# PART I: OVERVIEW

## 1. Introduction

1.1 The maintenance of adequate and strong capital is important in ensuring that development financial institutions (DFIs) have the financial capacity and capability to undertake business activities in supporting mandated roles.

1.2 The overall capital framework (the Framework) aims to further strengthen and preserve the capital position of the DFIs. The Framework comprises a set of comprehensive capital requirements, namely, the maintenance of absolute minimum capital, capital adequacy framework and maintenance of reserve fund. The framework set out the approach and provides the guidance for DFIs to optimise the use of financial resources at a prudent level and ensure that risks taken commensurate with the level of capital maintained.

## 2. Scope

2.1 The Framework is applicable to all DFIs prescribed under the Development Financial Institutions Act 2002 (DFIA).

## 3. Legal provisions

3.1 The Framework is issued pursuant to:

- Section 41 of DFIA (Other prudential requirements)
- Section 38 of DFIA (Maintenance of capital funds)
- Section 39 of DFIA (Maintenance of reserve fund)

# PART II: OVERALL CAPITAL FRAMEWORK

## A. Absolute Minimum Capital

## 4. Minimum Capital Requirements

4.1 The DFIs are required to maintain an absolute minimum capital of **RM300 million** at all times.

4.2 Minimum capital requirements are put in place to ensure that DFIs have sufficient financial capacity to sustain business operations on an on-going basis.

4.3 The minimum capital funds refer to paid-up capital and reserves as defined in Section 3 of DFIA. These capital funds maintained by DFIs should be unimpaired by losses. For the purpose of minimum capital requirement calculation, capital funds are defined as the sum of:

- Paid-up Ordinary Shares;
- Paid-up Non-cumulative Perpetual Preference Shares;
- Share Premium;
- Statutory Reserve Fund;
- General Reserve Fund;
- Retained Profits/Accumulated Losses; and
- Revaluation Reserves.

# B. Capital Adequacy Framework

## 5. Introduction

5.1 The capital adequacy framework (also known as the Risk Weighted Capital Adequacy Framework) was introduced in 1989. It was developed based on the international standards on capital adequacy introduced by the Basel Committee on Banking Supervision (BCBS) in 1988 (known as Basel I).

5.2 The capital adequacy framework, which comprises three broad categories, namely, the general capital adequacy requirements, components of eligible regulatory capital and the Risk Weighted Assets (RWA), sets out the approach for the computation of capital required by DFIs in order to operate as a going concern entity.

5.3 In addition to maintaining the absolute minimum capital, DFIs are required to adopt the capital adequacy framework.

## 6. Application and general treatment

6.1 DFIs are required to comply with the Risk Weighted Capital Ratio (RWCR) requirement at all times at the entity level. The entity level refers to the Malaysian operations of a DFI.

6.2 The general treatment on equity investment at entity level is given as follows:

| Type of Investment | | Treatment At entity level |
|---|---|---|
| Banking | Subsidiaries | Deduction from capital base |
| | Associates | Deduction from capital base |
| | Others | Deduction from capital base[1] |
| Insurance Companies | Subsidiaries | Deduction from capital base |
| | Associates /Others | As investment in the banking book |
| Other Financial[2] Entities | Subsidiaries | Deduction from capital base |
| | Associates /Others | As investment in the banking book |
| Other Commercial Entities | Subsidiaries | Deduction from capital base |
| | Associates/Others | As investment in the banking book |

## 7. Capital adequacy requirements

7.1 The RWCR requirements based on Basel I are as follows:

7.1.1 DFIs are required to maintain a minimum **RWCR**[3] **of 8%** at all times at the entity level.

7.1.2 Computation of RWCR for DFIs:

$$\text{RWCR} = \frac{\text{Capital Base}}{\text{Total Risk Weighted Assets}}$$

1 If the investment is more than 5% of the investee's paid-up ordinary share capital but not yet considered as associates.

2 Other financial entities would include securities or stock-broking firms, fund management companies, asset management companies, leasing and factoring companies and any other entities which conduct similar business. However, insurance companies will be specifically excluded.

3 Please refer to Appendix 1 for RWCR requirements on Islamic banking window.

## 8. Capital base

8.1 Capital represents resources that can be used to absorb current losses, while leaving the DFIs with the ability to continue operating as a going concern. While equity is the main component of capital for DFIs, there are other legitimate constituents of capital which may be included for purposes of the capital base computation.

8.2 The capital base, which is used to compute the RWCR ratio is defined as the sum of Eligible Tier 1 Capital and Eligible Tier 2 Capital less any other deductions from total capital.

### *(a) Tier 1 capital (core capital)*

8.3 Capital instruments that qualify[4] as Tier 1 Capital should possess the following characteristics:

i) It should be fully paid-up and permanently available;

ii) It should be freely available and not earmarked to particular assets or banking activities;

iii) It should be able to absorb losses occurring in the course of on-going business; and

iv) It should represent no fixed charge on the earnings of the DFI.

8.4 Items which qualify as Tier 1 capital are as follows:

i) Ordinary paid-up share capital;

ii) Share premium;

iii) Statutory reserve fund;

iv) General reserve fund;

[4] Items that qualify as Tier 1 capital may be subject to certain limits under Item (e) on Limits, after which they are termed as Eligible Tier 1 capital instruments.

v) Retained profits brought forward from previous financial year as in last audited accounts less any accumulated losses, including current unaudited losses;

vi) Surplus after tax arising from the sale of fixed and long-term investments in the course of the DFI's current financial year;

vii) Current unadjusted net profits on a half-yearly basis, subject to certification by the DFI's approved external auditors;

viii) Non-innovative Tier 1 (Non-IT1) capital, subject to prescribed limits; and

ix) Innovative Tier 1 (IT1) capital, subject to prescribed limits.

Positive goodwill (including goodwill arising from consolidation and business combinations) shall be deducted from the above items.

8.5 Tier 1 capital shall be defined as follows:

i) Tier 1 capital = Eligible Tier 1 Capital

[if Deduction from Total Capital[5] is less than Eligible Tier 2 Capital[6]]; otherwise

ii) Tier 1 capital = Capital Base

[if Deduction from Total Capital is more than Eligible Tier 2 capital. In this instance, the Tier 1 Capital Ratio (Core Capital Ratio) will be equal to the RWCR]

***(b) Tier 2 capital (supplementary capital)***

8.6 Elements which do not meet Tier 1 capital characteristics but which contribute to the underlying strength of a DFI are included in total capital as Tier 2 or supplementary capital, subject to prescribed limits.

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5 Explained in Item (c) on Deductions from total capital

6 Explained in Item (b) on Tier 2 Capital (supplementary capital)

8.7 Items that qualify for inclusion as Tier 2 capital are as follows:

i) Government grants and subsidies;

ii) Hybrid (debt/equity) capital instruments;

iii) Subordinated term debt, subject to the prescribed limit;

iv) Reserves arising from the revaluation of premises, provided it is approved by the Bank, subject to the following conditions:

   a. Based on excess of forced sale value over net book value, or 50% of the excess of fair market value over net book value, whichever is lower;

   b. Revaluation is permitted only after a period of 10 years from the date of purchase or from the date of last revaluation, whichever is later; and

   c. The policy of revaluation is optional but once adopted by an institution, it should be applied consistently. All the DFI's premises should be revalued at a predetermined regular interval (but not less than 10 years). However, at any point of time when the aggregate fair market value for all the DFI's premises falls below the total net book value (acquisition cost or revalued amount minus accumulated depreciation, if any) of the premises, an immediate downward revaluation should be made. The Bank should be informed of the downward adjustment as soon as possible;

v) General provisions[7]; and

vi) Any Non-IT1 and IT1 capital instruments in excess of the 35% and 15% limits described in Item (e) on Limits.

Items that qualify as Tier 2 capital may be subject to certain limits described in Item (e) on Limits, after which they are termed as Eligible Tier 2 capital instruments.

[7] As prescribed under BNM/DFI/GP3 Guideline on Classification of Impaired Loans/Financing and Provisioning for Bad and Doubtful Debts dated 13 March 2003.

8.8 The Bank may, on a case-to-case basis, approve certain items for inclusion as either Tier 1 capital or Tier 2 capital.

***(c) Deductions from total capital***

8.9 For the purpose of calculating the capital base, the following deductions should be made from total capital (first from Tier 2 capital, followed by Tier 1 capital for investments in excess of Tier 2 capital):

i) Investment in subsidiaries[8] to prevent the multiple use of the same capital resources in the entity;

ii) Any significant[9] minority interests in banking and other financial entities, where control does not exist, shall be deducted from the DFI's capital base;

iii) Holdings of capital instruments of other banking institutions[10,11]. Nevertheless, to facilitate trading and provide liquidity for such instruments, certain exemptions are provided as described in paragraph 8.10[12];and

iv) Any equity tranches of asset backed securities (ABS).

8.10 Holdings of other banking institution's capital instruments are not subject to deduction from total capital in the following circumstances:

i) As manager or underwriter for a new issue

- Where the DFI is acting as a manager or underwriter for a new issue, the holdings of such securities up to 90 days from the date of issue shall be subject to a 100% risk weight. Deduction will be made if the investment exceeds 90 days, unless the DFI also

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8 Financial and non-financial subsidiaries.

9 Significant minority interests would be defined as more than 20% and below 50% of the issuer's paid-up capital.

10 Licensed and supervised by the Bank.

11 To discourage double-leveraging of capital which can have systemic dangers for the banking system by making it more vulnerable to the rapid transmission of problems from one institution to another.

12 Holdings of shares and interest-in-shares shall be subject to the relevant provisions in the Development Financial Institutions Act 2002 and other conditions as specified by the Bank

qualifies as a secondary market maker or holds the instruments for trading purposes. [see (ii) below]

ii) As secondary market maker or for trading purposes

- Where the holdings of other banking institution's capital instruments are primarily for the purpose of trading or market making, a 100% risk weight shall be applied.
- Holdings of other banking institutions' capital instruments are subject to the following:
  - a) Holding of other banking institutions' hybrid Tier 1 and Tier 2 capital instruments not exceeding 10% of the individual issuer's total hybrid Tier 1 and Tier 2 capital instruments or 10% of the DFI's capital base, whichever is lower, will be subject to a 100% risk weight in the computation of the RWCR (non-deduction rule);
  - b) Total holdings of other banking institution's hybrid Tier 1 and Tier 2 capital instruments shall not exceed 10% of the DFI's capital base at all times for the application of the non-deduction rule. Amounts in excess of the 10% limit shall be deducted from capital base; and
  - c) The non-deduction rule will not apply in the case of direct holdings of Tier 1 and/or Tier 2 capital instruments of related companies or companies within the same group.
- In the case of holdings of bonds where the underlying assets comprise of banking institution's capital instruments, the non-deduction rule would apply if the following conditions are met:
  - a) Bond holdings per issuer should not exceed 10% of the individual issue size or 10% of the DFI's capital base, whichever is lower;
  - b) Total bond holdings (in aggregate) should not exceed 10% of the DFI's capital base at all times; and
  - c) The bonds must be rated at least BBB.

The non-deduction rule will not apply if the above mentioned conditions are not complied with in which case such holdings shall be deducted from capital base.

***(d) Exclusions***

8.11 Deferred tax income or (expense) shall be excluded[13] from the computation of the capital base of DFIs.

***(e) Limits***

8.12 Capital instruments are recognised for purposes of calculating the capital base subject to the following limits:

i) The total amount of supplementary capital eligible for inclusion shall not exceed the amount of Eligible Tier 1 capital;

ii) The amount of subordinated term loans eligible for inclusion as Tier 2 capital are limited to 50% of Eligible Tier 1 capital. In exceptional cases, this limit may be exceeded with the prior written consent of the Bank, on a case-by-case basis;

iii) Total issuance of IT1 capital instruments shall not exceed 15% of total Eligible Tier 1 capital (after the inclusion of the IT1 instruments and net of goodwill). (Refer to **Appendix 2** for illustration);

iv) A limit of 50% of total Eligible Tier 1 capital (net of goodwill) is imposed on the total of Non-IT1 and IT1 capital instruments, with IT1 capital still limited at 15% of Eligible Tier 1 capital. As such, the composition of Tier 1 capital can be summarised as follows:

[13] Deferred tax assets are also excluded from the calculation of risk-weighted assets.

**Tier 1 capital**

| | | |
|---|---|---|
| Retained earnings, reserves, ordinary shares | | |
| Non-Innovative Tier 1 [consisting of qualifying Non-Cumulative Perpetual Preference Shares (NCPPS) only] | 35% | 50% (maximum of NCPPS if there is no IT1 instruments) |
| Innovative Tier 1 (consisting of other types of preference shares, hybrid and debt instruments) | 15% | |

v) Any amount in excess of the prescribed limit shall be eligible for inclusion as upper Tier 2 capital. Notwithstanding the above limits, the Bank reserves the right to impose a lower limit based on the soundness of individual issuer; and

vi) DFIs should limit its long-term investments in fixed assets and shares (other than those deducted from total capital, i.e. investments in subsidiaries and holdings of other banking institutions' capital) to not more than 50% of its capital base. The 50% limit is to ensure that DFIs do not over-invest in assets which yield no specific and reasonably certain returns without a ringgit-for-ringgit capital support.

## 9. Specific Requirements on Capital Instruments

### 9.1 Non-Innovative Tier 1 capital instruments (Non-IT1)

9.1.1 Non-IT1 capital instruments consist only of Non-Cumulative Perpetual Preference Shares (NCPPS) which fulfils the Tier 1 capital instruments requirements as follows:

i) Fully paid-up and permanently available;

ii) Be freely available and not earmarked to particular assets or banking activities;

iii) Be able to absorb losses occurring in the course of the on-going business;

iv) Should represent no fixed charge on the earnings of the DFI;

v) Ranks senior only to ordinary shares on a winding up;

vi) Redeemable no earlier than its 5th year of anniversary at the option of the issuer, except where the instruments were issued for the purpose of merger or acquisition which is subsequently aborted. Any redemption is subject to the Bank's approval;

vii) Does not have additional features that:

- impose pressure for early redemption, for example step-ups in coupon rates; and
- involves structures that are complex and non-transparent, which may raise doubt on its performance as high quality capital in times of distress, for example indirect issuance via a Special Purpose Vehicle (SPV).

9.1.2 The accounting classification of the NCPPS, either as equity or debt, should not be used as a key criterion for inclusion in Non-IT1 category. However, the issuer shall demonstrate, substantiated by legal opinions, that the Tier 1 characteristics are not compromised even if the instruments are classified as a liability.

## 9.2 Innovative Tier 1 capital instruments (IT1)

9.2.1 While there is no common definition of IT1 capital across jurisdictions, it generally covers hybrid capital instruments with the characteristics of both equity (e.g. loss absorbing on going concern basis, perpetual) and debt (e.g. tax deductible).

In Malaysia, IT1 capital is defined to include:

i) Preference shares that have additional features including moderate step-up rates and limited call provisions; and

ii) Hybrid instruments not classified as hybrid Tier 2 capital instruments that meet all the minimum requirements for IT1 capital instruments specified in paragraphs 9.2.4 and 9.2.5.

9.2.2 These instruments may be issued either directly by the DFI or through a Special Purpose Vehicle (SPV), with the proceeds being passed to the DFI via an inter-company loan. Due to its complexity and less transparent nature, issuances through SPVs are subject to additional requirements as in paragraph 9.2.5 below.

9.2.3 Regardless of the approach adopted, the issuer is responsible to clarify with the Inland Revenue Board that the tax status of such instruments is in compliance with the tax provisions in Malaysia.

9.2.4 The IT1 capital instruments (both direct and indirect issuances) shall fulfill the following minimum requirements:

i) Issued and fully paid-up;

ii) Permanent;

iii) Non-cumulative. However, interest/dividends cumulative in the form of stock settlement may be considered on a case-by-case basis[14], whereby a maximum limit as deemed appropriate by the Bank may be imposed to avoid unreasonably large accumulation of amount owing on deferred interest/dividends;

[14] DFIs must have a strong justification for incorporating the coupon stock settlement feature.

iv) Able to absorb losses on a going-concern basis. For IT1 capital instruments classified as debt, this could be achieved by either:

- Full disclosure of nature of loss absorption in the agreement governing the issuance of capital instruments indicating the fulfillment of this condition (write down of instruments); or
- Mandatory conversion from debt to equity upon the occurrence of the following minimum trigger events:
  a. Breach of minimum 8% Risk Weighted Capital Ratio;
  b. Commencement of proceedings for winding up of the DFI; or
  c. Upon appointment of administrator for the DFI.

v) The rate of conversion must be fixed at the time of issuance and the DFI shall maintain a sufficient margin of unissued authorised share capital, for conversion to take place at any time. For indirect issuance, this would involve conversion into equity issued by the DFI;

vi) Senior only to all equity shareholders;

vii) Neither secured nor covered by a guarantee of the DFI or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis DFIs' creditors;

viii) Callable at the initiative of the issuer after 5 years from the issue date subject to regulatory approval. Earlier redemption (less than 5 years) is allowed only in the following cases:

- The IT1 capital was issued for the purpose of merger and acquisition (M&A) but the M&A was subsequently aborted or unsuccessful; or
- There was a change in the tax status of the IT1 capital instruments due to changes in tax laws, provided there is reasonable capital buffer after the DFI is subjected to stress testing by the Bank.

ix) Proceeds should be immediately available to the DFI without any limitation;

x) There is no provision in the agreement governing the issuance of IT1 capital instruments which may cause an early redemption such as restrictive covenants, cross-default or negative pledge clauses. However, a moderate step-up is permitted with a call option subject to the following:

- Only one rate step-up is allowed over the life of the instrument;
- The step-up occurs no earlier than 10 years after the issue date; and
- The stepped-up rate over the initial rate is no greater than 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis (if there is a change in the index basis) or a higher rate as deemed appropriate by the Bank[15]. Swap spread is fixed as at the pricing date and reflect the differential in pricing on that date between the initial reference security rate and the stepped-up reference security rate. (See **Appendix 3** for illustration).

