16.1(j), 16.1(m) and 17.1(j), for a capital instrument to be written-off–

(a) the write-off shall reduce:
  (i) the claim of the instrument in liquidation;
  (ii) the amount re-paid when a call option is exercised; and
  (iii) coupon or dividend payments on the instrument;

(b) the write-off shall be permanent;

(c) the provisions governing the issuance of the instrument must specify that a write-off shall not constitute an event of default for that capital instrument or trigger cross-default clauses; and

(d) the write-off must generate CET1 Capital under MFRS and the instrument will only receive recognition in Additional Tier 1 Capital or Tier 2 Capital up to the level of CET1 Capital generated by a full write-off of the instrument.

S 34.2 In respect of the requirement in paragraphs 16.1(j), 16.1(m) and 17.1(j) for a capital instrument to be converted into ordinary shares–

(a) the financial institution must maintain at all times all prior authorisation necessary to immediately issue the relevant number of ordinary shares specified in the provisions governing the issuance of the instrument should the trigger event occur[96,97];

(b) the conversion formula and/or ratio for determining the number of ordinary shares received upon conversion of the instrument must be determined in advance in the provisions governing the issuance of the instrument and must include a cap on the maximum number of ordinary shares that holders will receive upon conversion;

(c) the offering documents and other marketing literature of the capital instrument shall contain cautionary statements that highlight the

[96] The contractual terms of the instrument therefore need to be formulated within perimeters permitted under company law and the financial institution's memorandum and articles of association. Where necessary, a financial institution shall seek all necessary approvals from shareholders at the point of the issuance of an Additional Tier 1 or Tier 2 instrument with conversion features.

[97] For the purpose of paragraph 8.4, the amount of Islamic Additional Tier 1 and Tier 2 capital instruments converted into ordinary shares, must immediately be reallocated to the SPI in the form of Islamic Banking Funds.

possibility that certain investors may not be permitted to fully exercise their rights as shareholders, or may be required to pare down their holdings in shares, after conversion to comply with legal and regulatory requirements;

(d) the issuance of any new ordinary shares as a result of the trigger event must occur prior to any public sector injection of capital (or equivalent support);

(e) any ordinary shares arising from the conversion must be the ordinary shares of either the issuing financial institution, its parent company or any other affiliated entity, including any successor in resolution;

(f) the provisions governing the issuance of the instrument must specify that a conversion shall not constitute an event of default for that instrument or trigger cross-default clauses; and

(g) the conversion must generate CET1 Capital under MFRS and the instrument will only receive recognition in Additional Tier 1 Capital or Tier 2 Capital up to the level of CET1 Capital generated by a full conversion of the instrument.

S 34.3 In applying the requirements in paragraphs 16.1(j), 16.1(m) and 17.1(j) in respect of instruments issued by an SPI[98], if the write-off mechanism is used, it shall be conducted in accordance with Appendix 5[99].

S 34.4 In respect of the requirement in paragraph 16.1(j), where a financial institution provides for a hierarchy of write-off or conversion among Additional Tier 1 capital instruments (i.e. certain instruments are written-off or converted before others in the event of a partial write-off or conversion), the terms governing such hierarchy shall be clearly stipulated and provided for in the issue and offering documents. In the event where no hierarchy is provided, all Additional Tier 1 capital instruments shall absorb losses proportionately.

35 Disclosure requirements

S 35.1 The full terms and conditions[100,101] of all Additional Tier 1 and Tier 2 capital instruments included in regulatory capital[102] shall be made available on the financial institution's website no later than 2 weeks after the issuance date[103].

98 This paragraph shall also apply in the case of the capital instruments issued by a subsidiary, which is an Islamic bank licensed under section 10 of the Islamic Financial Services Act 2013 for the purpose of paragraphs 18.4 and 18.6.

99 Use of any other mechanisms shall be subject to the prior written approval of the Bank.

100 Including any other relevant pricing supplements.

101 For the purpose of paragraph 8.4, the terms and conditions shall clearly provide that the conversion is into ordinary shares of the banking institution which operates the SPI.

102 For the avoidance of doubt, the terms and conditions of capital instruments issued by subsidiaries and held by third party investors shall also be disclosed to the extent that such capital is recognised at the consolidated level.

103 If the issuance is under a programme, the principal terms and condition of the programme shall also be made available on the website.

36 Regulatory process and submission requirements

S 36.1 A financial institution is required to obtain the Bank's written approval prior to the issuance of regulatory capital by the financial institution, or the issuance to third parties out of an SPV and included in entity and consolidated level Additional Tier 1 Capital or Tier 2 Capital. An application must be supported with the following:

(a) a confirmation of compliance by the Chief Executive Officer that the proposed capital instruments comply with all the criteria for inclusion in capital as set out in paragraph 16 or 17, as well as paragraphs 33 and 34[104];

(b) indicative issue and offering documents (e.g. prospectus, offering circular, pricing supplement, information memorandum, trust deed, loan agreement) and as soon as practicable, the final issue and offering documents;

(c) for the purpose of ensuring compliance with the requirements set out in paragraphs 33 and 34, an external legal opinion–

(i) confirming that write-off or conversion into ordinary shares at the relevant trigger point is enforceable under the financial institution's memorandum and articles of association, and relevant company and/or securities law;

