Domestic Systemically Important Banks Framework
Exposure Draft

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

Issued on: 3 April 2019
This Exposure Draft sets out the Bank’s proposals on the Domestic Systemically Important Banks (D-SIB) framework, which is part of the Basel III regulatory reforms.

Submission of feedback –

(a) The Bank invites written feedback on the proposed policy framework, including suggestions on areas to be clarified and alternative proposals that the Bank should consider. The written feedback should be constructive and supported with clear rationale, including accompanying evidence, empirical analysis or illustrations where appropriate; and

(b) In addition to providing general feedback, financial institutions are requested to respond to specific questions set out throughout this Exposure Draft.

Pursuant to sections 143(2) of the Financial Services Act 2013 and 155(2) of the Islamic Financial Services Act 2013, financial institutions which are apex entities (as defined in the Exposure Draft) are required to prepare and submit completed D-SIB reporting template (at the consolidated level) for the period ending 31 December 2018 using the attachments provided in Appendices 4a and 4b. Please attach this reporting template to your feedback under paragraphs (a) and (b).

Responses including the completed D-SIB reporting template must be submitted by 15 May 2019 to –

Pengarah
Jabatan Pemantauan dan Pengawasan Kewangan
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur
Email: dsib@bnm.gov.my

Electronic submission is encouraged. Feedback received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

In the course of providing your feedback, you may direct any queries to, or seek clarification through email from, dsib@bnm.gov.my or contact the following officers at +603-26988044:
1. Harikumara Sababathy (ext. 8531)
2. Syairah Hanin binti Shaharuaddin (ext. 8425)
## TABLE OF CONTENTS

**PART A**

| 1 Introduction | 1 |
| 2 Applicability | 2 |
| 3 Legal provisions | 2 |
| 4 Effective date | 2 |
| 5 Interpretation | 2 |
| 6 Related legal instruments and policy documents | 3 |
| 7 Policy documents and circulars superseded | 3 |

**PART B**

| 8 Level of application | 4 |
| 9 Overview of assessment methodology | 4 |
| 10 Higher loss absorbency requirement | 5 |
| 11 Reporting requirements | 7 |

**APPENDIX 1**

RELATED LEGAL INSTRUMENTS AND POLICY DOCUMENTS | 8

**APPENDIX 2**

ASSESSMENT METHODOLOGY | 9

**APPENDIX 3**

ANCILLARY INDICATORS | 13
PART A  OVERVIEW

1  Introduction

1.1  The transformation of the Malaysian financial landscape in recent years has resulted in deeper interlinkages between the domestic banking system and other intermediaries in the financial system. Financial groups are also expanding regionally across a wide range of activities and markets.

1.2  These developments underscore the need to ensure that the existing regulatory framework and policy tools are continuously enhanced to address the risks posed by the banking system to the stability of the Malaysian financial system and the wider economy.

1.3  In particular, there is a greater need to identify and manage risks posed by systemically important financial institutions. These institutions, hereafter referred to as domestic systemically important banks (D-SIBs), are financial institutions whose distress or disorderly failure may cause significant disruption and result in spillovers to the domestic financial system and the wider economy.

1.4  Against this backdrop, the Bank’s proposed D-SIB policy framework, developed in line with the principles\(^1\) outlined by Basel Committee on Banking Supervision (BCBS), aims to strengthen the resilience of the Malaysian banking system and address the following elements –

(a)  regulatory requirements and policy measures that may be applicable to D-SIBs, such as the higher loss absorbency (HLA) requirement\(^2\);

(b)  intensity of supervisory oversight by the Bank; and

(c)  macroprudential surveillance of the Bank.

1.5  This policy document sets out the HLA and reporting requirements applicable to financial institutions along with the proposed assessment methodology employed to identify D-SIBs in Malaysia. The Bank at its discretion may impose additional requirements and policy measures as deemed appropriate by the Bank to manage risks posed by D-SIBs.