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15 This shall be within the 50% of the initial credit spread as recommended by the Basel Committee on Banking Supervision.

xi) DFI has full discretion over the amount and timing of interest/dividend payments except where interest/dividends are paid on any obligations that are ranked junior to the IT1 capital instruments. In addition, DFI must have full control and access to waived payments including dividends waived by the SPV in the indirect structure[16];

xii) Payments can only be paid out of distributable reserves. Interest/dividend rate (including step-up rate) shall be preset at the time of issuance of the IT1 capital and shall not be reset based on the credit standing of the DFI;

xiii) Adequate disclosure and explanation of the features of IT1 capital instruments; and

xiv) Amendments to the terms and conditions governing the issuance of IT1 capital instruments shall only be made with the prior approval of the Bank.

9.2.5 Indirect issuances of IT1 capital instruments shall be eligible as Tier 1 capital if the following requirements are met at the solo consolidated level:

i) SPV is domiciled in Labuan;

ii) SPV is wholly-owned and managed by the DFI;

iii) SPV is set up for the purpose of capital issuance for the DFI and does not conduct any other business or activity;

iv) SPV has no external creditors at any time;

v) The entire proceeds from the capital issuance via SPV shall be on-lent (via inter-company loan) to the DFI without any restrictions; and

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[16] The full control on waived payments means that DFIs can use the waived payments for any other purposes and not to be earmarked for future distribution to investors.

vi) The inter-company loan shall be:

- Permanent;
- Consistent with the terms and conditions of the preference shares issued by the SPV;
- Senior only to all equity holders; and
- Able to absorb losses of the DFI on a going-concern basis.
- In addition:
  a. The agreement governing the issuance of the inter-company loan does not contain any provisions that could trigger an acceleration of repayments; and
  b. Amendments to the agreement governing the inter-company loan shall only be made with the prior approval of the Bank.

9.2.6 DFIs are required to confirm to the Bank that it has received third party legal and accounting opinions on the fulfillment of the minimum requirements for IT1 capital instruments and the tax treatment of these capital instruments.

9.2.7 The tax treatment for the computation of income tax by the issuer on the issuance of IT1 capital instruments is subject to approval from the Minister of Finance.

## 9.3 Hybrid Tier 2 capital instruments

9.3.1 Subject to the approval of the Bank, on a case-by-case basis, hybrid (debt/equity) capital instruments, such as cumulative preference shares, perpetual loan stocks and mandatory convertible loan stocks.

9.3.2 The hybrid capital instruments should have close similarities to equity; in particular, these instruments must be able to support losses on an on-going basis without triggering liquidation. Hybrid capital instruments which do not meet fully the above criteria may be eligible for inclusion under the category of subordinated term debt. The Bank will only approve the issue of irredeemable convertible unsecured loan stocks with maturity not exceeding 5 years.

9.3.3 Hybrid Tier 2 capital instruments should satisfy the following requirements:

i) Unsecured, subordinated and fully paid-up;

ii) Not redeemable at the initiative of the holder or without prior consent of the Bank;

iii) Available to participate in losses without the DFI being obliged to cease trading; and

iv) Service obligation can be deferred where the profitability of the institution would not support payment.

## 9.4 Subordinated debt instruments

9.4.1 Unlike the hybrid capital instruments, the instruments under this category are not normally available to participate in the losses of a DFI which continues operations as the instruments are able to absorb losses only in a liquidation. The items under this category would, subject to the approval of the Bank on a case-by-case basis, include term debt[17] and limited life redeemable preference shares which do not fully meet the requirements stated in paragraph 9.3, but which satisfy the following conditions:

i) Unsecured, subordinated and fully paid-up;

ii) A minimum original fixed term to maturity of five years;

[17] Includes Exempt Subordinated Debt Capital.

iii) Early repayment or redemption shall not be made without the prior consent of the Bank;

iv) The instruments should be subject to straight line amortisation over the last 5 years of their life; and

v) There should be no restrictive covenants.

## 10. Risk Weighted Assets (RWA)

10.1 The RWA is measured by classifying on-balance sheet assets[18] and assigning risk weights to each class of assets according to the relevant riskiness. It also incorporates off-balance sheet exposures, which bear a significant credit risk, calculated as follows:

i) The conversion of off-balance sheet exposures into credit equivalent; and

ii) The application of a risk weight to the credit equivalent according to the nature of the obligor.

The aggregate weighted on-balance sheet assets and weighted credit equivalent of the off-balance sheet exposures will form the total RWA which acts as the denominator[19] of the RWCR.

10.2 The classification of risk weights is kept as simple as possible and only 5 weights (0%, 10%, 20%, 50% and 100%) are used. Inevitably, there are elements of subjectivity in deciding which weight would apply to different types of assets. Therefore, the weightings should not be regarded as a substitute for DFIs' commercial judgment for purposes of market pricing of the different instruments.

[18] Asset exposure amount is calculated as the outstanding amount net of specific provisions made.

[19] Refer to Item 7.1: Capital adequacy requirements

### *(a) On-balance sheet items*

**10.3 0% category**

i) Cash or claims collateralised by cash;

ii) Claims on (including reverse repos with the Bank), guaranteed by, or collateralised by securities (including repos and reverse repos of securities) issued by the Federal Government of Malaysia and the Bank;

iii) Claims on and guaranteed by the Organisation for Economic Co-operation and Development (OECD) [20] central governments and central banks[21];

iv) Claims collateralised by securities (including repos and reverse repos of securities) issued by the OECD central-governments[22];

v) Claims on non-OECD central governments and central banks denominated in the national currency (of the debtor) and funded by liabilities in the same currency[23];

vi) Ringgit denominated bonds issued by Multilateral Development Banks (MDBs) and Multilateral Financial Institutions (MFIs) [24];

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[20] For this purpose, OECD countries would include Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States and Saudi Arabia. These countries are regarded as nations with high credit standing. Claims on the rest of the world are regarded as bearing significant country transfer risk. An OECD bank is a bank incorporated in any of the OECD countries. Branches of OECD banks in non-OECD countries are also deemed to be OECD banks, for example, an OECD bank's branch in Singapore (a non-OECD country).

[21] Commercial loans partially guaranteed by these bodies will attract equivalent low weights on that part of the loan which is fully covered.

[22] Loans partially collateralised by cash or securities issued by these bodies will attract equivalent low weights on that part of the loan which is fully covered.

[23] The 0% weightage reflects the absence of risks relating to the availability and transfer of foreign exchange on such claims.

[24] MDBs currently eligible for a 0% risk weight are the World Bank Group, which comprises the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC), the Asian Development Bank (ADB), the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IADB), the European Investment Bank (EIB), the European Investment Fund (EIF), the Nordic Investment Bank (NIB), the Caribbean Development Bank (CDB), the Islamic Development Bank (IDB), and the Council of Europe Development Bank (CEDB). The Bank shall

vii) Holdings of ABF Malaysia Bond Index Fund;

viii) Ringgit denominated bonds issued by Kreditanstalfur Wiederaufbau (Kfw) Bankengruppe; and

ix) Sukuk Bank Negara Malaysia – Ijarah.

10.4 **10% category**

i) Holdings of Cagamas debt securities issued before 4 September 2004[25] (risk weight remains until these securities are redeemed); and

ii) Other claims on Cagamas Berhad (Cagamas).

10.5 **20% category**

i) Claims (all maturities) on, guaranteed by or collateralised by securities[26] issued by licensed banking institutions in Malaysia (including branches of foreign banking institutions operating in Malaysia);

ii) Claims on and guaranteed by banking institutions incorporated in the OECD;

iii) Claims on, guaranteed by, or collateralised by securities issued by domestic development banking institutions[27];

iv) Claims on, guaranteed by, or collateralised by securities issued by other MDBs (other than those eligible for 0% risk weight above);

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inform DFIs on any updates to this list.

25 Please refer to paragraph 10.5 for treatment of Cagamas debt securities issued after that date.

26 This includes:

- Negotiable Certificate of Deposits issued and Bankers Acceptances accepted by, such banking institutions; and
- reverse repos of instruments with licensed banking institutions, which are treated as collateralised loans to these institutions [except where the collateral belongs to a lower risk category (e.g. Malaysian Government Securities and Treasury Bills, reverse repos of which will be weighted at 0%)].

27 Bank Pertanian Malaysia, Bank Pembangunan Malaysia Berhad, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (formerly known as Bank Industri dan Teknologi Malaysia Berhad), Export-Import Bank of Malaysia Berhad, Bank Simpanan Nasional and Bank Kerjasama Rakyat Malaysia Berhad.

v) Claims (with a residual maturity of up to one year) on and guaranteed by banking institutions incorporated in countries outside the OECD;

vi) Claims on and guaranteed by domestic non-central governments (i.e. state governments) and other public sector entities established by statute;

vii) Claims on and guaranteed by OECD public-sector entities, excluding central government;

viii) Investments in the share capital of the Credit Guarantee Corporation (CGC);

ix) CGC guaranteed portions of all new Principal Guarantee Scheme Loans;

x) Housing loans and hire purchase and leasing debts purchased by an intermediary banking institution from an originating banking institution[28] (i.e. sold to Cagamas under the back-to-back arrangement);

xi) First, second, third and fourth tranche[29] of the residential mortgage-backed securities (RMBS) issued by Cagamas MBS Berhad and backed by underlying pool of Government of Malaysia's staff housing loans;

xii) Holdings of Cagamas debt securities[30] issued after 4 September 2004; and

xiii) Islamic CP/MTN programme by Rantau Abang Capital Berhad (a wholly-owned subsidiary of Khazanah Nasional Berhad), provided the programme maintains a AAA/P1/MARC-1 rating by a recognised rating agency.

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[28] Please refer to paragraph 10.7 for treatment on purchases made from a non-banking institution.

[29] Please refer to Part B (Capital Adequacy Framework) above on the deductions required for subordinated tranches.

[30] Please refer to paragraph 10.4 for treatment of Cagamas debt securities issued before that date.

10.6 **50% category**

i) Loans secured by mortgage[31] on residential property, subject to the following conditions:

  i. That is or will be occupied by the borrower or is rented; and

  ii. Secured by first charge on the property.

10.7 **100% category**

i) Claims on banking institutions incorporated outside the OECD with a residual maturity of over one year;

ii) Claims on non-OECD central governments other than those denominated in national currency (of the debtor) and funded in that currency;

iii) Claims on commercial companies owned by the public sector (Non-Financial Public Enterprises (NFPEs);

iv) Investments in shares (other than those deducted from the capital base);

v) Other claims on the private sector, which includes loans and advances and corporate debt securities;

vi) Loans for business, investment or consumption purposes collateralised by residential property;

vii) For housing loans cum revolving credit/overdraft facility, the remaining amount which is not attributable to housing loans (fully secured by mortgage on residential property that is or will be occupied by the borrower or is rented).

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[31] It is not applicable to loans to companies engaged in speculative residential building or property development. In the case of refinancing of housing loans leading to a full repayment of the original outstanding housing loans with the remaining amount used for business, investment or consumption purposes, the part used to refinance the original outstanding housing loans would be eligible for the 50% weight, while the other part used for business, investment or consumption purposes would be subject to 100% weight. Borrowings by a house owner secured against his house, for business, investment or consumption purposes should not be accorded preferential treatment that is granted to housing finance for residential purposes. In the case of a single claim involving both a housing loan and an overdraft, the exposure is to be broken down into both exposures and the housing loan is given a 50% RW whilst the overdraft is accorded a 100% RW. Where the exposure is unable to be broken down, a 100% RW applies.

However, if unable to segregate, the whole facility is provided a 100% risk weight;

viii) Non-performing housing loans secured by first charge;

ix) Housing loans and hire purchase and leasing debts purchased from the originating non-banking institution (except domestic development banks as defined under this Framework), which are sold to Cagamas under a back-to-back sale arrangements;

x) Claims from universal brokers (both interbank and non-interbank);

xi) Holdings of capital instruments of other licensed banking institutions which, in isolated cases, are transferred from trading to banking book under the non-deduction rule; and

xii) All other assets (including investment in fixed assets).

### *(b) Conversion Factor (CCF) for off-balance sheet items*

10.8 A relatively simple methodology is used to approximate off-balance sheet exposures into risk-weighted capital ratio. It entails the conversion of credit risk inherent in each off-balance sheet instrument into an on-balance sheet equivalent (credit equivalent) by multiplying the nominal principal amount by a credit conversion factor; the resulting amount then being weighted according to the nature of counterparty.

The credit conversion factors for various types of instruments are as follows:

| | **Instruments** | **CCF** |
|---|---|---|
| i) | Direct credit substitutes, such as general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances) | 100% |
| ii) | Certain transaction-related contingent items, such as performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions | 50% |
| iii) | Short-term self-liquidating trade-related contingencies, such as documentary credits collateralised by the underlying shipments | 20% |
| iv) | Assets sold with recourse, where the credit risk remains with the selling institution[32] | 100% |
| v) | Forward asset purchases, and partly-paid shares and securities, which represent commitments with certain drawdown[33] | 100% |
| vi) | Obligations under an on-going underwriting agreement (including underwriting of shares/ securities issue) and revolving underwriting facilities | 50% |
| vii) | Other commitments, such as formal standby facilities and credit lines, with an original maturity of over one year | 50% |
| viii) | Similar commitments [as in (vii)] with an original maturity of up to one year, or which can be unconditionally cancelled at any time | 0% |

[32] These items, which include housing loans sold to Cagamas, should be weighted according to the type of asset (i.e. housing loans) and not according to the counterparty (i.e. Cagamas) with whom the transaction has been entered into. The institution is only exposed to credit risk inherent in the assets 'sold' with recourse.

[33] Similarly as in (iv), the credit equivalent of item (v) should be weighted according to the type of asset and not the counterparty.

### *(c) Risk weight for foreign exchange and interest rate contracts*

10.9 DFIs are not exposed to credit risk for the full face value of foreign exchange and interest rate contracts, but only to the potential cost of replacing the cash-flow if the counterparty defaults. The credit equivalent amounts will depend, inter alia, on the maturity of the contract and on the volatility of the rates underlying that type of instrument.

10.10 Exchange rate contracts would include:

i) Cross-currency interest rate swaps;
ii) Forward foreign exchange contracts;
iii) Currency futures;
iv) Currency options purchased; and
v) Other similar instruments;

But, exclude contracts with an original maturity of 14 calendar days or less.

10.11 Interest rate contracts are defined to include:

i) Single-currency interest rate swaps;
ii) Basis swaps;
iii) Forward rate agreements;
iv) Interest rate futures;
v) Interest rate options purchased; and
vi) Other similar instruments

10.12 The netting of contracts subject to novation would be permitted. The net rather than the gross claims arising out of swaps and similar contracts (subject to novation) with the same counterparties would be weighted. In this context, novation is defined as a bilateral contract between two counterparties under which any obligation to each other to deliver a given currency on a given date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single net amount for the previous gross obligations.

10.13 The credit equivalent amounts of exchange rate and interest rate contracts are weighted according to the category of counterparty. For exchange rate and interest rate related contingencies, a 50% weight will be applied in respect of counterparties which would otherwise attract a 100% weight. This is to reflect the high credit standing of the counterparties.

10.14 Under the current exposure method, computation of credit equivalent exposure for interest rate and exchange rate related contracts is based on the summation of the following two elements:

i) The replacement costs (obtained by marking-to-market) of all contracts with positive value (zero for contracts with negative replacement costs); and

ii) The amount of potential future exposure calculated by multiplying the notional value of each contract by an "add-on" factor.

| Credit exposure = positive MTM + (NP x "add-on" factor (%)) |
|---|

where : MTM is Mark-to-Market
NP is Notional Principal

(Illustration of calculation under the current exposure method is given in **Example 1** of **Appendix 4**)

10.15 In certain cases, credit exposures arising from interest rate and exchange rate related contracts may already be reflected on balance sheet. For example, DFIs may have recorded current credit exposures to counterparties (such as mark to market values) under foreign exchange and interest rate related contracts on the balance sheet as 'other assets' or 'sundry debtors'. To avoid double counting, such exposures should be excluded from the on-balance sheet exposures and treated as off-balance sheet exposures subject to the current exposure method.