(ii) confirming that write-off or conversion into ordinary shares at the relevant trigger point does not constitute an event of default for that instrument or trigger cross-default clauses;

(iii) highlighting other potential impediments to the write-off or conversion of the instrument into ordinary shares upon a trigger event and how they have been resolved; and

(iv) confirming that the hierarchy provided for in paragraph 34.4 does not impede the ability of the capital instruments to be immediately written-off or converted into ordinary shares;

(d) a confirmation from an accounting firm that the write-off or conversion generates CET1 Capital under MFRS at the relevant trigger point; and

(e) where applicable, for the purpose of ensuring compliance with Shariah requirements for capital instruments issued by an SPI, the Chairman of the Shariah Committee shall submit–

(i) a confirmation that the write-off mechanism is Shariah-compliant, if the mechanisms other than those specified in Appendix 5 are used; and

(ii) an explanation of the salient features of the Shariah contract and Shariah-compliant mechanisms[105] used in structuring the capital instruments, if not already provided in the terms and conditions.

S 36.2 For the purpose of paragraph 36.1, a financial institution shall seek the Bank's approval for either an individual issuance or an issuance programme. Approval for an issuance programme allows subsequent issuances under the programme

[104] This should include an annexe that sets out to demonstrate compliance with the applicable requirements by making references to the relevant parts of the offering documents.

[105] For example, the mechanisms used for profit smoothening, redemption of principal amount, subordination of capital instruments and loss absorption requirements.

to be deemed approved for recognition to the extent that the criteria for inclusion in capital continues to be met. A financial institution is however required to notify the Bank prior to subsequent issuances under the approved programme.

S 36.3 A financial institution must seek the Bank's written approval prior to any subsequent modification of the terms and conditions of an instrument that may affect its eligibility as regulatory capital.

S 36.4 A financial institution shall notify the Bank of any capital instrument issued out of foreign subsidiaries to third parties that is included in consolidated CET1 Capital, Additional Tier 1 Capital or Tier 2 Capital. This shall be supplemented with, where available, a copy of the approval letter from the host authority confirming inclusion of the capital instrument in the foreign subsidiary's regulatory capital, and copies of the indicative or where available, final issue and offering documents. In addition, for locally-incorporated foreign banking institutions, the banking institution shall notify the Bank if it issues a capital instrument which is included in the consolidated Additional Tier 1 Capital or Tier 2 Capital of (any of) its non-Malaysian parent company(ies).

S 36.5 In addition to the requirements set out in paragraphs 36.1 and 36.4, where a financial institution is required to provide the Bank with an external legal opinion confirming that the instrument complies with all relevant criteria for inclusion in capital from a law firm of the Bank's choice, the financial institution shall provide the Bank with such legal opinion and the related expenses shall be borne by the institution.

S 36.6 A financial institution is required to obtain the Bank's written approval prior to making any planned reduction in its capital[106], including capital instruments issued out of consolidated subsidiaries and held by third parties recognised in paragraphs 12.1(e), 13.1(c) and 14.1(c). The financial institution is required to demonstrate, through its capital plans, that the planned reduction of capital results in capital levels remaining well above the minimum capital adequacy requirements and capital buffer requirements, and consistent with its risk profile and business plans.

S 36.7 A financial institution shall direct any application or notification under this policy document to–

Pengarah
Jabatan Penyeliaan Konglomerat Kewangan or
Jabatan Penyeliaan Perbankan (as applicable)
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur

[106] This includes a share buy-back or an early redemption, repurchase or repayment of a capital instrument, including through the exercise of a call option.

37 Statistical reporting requirements

S 37.1 A financial institution shall submit periodic reports on its capital adequacy ratios using the reporting templates provided by the Bank.

S 37.2 A financial institution shall submit the electronic copy of the reporting templates through STATsmart Submission module as specified in the policy document on *STATsmart Reporting Requirements on Data Submission for Reporting Entities*. Unless otherwise specified by the Bank, submission of the printed copy of the reporting templates is not required.

S 37.3 For a financial institution applying the transitional arrangements as set out in paragraphs 39.4 to 39.10, the financial institution shall−

(a) complete two reporting forms "Capital Adequacy Framework (Capital Components)" based on requirements−

(i) computed in accordance with the transitional arrangements; and

(ii) had the transitional arrangements not been applied; and

(b) in respect of paragraph 37.3(a)(i), report the add-back amount under "Other CET1 regulatory adjustments specified by the Bank" (Row 63) in the "C.3(RegAdj)" or "C.3i(RegAdj)" worksheet, as the case may be.

PART G TRANSITIONAL ARRANGEMENTS

38 Transitional arrangements for banking institutions

Capital instruments (other than minority interest and capital instruments issued out of consolidated subsidiaries and held by third parties)

S 38.1 The following paragraphs describe transition arrangements for regulatory capital instruments issued prior to 1 January 2013. For the avoidance of doubt, instruments issued in excess of the limits allowed for recognition prior to 1 January 2013 (e.g. Tier 2 Capital limited to 50% of Tier 1 Capital) will not be eligible for the gradual phasing-out treatment. Nevertheless, such instruments will be allowed to be fully recognised (i.e. without limitation) on and after 1 January 2013 if they meet all the criteria for inclusion set out in paragraph 16 or 17, and have received the prior written approval of the Bank pursuant to paragraph 36.1.