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\(^2\) Refers to capital surcharge imposed on D-SIBs above the minimum regulatory requirement to increase its going-concern loss absorbency capacity.
2 Applicability

2.1 This policy document is applicable to all financial institutions as set out in paragraphs 8.1 and 8.3.

3 Legal provisions

3.1 This policy document is issued pursuant to –
(a) sections 47(1), 143(2) and 266 of the Financial Services Act 2013 (FSA); and
(b) sections 57(1), 155(2) and 277 of the Islamic Financial Services Act 2013 (IFSA).

4 Effective date

4.1 This policy document comes into effect on [DD MM YYYY], save for transitional arrangement for higher loss absorbency requirement as outlined in paragraph 10.7.

5 Interpretation

5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the FSA and IFSA, as the case may be, unless otherwise defined in this policy document.

5.2 For the purpose of this policy document –

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

“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;

“apex entity” refers to a financial institution that is not a subsidiary of another financial institution;

“banking institution” refers to –
(a) a licensed bank;
(b) a licensed investment bank; and
(c) a licensed Islamic bank, except for a licensed international Islamic bank;
“financial group” refers to a banking institution or a financial holding company and the group of related corporations under such banking institution or financial holding company;

“financial holding company” refers to a financial holding company approved pursuant to section 112(3) of the FSA or section 124(3) of the IFSA and holds investment directly or indirectly in corporations that are engaged predominantly in banking business;

“financial institution” refers to a banking institution and financial holding company.

6 Related legal instruments and policy documents

6.1 This policy document must be read together with other relevant legal instruments and policy documents that have been issued by the Bank, in particular those listed in Appendix 1.

7 Policy documents and circulars superseded

7.1 This policy document supersedes the Domestic Systemically Important Banks Framework Survey issued on 10 October 2016.
PART B  POLICY REQUIREMENTS

8  Level of application

S  8.1 The requirements set out in this policy document shall apply to apex entities on a consolidated basis. This includes consolidation of all subsidiaries, except insurance and/or takaful subsidiaries.

G  8.2 The consolidated requirement is vital given the contagion risk arising from intra-group interdependencies (e.g. operational, financial and reputational associations) between entities within a financial group.

S  8.3 The Bank at its discretion may require a financial institution to additionally comply with the policy requirements as specified by the Bank at the entity level.

9  Overview of assessment methodology

G  9.1 An indicator-based measurement approach (IBA) will be adopted by the Bank to identify D-SIBs. The assessment of systemic importance will also incorporate additional information via a supervisory overlay process (explained further in Appendix 2).

G  9.2 Under the IBA, a financial institution’s systemic importance will be assessed in terms of the impact of distress or failure of the financial institution on the domestic financial system and economy. Indicators are selected across three categories of systemic importance namely –

(a) size;
(b) interconnectedness; and
(c) substitutability.

G  9.3 An overall score will be computed for each financial institution by the Bank. A financial institution with an overall score exceeding a pre-determined cut-off threshold will be designated as a D-SIB by the Bank, subject to any modification made through supervisory overlay process.

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3 In accordance with Malaysian Financial Reporting Standards (MFRS).
4 In accordance to the Bank’s Capital Adequacy Framework (Capital Components) and Capital Adequacy Framework for Islamic Banks (Capital Components).
5 Refers to the global operations of the financial institution (i.e. including its overseas branch operations) on a stand-alone basis, and including its Labuan banking subsidiary. Also referred to as the “solo” or “stand-alone” level.
6 Equivalent to sum of weighted market share for each indicator across all categories of systemic importance in basis points (bps). A financial institution’s overall score ranges from 0 - 10,000bps. In a hypothetical scenario comprising one financial institution in the financial system, that financial institution would score 10,000bps under the IBA. For further details, refer to BCBS, The G-SIB assessment methodology - score calculation, November 2014 (https://www.bis.org/bcbs/publ/d296.htm).
7 The cut-off threshold is calibrated with reference to the distribution of financial institutions’ overall scores and cluster analysis. For further details, refer to Appendix 2.
9.4 The list of D-SIBs will be reviewed on an annual basis. The Bank may also review the list as and when deemed necessary if there are major structural changes in the banking system, e.g. a merger or significant restructuring exercise by banks.