10.16 The choice of "add-on" factors in computing the potential future exposure is determined based on the type of exposure and the residual maturity of each contracts. The “add-on” factors for contracts with interest rate exposure and foreign exchange rate exposure are listed as follows:

**Table 1: “Add-on” factors for derivative contracts with interest rate exposures**

| Residual maturity | Factor (%) |
|---|---|
| 14 calendar days | Nil |
| > 14 calendar days and 6 months | 0.10% |
| >6 months and 1 year | 0.25% |
| > I year and 2 years | 1.0% |
| > 2 year and 3 years | 2.0% |
| > 3 year and 4 years | 3.0% |
| > 4 year and 5 years | 4.0% |
| > 5 year and 6 years | 5.0% |
| > 6 year and 7 years | 6.0% |
| for each additional year | add 1.0% |

**Table 2: “Add-on” factors for derivative contracts with foreign exchange exposures**

| Residual maturity | Factor (%) |
|---|---|
| 14 calendar days | Nil |
| > 14 calendar days and 6 months | 1.5% |
| >6 months and 1 year | 3.0% |
| > I year and 2 years | 5.0% |
| > 2 year and 3 years | 7.0% |
| > 3 year and 4 years | 8.0% |
| > 4 year and 5 years | 9.0% |
| > 5 year and 6 years | 10.0% |
| > 6 year and 10 years | 11.0% |
| > 10 years | 12.0% |

10.17 The following additional note for the "add-on" factors are as follows:

i) For derivative contracts which are sensitive to movements in both the interest and exchange rates, the "add-on" factors used will be the summation of the "add-on" factors for interest rate exposures and the "add-on" factors for exchange rate exposures of the relevant residual maturity bucket;

ii) For contracts with multiple exchanges of principal, the notional principal amount is the sum of the remaining exchanges of principal;

iii) Exchange traded derivative contracts with strict daily mark-to-market margining requirement is excluded from this framework[34]; and

iv) For single currency floating-to-floating interest rate swaps, the "add-on" factor is zero. Thus, the credit exposure for such contracts will comprise only the positive mark-to-market value.

10.18 For both forward rate agreements and over-the-counter interest rate contracts of similar nature which are settled in cash on start date, residual maturity is measured as the sum of the remaining contract period and the underlying tenor of the contract (Illustration is provided in **Example 2** of **Appendix 4**). Institutions may choose to apply discounts to the "add-on" factors if the remaining contract period, as a fraction of residual maturity, falls within a certain range based on the following:

[34] This shall include the 3 month KLIBOR Futures Contracts, 3 and 5-year MGS Futures Contracts, KLSE Composite Index Futures Contracts and KLSE Composite Index Options Contracts. The credit risk for these excluded contracts shall be based on the outstanding margin placed with the broker for all outstanding trades, weighted by the relevant counterparty risk weights.

**Table 3: Discount factor and range of residual maturity**

| t = Remaining contract period residual maturity | Discount to "Add-on" Factor |
|---|---|
| t < 0.01 | 75% |
| 0.01 t < 0.05 | 50% |
| 0.05 t < 0.10 | 25% |
| 0.10 t < 0.65 | no discount |
| 0.65 t < 0.80 | 25% |
| 0.80 t < 0.90 | 50% |
| t < 0.90 | 75% |

### *(d) Risk capital treatment for credit derivatives*

10.19 The capital treatment for credit derivative instruments held in the banking book is prescribed below. The requirements for an effective risk transfer and the limitations to risk transfer is given in **Appendices 5** and **6** respectively.

10.20 Credit Default Swap (CDS)

i) Where protection is purchased using a CDS to a single reference entity, the protection buyer may replace the risk weight of the reference asset with the risk weight of the protection seller. The amount of protection that may be recognised is determined by the credit event payment or settlement amount. This could be payment of par value or other specified value in exchange for physical delivery of the reference asset, or payment of par less recovery value or payment of fixed amount as per the CDS agreement. For the unprotected portion, the risk weight of the reference asset will apply.

ii) Where protection is sold[35] via a CDS to a single reference entity, the protection seller acquires an exposure to the specific risk of that entity. In this case, the risk weight that must be applied to the exposure is the risk weight attached to the reference entity. The amount of the exposure is the maximum possible amount payable under the terms of the credit derivative contract if a credit event were to occur.

10.21 First-to-Default Baskets (FTDB)

i) Where an institution has purchased protection using a credit derivative that is referenced to more than one entity and that protection terminates after a credit event occurs on any of those entities, protection is only recognised against one entity in the basket. The protection buyer may choose which entity is protected, with the risk weight of that entity being replaced by the risk weight of the protection seller.

ii) If the contract allocates protection proportionately amongst assets in the basket (sometimes known as a green bottle structure), protection is recognised in setting capital requirements against all the assets in the basket according to the proportions in the contract. Thus, if there is two reference entities in a RM100 million contract (one with a 100% risk weight and a 20% share of protection and the other with a 20% risk weight and a 80% share of protection), the risk-weighted exposure is RM36 million (i.e. RM20 million x 100% + RM80 million x 20%).

iii) Where an institution has sold protection using a FTDB product, capital must be held against all the reference entities in the basket[36]. The risk-weighted exposure arising from the credit

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35 Where a DFI has sold protection using a credit derivative, it should be assumed that 100% of the specific risk is purchased irrespective of the range of credit events specified.

36 The Bank may at its discretion, waive this additive rule on a case-by-case basis, if it can be demonstrated to the Bank's satisfaction, that there is a very strong correlation between the assets in the baskets.

derivative will be the sum of the individual risk-weighted exposures in the basket, with the amount of capital held capped at the maximum payout possible under the contract.

10.22 Credit-Linked Notes (CLN)

i) Where protection is purchased using a CLN, the protection buyer is not required to calculate a specific risk capital charge because the risk weight of any funded protection acquired or cash collateral attracts zero risk weight. However, the amount of protection that may be recognised is determined by the amount of funding received. Where protection is sold via a CLN, the protection seller acquires an exposure to both the reference entity and the protection buyer, with the amount of the exposure being the face value of the note. To account for this exposure, the higher of the risk weights applicable to the reference asset or the protection buyer must be applied to the exposure.

10.23 Total Rate of Return Swap (TRORS)

i) Where protection is purchased using a TRORS, the protection buyer may replace the risk weight of the reference asset with the risk weight of the protection seller. Similarly to a CDS, the amount of protection that may be recognised is determined by the credit event payment or settlement amount. Protection sold via a TRORS should be included in the protection seller's trading book with the exception of those that are hedging an underlying banking book exposure.

ii) These instruments differ from typical direct credit substitutes in that the instruments cover not only the default of the reference obligation but any changes in its market value. Changes in market value may be settled frequently, exposing a bank to significant market risk that is not captured by the capital treatment of the banking book.

10.24 DFIs may only net notional positions in reference assets created by credit derivatives with positions in underlying assets or other notional positions created by other credit derivatives if these positions are equal and opposite in all respects. Where the notional positions are equal and opposite in all respects other than tenor, the specific risk capital charges cannot be offset. Instead, a single specific risk charge should be calculated, based on the reference entity.

***(e) Risk weight for Asset Backed Securitisation (ABS) transactions***

10.25 The capital treatment for ABS transactions held in the banking book is prescribed below:

10.26 Asset Transfer

i) Where asset transfer satisfies the true sale criteria set by the Securities Commission (SC) and other provisions contained in the prudential standards[37] such that risks have been effectively transferred to the SPV, the originating DFIs are allowed to exclude the assets from the computation of the risk-weighted capital ratio, upon receiving written consent/confirmation from the Bank and approval of the SC. If subsequently the Bank finds that any of the true sale criteria have not been complied with, or substantial risks have not been effectively transferred, the originating institution would be required by the Bank to hold capital against the transferred assets partially, or fully as if the assets had remained on its books.

ii) Although capital relief is given to the originating DFIs upon effective transfer of the risks, capital requirement would still be imposed

[37] Please refer to the FI@KijangNet on the Prudential Standards on Asset-Backed Securitisation Transactions by Licensed Institutions. The DFIs are required to seek approval from Bank Negara Malaysia pursuant to Section 15 of DFIA for the DFIs' participation in securitisation activities.

should the institutions continue to retain credit exposure by way of providing credit enhancements and liquidity facilities.

iii) While accounting standards would have implication on whether the asset sold is taken off the balance sheet for financial reporting purposes, interpretation of accounting standards that lead to the requirement for consolidation of SPV into the originator's book should not result in the non-eligibility of the originating DFI for the capital relief.

10.27 Credit Enhancement

i) DFIs may provide credit enhancement facilities to improve the credit attractiveness of a securitisation scheme. These facilities may be in the form of first or second loss facilities that include but not limited to arrangements such as subordinated loan facilities, overcollateralisation or cash collaterals.

*First Loss Facility*

ii) First loss credit enhancement facility represents the first level of protection against potential loss. This amount is determined with the rating agencies based on certain formula such as the multiples of expected loss of the asset pool or certain minimum levels of overcollateralisation and interest cover ratios with a view to secure a particular rating for the senior classes. First loss credit enhancement can be provided in several forms such as a subordinated investment, capitalisation of the SPV, or over-collateralisation (discussed separately below). Irrespective of its form, the purpose of first loss credit enhancement is to absorb any losses in the asset pool caused by the risks to which the asset pool is exposed to.

iii) Where a DFI (both originating and third party DFI) provides first loss facility, directly or indirectly to the SPV, the DFI is required under the capital adequacy framework to deduct the full amount of the facility from its capital base (i.e total capital). The deduction will however, be capped at the amount which would have been provided for as if the entire assets were to remain or appear in the institution's balance sheet. In this respect, unqualified liquidity facilities (which do not meet the specified requirement) could be deemed as an implicit credit enhancement, which may require more capital buffer.

iv) In cases where the asset transferred to the SPV is more than the total amount of securities being issued by the SPV, the difference between the two values would normally constitute an over-collateralisation amount (transferred as security). This could act as a first loss facility in which case will require capital deduction by the originating DFI, unless provision has been made through the income statement.

v) A first loss facility may also be in the form of a maintenance of cash collateral account, where cash is provided upfront by the provider of the credit enhancement. DFIs that provide such facility as first loss facility would normally write off that amount in the income statement, failing which, the amount (i.e. outstanding amount) would have to be deducted from its capital base (total capital) under the capital adequacy computation.

vi) Credit enhancement could also be provided through the structure of the securities issued itself. This will involve the issuance of senior and subordinated securities, the latter is normally unrated and held by the originator as a form of first loss facility, in which case, capital deduction is applied.

vii) The maintenance of excess spread accounts within the SPV could also be a form of credit enhancement. If the excess spread is provided as first loss facility and has been captured as a gain on sale (and therefore become part of the capital of the originating institution), the amount shall be deducted from the capital base.

*Second loss facility*

viii) A credit enhancement facility will be treated as ‘second loss facility’ if it ranks above the first loss facility that has been agreed by the Bank. Such facility is often rated lower than BBB or equivalent quality and is often provided as protection against the mezzanine risks tranches. DFIs that provide ‘second loss facility’ shall assign a 100% risk weight to the facility on its balance sheet.

ix) Where various credit enhancements are given for a transaction in a hierarchy (that is, one being senior to the other in terms of allocation of cashflows), the Bank may consider the senior ones among the several enhancements as being a ‘second loss’ in limited circumstances, where the Bank has to be satisfied that the junior forms of credit enhancement are sufficient as a first loss facility. For instance, if there is an over collateralisation as well as a subordinated debt security in a transaction, where the level of over-collateralisation is considered sufficient and no less than that enjoyed by any BBB-rated tranche in a securitisation transaction, the subordinated debt may be treated as second loss piece. In such circumstances, DFIs shall demonstrate to the Bank the basis of claim on the quality of the unrated/subordinated tranche treated as ‘second loss’ and shall obtain the opinion of the rating agencies as to the quality of the subordinated tranche.

x) In the event of downgrades of the second loss facility, the facility may continue to be treated as ‘second loss’ and held by DFIs. However, the Bank reserves the right to assign a higher risk weight, require provision to be made, or reclassify the facility as first loss (in which case capital deduction is required and subject to the 8% cap) should the situation warrant.

xi) In any traditional securitisation where several forms of credit enhancements are involved, the originating DFIs must be able to demonstrate to the Bank the order in which it will be used to absorb losses from the underlying assets.

xii) Where credit enhancements provided are other than those mentioned herein (e.g. third party credit enhancements), the principles in the preceding paragraphs and the existing capital adequacy framework shall apply. DFIs are advised to discuss with the Bank the regulatory impact of providing such a facility.

xiii) While an originating DFI is allowed to provide both first and second loss facility, the Bank reserves that right to require that the second loss facility be provided by a third party, which could be another DFI, under certain circumstances such as deteriorating capital strength of the originating DFI.

10.28 Servicing and Liquidity Facilities

i) A DFI may become a service provider or servicer to the SPV directly, which includes remitting funds provided as a liquidity facility until it has received funds generated from the underlying assets.

ii) Liquidity facilities that fulfill all the prescribed conditions would be deemed to have limited credit risks. Such facilities would primarily be cash advances and for capital purposes, may be treated as commitments that are converted to an on-balance-sheet equivalent of 20% and assigned 100% risk weight (except in the case of Cagamas being the SPV, where the risk weight is 10%). In the event that any of the conditions for liquidity provider is not met, the DFI could be deemed to be providing credit enhancement, resulting in additional capital or provision having to be made against the facility.

10.29 Underwriting

i) A DFI may also act as underwriter for securities issued by an SPV. If as a result of underwriting, a DFI ends up holding more than 10% of total ABS issued (excluding first loss facility) or more than its single customer credit limit (SCCL), whichever is lower, it is given a maximum of 90 days to reduce the holding so as to observe the limit. The Bank reserves the right to require additional capital to be provided should a DFI fail to comply with the requirements.

ii) A DFI acting as an underwriter may treat the facility as an underwriting obligation for capital adequacy purposes with a 50% credit conversion factor and a 100% risk weight covering the amount of the facility.

## C. Maintenance of Reserve Fund

### 11. Reserve fund requirements

11.1 The objective of the reserve fund requirements is to further strengthen the capital position of DFIs through a progressive and systematic building up of the reserve fund. The DFIs are required to maintain a reserve fund and transfer a certain percentage of net profits to the reserve fund as required under Section 39 of DFIA, once the RWCR of the DFI is below a certain threshold as specified by the Bank. With the maintenance of the reserve fund, the fund shall only be used for the specific purpose as defined under Section 39 of DFIA.

## PART III: REPORTING REQUIREMENTS

### 12. Frequency of submission

12.1 Upon implementation of the capital adequacy framework, the DFIs are required to submit to Bank Negara Malaysia regular returns on RWCR position. The DFIs are required to submit the statistical returns not later than the 15th day after the close of each month.

### 13. Reporting template

13.1 The DFIs are required to submit to Bank Negara Malaysia the Return on Risk-Weighted Capital Ratio (Return) which comprises the following components:

I. Capital Base
II. Risk Weighted Assets
III. Off- Balance Sheet (includes the credit conversion factor)

13.2 On the submission of the above Return, DFIs must be guided by the notes for guidance as per paragraph 14 below and the requirements in Part II "Overall Capital Framework".