S 38.2 Additional Tier 1 and Tier 2 capital instruments issued on, or before, 16 December 2011[107], excluding those which have call features and incentives to be redeemed, will be subject to the following transitional arrangements:

(a) a capital instrument meeting all the relevant criteria for inclusion[108] will continue to be fully recognised; and

(b) a capital instrument not meeting all the relevant criteria for inclusion will be subject to the gradual phase-out treatment.

S 38.3 Additional Tier 1 and Tier 2 capital instruments issued on, or before, 16 December 2011 that have call features and incentives to be redeemed, are subject to the following transitional arrangements:

(a) a capital instrument with an effective maturity date[109] on, or before, 16 December 2011 that remains not called after its effective maturity date–

(i) will continue to be fully recognised if it meets all the relevant criteria for inclusion on a forward looking basis[110]; and

(ii) will be subject to the gradual phase-out treatment if it does not meet all the relevant criteria for inclusion on a forward looking basis;

(b) a capital instrument with an effective maturity date between, and including, 17 December 2011 and 31 December 2012 that remains not called after its effective maturity date–

(i) will continue to be fully recognised if it meets all the relevant criteria for inclusion on a forward looking basis;

(ii) will be subject to the gradual phase-out treatment if it meets all the relevant criteria for inclusion, with the exception of the items set out in paragraph 38.5, on a forward looking basis; and

[107] As indicated in paragraph 2.3 of the Bank's notification on *Implementation of Basel III* dated 16 December 2011.

[108] Paragraphs 16 and 17 for Additional Tier 1 and Tier 2 capital instruments respectively.

[109] The first date of the incentive to be redeemed (e.g. step-up) that a capital instrument may have.

[110] From the effective maturity date onwards.

(iii) with the exception of the items set out in paragraph 38.5, will be derecognised if it does not meet all other relevant criteria for inclusion, on a forward looking basis; and

(c) a capital instrument with an effective maturity date on, or after, 1 January 2013 that remains not called after its effective maturity date will be subject to the gradual phase-out treatment prior to the effective maturity date, and after its effective maturity date–

(i) will be fully recognised if it meets all the relevant criteria for inclusion on a forward looking basis; and

(ii) will be derecognised if it does not meet all the relevant criteria for inclusion on a forward looking basis.

S 38.4 Additional Tier 1 and Tier 2 capital instruments issued between, and including, 17 December 2011 and 31 December 2012 shall be subject to the following transitional arrangements:

(a) a capital instrument meeting all the relevant criteria for inclusion will continue to be fully recognised[111];

(b) a capital instrument meeting all the relevant criteria for inclusion, with the exception of the items set out in paragraph 38.5, will subject to the gradual phase-out treatment; and

(c) with the exception of the items set out in paragraph 38.5, a capital instrument not meeting all other relevant criteria for inclusion, will be derecognised.

S 38.5 Additional Tier 1 and Tier 2 capital instruments with an effective maturity date, or issued between, and including, 17 December 2011 and 31 December 2012 which comply with the criteria for inclusion set out by the BCBS[112], but which do not meet the additional criteria specified by the Bank, will continue to be recognised after 1 January 2013, subject to the gradual phase-out treatment[107]. These are–

(a) paragraphs 16.1(m) and 16.1(p) for an Additional Tier 1 capital instrument, and paragraph 16.1(j) concerning Additional Tier 1 capital instruments classified as equity under MFRS; and

(b) paragraph 17.1(j) for a Tier 2 capital instrument.

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[111] For the avoidance of doubt, any Additional Tier 1 and Tier 2 capital instruments issued on, or before, 31 December 2012 and approved by the Bank as fully complying with the requirements in *Concept Paper – Risk-Weighted Capital Adequacy Framework and Capital Adequacy Framework for Islamic Banks (General Requirements and Capital Components),* dated 25 May 2012, will continue to be fully recognised.

[112] *Basel III: A global regulatory framework for more resilient banks and banking systems,* Basel Committee on Banking Supervision, December 2010 (revised June 2011).

S 38.6 The gradual phase-out treatment referred to in paragraphs 38.2 to 38.4 will allow for a limited recognition of certain capital instruments previously recognised but no longer meeting the criteria for inclusion in Additional Tier 1 Capital and Tier 2 Capital, eventually resulting in such instruments fully derecognised by 1 January 2022. The treatment for the limited recognition is as follows:

(a) determine the base for the phase-out treatment, which shall be the total amounts of Additional Tier 1 and Tier 2[113] capital instruments outstanding on 1 January 2013 eligible for the gradual phase-out treatment, counted separately;

(b) the amount of capital instruments eligible for the gradual phase-out treatment that may be recognised shall be capped at 90% of the base in 2013 (as counted separately for Additional Tier 1 Capital and Tier 2 Capital), with the cap reducing by 10% in each subsequent year; and

Calendar year	Cap
2013	90%
2014	80%
2015	70%
2016	60%
2017	50%
2018	40%
2019	30%
2020	20%
2021	10%
2022 onwards	0%

(c) to the extent an instrument is redeemed, or derecognised, after 1 January 2013, the amount serving as the base is not reduced[114].