**Question 1**

Public disclosure practices of D-SIB frameworks across countries vary, particularly in respect of the outcome of the assessment.

(a) The Bank invites comments on considerations that would be relevant to inform the type of information (e.g. name of D-SIBs, D-SIB scores and buckets) to be made public.

(b) Please highlight any potential issues or challenges faced by a financial institution if the list of D-SIBs is publicly announced.

9.5 The assessment methodology and corresponding policy requirements shall be reviewed by the Bank every three years to ensure the policy framework takes into account developments in approaches to assess systemic importance and structural changes in the domestic banking system.

**10 Higher loss absorbency requirement**

10.1 The HLA requirement for D-SIBs aims to reduce the probability of a D-SIB’s failure by increasing its going-concern capital buffers.

10.2 The calibration of the HLA requirement for D-SIBs in Malaysia by the Bank will take into consideration –

(a) the result of the Expected Impact Approach\(^8\), where the level of HLA is set as the amount of additional capital required to be held by a D-SIB to reduce its expected system-wide impact of failure as compared to that of a non-DSIB; and

(b) the levels of HLA prescribed by the BCBS for G-SIBs and peer jurisdictions for D-SIBs.

10.3 A financial institution designated as a D-SIB by the Bank shall hold and maintain capital buffers to meet the HLA requirement –

(a) at the consolidated level in accordance with paragraph 8.1;

(b) in the form of CET1 Capital\(^9\); and

(c) in the manner set out in paragraphs 10.4, 10.5, 10.7 and 10.8.

10.4 For avoidance of doubt, a financial institution shall hold and maintain capital buffers to meet the HLA requirement above the minimum CET1 Capital, Tier 1

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\(^8\) For further details, refer to Annex 2 of BCBS, *Global systemically important banks: revised assessment methodology and the higher loss absorbency requirement*, July 2018 ([https://www.bis.org/bcbs/publ/d445.htm](https://www.bis.org/bcbs/publ/d445.htm)).

\(^9\) As defined in the Bank’s *Capital Adequacy Framework (Capital Components)* and *Capital Adequacy Framework for Islamic Banks (Capital Components)*.
Capital, and Total Capital adequacy levels as well as other capital buffer requirements as set out in the Bank’s Capital Adequacy Framework (Capital Components) and Capital Adequacy Framework for Islamic Banks (Capital Components).

S 10.5 The HLA requirement applicable to designated D-SIBs shall correspond to the financial institutions’ bucket placement (refer to Table 1), unless otherwise specified by the Bank.

Table 1 – HLA requirement for D-SIBs

<table>
<thead>
<tr>
<th>Bucket</th>
<th>HLA requirement (as % of risk-weighted assets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 (empty)</td>
<td>2.0</td>
</tr>
<tr>
<td>2</td>
<td>1.0</td>
</tr>
<tr>
<td>1</td>
<td>0.5</td>
</tr>
</tbody>
</table>

G 10.6 An empty bucket attracting a higher HLA requirement will be maintained above the current highest populated bucket to disincentivise D-SIBs from further increasing their systemic importance. If the empty bucket becomes populated in the future, an additional bucket with a higher HLA requirement shall be added.

S 10.7 Where a financial institution is required to comply with the HLA requirement due to –
(a) its designation as a D-SIB; or
(b) a migration to a higher bucket for D-SIB (e.g. Bucket 1 to Bucket 2); the revised HLA requirement shall become applicable to such financial institution within 12 months upon notification by the Bank, unless otherwise specified by the Bank.

S 10.8 Where a financial institution is required to comply with a lower (or nil) HLA requirement than its current HLA requirement due to –
(a) cessation of its D-SIB status; or
(b) a migration to a lower bucket (e.g. Bucket 2 to Bucket 1); the revised HLA requirement shall become applicable to such financial institution immediately upon notification by the Bank, unless otherwise specified by the Bank.

Question 2
Please highlight any potential issues or challenges faced by a financial institution in complying with a HLA requirement as specified in paragraph 10.3 within 12 months upon designation as a D-SIB or migration to a higher bucket.