## Return on Risk-Weighted Capital Ratio

| |
|---|
| I. Capital Base= Tier 1 Capital + Max. Allowable Tier 2 Capital + Exempt Subordinated Debt – (Investment in Subsidiaries + Investment in Capital of Domestic/ Foreign Banking Institution + Investment in Subordinated Instruments) |

## I. Capital Base

| Capital Base | RM'000 Sub Total | RM'000 Total |
|---|---|---|
| **Tier 1 Capital** | | |
| Ordinary Share Capital/Islamic Banking Fund | | |
| Share Premium | | |
| Statutory Reserve Fund | | |
| General Reserve Fund | | |
| Retained Profit/(Loss) | | |
| Approved Audited Half-Year Profit/(Loss) | | |
| Current Unaudited Unadjusted Profit/(Loss) | | |
| Prior Year's Profit/(Loss) | | |
| Capital Redemption Reserve | | |
| Non-Cumulative Perpetual Preference Shares | | |
| Innovative Tier 1 Capital | | |
| • RM Innovative Tier 1 Capital | | |
| o Innovative Non-Cumulative Perpetual Preference Share Capital | | |
| o RM Approved Innovative Debt Capital Securities Issued | | |
| • FX Approved Innovative Debt Capital Securities Issued | | |
| Current Surplus/(Loss) from Sale of Fixed and Long-term Investment | | |
| **Less**: Goodwill | | |
| **Total Tier 1 Capital** | | |

| Capital Base | RM'000 Sub Total | RM'000 Total |
|---|---|---|
| Total Tier 1 Capital c/f from previous page | | |
| **Maximum Allowable Tier 2 Capital** | | |
| **Eligible Tier 2 Capital:** | | |
| Maximum Allowable Subordinated Debt Capital# | | |
| • RM Subordinated Debt Capital | | |
| • FX Subordinated Debt Capital | | |
| • RM Subordinated Debt Capital with Special Approval from BNM | | |
| • FX Subordinated Debt Capital with Special Approval from BNM | | |
| Property Revaluation Reserve | | |
| Ordinary Shares Capitalised from Property Revaluation Reserve | | |
| Cumulative Perpetual Preference Shares | | |
| Approved Hybrid Debt Capital Securities Issued | | |
| • ICUL Issued | | |
| • RCULS Issued | | |
| • Other Approved Hybrid Debt Capital Securities Issued | | |
| RM General Provision for Bad & Doubtful Debts | | |
| Government Grants and Subsidies | | |
| **Total Eligible Tier 2 Capital** | | |
| **Maximum Allowable Tier 2 Capital** <br>• *If Tier 1 Capital < 0, Max. Allowable Tier 2 = 0* <br>• *If Tier 1 Capital < Eligible Tier 2 Capital, Max. Allowable Tier 2 Capital = Tier 1 Capital; otherwise Max. Allowable Tier 2 Capital = Eligible Tier 2 Capital.* | | |
| **Total Capital** <br>**[ Tier 1 Capital + Max. Allowable Tier 2 Capital ]** | | |

# Please refer to the definition of Max. Allowable Subordinated Debt Capital in the Notes for Guidance

| **Capital Base** | **RM'000 Sub Total** | **RM'000 Total** |
|---|---|---|
| **Exempt Subordinated Debt Capital** | | |
| **Less:** | | |
| Investment in Subsidiary Companies | | |
| Investment in Capital of Domestic/Foreign Banking Institution | | |
| Investment in Subordinated Instruments | | |
| Total Deductions | | |
| **Capital Base** | | |
| **Risk Weighted Capital Ratio (%)**<br>= [ Capital Base / Total Risk Weighted Asset x 100% ] | | |
| **Core Capital**<br>• *If Max. All. Tier 2 Capital Investment in Subs Companies + Investment in Capital of Domestic/ Foreign Banking Institution, then*<br>→ *Core Capital = Tier 1 Capital,*<br>• *If Max. All. Tier 2 Capital Investment in Subs Companies + Investment in Capital of Domestic/ Foreign Banking Institution, then*<br>→ *Core Capital = Capital Base* | | |
| **Core Capital Ratio (%)**<br>= [ Core Capital / Total Risk Weighted Asset x 100% ] | | |
| **Investment to Capital Ratio (%)**<br>= [ Investment in Shares Not Deductible from Capital Base + Unit Trust and Property Trust Held + Investments in Fixed Assets & Foreclosed Property Held Longer than Specified Period ] / Capital Base ( x 100% ) | | |
| **Preference Share Capital**<br>• Non-Cumulative Perpetual Preference Shares<br>• Cumulative Perpetual Preference Shares<br>• Innovative Non-Cumulative Perpetual Preference Share Capital<br>• Other Preference Shares | | |

## II. Risk Weighted Assets (RWA)

| Categories | RWA RM'000 |
|---|---|
| • *Total Assets Assigned 0% RW* | |
| • *Total Assets Assigned 10% RW* | |
| • *Total Assets Assigned 20% RW* | |
| • *Total Assets Assigned 50% RW* | |
| • *Total Assets Assigned 100% RW* | |
| • *OBS Claims Assigned 0% RW* | |
| • *OBS Claims Assigned 10% RW* | |
| • *OBS Claims Assigned 20% RW* | |
| • *OBS Claims Assigned 50% RW* | |
| • *OBS Claims Assigned 100% RW* | |
| **Total Risk Weighted Assets**[38] | |

[38] Total Risk Weighted Assets forms the denominator in the computation of Risk Weighted Capital Ratio (RWCR) in I. Capital Base

| Assets for RWCR | Amount RM’000 | RWA RM’000 |
|---|---|---|
| **Total Assets for RWCR** | | |
| • Assets Assigned 0% RW | | |
| o RM Cash | | |
| o RM Balance in Current A/C with BNM | | |
| o RM BNM Debt Securities Held | | |
| o BNM Debt Securities Sold under Repo | | |
| o Other Claims on BNM | | |
| o Government Debt Securities Held | | |
| o Government Debt Securities Sold under Repo | | |
| o Other Claims on Federal Government | | |
| o Danaharta Bonds Held | | |
| o Danaharta Bonds Sold under Repo | | |
| o RM Bonds Issued by MDB/MFI | | |
| o RM Bonds Issued by MDB/MFI Sold under Repo | | |
| o Gold | | |
| o FX Notes & Coins | | |
| o Claims on OECD Central Governments and Central Banks | | |
| o Claims on non-OECD Central Governments and Central Banks Denominated in Own Currency | | |
| o Claims Collateralalised by Cash and Securities Issued by the Federal Government/BNM/OECD Central Government | | |
| o Claims Guaranteed by Federal Government/BNM/OECD Central Government/Central Banks | | |
| **Total Assets Assigned 0% RW** | | |
| • Assets Assigned 10% RW | | |
| o Cagamas Debt Securities | | |
| o Other Claims on Cagamas | | |
| o Cagamas Debt Securities Sold under Repo | | |
| **Total Assets Assigned 10% RW** | | |

| Assets for RWCR | Amount RM'000 | RWA RM'000 |
|---|---|---|
| • Assets Assigned 20% RW | | |
| o RM NIDs Held | | |
| o Other Acceptances Discounted | | |
| o Cagamas Debt Securities Held (issued after 4/9/04) | | |
| o Residential Mortgage-backed Securities (RMBS) | | |
| o NIDs Sold under Repo | | |
| o Acceptances Sold under Repo | | |
| o Cagamas Debt Securities Sold under Repo (issued after 4/9/04) | | |
| o Residential Mortgage-backed Securities Sold under Repo | | |
| o Reverse Repo with DBI on Securities not Issued by Government/BNM | | |
| o Claims Collateralised by Non-equity Securities Issued by DBI | | |
| o Claims Guaranteed by DBI | | |
| o Other Claims on DBI | | |
| o Claims on OECD Banks | | |
| o Claims on Multilateral Development Banks | | |
| o Claims on DFIs & Building Society | | |
| o Claims on Non-OECD Banks with Remaining Maturity  1 year | | |
| o Claims on Domestic State Government/ Local Government/ Statutory Authority | | |
| o Claims on OECD Public Entities | | |
| o Shares in CGC & Loans Guaranteed by CGC | | |
| **Total Assets Assigned 20% RW** | | |

| Assets for RWCR | Amount RM'000 | RWA RM'000 |
|---|---|---|
| • Assets Assigned 50% RW | | |
| o Housing Loans Secured by 1st Charge | | |
| o Claims on Private Sector Exclude from 100% RW | | |
| **Total Assets Assigned 50% RW** | | |
| • Assets Assigned 100% RW | | |
| o Own Acceptances Discounted | | |
| o Unit Trust and Property Trust Held | | |
| o Claims on Non-OECD Banks with Remaining Maturity > 1 year | | |
| o Claims on Non-OECD Central Government Not in Own Currency | | |
| o Investment in Fixed Assets and Foreclosed Property Held Longer than Specified Period | | |
| o Investment in Shares not Deductible from Capital Base | | |
| o Holdings of Other Licensed Financial Institutions' Capital Instruments Not Deductible from Capital Base/ Capital Funds | | |
| o Claims on Non-Bank Private Sector | | |
| o Other Assets for RWCR Purpose | | |
| **Total Assets Assigned 100% RW** | | |

## III. Off-Balance Sheet

### (a) Conversion of Off-Balance Sheet Items

| Instruments | Amount RM'000 | CE* RM'000 |
|---|---|---|
| **Direct Credit Substitutes (100%)** | | |
| • Standby Letters of Credit Serving as Financial Guarantees | | |
| • Other Direct Credit Substitutes | | |
| **Total Direct Credit Substitutes** | | |
| **Transaction Related Contingencies (50%)** | | |
| • Performance/Bid Bonds | | |
| • Transaction Related Standby Letters of Credit | | |
| • Other Transaction Related Contingencies | | |
| **Total Transaction Related Contingencies** | | |
| **Trade Related Contingencies (20%)** | | |
| • Documentary Letters of Credit | | |
| • Shipping Guarantees | | |
| • Other Trade-Related Contingencies | | |
| **Total Trade Related Contingencies** | | |
| **Assets Sold With Recourse & Commitments With Certain Drawdown (100%)** | | |
| • Loans Sold To Cagamas with Recourse | | |
| • Sell Buy Back Agreement (SBBA) | | |
| • Other Assets Sold with Recourse | | |
| • Forwards Asset Purchases | | |
| • Unpaid Portion of Partly-paid Shares/Securities | | |
| • Other Commitments with Certain Drawdowns | | |
| **Total Assets Sold With Recourse & Commitments With Certain Drawdown** | | |

* Credit Equivalent (CE)

| Instruments | Amount RM'000 | CE RM'000 |
|---|---|---|
| **Underwriting Obligations (50%)** | | |
| • Underwriting of Issues of Short Term Debt Securities | | |
| • Underwriting of Issues of Long Term Debt Securities | | |
| • Underwriting of Issues of Shares | | |
| • Other Underwriting Obligations | | |
| **Total Underwriting Obligations** | | |
| **Credit Extension Commitments** | | |
| • Formal Standby Facilities and Credit Lines<br>o With Original Maturity (OM) Up to One Year (0%)<br>o With OM More Than One Year (50%) | | |
| • Undrawn Loan<br>o Undrawn Term Loans<br>▪ With OM Up to One Year (0%)<br>▪ With OM More Than One Year (50%)<br>o Undrawn Overdraft Facilities<br>▪ With OM Up to One Year (0%)<br>o Other Undrawn Loans<br>▪ With OM Up to One Year (0%)<br>▪ With OM More Than One Year (50%) | | |
| • Other Credit Extension Commitments<br>o With Original Maturity Up to One Year (0%)<br>o With Original Maturity More Than One Year (50%) | | |
| **Total Credit Extension Commitments** | | |
| **Foreign Exchange Related Contracts**** | | |
| **Interest Rate Related Contracts**** | | |

** Please fill in the details of these contracts in the next template

| Instruments | Amount RM'000 | CE RM'000 |
|---|---|---|
| **Foreign Exchange Related Contracts** | | |
| • Purchase/Receive Foreign Currency Against Ringgit | | |
| o FX Purchases Spot & Tom | | |
| o FX Purchased Outright Forward | | |
| o FX Receivable in Currency Swaps | | |
| • Miscellaneous Forward Purchase of FX | | |
| o FX Futures Contracts Purchased (Obligation to Buy FX) | | |
| o FX Put Option Written (Obligation to Buy FX) | | |
| o FX Call Option Purchased (Right to Buy FX) | | |
| o Other Commitments to Purchase/Receive FX Against Ringgit | | |
| • Sale/Pay Foreign Currency Against Ringgit | | |
| o FX Sold Spot & Tom | | |
| o FX Sold Outright Forward | | |
| o FX Payable in Currency Swaps | | |
| • Miscellaneous Forwards Sale of FX | | |
| o FX Future Contracts Sold (Obligation to Sell FX) | | |
| o FX Call Option Written (Obligation to Sell FX) | | |
| o FX Call Option Sold (Right to Sell FX) | | |
| o Other Commitments to Sell/Pay FX Against Ringgit | | |
| • Third Currency Transactions | | |
| o Third Currency – Spot & Value Tomorrow Transactions | | |
| o Third Currency – Forward Contracts | | |
| o Third Currency Swaps | | |
| ▪ Third Currency – Forward Sales in MM Swaps | | |
| ▪ Third Currency – Spot Purchases in MM Swaps | | |
| ▪ Third Currency – Cross Interest Rate Swaps | | |
| ▪ Third Currency – Other Swap | | |

| Instruments | Amount RM'000 | CE RM'000 |
|---|---|---|
| • Third Currency Misc. Forward Transactions | | |
| o Third Currency – Futures Contracts | | |
| ▪ Third Currency – Futures Purchased | | |
| ▪ Third Currency – Futures Sold | | |
| o Third Currency – Option Written (Obligation to Buy/Sell) | | |
| o Third Currency – Option Purchased (Obligation to Buy/Sell) | | |
| o Third Currency – Other Commitments | | |
| **Total Foreign Exchange Related Contracts** | | |

| Instruments | Amount RM'000 | CE RM'000 |
|---|---|---|
| **Interest Rate Related Contracts** | | |
| • RM Interest Rate Related Contracts | | |
| o RM FRA Purchased | | |
| o RM FRA Sold | | |
| o RM Interest Rate Futures Purchased | | |
| ▪ With Remaining Maturity 1 year | | |
| ▪ With Remaining Maturity 2 years | | |
| ▪ With Remaining Maturity > 2 to 3 years | | |
| o RM Interest Rate Futures Sold | | |
| ▪ With Remaining Maturity 1 year | | |
| ▪ With Remaining Maturity 2 years | | |
| ▪ With Remaining Maturity > 2 to 3 years | | |
| o RM Interest Rate Swap – Receiving Fixed | | |
| o RM Interest Rate Swap – Floating vs Floating | | |
| o RM Interest Rate Option Purchased | | |
| o RM Interest Rate Option Written | | |
| o RM Other Interest Rate Related Contracts | | |
| • FX Interest Rate Related Contracts | | |
| **Total Interest Rate Related Contracts** | | |

## (b) Credit Equivalent of Off-Balance Sheet Items

| Credit Equivalent of Off-Balance Sheet Items | Amount RM’000 | RWA RM’000 |
|---|---|---|
| **Total Credit Equivalent (CE) of Off-Balance Sheet Items** | | |
| • OBS Claims Assigned 0% RW (CE) | | |
| o On BNM & Federal Government (CE) | | |
| o On OECD Central Government/Bank (CE) | | |
| o On Non-OECD Central Government/Bank in Own Currency (CE) | | |
| o Collateralised by Cash & Securities Issued by Government/BNM/OECD Central Government (CE) | | |
| o Guaranteed by Government/BNM/OECD Government/OECD Central Bank | | |
| **Total OBS Claims Assigned 0% RW** | | |
| • OBS Claims Assigned 10% RW (CE) | | |
| o OBS Claims on Cagamas (CE) | | |
| **Total OBS Claims Assigned 10% RW** | | |
| • OBS Claims Assigned 20% RW (CE) | | |
| o On Securities Not Issued by BNM/Government with DBI (CE) | | |
| o On Collateralised by Non-Equity Security Issued by DBI (CE) | | |
| o Guaranteed by DBI (CE) | | |
| o On OECD Banks (CE) | | |
| o On Multilateral Development Bank (CE) | | |
| o On Domestic DFI & Building Society (CE) | | |
| o On Non-OECD Banks with Remaining Maturity 1 year (CE) | | |
| o On Domestic Non-Central Government and Other Public Sector (CE) | | |
| o On OECD Public Entities | | |
| **Total OBS Claims Assigned 20% RW** | | |

| **Credit Equivalent of Off-Balance Sheet Items** | **Amount RM'000** | **RWA RM'000** |
|---|---|---|
| • OBS Claims Assigned 50% RW(CE) | | |
| o On OBS Housing Loans Secured by First Charge (CE) | | |
| o On OBS FX & Interest Rate Contracts with Person under the 100% RW (CE) | | |
| o On OBS Loan to Non-Bank Private Sector excluded from 100% RW (CE) | | |
| **Total OBS Claims Assigned 50% RW** | | |
| • FX & IR in 0/10/20% RW (CE) | | |
| • OBS Claims Assigned 100% RW (CE) | | |
| o On Non-OECD Bank with Remaining Maturity > 1 year (CE) | | |
| o On Non-OECD Central Government Not in Own Currency (CE) | | |
| o On Non-Bank Private Sector (CE) | | |
| o OBS Items nie (CE) | | |
| **Total OBS Claims Assigned 100% RW** | | |

## 14. Notes for guidance

### I. Capital Base

14.1 Capital Base

Refers to the capital base of a reporting institution. This is derived from the followings:-

(a) Tier 1 Capital;

(b) Maximum Allowable Tier 2 Capital;

(c) Exempt Subordinated Debt Capital;

(d) Investments in Subsidiary Companies;

(e) Investment in Capital of Domestic/Foreign Banking Institutions (BIs); and

(f) Investment in Subordinated Instruments

The capital base is derived as follows:-

| |
|---|
| Sum of:<br>Tier-1 Capital + Max. Allowable Tier-2 Capital + Exempt Subordinated Debt Capital;<br>Less:<br>Investments in Subsidiary Companies, Investment in Capital of Domestic/Foreign BIs and Investment in Subordinated Instruments |

14.2 Tier 1 Capital

This item comprises the following items:-

(a) Ordinary Share Capital/Islamic Banking Fund

Refers to a reporting institution’s issued and paid-up ordinary share capital. For Islamic banking business, Islamic Banking Fund refers to the fund allocated by the reporting institution for Islamic banking business. Exclude share premium, which is reportable separately in item Share Premium. Exclude other forms of equity. Only ordinary share capital should be included in this item. Exclude ordinary share capital, which is created from the capitalization of reserves attributable to revaluation of property, which is reportable separately in item Shares capitalised from property revaluation reserve.

(b) Share Premium

Refers to a reporting institution's outstanding premium attributable to ordinary shares and preferred shares. The premium is the amount received by the reporting institution over and above the par value of shares and preferred shares when the shares were subscribed by the shareholders of the institution.