S 38.7 For the avoidance of doubt, CET1 capital instruments, regardless of issuance date, do not qualify for any of the transition arrangements described above.

S 38.8 A summary of the treatment referred to in paragraphs 38.2 to 38.5 is set out in Appendix 3, while an illustration of the gradual phase-out treatment specified in paragraph 38.6 is provided in Appendix 4.

[113] The amount of Tier 2 instruments in the base shall refer to outstanding amounts of Tier 2 capital instruments, less amounts derecognised over the last four years of its contractual maturity.

[114] Individual Tier 2 capital instruments will also continue to be derecognised at a rate of 20% per year in the final four years of the contractual maturity, while the aggregate cap will be reduced at a rate of 10% per year.

39 Transitional arrangements for financial institutions

Provisions for expected credit loss (ECL)

S 39.1 Where a financial institution elects to apply the transitional arrangements as specified in paragraphs 39.4 to 39.10[115], the financial institution shall submit a one-time written notification to the Bank containing the following information:

(a) indication of its election –

(i) latest by 31 December 2020, where the transitional arrangements are applied for four financial years beginning on or after 1 January 2020; or

(ii) at least fourteen calendar days before the transitional arrangements are first applied, where the transitional arrangements are applied for three financial years beginning on or after 1 January 2021; and

(b) the intended first reporting period of the application of the transitional arrangements.

The notification shall be submitted to the Bank in accordance with paragraph 36.7.

S 39.2 Once a written notification has been submitted to the Bank under paragraph 39.1, a financial institution shall apply the transitional arrangements throughout the four financial years or three financial years.

S 39.3 Notwithstanding paragraph 39.2, a financial institution must obtain the Bank's prior written approval to disapply the transitional arrangements during the transitional period. In making the application, the financial institution must clearly demonstrate that the transitional arrangements are no longer appropriate under exceptional circumstances.

S 39.4 A financial institution is allowed to add back the amount of loss allowance measured at an amount equal to 12-month and lifetime expected credit losses to the extent they are ascribed to non-credit-impaired exposures (hereinafter referred to as Stage 1 and Stage 2 provisions) to CET1 Capital.

S 39.5 The amount of Stage 1 and Stage 2 provisions to be added back to CET1 Capital shall be calculated as follows:

$$\text{Add-back} = \max\{0; [(\text{Provisions}_{\text{Current}} - \text{Provisions}_{\text{Base}}) \times F]\}$$

where–

Add-back amount of Stage 1 and Stage 2 provisions eligible to be added back to CET1 Capital as at the reporting date

[115] For the avoidance of doubt, the election to apply the transitional arrangements may be made separately by each financial institution within a financial group.

$Provision_{Current}$ total Stage 1 and Stage 2 provisions as at the reporting date

$Provision_{Base}$ total Stage 1 and Stage 2 provisions as at the base reference date, which shall be as follows:

i. 1 January 2020 where the transitional arrangements are applied over a four-financial year period; or
ii. first day of the financial year beginning on or after 1 January 2021 where transitional arrangements are applied over a three-financial year period[116]

F add-back factor as at the reporting financial year, as follows:

Financial year beginning on or after 1 January	Add-back factor (%)
2020	100
2021	100
2022	75
2023	50
2024 onwards	0

S 39.6 A financial institution shall include the amount of Stage 1 and Stage 2 provisions not eligible to be added back to CET1 Capital in the calculation of Tier 2 Capital in accordance with paragraphs 14.1(d)[117] and 39.7(b)(ii).

S 39.7 In respect of Stage 1 and Stage 2 provisions allocated to exposures under the Internal Ratings-Based approach for credit risk, the calculation of the amount to be added back to CET 1 Capital under paragraph 39.5 shall be subject to the following:

(a) a financial institution shall not add back any provisions to CET1 Capital where there is a shortfall of eligible provisions[118] to expected losses[119] as at a reporting date; and

(b) in the case of a surplus[120] of eligible provisions over expected losses as at a reporting date–

(i) the amount to be added back to CET1 Capital shall be the lower of the amount calculated under paragraph 39.5 and the surplus of eligible provisions over expected losses; and

[116] For example, for a financial institution with June financial year-end, the base reference date is 1 July 2021.

[117] For the avoidance of doubt, the amount to be added to Tier 2 Capital, subject to the conditions as specified in paragraph 14.1(d), shall include–

(i) the amount of Stage 1 and Stage 2 provisions not eligible to be included in the CET1 Capital as calculated in accordance with paragraph 39.5;
(ii) the amount of Stage 1 and Stage 2 provisions as at the base reference date; and
(iii) regulatory reserves as at the reporting date, if any.

[118] Refer to footnote 71.

[119] Refer to footnote 72.

[120] Prior to the application of the limit as specified in paragraph 14.1(d)(i).

(ii) no add back to Tier 2 Capital is allowed where the amount of provisions added back to CET1 Capital is capped by the surplus of eligible provisions over expected losses.

S 39.8 A financial institution adopting the Internal Ratings-Based approach for credit risk shall segregate the Stage 1 and Stage 2 provisions allocated to exposures under the Internal Ratings-Based approach and Standardised Approach[121] in the calculation of the add back under paragraph 39.5.