10 For further details on the bucketing approach, please refer to Appendix 2.
11 Reporting requirements

S 11.1 A financial institution must report the data set out in the D-SIB reporting template (Requested Data) at the consolidated level in accordance with paragraph 8.1.

S 11.2 A financial institution must submit an electronic copy of the D-SIB reporting template (Appendix 4a) through Statistical Mart for Analysis and Reporting (STATsmart), as follows:

Table 2 – Reporting requirements

<table>
<thead>
<tr>
<th>Reporting level</th>
<th>Reporting frequency</th>
<th>Reporting deadline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consolidated</td>
<td>Annual</td>
<td>60 calendar days from reporting position date</td>
</tr>
</tbody>
</table>

S 11.3 For avoidance of doubt, the apex entity of a financial group shall prepare and submit the reporting template for each reporting period to the Bank.

S 11.4 A financial institution must provide the Requested Data in accordance with interpretations as set out in Appendix 4b.
APPENDIX 1 RELATED LEGAL INSTRUMENTS AND POLICY DOCUMENTS

1. Capital Adequacy Framework (Capital Components)
2. Capital Adequacy Framework for Islamic Banks (Capital Components)
4. Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)
5. STATsmart Reporting Requirements on Data Submission for Reporting Entities
6. Liquidity Coverage Ratio
8. Definition of Small and Medium Enterprises (SMEs)
APPENDIX 2   ASSESSMENT METHODOLOGY

1 Assessment methodology

Indicator-based measurement approach (IBA)

1.1 The IBA aims to measure domestic systemic impact arising from distress or failure of a financial institution. In assessing suitability of indicators for use in the IBA, the Bank considers the following –
(a) indicators that –
(i) relate to factors that contribute to a financial institutions’ systemic impact;
(ii) reflect critical functions\(^{11}\); and
(iii) capture material exposures/activities of financial institutions;
(b) consistency with the overall regulatory framework and policy objectives of the Bank; and
(c) supervisory overlay process, which supplements the IBA.

Size

1.2 The impact of a financial institutions’ distress or failure is likely to cause greater disruption to the domestic financial system and economy if the financial institution is large and its activities comprise a significant share of the domestic financial system and economy.

1.3 The following indicators are used to measure size –
(a) total assets; and
(b) total off-balance sheet exposures (credit-equivalent).

Interconnectedness

1.4 As financial institutions operate in an increasingly interconnected financial system, distress originating from one financial institution can generate broader spillovers and increase the likelihood of distress in other financial institutions. Thus, a financial institution’s systemic importance is likely to be positively related to its interconnectedness in the financial system.

1.5 The following indicators are used to assess interconnectedness –
(a) total intra-financial system assets;
(b) total intra-financial system liabilities; and
(c) total securities outstanding.

\(^{11}\) Refers to functions performed by a financial institution for third parties whereby the sudden failure of the financial institution would have material impact on third parties, give rise to contagion or undermine confidence of market participants, due to the systemic relevance of the function to third parties and systemic relevance of the financial institution in providing that function. For further info, refer to FSB, Identification of Critical Functions and Critical Shared Services, July 2013 (http://www.fsb.org/2013/07/r_130716a/).
**Substitutability**

1.6 Substitutability indicators aim to reflect the financial institutions’ degree of substitutability or lack thereof, in a particular business line and as a service provider in relation to the provision of critical functions. The greater a financial institutions’ role as a market participant and a client service provider, the greater the risk of significant disruption following its failure given the limited capacity and ability of other financial institutions to address the service gaps in a timely manner.

1.7 The scope of substitutability indicators shall be limited to financial institutions’ Malaysian activities/exposures. This is due to the higher relevance of financial institutions’ domestic activities in assessing systemic impact from the disruption of services to the domestic financial system and economy.

1.8 The following indicators are used to assess substitutability –
(a) value and volume of payments and settlement activities\(^{12}\);  
(b) total assets under custody; and  
(c) total underwriting activity.

**Ancillary indicators**

1.9 Ancillary indicators (refer to Appendix 3) covering specific areas of systemic importance shall be collected as part of the reporting requirements to facilitate the supervisory overlay process and inform future refinements to the assessment methodology.

