Response to feedback received
Capital Adequacy Framework

Introduction

The Bank today finalised the revision to the *Capital Adequacy Framework (Capital Components)* and *Capital Adequacy Framework (Basel II – Risk-Weighted Assets),* and the *Capital Adequacy Framework for Islamic Banks (Capital Components)* and *Capital Adequacy Framework for Islamic Banks (Basel II – Risk-Weighted Assets)*, incorporating the proposals from the Discussion Paper[1] issued in October 2014 and the Concept Paper[2] issued in July 2015, and taking into account feedback received during the consultation period.

The Discussion Paper and Concept Paper set out the Bank's proposals to:

(i) extend the capital adequacy requirements to financial holding companies which are engaged predominately in banking business; and

(ii) detail out the formula to incorporate the countercyclical capital buffer requirements into the calculation of the capital adequacy ratios.

The Bank appreciates the feedback and suggestions received. Key comments received and the Bank's responses are set out in the following sections. Other comments received and suggestions for clarification have been incorporated in the frameworks.

Bank Negara Malaysia
13 October 2015

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[1] Discussion paper on *Capital Adequacy Framework for Financial Holding Companies (Banking groups)* issued on 23 October 2014.

[2] Concept Paper on *Capital Adequacy Framework (Capital Components)* and *Capital Adequacy Framework for Islamic Banks (Capital Components)* issued on 14 July 2015.

1. Inclusion of the group-level loss absorbency trigger for recognition as regulatory capital at the group level

1.1 In ensuring the loss absorbent quality of capital instruments recognised as regulatory capital at the consolidated level of a financial holding company, the Discussion Paper proposed that the capital instrument contains an additional loss absorbency clause referenced to the financial group. A number of respondents highlighted that this additional group-level loss absorbency requirement could result in a potential adverse impact on the marketability and pricing of Basel III capital instruments issued by the banking subsidiaries.

1.2 The inclusion of the group-level loss absorbency trigger reflects the Bank's view that for a capital instrument to be recognised as regulatory capital at the consolidated level of a financial holding company, the capital instrument must have the ability to absorb losses at the level of the group. The group-level trigger is also designed to avert contagion risk between entities within the group that could put the interest of depositors or creditors of a banking institution in the group at risk. The Bank also wishes to clarify that where a financial holding company has already met the group level capital requirements, a banking institution within the group would not be restricted from issuing capital instruments to meet its internal capital targets without the group level trigger. However, these capital instruments would not be recognised as regulatory capital at the consolidated level of the financial holding company.

1.3 The Bank therefore intends to maintain the requirement that the capital instrument contains an additional loss absorbency clause referenced to the financial group, while keeping this issue under review as more progress is made in the implementation of recovery and resolution plans (including in a cross-border context) for financial groups.

2. Application of scaling factors in determining the Countercyclical Capital Buffer (CCyB) during transition period

2.1 The Concept Paper proposed that the CCyB be phased-in over a 3-year period starting 1 January 2016 based on a predetermined set of scaling factors.

2.2 Several respondents highlighted that the scaling factors are potentially difficult to operationalise as it would require financial institutions to determine the 'fully-loaded' CCyB rate based on the rate announced by relevant national authorities, which could be interpreted differently by different financial institutions.

2.3 In consideration of these operational challenges, the Bank has removed the scaling factor table in the final policy document. Accordingly, a financial institution shall calculate the CCyB based on the prevailing rates as announced by relevant national authorities.

3. Disclosure of the factors considered by the Bank in determining Malaysia's CCyB rate

3.1 Several respondents sought clarification on the factors that the Bank would consider in formulating its CCyB decision.

3.2 The Bank will provide more information on such factors as work in this area progresses. In its determination of CCyB decision, the Bank will consider a range of indicators that may point to the build-up of systemic risks. Some of these indicators can be found in the document *"Guidance for national authorities operating the countercyclical capital buffer"* issued by the Basel Committee on Banking Supervision in December 2010. It is important to note that a broad set of information is used in guiding buffer decision with the aim being to closely reflect the behaviour of domestic financial system that can contribute to increased system-wide risks.

3.3 The Bank also wishes to clarify that for exposures in Malaysia, the Bank will announce its decision on the CCyB rate by up to 12 months prior to the rate taking effect (i.e. paragraph 10.4 in the final framework). Pending that announcement, the CCyB rate for exposures in Malaysia is deemed to be 0%.