S 39.9 A banking institution applying the transitional arrangements shall disclose the following in the Pillar 3 disclosures[122]:

(a) a description of the transitional arrangements, including the financial year where the transitional arrangements is first applied and duration of the application; and

(b) the comparison of−

(i) the capital ratios computed in accordance with the transitional arrangements; and

(ii) the capital ratios, had the transitional arrangements not been applied.

(c) where the Bank grants an approval under paragraph 39.3, the decision to disapply the transitional arrangements.

S 39.10 A financial holding company applying the transitional arrangements shall disclose the information as specified in paragraphs 39.9 as part of the explanatory notes in the interim financial reports and annual financial statements.

G 39.11 An illustration of the transitional arrangements specified in paragraphs 39.5 to 39.8 is provided in Appendix 6.

[121] Applicable to asset classes exempted from the Internal Ratings-Based approach.

[122] Refer to the policy document on *Risk Weighted Capital Adequacy Framework (Basel II) – Disclosure Requirements (Pillar 3).*

APPENDICES

APPENDIX 1 General treatment of equity investments

<table>
<tr><th colspan="2" rowspan="2">Type of investment</th><th colspan="2">Treatment</th></tr>
<tr><th>At the entity level</th><th>At the consolidated level</th></tr>
<tr><td rowspan="2">Banks and other financial entities excluding insurance/takaful companies</td><td>Subsidiaries</td><td>Paragraph 31</td><td>Consolidate, or deduct from CET1 Capital if allowed under paragraph 8.3</td></tr>
<tr><td>Others</td><td colspan="2">Paragraph 31</td></tr>
<tr><td rowspan="2">Insurance/takaful companies</td><td>Subsidiaries</td><td colspan="2" rowspan="2">Paragraph 31</td></tr>
<tr><td>Others</td></tr>
<tr><td rowspan="2">Other commercial entities</td><td>Subsidiaries</td><td>Risk-weight at 1250%[123]</td><td>Consolidate, or risk-weight at 1250%[123] if allowed under paragraph 8.3</td></tr>
<tr><td>Others</td><td colspan="2">Risk-weight in accordance with the policy document on Capital Adequacy Framework (Basel II – Risk-Weighted Assets)</td></tr>
</table>

[123] In accordance with paragraphs 2.44, 3.4 and 3.195 of the policy document on *Capital Adequacy Framework (Basel II – Risk-Weighted Assets).*

APPENDIX 2 Illustration of minority interest and capital instruments issued out of consolidated subsidiaries held by third parties

A financial group consists of two legal entities that are both banking institutions. Bank P is the parent company and Bank S is the subsidiary and their unconsolidated balance sheets are set out below:

Bank P balance sheet		Bank S balance sheet	
Assets		**Assets**	
Loans to customers	100	Loans to customers	150
Investment in CET1 of Bank S	7		
Investment in the AT1 of Bank S	4		
Investment in the T2 of Bank S	2		
Liabilities and equity		**Liabilities and equity**	
Depositors	70	Depositors	127
Tier 2	10	Tier 2	8
Additional Tier 1	7	Additional Tier 1	5
Common equity	26	Common equity	10

The balance sheet of Bank P shows that in addition to its loans to customers, it owns 70% of the ordinary shares of Bank S, 80% of the Additional Tier 1 Capital of Bank S and 25% of the Tier 2 Capital of Bank S. The ownership of the capital of Bank S is therefore as follows:

Capital issued by Bank S			
	Amount issued to parent company (Bank P)	**Amount issued to third parties**	**Total**
Common Equity Tier 1 (CET1)	7	3	10
Additional Tier 1 (AT1)	4	1	5
Tier 1 (T1)	11	4	15
Tier 2 (T2)	2	6	8
Total (TC)	13	10	23

The consolidated balance sheet of the banking group is set out below:

Consolidated balance sheet	
Assets	
Loan to customers	250
Liabilities and equity	
Depositors	197
Tier 2 issued by subsidiary to third parties	6
Tier 2 issued by parent company	10
Additional Tier 1 issued by subsidiary to third parties	1
Additional Tier 1 issued by parent company	7
Common equity issued by subsidiary to third parties (i.e. minority interest)	3
Common equity issued by parent company	26

For illustrative purposes, Bank S is assumed to have risk-weighted assets of 100. In this example, the minimum capital requirements of Bank S and the subsidiary's contribution to the consolidated requirements are the same since Bank S does not have any loans to Bank P. This means that it is subject to the following minimum plus Capital Conservation Buffer requirements and has the following surplus capital:

Minimum and surplus capital of Bank S		
	Minimum plus Capital Conservation Buffer	**Surplus**
CET1	7.0 (= 7.0% of 100)	3.0 (=10 – 7.0)
T1	8.5 (= 8.5% of 100)	6.5 (=10 + 5 – 8.5)
TC	10.5 (= 10.5% of 100)	12.5 (=10 + 5 + 8 – 10.5)

The following table illustrates how to calculate the amount of capital issued by Bank S to include in consolidated capital, following the calculation method set out in paragraph 18:

Bank S: amount of capital issued to third parties included in consolidated capital					
	Total amount issued (a)	**Amount issued to third parties (b)**	**Surplus (c)**	**Surplus attributable to third parties (i.e. amount excluded from consolidated capital) (d) =(c)*(b)/(a)**	**Amount included in consolidated capital (e) = (b) – (d)**
CET1	10	3	3.0	0.90	2.10
T1	15	4	6.5	1.73	2.27
TC	23	10	12.5	5.43	4.57

The following table summarises the components of capital for the consolidated group based on the amounts calculated in the table above. Additional Tier 1 is calculated as the difference between Common Equity Tier 1 and Tier 1, and Tier 2 is the difference between Total Capital and Tier 1.