**Question 3**

(a) The Bank invites comments on the suitability of indicators used under the IBA to measure the impact of distress or failure of a financial institution on the domestic financial system and economy. Please provide empirical evidence to support your views, particularly where indicators are proposed to be removed from the IBA or additional indicators are proposed to be included in the IBA.

(b) While the BCBS G-SIB framework adopts an approach that applies equal weights for each category of systemic importance in computing bank scores under the IBA, BCBS principles for D-SIB framework allows for the use of appropriate relative weights depending on national circumstances. In this regard, the Bank invites comments on specific issues and consideration that would be relevant in applying equal or differentiated weights to the identified indicators for the computation of a banks’ degree of systemic importance.

\(^{12}\) Refers to financial institutions’ transaction value and volume in (i) RENTAS activities and (ii) selected retail payment activities (e.g. Interbank GIRO).
Bucketing approach

1.10 D-SIBs shall be grouped into buckets (i.e. clusters) by the Bank based on their degree of systemic importance as reflected by the overall scores derived from the IBA.

1.11 The bucketing approach facilitates the application of policy measures that are commensurate with a D-SIB’s degree of systemic importance.

1.12 The number of buckets and calibration of corresponding bucket thresholds are determined by—
(a) distribution of financial institutions’ overall scores derived from IBA;
(b) outcome of cluster analysis; and
(c) reference to BCBS G-SIB and D-SIB frameworks as well as other D-SIB frameworks internationally.

Supervisory overlay

1.13 The supervisory overlay process ensures the assessment of systemic importance by the Bank incorporates information that may not be easily quantified or fully captured by the IBA thus mitigating limitations often associated with a purely quantitative-based assessment. Such an approach is consistent with international best practice in identifying systemically-important banks at the global and national level by BCBS and national authorities, respectively.

1.14 The supervisory overlay process will focus on the impact of failure or distress of a financial institution on the domestic financial system and economy and not based on probability of distress or failure. It will incorporate information including but not limited to financial institutions’:
(a) market share in a particular product or market segment,
(b) performance of critical functions not taken into account in the IBA,
(c) business, structural and operational complexity as well as degree of resolvability, and
(d) ongoing or anticipated business restructuring, merger and acquisition plans.

1.15 To better inform supervisory judgement, ancillary indicators covering specific areas of systemic importance such as those outlined in paragraph 1.14 have been identified by the Bank (refer to Appendix 3). The list of ancillary indicators is non-exhaustive and shall be updated by the Bank on a periodic basis in line with developments in the domestic banking system and insights gathered from the ongoing supervision of financial institutions.

1.16 The supervisory overlay process shall be used to refine the list of potential D-SIBs identified by the IBA and may result in:
(a) changes to the financial institution(s) being included to the final list of D-SIBs; and/or
(b) financial institution(s) being assigned to a different bucket.
It is expected that these changes would be rare given the ongoing process to review and refine the IBA assessment methodology (refer to paragraph 9.5).
APPENDIX 3     ANCILLARY INDICATORS

1. Total net revenue
2. Total foreign revenue
3. Total cross-jurisdictional claims
4. Total cross-jurisdictional liabilities
5. Aggregate gross amount of over-the-counter (OTC) derivatives outstanding cleared through a central counterparty and settled bilaterally
6. Total amount of deposits guaranteed by PIDM
7. Total securities measured at Fair Value through Profit or Loss (FVTPL) and Fair Value through Other Comprehensive Income (FVOCI) that do not qualify as High Quality Liquid Assets (HQLA)
8. Total Level 3 assets
9. Total securities held at amortised cost that do not qualify as HQLA
10. Gross value of cash provided and gross fair value of securities provided in securities financing transactions (SFTs)
11. Gross value of cash borrowed and gross fair value of securities borrowed in SFTs
12. Gross positive fair value of OTC derivatives transactions
13. Gross negative fair value of OTC derivatives transactions
14. Total trading volume
15. Total deposits accepted from non-financial institutions (non-FIs)
16. Total loans to non-FIs
17. Number of non-FIs deposit accounts