(c) Statutory Reserve Fund

Refers to a reporting institution's outstanding reserve fund established and maintained in accordance with Section 39 of DFIA. See Section 39 of DFIA for more details. Report the amount as per last audited accounts approved by Bank Negara Malaysia.

(d) General Reserve Fund

Refers to a reporting institution's outstanding reserve fund established and maintained on the basis of the institution's internal policies. Report the amount as per last audited accounts approved by Bank Negara Malaysia.

(e) Retained Profit/(Loss) Carried Forward

Refers to the accumulated amount of prior years' profit after tax, which was not distributed as dividends to shareholders or credited to the statutory reserve fund or general reserve fund. The amount to be reported in this item should be as per the latest “approved” accounts of the reporting institution.

The item may be in the negative due to losses suffered, in which case the amount should be reported with a minus sign [ - ] on the lefthand side of the number.

(f) Approved Audited Half-Year Profit/(Loss)

Refers to the approved audited profit/(loss) after tax earned/(suffered) during the first six months of the current financial year. The difference between item Retained Profit/(Losses) Carried Forward and item Approved Audited Half-Year Profit/(Loss) is that the former is referring to the approved audited amount as at the last financial year-end, whereas the latter is referring to the approved audited amount as at the half-year end of the current financial year.

(g) Current Unaudited Unadjusted Profit/(Loss)

Refers to a reporting intitution’s outstanding unaudited unadjusted profit/(loss) earned/(suffered) during the current financial year. If an institution has suffered a loss, the amount reported should be prefixed with a [ - ] sign. Where a reporting institution has an approved audited half-year profit/(loss), the amount to be reported should only include results obtained after the current financial half-year.

(h) Prior Year’s Profit/(Loss)

Refers to a reporting institution’s outstanding audited profit/(loss) earned or incurred in the year(s) preceding the current financial year. This item is applicable during the transitionary period between the end-of the previous financial year(s) and the date the Bank “approves” the previous financial year(s) accounts. Once the accounts are approved by the Bank, the amount may be included in the items Statutory Reserve Fund, General Reserve Fund and Retained Profit/(Loss).

(i) Capital Redemption Reserve

Refers to a reporting institution's outstanding reserve equivalent to the nominal amount of redeemable preference shares that arose upon the redemption of these shares out of profits which would otherwise have been available for dividend.

(j) Non-cumulative Perpetual Preference Shares

Refers to a reporting institution's outstanding issued and paid-up capital arising from the issue of preference shares on the following terms:-

i. The preference shares have indetermined life; and
ii. The obligation to pay dividends on the preference shares can be reduced or waived permanently in the event that the profitability of the institution is insufficient to pay the specified dividend rate.

(k) Innovative Tier 1 Capital

Refers to a reporting institution's outstanding issued and paid-up capital arising from the issuance of Innovative Tier 1 Capital which consist of:

i. Preference shares with additional features including moderate step-up rate and limited call provisions; and
ii. Hybrid instruments not classified as hybrid Tier 2 capital instruments, that meet the minimum requirements for Innovative Tier 1 capital instruments as set by the Bank; and

Limited to 15% of total Tier 1 capital (after the inclusion of the Innovative Tier 1 capital instruments and net of goodwill)

The item Innovative Tier 1 Capital is further divided into two types, as follows:-

a) RM Innovative Tier 1 Capital

Refers to a reporting institution's outstanding amount of all RM-denominated issued and paid-up capital from the issuance of Innovative Tier 1 capital instruments.

This item is further sub divided into two types, as follows:-

(i) Innovative Non-cumulative Perpetual Preference Share Capital

Refers to a reporting institution's outstanding issued and paid-up capital arising from the issuance of preference shares classified as equity, that meet the minimum requirements for Innovative Tier 1 capital instruments as set by the Bank.

(ii) RM Approved Innovative Debt Capital Securities Issued

Refers to a reporting institution's outstanding amount (RM'000) of RM-denominated securities issued classified as **debt**, approved by the Bank as qualifying Tier 1 capital for purposes of determining capital adequacy.

b) FX Approved Innovative Debt Capital Securities Issued

Refers to a reporting institution's outstanding amount of all FX-denominated securities issued classified as **debt**, approved by the Bank as qualifying Tier 1 capital for purposes of determining capital adequacy.

(l) Current Surplus/(Loss) from sale of fixed & long-term investment

Refers to a reporting institution's outstanding surplus/(loss) after tax, arising from the sale of fixed and long-term investments during the current financial year of the reporting institution. A loss amount should be prefixed with a minus [ - ] sign.

(m) Goodwill

Refers to amount of intangible assets which are not separately identifiable from the business entity as a whole. Separately identifiable intangible, such as franchises and patents, are excluded.

14.3 Maximum Allowable Tier 2 Capital

Refers to a reporting institution's maximum allowable Tier 2 capital as at a report date. **Eligible Tier 2 capital** comprises the following items:-

(a) Maximum Allowable Subordinated Debt Capital.

Refers to the amount of subordinated debt capital which a reporting institution may include in the computation of the institution's eligible Tier 2 capital. To obtain item Maximum Allowable Subordinated Debt Capital, the following steps are required:-

i. Add items RM Subordinated Debt Capital and FX Subordinated Debt Capital respectively

ii. If the sum of items RM Subordinated Debt Capital and FX Subordinated Debt Capital is;

(i) Greater than 50% of Tier 1 Capital, item Maximum Allowable Subordinated Debt Capital is equal to 50% of item Tier 1 Capital; or

(ii) Lower than or equal to 50% Tier 1 Capital, item Maximum Allowable Subordinated Debt Capital is equal to the sum of item RM Subordinated Debt

Capital and FX Subordinated Debt Capital as computed in step i. above.

iii. If the items RM Subordinated Debt Capital with Special Approval from BNM and FX Subordinated Debt Capital with Special Approval from BNM are affected due to special approval given by BNM then the above condition is not applicable and the Max Allowable Subordinated Debt Capital will be calculated from items RM Subordinated Debt Capital + FX Subordinated Debt Capital + RM Subordinated Debt Capital with Special Approval from BNM + FX Subordinated Debt Capital with Special Approval from BNM.

(b) <u>Property Revaluation Reserve</u>

Refers to the outstanding reserve of a reporting institution arising from a revaluation of property (land and buildings), for which the Bank has given approval.

(c) <u>Ordinary Shares Capitalised from Property Revaluation Reserve</u>

Refers to a reporting institution's outstanding ordinary share capital that was created by the capitalisation of reserves attributable to revaluation of property.

(d) <u>Cumulative Perpetual Preference Shares</u>

Refers to a reporting institution's outstanding issued and paid-up capital arising from the issue of preference shares which have an indeterminate life and which do not cause the institution to cease trading in the event of non-payment of dividends due to the institution's insufficient profitability. However, dividends may be accumulated for future payment subject to the profitability of the institution.

(e) Approved Hybrid Debt Capital Securities Issued

Refers to a reporting institution's outstanding amount of RM-denominated debt securities issued which are approved by the Bank as qualifying Tier 2 capital for purposes of determining capital adequacy. To qualify as Tier 2 capital, the securities must meet the following requirements:-

i. Unsecured, subordinated and fully paid-up;
ii. Not redeemable at the initiative of the holder or without the prior consent of BNM;
iii. Available to cover losses without the issuer being obliged to cease trading; and
iv. Interest payment can be deferred where the profitability of the issuer is insufficient to cover such payments.

The items Approved Hybrid Debt Capital Securities Issued is further divided into 3 types, as follows:-

(i) **ICULS Issued**, or Irredeemable Convertible Unsecured Loan Stocks, which refers to debt securities (or whatever name called) issued on terms that on maturity date, the debt would be mandatorily converted to equity in the issuing company, if not already converted earlier; and

(ii) **RCULS Issued**, or Redeemable Convertible Unsecured Loan Stocks, which refers to debt securities issued (or whatever name called) on terms that on maturity date, the debt securities are convertible to equity in the issuing company, if not already converted earlier. In the case of RCULS, it is necessary that conversion is at the option of the reporting institution and not at the holder's option. Only when such condition is met that the securities can be classified as RCULs Issued and eligible as Tier 2 capital (see criteria above)

(iii) **Other Approved Hybrid Debt Capital Securities Issued**, which refers to all other debt securities issued by a reporting institution which are approved by the Bank as qualifying Tier 2 Capital but cannot be classified in item ICULs Issued or RCULs Issued.

(f) RM General Provision for Bad and Doubtful Debts

Refers to the outstanding amount set aside as general provision of X% of total outstanding loans (including housing loans sold to Cagamas Berhad), net of interest-in-suspense and specific provision for substandard and doubtful debts pursuant to BNM/DFI/GP3 issued by Bank Negara Malaysia. Includes provision set for FX-denominated loans.

(g) Government Grants and Subsidies

Refers to the outstanding grants and subsidies received from the government by the reporting institution.

14.4 Exempt Subordinated Debt Capital

Refers to the outstanding amount of Exchangeable Subordinated Capital Loan (ESCL) from Danamodal Nasional Berhad (Danamodal).

14.5 Investment in Subsidiary Companies

Refers to the outstanding amount of a reporting institution's investment (holding of shares) in subsidiary companies (quoted and unquoted valued at cost).

14.6 Investment in Capital of Domestic/Foreign Banking Institutions

Refers to the outstanding amount of a reporting institution's investment in capital of domestic or foreign banking institutions which are deductible from capital base.

14.7 Investment in Subordinated Instruments

Refers to subordinated instruments held by a reporting institution, which are deductible from capital base.

14.8 Preference Share Capital

Refers to a reporting institution's outstanding issued and paid-up capital arising from the issue of preference shares. This item is derived from the sum of four component items, i.e. Non-cumulative Perpetual Preference Share Capital, Cumulative Perpetual Preference Share Capital, Innovative Non-cumulative Perpetual Preference Share Capital and Other Preference Share Capital. The full interpretation of these breakdown items are as follows:-

(a) Non-cumulative Perpetual Preference Share Capital

Refers to a reporting institution's outstanding issued and paid-up capital arising from the issue of preference shares on the following terms:-

i. The preference shares have indetermined life; and
ii. The obligation to pay dividends on the preference shares can be reduced or waived permanently in the event that the institution is not able to pay the specified dividend rate.

(b) Cumulative Perpetual Preference Share Capital

Refers to a reporting institution's outstanding issued and paid-up capital arising from the issue of preference shares which have an indeterminate life and which do not cause the institution to cease trading in the event of non-payment of dividends due to the institution's insufficient profitability. However, dividends may be accumulated for future payment subject to the profitability of the institution.

(c) Innovative Non-cumulative Perpetual Preference Share Capital

Refers to a reporting institution’s outstanding issued and paid-up capital arising from the issuance of preference shares classified as equity, that meet the minimum requirements for Innovative Tier 1 capital instruments as set by the Bank.

(d) Other Preference Share Capital

Refers to a reporting institution's outstanding issued and paid-up capital arising from the issue of preference shares which are neither cumulative nor non-cumulative perpetual preference shares as defined above.

14.9 Other RM Subordinated Borrowings

Refers to the outstanding amount of subordinated borrowings which are not classifiable as “Subordinated Debt Capital”.

14.10 Other FX Subordinated Borrowings

Refers to a reporting institution’s outstanding FX-denominated borrowings which do not qualify for subordinated Eligible Tier 2 Capital.

14.11 Risk Weighted Capital Ratio (RWCR)

Refers to a reporting institution's computed RWCR as at report date. The RWCR is derived as follows:-

$$\frac{\text{Capital Base}}{\text{Total Risk Weighted Assets}} \text{ X } 100\% \text{ (up to 2 decimal places only)}$$

14.12 Core Capital

Refers to a reporting institution's core capital (RM'000) as at a report date. To obtain item Core Capital, the following steps are required:-

(a) Core capital = Tier 1 Capital, if Maximum Allowable Tier 2 Capital is more or equals to Investment in Subsidiary Companies plus Investment in Capital of Domestic/Foreign Banking Institution; OR

(b) Core capital = Capital Base, if Maximum Allowable Tier 2 Capital is less than Investment in Subsidiary Companies plus Investment in Capital of Domestic/Foreign Banking Institution

14.13 Eligible Tier 2 Capital

This item is derived from the summation of items Maximum Allowable Subordinated Debt Capital, Property Revaluation Reserve, Ordinary Shares Capitalised from Property Revaluation Reserve, Cumulative Perpetual Preference Shares, Minority Interest in Cumulative Perpetual Preference Shares of Non-wholly Owned Subsidiaries, Approved Hybrid Debt Capital Securities Issued, RM General Provision for Bad & Doubtful Debts and Government Grants & Subsidies. The interpretation of these breakdown items are explained in the earlier paragraphs.

14.14 Core Capital Ratio

Refers to a reporting institution's computed core capital ratio as at report date. This ratio is derived as follows:-

$$\frac{\text{Core Capital}}{\text{Total Risk Weighted Assets}} \times 100\% \quad \text{(up to 2 decimal places only)}$$

14.15 Investment to Capital Ratio (ICR)

Refers to a reporting institution's computed ICR for compliance determination as at report date. The ICR is derived from the following formula:-

$$\frac{\text{Investment in Shares not Deductible from Capital Base + Unit Trust and Property Trust Held + Investment in Fixed Assets and Foreclosed Property Held Longer Than Specified}}{\text{Capital Base}} \times 100\% \quad \text{(up to 2 decimal places only)}$$

The interpretation of items Investment in Shares not Deductible from Capital Base, Unit Trust and Property Trust Held and Investment in Fixed Assets and Foreclosed Property Held Longer than Specified Period are given in sub-section on para 14.22 (Assets Assigned 100% RW) of this Part.

## II. Risk Weighted Assets

14.16 Total Risk Weighted Assets

Refers to the outstanding amount of total assets net of selected provisions (specific provision for bad and doubtful debts, interest-in-suspense, depreciation on fixed assets, amortisation of deferred assets, provision for commitment and contingencies and provision for diminution in value of shares and debt securities) of a reporting institution after adjustment for “risk” made based on a risk weighting system for the various types of assets of the institution.

14.17 Total Assets for RWCR

Refers to the outstanding amount of total assets of a reporting institution **net** of selected provisions (as mentioned in para 14.16 above).

The item “Total Assets for RWCR” is further divided into the following broad categories:-

(a) Assets assigned 0% risk weight;

(b) Assets assigned 10% risk weight;

(c) Assets assigned 20% risk weight;

(d) Assets assigned 50% risk weight; and

(e) Assets assigned 100% risk weight.

14.18 Assets Assigned 0% RW

This item is divided into categories as given in the template. The interpretation of these breakdown items are as follows:-

14.18.1 RM Cash

Refers to the outstanding RM cash held by a reporting institution.

14.18.2 RM Balances in Current A/C with BNM

Refers to the outstanding amount of balances in current accounts with BNM. If overdrawn, the amount should be reported as ‘0’ and not with the ’negative’ actual amount overdrawn.

14.18.3 RM BNM Debt Securities Held

Refers to the outstanding amount of BNM securities held. Excludes securities sold under repo and excludes securities bought under reverse repos.

14.18.4 BNM Debt Securities Sold Under Repo

Refers to the outstanding amount of BNM Securities sold under repo.

14.18.5 Other Claims on BNM & Federal Government

Refers to the outstanding amount of all other direct claims on BNM and/or the Federal Government, other than RM Cash, RM Balances in Current A/C with BNM, RM BNM Debt Securities held, Government Debt Securities held, Claims Collateralised by Cash/Securities Issued by the Federal Government/BNM (part of item Claims Collateralised by Cash and Securities Issued by the Federal Government/BNM/OECD Central Government) and Claims Guaranteed by Federal Government/BNM (part of item Claims Guaranteed by Federal Government/BNM/OECD Central Government/Central Banks).

14.18.6 Government Debt Securities Held

Refers to the outstanding RM-denominated debt securities issued by the Government (e.g. Treasury bills, MGS). **Excludes** securities sold under repurchase agreements and securities bought under reverse repos.

14.18.7 Government Debt Securities Sold Under Repo

Refers to outstanding amount of debt securities issued by the Government, which are sold under repo.

14.18.8 Danaharta Bonds Held

Refers to the amount of bonds issued by Danaharta Nasional Berhad (Danaharta), which are being held by a reporting institution.

14.18.9 Danaharta Bonds Sold Under Repo

Refers to the outstanding amount of Danaharta bonds, which a reporting institution has sold under repurchase agreements.

14.18.10 RM Bonds Issued by Multilateral Development Banks (MDB)/Multilateral Financial Institution (MFI)

Refers to the amount of Ringgit-denominated bonds issued by Multilateral Development Banks and Multilateral Financial Institutions, which are being held by a reporting institution.

14.18.11 RM Bonds Issued by Multilateral Development Banks (MDB)/Multilateral Financial Institutions (MFI) Sold under Repo

Refers to the amount of Ringgit-denominated bonds issued by Multilateral Development Banks and Multilateral Financial Institutions, which a reporting institution has sold under repurchase agreements.

14.18.12 Gold

Refers to the outstanding gold holdings of a reporting institution

14.18.13 FX Notes and Coins

Refers to the outstanding FX notes and coins held by a reporting institution.