	Total amount issued by parent company (all of which is to be included in consolidated capital)	**Amount issued by subsidiaries to third parties to be included in consolidated capital**	**Total amount issued by parent company and subsidiary to be included in consolidated capital**
CET1	**26**	**2.10**	**28.10**
AT1	7	0.17	7.17
T1	**33**	**2.27**	**35.27**
T2	10	2.30	12.30
TC	**43**	**4.57**	**47.57**

APPENDIX 3 Transitional arrangements for capital instruments

Additional Tier 1 and Tier 2 capital instruments, excluding those which have call features and incentives to be redeemed

	Issuance date		
	On, or before, 16 December 2011[124]	**Between 17 December 2011 and 31 December 2012[125]**	**On, or after, 1 January 2013**
Meets all criteria	Recognised	Recognised	Recognised
Meets all criteria except for those set out in paragraph 38.5	Gradually phased-out	Gradually phased-out	Derecognised
Other than those set out in paragraph 38.5, does not fully meet criteria	Gradually phased-out	Derecognised	Derecognised

[124] Paragraph 38.2
[125] Paragraph 38.4

Additional Tier 1 and Tier 2 capital instruments issued on, or before, 16 December 2011 with call features and incentives to be redeemed

	Effective maturity date			
	On, or before, 16 December 2011[126]	**Between 17 December 2011 and 31 December 2012[127]**	**On, or after, 1 January 2013[128]**	
			Prior to effective maturity date	**After effective maturity date**
Meets all criteria	Recognised	Recognised	Gradually phased-out	Recognised
Meets all criteria except for those set out in paragraph 38.5	Gradually phased-out	Gradually phased-out	Gradually phased-out	Derecognised
Other than those set out in paragraph 38.5, does not fully meet criteria	Gradually phased-out	Derecognised	Gradually phased-out	Derecognised

Note: No transition arrangements are provided for CET1 capital instruments, regardless of issuance date.

[126] Paragraph 38.3(a)
[127] Paragraph 38.3(b)
[128] Paragraph 38.3(c)

APPENDIX 4 Illustration of the gradual phase-out treatment

Scenario 1: No capital instrument is redeemed[129], or is called, during the transition period. Some Tier 2 capital instruments start the last four years of their contractual maturity before 1 January 2013.

- On 1 January 2013, Bank A has RM150 million Additional Tier 1 and RM350 million Tier 2 capital instruments, of which RM250 million is in the last three years of its contractual maturity. All these capital instruments qualify for the phase-out treatment.

Base for Additional Tier 1 capital instruments outstanding[130] on 1 January 2013 (million)	Base for Tier 2 capital instruments outstanding on 1 January 2013 (million)
150	100 + [250*(0.6)] = 250

Calendar year	Additional Tier 1 capital instruments (million)		Tier 2 capital instruments (million)		
	Cap[131]	Amount recognised	Cap	Outstanding amount[132]	Amount recognised[133]
2013	135	135	225	250	225
2014	120	120	200	200	200
2015	105	105	175	150	150
2016	90	90	150	100	100
2017	75	75	125	100	100
2018	60	60	100	100	100
2019	45	45	75	100	75
2020	30	30	50	100	50
2021	15	15	25	100	25
2022	0	0	0	100	0

129 Based on contractual maturity.
130 Paragraph 38.6(a)
131 Paragraphs 38.6(b) and (c)
132 The outstanding amount for individual capital instruments shall continue to be derecognised at a rate of 20% per year.
133 Amount recognised under the gradual phase-out treatment is the lower of the aggregate cap and the amount outstanding.

Scenario 2: Some capital instruments are called, and some capital instruments start the last four years of their contractual maturity within the transition period.

- On 1 January 2013, Bank A has RM150 million Additional Tier 1 and RM450 million Tier 2 capital instruments. All these capital instruments qualify for the phase-out treatment.
- RM35 million of Additional Tier 1 capital instrument is called on 30 June 2016.
- RM70 million of Additional Tier 1 capital instrument was issued before 16 December 2011 and is not called on its effective maturity date, 31 July 2018. Based on a forward looking basis, the instrument does not meet all requirements in paragraph 16.
- RM20 million of Additional Tier 1 capital instrument was issued before 16 December 2011 and is not called on its effective maturity date, 31 August 2020. Based on a forward looking basis, the instrument meets all requirements in paragraph 16.
- RM400 million of Tier 2 capital instrument starts its last four years to maturity in 2015.

Base for Additional Tier 1 capital instruments outstanding on 1 January 2013 (million)	Base for Tier 2 capital instruments outstanding on 1 January 2013 (million)
150	450

Calendar year	Additional Tier 1 capital instruments (million)			Tier 2 capital instruments (million)		
	Cap	Outstanding amount	Amount recognised	Cap	Outstanding amount	Amount recognised
2013	135	150	135	405	450	405
2014	120	150	120	360	450	360
2015	105	150	105	315	450	315
2016	90	115[134]	90	270	370	270
2017	75	115	75	225	290	225
2018	60	45	45	180	210	180
2019	45	45	45	135	130	130
2020	30	25[135]	25	90	50	50
2021	15	25	15	45	50	45
2022	0	25	0	0	50	0

[134] The outstanding amount shall exclude the amount of instruments that have been called.
[135] Although the amount of RM20 million will be removed from the outstanding amount for phase-out calculation, this shall be recognised as fully eligible for Additional Tier 1 capital instrument.

APPENDIX 5 Write-off mechanism for Additional Tier 1 and Tier 2 capital instruments

Contract	Write-off mechanism
Mudarabah, Wakalah, Musyarakah	Write-off may be achieved through either of the following: i. Investor undertakes to waive his rights on the capital instrument at the point of non-viability or specified point of loss absorption, via a *Wa'd*; or ii. Investor agrees to waive his rights on the capital instrument at the point of non-viability or specified point of loss absorption, as provided in the legal documentation[136].
Murabahah, Tawarruq	Write-off may be achieved through either of the following: i. Investor (as creditor) undertakes to waive his rights on the debts at the point of non-viability, via a *Wa'd*; or ii. Investor (as creditor) agrees to waive his rights on the debts at the point of non-viability, as provided in the legal documentation[136].
Ijarah	Write-off may be achieved subject to the following: i. Investor (as lessor) agrees to waive his rights on accrued rental at the point of non-viability, as provided in the legal documentation[136] with the lessee; and ii. Investor (as lessor) undertakes to transfer his ownership over the underlying asset (beneficial or otherwise) to the lessee without consideration via a *Wa'd*.

[136] The waiver or transfer should be incorporated in the appropriate legal documentation (e.g. issue and offering documents, lease agreement, sale and purchase agreement).

APPENDIX 6 Illustration of transitional arrangements for provisions for expected credit losses (ECLs)

Scenario 1: Bank A, with 30 June financial year-end, has elected to apply the transitional arrangements for four financial years. Bank A intends to apply the transitional arrangements starting from the reporting period as at 31 March 2021.

- On 1 January 2020 (base reference date), Bank A has−
  - RM100 million Stage 1 and Stage 2 provisions for its exposures under the Standardised Approach; and
  - RM125 million of total general provisions, of which RM25 million are regulatory reserves.
- As at 31 March 2021−
  - the amount of Stage 1 and Stage 2 provisions increased to RM150 million; and
  - the total general provisions increased to RM175 million, of which RM25 million are regulatory reserves
- As at 30 June 2023−
  - the amount of Stage 1 and Stage 2 provisions increased to RM200 million; and
  - the total general provisions increased to RM250 million, of which RM50 million are regulatory reserves.

For reporting period as at 31 March 2021, the amount of Stage 1 and Stage 2 provisions eligible to be added back to CET1 Capital is computed as follows:

$$\begin{aligned} \text{Add-back} &= \max\{0; [(\text{Provisions}_{\text{Current}} - \text{Provisions}_{\text{Base}}) \times F]\} \\ &= \max\{0; [(\text{RM150 million} - \text{RM100 million}) \times 100\%]\} \\ &= \max\{0; \text{RM50 million}\} \\ &= \text{RM50 million} \end{aligned}$$

Since 100% of the increase in the Stage 1 and Stage 2 provisions is added back to CET1 Capital, there is no remaining amount of Stage 1 and Stage 2 provisions to be added back to Tier 2 Capital.

For the avoidance of doubt, the total general provisions of RM125 million (as at 1 January 2020) continues to be allowed to be added to Tier 2 Capital subject to the limit as specified in paragraph 14.1(d)(ii).

For reporting period as at 30 June 2023, the amount of Stage 1 and Stage 2 provisions eligible to be added back to CET1 Capital is computed as follows:

$$\begin{aligned} \text{Add-back} &= \max\{0; [(\text{Provisions}_{\text{Current}} - \text{Provisions}_{\text{Base}}) \times F]\} \\ &= \max\{0; [(\text{RM200 million} - \text{RM100 million}) \times 75\%]\} \\ &= \max\{0; \text{RM75 million}\} \\ &= \text{RM75 million} \end{aligned}$$

The amount eligible to be added back to Tier 2 Capital[137] subject to the limit as specified in paragraph 14.1(d)(ii), shall comprise[138] the following:

(a) RM25 million of Stage 1 and Stage 2 provisions not added back to CET1 Capital (RM100 million less RM75 million);
(b) RM100 million of Stage 1 and Stage 2 provisions (as at 1 January 2020); and
(c) RM50 million of regulatory reserves.

Scenario 2: Bank B, with 31 March financial year-end, has elected to apply the transitional arrangements for three financial years. Bank B intends to apply the transitional arrangements starting from the reporting period as at 30 June 2021.