14.18.14 Claims on OECD Central Governments and Central Banks

Refers to the outstanding amount of all direct claims of a reporting institution on OECD Government/Central Banks, including loans to such entities and holding of debt securities issued by such entities. Excludes claims collateralised by securities issued by such entities (which are reportable in item Claims Collateralised by Cash and Securities Issued by the Federal Government/BNM/OECD Central Government) and claims guaranteed by such entities (which are reportable in item Claims Guaranteed by Federal Government/BNM/OECD Central Government/Central Banks). See list of OECD countries at the beginning of this

Capital Framework. The list is applicable for the purposes of this Guideline only.

14.18.15 Claims on non-OECD Central Governments and Central Banks Denominated in Own National Currency

Refers to the outstanding amount of direct claims of a reporting institution on non-OECD Governments/Central Banks, including loans to, and holdings of securities issued by such entities, where the claims are intended to be settled in terms of the respective national currencies of such countries. For the purposes of this Guidelines, non-OECD Governments/Central Banks mean those Governments/Central Banks of countries which are not included in the list of OECD countries.

14.18.16 Claims Collateralised by Cash and Securities Issued by the Federal Government/BNM/OECD Central Government

Refers to the outstanding amount of claims on any person which are secured by cash deposits placed and pledged with a reporting institution, and/or securities by the Federal Government/BNM/OECD Central Governments.

14.18.17 Claims Guaranteed by Federal Government/BNM/OECD Central Government/Central Banks

Refers to the outstanding amount of claims on any person, which are explicitly guaranteed (as to the settlement of the claims) by the Federal Government of Malaysia/BNM/OECD Central Governments and/or OECD Central Banks. These claims would include all loans and securities guaranteed by the specified authorities.

14.19 Assets Assigned 10% RW

This item is divided into three categories as given in the template. The interpretation of these breakdown items are as follows:-

14.19.1 Cagamas Debt Securities

Refers to the outstanding amount of Cagamas debt securities held. Exclude those sold on repo and those bought on reverse repos.

14.19.2 Cagamas Debt Securities Sold Under Repo

Refers to the outstanding amount of Cagamas debt securities, which a reporting institution has sold under repo.

14.19.3 Other Claims on Cagamas

Refers to outstanding claims on Cagamas Berhad, excluding holdings of Cagamas debt securities. Include reverse repos on Cagamas debt securities with commercial banks, investment banks/merchant banks. Include claims guaranteed by Cagamas Berhad and claims collateralised by Cagamas debt securities.

14.20 Assets Assigned 20% RW

This item is divided into categories as given in the template. The interpretation of these breakdown items are as follows:-

14.20.1 RM NIDs Held

Refers to the outstanding amount of RM-denominated NIDs held by a reporting institution.

14.20.2 Other Acceptances Discounted

Refers to the outstanding amount of Bankers Acceptances and Islamic Acceptances Bills (IABs) drawn on and accepted by commercial banks or investment banks/merchant banks other than the reporting institution, which are being held by reporting institution.

14.20.3 Cagamas Debt Securities Held (Issued after 4/9/04)

Refers to the outstanding amount of Cagamas debt securities, **issued after 4 September 2004** by Cagamas Berhad for the purpose of financing purchases of loans from loan originators, which are being held by a reporting institution.

14.20.4 Residential Mortgage-backed Securities (RMBS)

Refers to the amount of residential mortgage-backed securities issued by Cagamas MBS Berhad for the purpose of financing purchases of staff housing loans from Government of Malaysia, which are being held by a reporting institution.

14.20.5 NIDs Sold Under Repo

Refers to the outstanding amount of NIDs (issued by other banking institutions), which a reporting institution has sold under repurchase agreements.

14.20.6 Acceptances Sold Under Repo

Refers to the outstanding amount of BAs and IABs which a reporting institution has sold under repurchase agreements.

14.20.7 Cagamas Debt Securities Sold Under Repo (issued after 4/9/04)

Refers to the outstanding amount of Cagamas debt securities **(issued after 4 September 2004)**, which a reporting institution has sold under repurchase agreements.

14.20.8 Residential Mortgage-backed Securities Sold under Repo

Refers to the outstanding amount of residential mortgage-backed securities issued by Cagamas MBS Berhad, which a reporting institution has sold under repurchase agreements.

14.20.9 Reverse Repo with DBI on Securities Not Issued by Government/BNM

Refers to the outstanding reverse repos with DBI, where the securities involved are not issued by BNM or the Federal Government of Malaysia.

14.20.10 Claims Collateralised by Non-Equity Securities Issued by Domestic Banking Institutions

Refers to all outstanding claims on any other person (except BNM/Federal Government, OECD Central Governments/Central Banks, C agamas Berhad and Domestic Banking Institutions), including loans which are collateralised by non-equity securities (including BAs, NIDs and other debt instruments) issued by domestic banking institutions. "Claims" here do not include "reverse repos". "Collateral" here does not include "guarantee" given by domestic banking institutions.

14.20.11 Claims Guaranteed by Domestic Banking Institutions

Refers to all outstanding claims on any other person (except BNM/Federal Government, OECD Central Governments/Central Banks, Cagamas Berhad and Domestic Banking Institutions), including loans which are covered by guarantee issued by domestic banking institutions.

14.20.12 Other Claims on Domestic Banking Institutions

Refers to outstanding claims on domestic banking institutions.

14.20.13 Claims on OECD Banks

Refers to all claims on OECD banks and claims covered by guarantee or collateralised by securities issued, by OECD banks. Excludes claims which can be classified in the 0% risk weight category.

14.20.14 Claims on Multilateral Development Banks

Refers to outstanding claims on multilateral development banks (see list of Multilateral Development Banks at the beginning of the capital framework) and claims covered by guarantee or collateralised by securities issued by multilateral development banks. **Excludes** claims which can be classified in the 0% risk weight category.

14.20.15 Claims on DFIs and Building Society

Refers to all outstanding claims on domestic development finance institutions (DFIs/building societies) and claims guaranteed by/or collateralised by securities issued by domestic DFIs/building societies.

14.20.16 <u>Claims on Non-OECD Banks with Remaining Maturity of up to 1 year</u>

Refers to all outstanding claims on non-OECD banks (i.e. banks incorporated in non-OECD countries), including claims covered by guarantee issued by such institutions, where the claims have a remaining maturity of one year or less.

14.20.17 <u>Claims on Domestic State Governments, Local Government and Statutory Authorities</u>

Refers to outstanding claims on, and claims guaranteed, by Malaysian State Governments, Local Governments and other Government sector entities, including statutory corporations like State Economic Development Corporations, (excluding companies incorporated under the Companies Act 1965, owned or controlled by the various Government entities).

14.20.18 <u>Claims on OECD Public Entities</u>

Refers to all outstanding claims on, and claims guaranteed, by public entities of OECD countries, other than the central governments and central banks.

14.20.19 <u>Shares in CGC and Loans Guaranteed by CGC</u>

Refers to a reporting institution’s investment in the shares of the Credit Guarantee Corporation (CGC) and loans guaranteed by CGC.

14.21 Assets Assigned 50% RW

This item is divided into categories as given in the template. The interpretation of these breakdown items are as follows:-

14.21.1 Housing Loans Secured by First Charge

Refers to outstanding housing loans, including such loans granted to employee, secured by first charge on residential property.

Excludes loans secured by first charge on residential property where the loans are granted for business, investment or consumption purposes (i.e. the proceeds of the loans are not used to settle the purchase cost of the residential property).

Excludes loans granted to corporations engaged in construction and property development activities even though such loans are secured by first charge on the property.

[Note : A loan obtained to refinance an existing housing loan is deemed to be a "housing loan" to the extent of the amount of loans proceeds utilised for the repayment of an existing housing loan. For example, if the redemption sum of an existing housing loan is RM50,000, and the total amount obtained by the borrower to refinance this existing loan is RM80,000 on the security (1$^{st}$ charge) of the residential property, the new lender (reporting institution) can only classify RM50,000 in item Housing Loans Secured by First Charge and not RM80,000 (the full amount lent).

A loan obtained to finance the purchase of property which is not exclusively meant for residential purposes shall not be itemised as Housing Loans Secured by First Charge, even if the loan is secured by first charge on the property.

For "housing loan" which have features of extending revolving or overdraft facilities to the borrowers for business, investment and consumption purposes, a reporting institution should segregate such loans into two parts, where that part relates to business, investment or consumption purposes is excluded from item Housing Loans Secured by First Charge. Where differentiation cannot be made, the whole loan should be excluded as 'housing loan'.

14.21.2 Claims on Private Sector Exclude from 100% RW

Refers to the outstanding amount of claims of a reporting institution to non-bank private sector entities, where approval has been given by Bank to exclude such claims from the 100% risk weight category.

14.22 Assets Assigned 100% RW

This item is divided into categories as given in the template. The interpretation of these breakdown items are as follows:-

14.22.1 Own Acceptances Discounted

Refers to outstanding amount of BAs discounted by the accepting bank.

14.22.2 Unit Trust and Property Trust Held

Refers to the outstanding amount of unit trust and property trust held by a reporting institution.

14.22.3 Claims on Non-OECD Banks with Remaining Maturity of more than 1 year

Refer to all claims on banks incorporated outside the OECD countries where the claims have a remaining maturity of more than 1 year.

14.22.4 Claims on Non-OECD Central Governments Not Denominated in Own National Currency

Refer to all claims of the Central Governments/Central Banks of non-OECD countries where the claims are denominated in currencies other than the national currency of the countries respectively.

14.22.5 Investment in Fixed Assets and Foreclosed Property Held Longer than Specified Period

Refers to fixed assets and foreclosed properties held by a reporting institution longer than the specified period. "Specified period" here means 24 months from the date of acquisition or such period as the Bank may specify from time to time.

14.22.6 Investment in Shares not Deductible from Capital Base

Refers to a reporting institution's investment in shares not deductible from capital base. All investments in shares are included in this item **except**:-

(a) Shares which are deductible from capital base namely:-

(i) Shares in subsidiary companies;

(ii) Shares in domestic banking institutions (commercial banks, investment banks/

merchant banks) and foreign banking institutions; and

(b) Shares acquired as a result of underwriting, satisfaction of debt and conversion from debt, which are held for a period within the specified period. "Specified period" means :-

(i) 12 months from date of acquisition for shares acquired in satisfaction of debt or as a result of underwriting commitments; and

(ii) 3 months after the audited accounts of the restructured company show a profit following the restructuring, for shares acquired from debt conversion.

(c) Shares in the Credit Guarantee Corporation (the amount of such investment is included in item Shares in CGC & Loans Guaranteed by CGC).

14.22.7 Holdings of Other Licensed Financial Institutions' Capital Instruments Not Deductible from Capital Base/Capital Funds

Refers to holdings of other licensed financial institutions' capital instruments that are subject to a 100% risk weight and exempted from capital deduction, which are being held by a reporting institution.

14.22.8 Claims on Non-Bank Private Sector

Refer to all claims (including loans granted) on the private sector, excluding claims classifiable as Own Acceptances Discounted and claims classifiable in lower risk categories. "Private sector" here refers to domestic business enterprises, individuals and non-bank financial institutions other than Cagamas Berhad and domestic NBFIs.

14.22.8.1 Item OBS Claims on Non-Bank Private Sector refers to the credit equivalent of off-balance sheet claims on the non-bank private sector, not included elsewhere.

14.22.9 Other Assets for RWCR Purpose

Refers to all other assets of a reporting institution which cannot be included elsewhere. Included are the following:-

(a) Foreclosed properties which are held for a period of 24 months or less from date of acquisition; and

(b) Shares acquired due to satisfaction of debt, underwriting and conversion from debt, where the holding period so far was less than or equal to the specified period, which is:-

(i) 12 months after date of acquisition in the case where the shares are acquired due to satisfaction of debt or underwriting; or

(ii) 3 months after the defaulting company has turned around following the restructuring programme.

## III. Off-Balance Sheet

### (a) Conversion of Off-Balance Sheet Items

14.23 Direct Credit Substitutes (100%)

Refers to the outstanding value of all guarantees and other instruments or agreements entered into by a reporting institution, where the institution promises (and is legally bound) to act as a substitute for customers' borrowing (includes credit arising from services obtained by customers from third parties) from another party, in the event the customers fail to honour obligations to third party. For risk-weighted asset computation purposes, "Direct Credit Substitutes" have a credit conversion factor of 100%. This broad category is divided into 2 sub-categories, as follows:-

(a) Standby Letters of Credit Serving as Financial Guarantee; and
(b) Other Direct Credit Substitutes.

The full interpretation of the breakdown items on Direct Credit Substitutes is given below:-

14.23.1 Standby Letters of Credit (L/C) Serving as Financial Guarantee

Refers to the amount of Standby L/C issued by a reporting institution on behalf of a customer, which promises to make funds available to the customer to fulfil obligations to settle borrowings (including payment of interest) from other parties.

14.23.2 Other Direct Credit Substitutes

Refers to all other direct credit substitutes which are not classifiable as Standby L/Cs issued. Included in this category are contingencies where the likelihood of crystallisation into actual liabilities is dependent on default on payment by the customer to third parties, including the following:-

(a) Guarantees of payment by customers like insurance agents, sales agents, etc. of insurance premiums, sales proceeds, etc. to third parties (beneficiaries);

(b) Bank guarantees in favour of the Royal Customs and Excise Department to cover the risk of non-payment by customers for customs and excise duties, sales tax, service tax, penalties and other claims; and

(c) Bank guarantees in favour of Tenaga Nasional Berhad to cover non-payment by customers for electricity bills, etc.

14.24 Transaction Related Contingencies (50%)

Refers to the outstanding amount of contingencies where crystallisation into actual liabilities is dependent on the occurrence or non-occurrence of specific events other than a default in payment by the customer. This broad item is divided into 3 parts, as follows:-

(a) Performance/Bid Bonds;
(b) Transaction Related Standby Letters of Credit; and
(c) Other Transaction-Related Contingencies.

For the risk-weighted asset computation purposes, “Transaction related contingencies” have a credit conversion factor of 50%. This category is divided into 3 sub-categories, as follows:-

(a) Performance/Bid Bonds;
(b) Transaction Related Standby Letters of Credit; and
(c) Other Transaction Related Contingencies.

14.24.1 Performance/Bid Bonds

Refers to the outstanding amounts of bonds issued by a reporting institution on behalf of customers which are required to perform certain contractual obligations to third parties, failing which financial compensation or penalties are payable to the latter. The bonds issued relate to the payment of such compensation or penalty.

14.24.2 Transaction Related Standby Letters of Credit (L/C)

Refers to the outstanding amount of Standby L/C issued by a reporting institution on behalf of customers, where the risk of loss (by the reporting institution) is independent of the credit-worthiness of the customers but dependent on the occurrence or non-occurrence of a transaction. Default in payment by the customer by itself does not result in the standby L/C being invoked.

14.24.3 Other Transaction Related Contingencies

Refers to the value of all other transaction-related contingencies not included under items Performance/Bid Bonds and Transaction Related Standby Letters of Credit. Include warranties-related contingencies.

14.25 Trade Related Contingencies (20%)

Refers to the outstanding amount of contingencies which may crystallise into liabilities due to financial facilities and services provided by a reporting institution to customers to facilitate payments or otherwise enhance trading of goods. Such contingencies are self-liquidating. Trade contingencies are assigned a credit conversion factor of 20% in the computation of risk weighted assets. This broad category is divided into 3 sub-categories, as follows:-

(a) Documentary Letters of Credit;
(b) Shipping Guarantees; and
(c) Other Trade-Related Contingencies.

14.25.1 Documentary Letters of Credit

Refers to the outstanding documentary credits collateralised by the underlying shipment of goods.

14.25.2 Shipping Guarantees

Refers to guarantees issued by a reporting institution to customers, whereby the reporting institution agrees to indemnify the named shipping agents against liabilities rising from the release of goods without production of bills of lading and/or other shipping documents by the receiving party. Exclude shipping guarantees where the reporting institution has issued documentary L/Cs in favour of the exporter relating to the same transaction. In such instances, the documentary L/Cs and shipping guarantees shall be integrated and classified under item Documentary Letters of Credit.

14.25.3 Other Trade Related Contingencies

Refers to all other contingencies relating to trading of goods which are not classifiable in items Documentary Letters of Credit and Shipping Guarantees.

14.26 Assets Sold with Recourse and Commitments with Certain Drawdown (100%)

Refers to outstanding value of assets sold by a reporting institution where recourse can be made to the institution in the event of defects in the assets, and to investment or purchase commitments entered into by the reporting institution, where drawdown is certain to occur.

For risk-weighted asset computation purposes, "Assets Sold With Recourse and Commitments with Certain Drawdown" have a credit conversion factor of 100%.

This item is divided into 6 parts as follows:-

(a) Loans Sold to Cagamas with Recourse;

(b) Sell Buy Back Agreement (SBBA);

(c) Other Assets Sold with Recourse;

(d) Forward Asset Purchases ;

(e) Unpaid Portion of Partly-paid Shares/Securities; and

(f) Other commitments with certain drawdown.