- On 1 April 2021 (base reference date), Bank B has−
  - RM RM50 million of Stage 1 and Stage 2 provisions for its exposures under the Standardised Approach; and
  - RM100 million of Stage 1 and Stage 2 provisions for its exposures under the Internal Ratings-Based approach.
- As at 30 June 2021−
  - the amount of Stage 1 and Stage 2 provisions increased to RM75 million for exposures under the Standardised Approach;
  - RM150 million for exposures under the Internal Ratings-Based approach; and
  - Bank B reported a surplus of eligible provisions over expected losses of RM45 million.
- No add back to CET1 Capital is allowed for financial year 2020 since Bank B has elected to apply the transitional arrangements for three financial years beginning 1 April 2021.

For reporting period as at 30 June 2021, the amount of Stage 1 and Stage 2 provisions eligible to be added back to CET1 Capital is computed as follows:

(i) For exposures under the Standardised Approach

$$\begin{aligned} \text{Add-back} &= \max\{0; [(\text{Provisions}_{\text{Current}} - \text{Provisions}_{\text{Base}}) \times F]\} \\ &= \max\{0; [(\text{RM75 million} - \text{RM50 million}) \times 100\%]\} \\ &= \max\{0; \text{RM25 million}\} \\ &= \text{RM25 million} \end{aligned}$$

Since 100% of the increase in the Stage 1 and Stage 2 provisions for exposures under Standardised Approach is added back to CET1 Capital, there is no remaining amount of Stage 1 and Stage 2 provisions to be added back to Tier 2 Capital.

For the avoidance of doubt, the total general provisions of RM50 million (as at 1 April 2020) are allowed to be added to Tier 2 Capital subject to the limit as specified in paragraph 14.1(d)(ii).

[137] Refer to footnote 117.
[138] Alternatively, the amount added back to Tier 2 Capital of RM175 million can be computed as the difference between the total general provisions and the amount of Stage 1 and Stage 2 provisions eligible to be added back to CET1 Capital i.e. RM250 million less RM75 million.

(ii) For exposures under the Internal Ratings-Based approach

Add-back = max {0; [($Provisions_{Current}$ – $Provisions_{Base}$) x F]}
= max {0; [(RM150 million – RM100 million) x 100%]}
= max {0; RM50 million}
= RM50 million

Since the amount of add back for exposures under Internal Ratings-Based approach is higher than the surplus of eligible provisions over expected losses of RM45 million, Bank B is only allowed to add back RM45 million[139] to CET1 Capital. In addition, the provisions not eligible to be added back to CET1 Capital (i.e. RM 5 million) shall not be added to Tier 2 Capital[140].

In summary, the total amount of Stage 1 and Stage 2 provisions eligible to be added back to CET1 Capital for Bank B is RM70 million (the sum of RM25 million for exposures under the Standardised Approach and RM45 million for exposures under the Internal Ratings-Based approach). However, only the total general provisions of RM50 million (as at 1 April 2021) for exposures under the Standardised Approach are eligible to be added to Tier 2 Capital subject to the limit as specified in paragraph 14.1(d)(ii).

Scenario 3: Bank C, with 31 December financial year-end, has elected to apply the transitional arrangements for three financial years. Bank C intends to apply the transitional arrangements starting from the reporting period as at 31 March 2021.

- On 1 January 2021 (base reference date), Bank C has RM100 million of Stage 1 and Stage 2 provisions for its exposures under the Internal Ratings-Based approach.
- As at 31 March 2021−
  - the amount of Stage 1 and Stage 2 provisions increased to RM137.5 million; and
  - Bank C reported a surplus of eligible provisions over expected losses of RM45 million.
- No add back to CET1 Capital is allowed for financial year 2020 since Bank C has elected to apply the transitional arrangements for three financial years beginning 1 January 2021.

For reporting period as at 31 March 2021, the amount of Stage 1 and Stage 2 provisions eligible to be added back to CET1 Capital is computed as follows:

Add-back = max {0; [($Provisions_{Current}$ – $Provisions_{Base}$) x F]}
= max {0; [(RM137.5 million – RM100 million) x 100%]}
= max {0; RM37.5 million}
= RM37.5 million

[139] As specified in paragraph 39.7(b)(i).
[140] As specified in paragraph 39.7(b)(ii).

Since the amount of add back is lower than the surplus of eligible provisions over expected losses of RM45 million, Bank C is allowed to add back RM37.5 million[141] to CET1 Capital. The remaining amount of RM7.5 million (RM45 million less RM37.5 million) shall be included in Tier 2 Capital[142] subject to the limit as specified in paragraph 14.1(d)(i).

Scenario 4: Bank D, with 31 December financial year-end, has elected to apply the transitional arrangements for four financial years. Bank D intends to apply the transitional arrangements starting from the reporting period as at 31 December 2020.

- On 1 January 2020 (base reference date), Bank D has RM100 million of Stage 1 and Stage 2 provisions for its exposures under the Internal Ratings-Based approach.
- As at 31 December 2020−
  - the amount of Stage 1 and Stage 2 provisions increased to RM150 million; and Bank D reported a shortfall of eligible provisions to expected losses of RM5 million.

For reporting period as at 31 December 2020, Bank D is not allowed to add back any Stage 1 and Stage 2 provisions to CET1 Capital due to the shortfall of eligible provisions to expected losses in the current reporting period[143].

[141] As specified in paragraph 39.7(b)(i).
[142] As specified in paragraph 39.6.
[143] As specified in paragraph 39.7(a).