14.26.1 Loans Sold to Cagamas with Recourse

Refers to only the **Islamic** housing and other types of loans originated by a reporting institution which are sold to Cagamas Berhad on terms that in the event of default by the loan customers, the loans can be repurchased by the reporting institution. It should be noted that item Housing Loans/Financing refers to housing loans carried in the books of reporting institution excluding only **Islamic** housing loans sold to Cagamas with recourse. Similarly, all other types of loans reported on-balance sheet should exclude, if applicable, **Islamic** amounts sold to Cagamas Berhad.

The item "Loans Sold to Cagamas with Recourse" is derived from the sum of six other reported items, as follows:-

(a) Housing Loans Sold to Cagamas

Refers to housing loans of a reporting institution which are sold to Cagamas Berhad on the terms that in the event of default by the loan customers, the loans can be repurchased by the reporting institution.

(b) Industrial Property Loans Sold to Cagamas

Refers to the industrial property loans of a reporting institution which are sold to Cagamas Berhad on the terms that in the event of default by the loan customers, the loans can be repurchased by the reporting institution.

(c) Commercial property Loans Sold to Cagamas

Refers to commercial property loans of a reporting institution which are sold to Cagamas Berhad on the terms that in the event of default by the loan customers, the loans can be repurchased by the reporting institution.

(d) Hire-purchase Receivables Sold to Cagamas

Refers to hire-purchase receivables of a reporting institution which are sold to Cagamas Berhad on the terms that in the event of default by the loan customers, the loans can be repurchased by the reporting institution.

(e) Leasing Receivables Sold to Cagamas

Refers to leasing receivables of a reporting institution which are sold to Cagamas Berhad on the terms that in the event of default by the loan customers, the loans can be repurchased by the reporting institution.

(f) Other Loans Sold to Cagamas

Refers to other types of loans of a reporting institution not classifiable under (a) to (e) above which are sold to Cagamas Berhad on the terms that in the event of default by the loan customers, the loans can be repurchased by the reporting institution.

14.26.2 Sell Buy Back Agreement (SBBA)

SBBA is an Islamic repurchase agreement transaction whereby a party (SBBA seller) sell Islamic securities at an agreed price to the other party (SBBA buyer) and subsequently the SBBA buyer and SBBA seller enter into another agreement thereon whereby the former promises to sell and latter to buy back the securities on a specified future date and at an agreed price.

14.26.3 Other Assets Sold with Recourse

Refers to other assets (i.e. not loans sold to Cagamas) which are sold by a reporting institution, where the credit risk associated with the assets remains with the reporting institution due to recourse provisions. Exclude rediscounting of other bank's BAs, which shall be excluded from the capital framework.

14.26.4 Forward Asset Purchases

Refers to commitments made by a reporting institution to purchase assets from other persons where drawdown is certain. Exclude forward purchases of foreign currencies, equities and commodities, as these are reportable in items Foreign Exchange Related Contracts and Miscellaneous Commitments and Contingencies respectively.

14.26.5 Unpaid Portion of Partly-Paid Shares/Securities

Refers to the outstanding amount of commitments made by a reporting institution to pay the unpaid portion of shares or other securities which are partially paid-up.

14.26.6 Other Commitments with Certain Drawdown

Refers to all other commitments made by a reporting institution to make payments for purchases or investments, where drawdown is certain.

14.27 Underwriting Obligations (50%)

Refers to obligations of a reporting institution arising from underwriting agreements relating to the issue of securities (shares, debt securities and other financial instruments falling within the definition of securities), where the reporting institution is obliged to subscribe or purchase the securities in the event the securities are not taken up by target investors when issued. This item is assigned a credit equivalent factor of 50% for purposes of computing the risk weighted assets.

"Underwriting Obligations" comprised the following items:-

(a) Underwriting of Issues of Short-term Debt Securities;
(b) Underwriting of Issues of Long-term Debt Securities;
(c) Underwriting of Issues of Shares; and
(d) Other Underwriting Agreements.

14.27.1 Underwriting of Issues of Short-term Debt Securities under Long-term Facilities

Refers to a reporting institution's obligations as an underwriter of issues of short-term debt securities but not limited to facilities known as Revolving Underwriting Facilities and Notes Issuance Facilities (with underwriting provisions). "Short-term debt securities" means debt securities issued for original maturity periods of one year or less.

The following points should be noted:-

(a) An underwriter may or may not hold debt securities underwritten by itself. If the underwriter (i.e. reporting institution) is a holder of short-term debt securities, its underwriting obligation (reportable in item Underwriting of Issues of Short-Term Debt Securities under Long-term Facilities) is reduced by the amount held (at face value). If the underwriter is not a holder, its full underwriting obligation under the long-term facility should be reported in item Underwriting of Issues of Short-Term Debt Securities under Long-term Facilities. In the event that the amount of debt securities held is more than the underwriting obligation, the amount to be reported in item

Underwriting of Issues of Short-Term Debt Securities under Long-term Facilities should be equal to zero, and not a negative figure.

(b) The holding of debt securities under a specific issuance facility should not be netted off against the underwriting obligation of another specific issuance facility.

14.27.2 Underwriting of Issues of Long-term Debt Securities

Refers to a reporting institution's obligations as an underwriter of issues of long-term debt securities, by whatever name called. "Long-term debt securities" means debt securities which have maturity periods longer than one year. The underwriting obligation is extinguished once the securities are issued and subscribed by investors, which may include the reporting institution itself.

In the case where long-term debt securities are issued in tranches, the underwriting obligation of unissued tranches should continue to be reported in this item.

The underwriting of issues of long term debt securities comprises of two other reported line items as follows:-

(a) Convertible long-term debt securities

Refers to a reporting institution's obligations as an underwriter of convertible long-term debt securities which are convertible into shares upon maturity period.

(b) Non-Convertible long-term debt securities

Refers to a reporting institution’s obligations as an underwriter of non-convertible long term debt securities which are not convertible into shares upon maturity period.

14.27.3 Underwriting of Issues of Shares

Refers to a reporting institution’s obligations as an underwriter of issues of shares.

14.27.4 Other Underwriting Agreements

Refers to a reporting institution's obligations as an underwriter of issues of securities (e.g. warrants) which are not classifiable in item Underwriting of Issues of Short-term Debt Securities under Long-term Facilities, Underwriting of Issues of Long-term Debt Securities or item Underwriting of Issues of Shares.

14.28 Credit Extension Commitments

Refers to the outstanding amount of credit extension commitments made by a reporting institution under "Formal Standby Facilities/Credit Lines" , non-standby credit facilities (i.e. undrawn portion of loans), and "Other Credit Extension Commitments". The interpretation of these types of commitments is given below.

Items Credit Extension Commitments are respectively broken down by original maturity (OM) as follows: -

(a) Credit Extension Commitments with OM of up to 1 year; and

(b) Credit Extension Commitments with OM of more than 1 year

The breakdown by OM is important, as the credit conversion factor applicable in the computation of risk weighted assets, depends on the OM. The credit conversion factor for credit extension commitments is:-

(a) 0% for those commitments which are cancellable unconditionally at any time or are due to be reviewed within one year; and
(b) 50% for those commitments which have an original maturity of more than one year.

14.28.1 Formal Standby Facilities and Credit Lines

Refers to the commitments of a reporting institution to provide credit to customers under formal standby facilities and credit lines, such as credit lines in the form of Letters of Credit (other than those reportable elsewhere), etc., where the customer may at any time request for drawdown in accordance with specified procedures in agreements made with the reporting institution. Its breakdown items by maturity, i.e. Formal Standby Facilities and Credit Lines (OM of up to one year) and Formal Standby Facilities and Credit Lines (OM of more than one year) are also reported.

14.28.2 Undrawn Loans

Refers to the outstanding amount of the undrawn amount of all types of credit facilities granted to customers, as follows:-

(a) Term loans (hire purchase, leasing, block discounting, bridging, syndications, factoring, personal, housing and other term loans)
(b) Trust receipt facilities
(c) Floor stocking facilities
(d) Overdraft facilities

(e) Revolving credit facilities

(f) Credit card facilities

(g) Staff loans

(h) Other loans

(i) FX loans/credit facilities

In general, the "undrawn amount" is defined as the "approved limit of the facilities" less the "utilised amount (drawdown amount)" of the credit facilities.

Its breakdown by original maturity (up to 1 year, and more than 1 year) are reported as items Undrawn Loans (OM Up To One Year) and Undrawn Loans (OM More Than One Year) respectively.

From another angle, the item "undrawn loans" is broken down into three other items, as follows:-

(a) Undrawn Term Loans;

(b) Undrawn Overdraft Facilities; and

(c) Other Undrawn Loans.

The full interpretation of the breakdown items of “Undrawn loans” is given below.

(a) Undrawn Term Loans

Refers to the outstanding amount of the undrawn/unutilized portion of loans granted as "term" loans to customers. Its breakdown by OM of "up to one year" and "more than one year" are reported as Undrawn Term Loans with OM Up To One Year and Undrawn Term Loans with OM More Than One Year respectively.

It should be noted that items Undrawn Term Loans with OM Up To One Year are respectively part of items Undrawn Loans. "Term Loans" has the following meaning:-

Term Loans/ Financing refers to the outstanding amount of RM-denominated loans/financing extended to all customers, on terms, which include the following: -

(a) The loans have a fixed period to maturity, normally more than one year;

(b) The loans are granted for a specified purpose stipulated in the respective loan agreements; and;

(c) The loans are repayable on the basis of fixed schedules, either on installment or bullet repayment basis.

Term Loans/Financing is further sub-divided (i.e. amount is derived from the sum of) into the following types of loans[39]: -

(a) RM Hire Purchase Receivables

(b) RM Leasing Receivables

(c) RM Block Discounting Receivables

(d) RM Bridging Loans

(e) RM Syndicated Term Loans/Financing

(f) RM Factoring Receivables

[39] Please to refer to the end part of Notes for Guidance for the full interpretation of types of term loans

(g) RM Personal Loans

(h) RM Housing Loans

(i) RM Other Term Loans

(b) Undrawn Overdraft Facilities

Refers to the unutilized amount of overdraft facilities extended by a reporting institution to its customers. All overdraft facilities are deemed to be for original maturity of "up to one year". Therefore, Undrawn Overdraft Facilities is the same as Undrawn Term Loans with OM Up To One Year.

(c) Other Undrawn Loans

Refers to the undrawn amount of other types of loans, excluding term loans and overdraft facilities. Its breakdown items by OM of "up to 1 year" and "more than 1 year" are reported as Other Undrawn Loans with OM Up To One Year and Other Undrawn Loans with OM More than One Year respectively.

14.28.3 Other Credit Extension Commitments

Refers to all other credit extension commitments of a reporting institution not included elsewhere. Its breakdown items by original maturity of "up to one year" and "more than one year" are reported as Other Credit Extension Commitments with OM Up to One Year and Other Credit Extension Commitments with OM More Than One Year respectively.

14.29 Foreign Exchange Related Contracts

Refers to the outstanding value of all contracts entered into by a reporting institution with other persons (including overseas branches) involving the exchange of RM against FX, or exchange of one FX against another FX, at a future date (i.e. date after the report date). Includes contracts where the exchange of principal is merely notional. It should be noted that the item is a broad categorization. For the purposes of this guideline, this broad item is sub-divided into six major components, as follows:-

(a) [Contracts involving] Purchase/Receipt of FX against RM
(b) [Contracts involving] Miscellaneous Forward Purchase of FX
(c) [Contracts involving] Sale/Payment of FX against RM;
(d) [Contracts involving] Miscellaneous Forward Sales of FX;
(e) [Contracts involving] Third Currency Transactions (i.e. exchange of one FX against another FX); and
(f) [Contracts involving]Third Currency Miscellaneous Forward Transactions.

The full interpretation of the breakdown item of “foreign exchange related contracts” is given below.

14.29.1 [Contracts involving] Purchase/Receipt of FX against RM

Refers to all foreign exchange related contracts of a reporting institution under which the reporting institution is required or entitled to purchase or receive foreign currency from counterparties, against RM at a future date. This item is divided into 3 sub-groups, namely:-

(a) FX Purchased Spot & Tom

Refers to the outstanding amount of FX purchased with RM under outright spot and value tomorrow transactions which are receivable by a reporting institution on the spot date (two business days after contract date) and the next business day respectively. Exclude spot leg of swap transactions entailing purchase of FX spot. The RM equivalent amount of FX reported should be based on the transacted FX/RM exchange rate.

The above item is broken down by customer/counterparty[40], as follows:-

i) FX Purchased spot & tom from BNM
ii) FX Purchased spot & tom from CB
iii) FX Purchased spot & tom from IB
iv) FX Purchased spot & tom from MB
v) FX Purchased spot & tom from DNBE
vi) FX Purchased spot & tom from FBI
vii) FX Purchased spot & tom from FNBE

(b) FX Purchased Forward (Outright)

Refers to the outstanding amount of FX purchased with RM under forward contracts, whereby a reporting institution is entitled to receive FX in exchange for RM at a pre-determined exchange rate at a future date longer than the spot date, normally in terms of number of months after such spot date.

[40] BNM – Bank Negara Malaysia, CB – Commercial Banks, IB – Islamic Banks, MB – Merchant Banks plus Investment Banks, DNBE – Domestic Non Bank Entities, FBI – Foreign Banking Institutions and FNBE – Foreign Non Bank Entities.

Such transactions may be described as outright forwards. The RM equivalent amount of FX should be based on the transacted FX/RM exchange rate.

The above item is broken by customer/counterparty, as follows:-

i) FX Purchased forward from BNM
ii) FX Purchased forward from CB
iii) FX Purchased forward from IB
iv) FX Purchased forward from MB
v) FX Purchased forward from DNBE
vi) FX Purchased forward from FBI
vii) FX Purchased forward from FNBE

(c) FX Receivable in Currency Swaps

Refers to the outstanding amount of FX receivable from an exchange against RM at a future date under all kinds of "swap" transactions. The Principal amount of swap may be physical or notional.

The above item is broken down by customer/counterparty, as follows:-

i) FX Receivable in Currency Swaps from BNM
ii) FX Receivable in Currency Swaps from CB
iii) FX Receivable in Currency Swaps from IB
iv) FX Receivable in Currency Swaps from MB
v) FX Receivable in Currency Swaps from DNBE
vi) FX Receivable in Currency Swaps from FBI
vii) FX Receivable in Currency Swaps from FNBE

14.29.2 [Contracts involving] Miscellaneous Forward Purchase of FX

Refers to the outstanding amount of FX purchased or receivable, whether on an optional or obligatory basis, to be delivered at a future date in exchange for RM, excluding FX transactions classifiable in the line items of FX Purchased Spot & Tom, FX Purchased Forward (outright), FX Receivable in Currency Swaps. Included in the item Miscellaneous Forward Purchase of FX are FX Futures Contracts Purchased, FX Put Options Written, FX Call Options Purchased and Other Commitments to Purchase or Receive FX/RM.

The above item is broken down by customer/counterparty, as follows:-

(a) Miscellaneous forward purchase of FX from BNM
(b) Miscellaneous forward purchase of FX from CB
(c) Miscellaneous forward purchase of FX from IB
(d) Miscellaneous forward purchase of FX from MB
(e) Miscellaneous forward purchase of FX from DNBE
(f) Miscellaneous forward purchase of FX from FBI
(g) Miscellaneous forward purchase of FX from FNBE

14.29.2.1 FX Futures Contracts Purchased

Refers to outstanding amount of futures contracts purchased by a reporting institution, whereby the institution is obliged to buy FX in exchange for RM at a future date at a specified exchange rate stipulated in the contract. A "futures contract" is a standardized contract tradable in a formal futures or other exchange (e.g. SIMEX, CME, etc.), whereas a forward contract (effectively the same as a futures contract) is not standardized (i.e. the size of the contract can differ in different transactions) and not tradeable in an exchange.

14.29.2.2 FX Put Option Written

Refers to the outstanding amount of FX which a reporting institution is obliged to buy against RM at a specified rate from counterparties in put options contracts written by the institution.

14.29.2.3 FX Call Option Purchased

Refers to the outstanding amount of FX which a reporting institution has the right to buy against RM at a specified rate from counterparties in call options contracts written by such counterparties.

14.29.2.4 Other Commitments to Purchase/Receive FX against RM

Refers to the outstanding amount of FX which a reporting institution has acquired, has a right to acquire, is obliged to acquire, which has to be delivered at a future date in exchange for RM, in transactions which cannot be classified as being under spot purchases, forward purchase outright, currency swaps, futures contracts and options contracts, as defined above.

14.29.3 [Contracts involving] Sale/Payment of FX against RM

Refers to all foreign exchange related contracts (RM'000) of a reporting institution under which the reporting institution is required or entitled to sell or pay FX to counterparties, against RM at a future date. Like item [Contracts involving] Purchase/Receipt of FX Against RM, item [Contracts involving] Sale/Payment of FX against RM is divided into 3 sub-groups:-

(a) FX Sold Spot & Tom

Refers to the outstanding amount of FX sold by a reporting institution in exchange for RM under spot and value tom transactions, which are deliverable by the reporting institution on the spot date (i.e. two business days after contract date) and the next business day, respectively. Exclude spot leg of money market swap transactions entailing the sale of FX spot. The RM equivalent amount FX reported should be based on the transacted FX/RM exchange rate.

The above item is broken down by customer/counterparty, as follows:-

i) FX Sold Spot & Tom to BNM
ii) FX Sold Spot & Tom to CB
iii) FX Sold Spot &Tom to IB
iv) FX Sold Spot & Tom to MB
v) FX Sold Spot & Tom to DNBE
vi) FX Sold Spot & Tom to FBI FX
vii) Sold Spot & Tom to FNBE

(b) FX Sold Forward (Outright)

Refers to the outstanding amount of FX sold by a reporting institution in exchange for RM under forward contracts, whereby the reporting institution is required to deliver the FX a future date which is more than two business days after the contract date, usually in terms of months after the spot date. Such transactions may also be described as outright forwards. The RM equivalent amount of FX should be based on the transacted FX/RM exchange rate.

The above item is broken down by customer/counterparty, as follows:-

i) FX Sold Forward (Outright) to BNM
ii) FX Sold Forward (Outright) to CB
iii) FX Sold Forward (Outright) to IB
iv) FX Sold Forward (Outright) to MB
v) FX Sold Forward (Outright) to DNBE
vi) FX Sold Forward (Outright) to FBI
vii) FX Sold Forward (Outright) to FNBE

(c) FX Payable in Currency Swaps

Refers to the outstanding amount of FX payable in exchange for RM at a future date under all kinds of swap transactions. The principal amount of exchange may be physical or notional.

The item is broken down by customer/counterparty, as follows:-

i) FX Payable in Currency Swaps, to BNM
ii) FX Payable in Currency Swaps, to CB
iii) FX Payable in Currency Swaps, to IB
iv) FX Payable in Currency Swaps, to MB

v) FX Payable in Currency Swaps, to DNBE

vi) FX Payable in Currency Swaps, to FBI

vii) Payable in Currency Swaps, to FNBE

14.29.4 [Contracts involving] Miscellaneous Forward Sales of FX

Refers to the outstanding amount (RM'000) of FX sold or payable, whether on an optional or obligatory basis, to be delivered at a future date in exchange for RM, excluding FX transactions classifiable in the line items of FX Sold Spot & Tom, FX Sold Forward (Outright), FX Payable in Currency Swaps (and sub-items). Included in the item [Contracts involving] Miscellaneous Forward Sales of FX are FX Futures Contracts Sold, FX Call Option Written, FX Call Option Sold and Other Commitments to Sell/Pay FX against RM.

The Miscellaneous Forward FX Sale is broken down into the following customer or counterparty categories; BNM, CB, IB, MB, DNBE, FBI and FNBE.

14.29.4.1 FX Futures Contracts Sold

Refers to the outstanding amount of futures contracts sold by a reporting institution, whereby the institution is obliged to sell FX in exchange for RM at a future date at a specified exchange rate stipulated in the contract. A "future contract" is a standardized contract tradeable in an organised futures or other exchange market (e.g. SIMEX, CME, etc.), whereas a forward contract is not standardized and is not tradeable in an exchange.

14.29.4.2 FX Call Option Written

Refers to the outstanding amount of FX which a reporting institution is obliged to sell against RM at a specified rate from counterparties in call options written by the reporting institution.

14.29.4.3 FX Call Option Sold

Refers to the outstanding amount of FX which a reporting institution has the right to sell against RM at a specified rate from counterparties in put options contracts written by such counterparties.

14.29.4.4 Other Commitments to Sell/Pay FX Against RM

Refers to the outstanding amount of FX which a reporting institution has disposed of, has a right to dispose of, is obliged to dispose of, which has to be delivered at a future date in exchange for RM, in transactions which cannot be classified as being under spot sales, forward sales (outright), currency swaps, futures contracts and options contracts, as defined above.

14.29.5 [Contracts involving] Third Currency Transactions

Refers to all foreign exchange related contracts of a reporting institution under which the reporting institution is required or entitled to buy or sell or pay or receive a particular foreign currency against another foreign currency. Report only the RM equivalent of the commodity currency which is bought/receivable or sold/payable. This broad item is divisible into 3 sub-groups, as follows:-

(a) Third Currencies - Spot & Tom Transactions;

(b) Third Currencies - Forward Contracts; and

(c) Third Currencies - Swaps.

The full interpretation of the above breakdown item is given below.

14.29.5.1 Third Currencies – Spot & Tom Transactions

Refers to the outstanding amount of FX bought on spot and tom basis against another FX. A reporting institution may have buy, say USD in a few transactions involving different other FX (e.g. Yen, DM). All these transactions can be summed up as total USD bought before converting the amount into RM for reporting purposes. Added on to the USD bought would be other currencies bought on spot/tom basis. It should be noted that one spot/tom deal should be counted (reported) only once.

14.29.5.2 Third Currencies – Forwards Contracts

Refers to the outstanding amount (RM'000) of FX bought forward against other FX. A reporting institution may have bought, say USD forward in a few transactions involving different other FX. All these transactions can be summed up as total USD bought forward before converting the amount into RM for reporting purposes. Added on to the USD bought forward would be other currencies bought forward. It should be noted that each forward deal should be counted (reported) only once.

14.29.5.3 Third Currencies – Swap

Refers to the outstanding amount of FX receivable at a future date under swap agreements, against other FX. A reporting institution may have entered into swap agreements to exchange, say to receive USD on maturity against other different FX in a few transactions. All these transactions can be summed up by total USD receivable. Added on to this would be other different transactions (agreements) in which the USD is payable. Each swap transaction should be counted (reported) only once.

This item is divided into 4 parts, as follows:-

(a) Third Currencies - Forward Sales in MM Swaps

Refers to the outstanding amount (RM'000) of FX receivables on the second leg of a money market offer swap of FX/FX. A "money market offer swap" of FX/FX loans two legs. On the first leg, FX is bought spot against FX. At the same time, the FX is sold forward against FX.

(b) Third Currencies - Spot Purchases in MM Swaps

Refers to the outstanding amount of FX receivables on the first leg of a money market offer swap of FX/FX. A "money market offer swap" of FX/FX has two legs. On the first leg, FX is bought spot against FX. At the same time, the FX is sold forward against other FX.

(c) Third Currencies - Gross Interest Rates Swaps

Refers to the outstanding of FX receivables at the end of a swap agreement which involves the exchange gross currency interest payment between a reporting institution and the counterparty at periodic intervals during the tenure of the swap agreement.

(d) Third Currencies - Other Swaps

Refers to the outstanding amount of FX receivables at a future date under swap agreements, against other FX, excluding FX transactions classifiable in the line items of Third Currencies - Forward Sales in MM Swaps, Third Currencies - Spot Purchases in MM Swaps and Third Currencies - Gross Interest Rates Swaps.

14.29.6 [Contracts involving] Third Currency Miscellaneous Forward Transactions

Refers to the outstanding amount of all other foreign exchange related contracts not classifiable as spot/tom purchases, forward purchases (outright) and swaps. Included would be futures contracts, options written, options purchased, other commitments, involving the buying/selling or receiving/paying FX against FX. This broad item is divisible into 4 sub-groups, as follows:-

(a) Third Currencies - Futures Contracts;
(b) Third Currencies - Option Written;
(c) Third Currencies - Option Purchased; and
(d) Third Currencies - Other Commitments.

The full interpretation of the above breakdown items is given below.

14.29.6.1 Third Currencies - Futures Contracts

Refers to the outstanding value of all futures contracts purchased and sold, where the futures contracts involve the delivery of one FX against other FX. This item is divided into 2 parts, as follows:-

(a) Third Currencies Futures Contracts Purchased

Refers to the outstanding value of futures contracts purchased by a reporting institution, which required the delivery of one FX quoted in terms of another FX at a future date.

(b) Third Currencies Futures Contracts Sold

Refers to the outstanding value of futures contracts sold by a reporting institution, which require the acceptance of delivery on a future date of one FX quoted in terms of another FX at a specified rate.

14.29.6.2 Third Currencies – Option Written

Refers to the outstanding amount of all put and call options written by a reporting institution, involving the possible exchange of one FX against another FX at a future date.

14.29.6.3 Third Currencies – Option Purchased

Refers to the outstanding amount of all put and call options purchased by a reporting institution, involving the possible exchange of one FX against another at a future date.

14.29.6.4 Third Currencies – Other Commitments

Refers to the outstanding amount of all other types of foreign exchange related contracts involving the exchange/possible exchange of one FX against another FX, not classifiable elsewhere (i.e. not included in Third Currencies – Spot & Tom Transactions, Third Currencies - Forward Contracts, Third Currencies - Swaps, Third Currencies - Futures Contracts, Third Currencies - Option Written and Third Currencies - Option Purchased.

### (b) Credit Equivalent of Off-Balance Sheet Items

14.30 OBS Claims Assigned 0%

This item is divided into categories as given in the template. The interpretation of these breakdown item is given below:-

14.30.1.1 OBS Claims on Federal Government and BNM

Refers to the credit equivalent of off-balance sheet claims on BNM and the Federal Government, other than those collateralised by cash/securities of the Federal Government/BNM and claims guaranteed by the Federal Government/BNM.

14.30.1.2 OBS Claims on OECD Central Government

Refers to the credit equivalent of off-balance sheet claims on OECD Central Governments and Central Banks.

14.30.1.3 OBS Claims on Non-OECD Central Government/Banks in Own Currency

Refers to the credit equivalent of off-balance sheet claims on non-OECD Central Governments and Central Bank denominated in the national currencies of such countries.

14.30.1.4 OBS Claims Collateralised by Cash and Securities Issued by Federal Government/BNM/OECD Central Government

Refers to the credit equivalent of off-balance sheet claims which are collateralised by cash and/or securities issued by the Federal Government/BNM/OECD Central Governments/Central Banks.

14.30.1.5 OBS Claims Guaranteed by Federal Government/BNM/OECD Central Government/OECD Central Banks

Refers to the credit equivalent of off-balance sheet claims which are guaranteed by Federal Government/BNM/OECD Central Government/OECD Central Banks.

14.31 OBS Claims Assigned 10% RW

This item is divided into a category as given in the template. The interpretation of these breakdown items is given below:-

14.31.1.1 OBS Claims on Cagamas

Refers to the credit equivalent of off-balance sheet claims on Cagamas Berhad, if any.

14.32 OBS Claims Assigned 20% RW

This item is divided into nine categories as given in the template. The interpretation of these breakdown items is given below:-

14.32.1.1 OBS Claims on Securities Not Issued by BNM/Government with DBI

Refers to the credit equivalent of off-balance sheet claims on securities not issued by BNM/Government with domestic banking institutions.

14.32.1.2 OBS Claims Collateralised by Non-Equity Security Issued by DBI

Refers to the credit equivalent of off-balance sheet claims collateralised by non-equity securities issued by domestic banking institutions.

14.32.1.3 OBS Claims Guaranteed by DBI

Refers to the credit equivalent of off-balance sheet claims guaranteed by domestic banking institutions.

14.32.1.4 OBS Claims on OECD Bank

Refers to the credit equivalent of off-balance sheet claims on OECD banks and such other off-balance sheet claims guaranteed or collateralised by securities issued by OECD banks.

14.32.1.5 OBS Claims on Multilateral Development Bank

Refers to the credit equivalent of off-balance sheet claims on multilateral development banks and other off-balance sheet claims guaranteed or collateralised by securities issued by multilateral development banks.

14.32.1.6 OBS Claims on DFIs and Building Society

Refers to the credit equivalent of off-balance sheet claims on domestic financial institutions (DFI) and other off-balance sheet claims guaranteed by/or collateralised by securities issued by the DFIs.

14.32.1.7 OBS Claims on Non-OECD Banks with Remaining Maturity <= 1 year

Refers to the credit equivalent of off-balance sheet claims on non-OECD banks and other off-balance sheet claims guaranteed by such non-OECD banks, where the claims have a remaining maturity of one year or less.

14.32.1.8 OBS Claims on Domestic Non-Central Government and Other Public Sector

Refers to the credit equivalent of off-balance sheet claims on domestic non-central Government and other public sector.

14.32.1.9 OBS Claims on OECD Public Entities

Refers to the credit equivalent of off-balance sheet claims on the OECD public entities and other off-balance sheet claims guaranteed by such public entities.

14.33 OBS Claims Assigned 50% RW

This item is divided into categories as given in the template. The interpretation of these breakdown items is given below.

14.33.1.1 OBS Housing Loan Secured by First Charge

Refers to the credit equivalent of off-balance sheet claims on housing loans secured by first charge on residential property.

14.33.1.2 OBS Claims on FX and Interest Rate Contracts with Persons Under the 100% Risk Weight Category

Refers to the credit equivalent of foreign exchange contracts which are off-balance sheet items, entered into by a reporting institutions with persons in the 100% risk weight category.

14.33.1.3 OBS Claims on Loan to Non-Bank Private Sector Excluded from 100% Risk Weight Category

Refers to the credit equivalent of loans granted by a reporting institution to non-bank private sector excluded from the 100% risk weight category.

14.34 Foreign Exchange and Interest-rate Contracts with persons under the 0%,10% and 20% Risk Weight Categories

Refers to the credit equivalent of such contracts (which are off-balance sheet items) entered into by a reporting institution with the persons in the 0%, 10% and 20% risk weight categories.

14.35 OBS Assigned 100% RW

This item is divided into categories as given in the Chart. The interpretation of these breakdown items is given below.

14.35.1 OBS Claims on Non-OECD Bank with Remaining Maturity > 1 year

Refers to the credit equivalent of off-balance sheet claims on non-OECD banks except claims arising from foreign exchange and interest rate related contracts.

14.35.2 OBS Claims on Non-OECD Central Government Non Denominated in Own Currency

Refers to the credit equivalent of off-balance sheet claims on non-OECD Central Governments, where the claims are not denominated in the respective national currencies of these countries.

14.35.3 OBS Claims on Non-Bank Private Sector

Refers to the credit equivalent of off-balance sheet claims on the non-bank private sector.

14.35.4 OBS Items on nie

Refers to the credit equivalent of all other off-balance sheet items which are not classified elsewhere.

**Interpretation of Types of Term Loans**

(a) Hire Purchase Receivables

Refers to the total outstanding amount of RM-denominated receivables (excluding unearned interest) from hire purchase facilities granted by a reporting institution under hire-purchase agreements, whether or not subject to the provision of the Hire-Purchase Act 1967. Hire purchase facilities are usually granted to firms and individuals for the purchase of capital assets, particularly motor vehicles, machinery and equipment and consumer durables. Repayment is normally required in regular instalments. During the tenure of the credit facility, the reporting institution has a claim on the asset. Once the facility is fully settled, ownership of the asset is completely transferred to the borrower.

Out of the total amount of hire purchase receivables, the respective amounts attributable to hire purchase facilities extended to customers for the Hire Purchase Receivables for Purchase of Passenger Cars and Hire Purchase Receivables for Purchase of Consumer Durables are also required to be reported.

Hire Purchase Receivables for Purchase of Passenger Cars

Refers to the outstanding amount of hire purchase facilities extended to customers to purchase passenger cars (defined to include multipurpose vehicles like vans, that are fitted to carry passengers [not goods] but excluding buses and mini buses).

Hire Purchase Receivables for Purchase of Consumer Durables

Refers to the outstanding amount of hire purchase facilities extended to customers to purchase household consumer durables (e.g. television, furniture and other goods that are meant to be used or are usable over a relatively long period of time [exceeding one year]).

(b) Leasing Receivables

Refers to the total outstanding amount of receivables (equal to the net investment in the lease) from leasing facilities granted by a reporting institution under a leasing agreement, whereby the lessor (i.e. the reporting institution) allows the lessee (i.e. the borrower) to use an asset (usually equipment and machinery) for an agreed period of time. During the term of the lease, the lessee would be required to pay “lease rental” to the lessor. Usually ownership of the asset is transferred to the lessee by the end of the lease term. The “net investment in the lease” means the balance of the cash outflows (e.g. cost of acquisition of the asset) and cash inflows (e.g. rental receipts) relating to the lease, but exclude cash flows which related to insurance, maintenance and similar recurrent costs payable by the lessee. It should be noted that leasing facilities are granted on the basis of the financial lease concept.

(c) Block Discounting Receivables

Refers to the total outstanding amount of receivables (excluding unearned interest) from block discounting facilities granted by a reporting institution, normally to equipment dealers who had extended hire purchase or lease finance facilities to customers.

Some reporting institutions may extend hire purchase and leasing facilities to customers and subsequently obtain refinancing from other institution under a block discounting agreement. The discounting institutions can include such receivables under refinancing agreements with the original hire purchase financier or lessor in this item.

(d) Bridging Loans

Refers to the outstanding amount of loans/financing granted by a reporting institution, generally for the purpose of financing the development and construction phase of large capital assets, especially on landed property. Includes any syndicated participation by a reporting institution.

(e) Syndicated Term Loans/Financing

Refers to the total amount of loans/financing granted by a reporting institution as a participating lender under syndicated or consortium loan/financing agreements. In general there would be at least two lenders to one borrower in a syndicated facility. Includes club deals, which are a less formal sort of syndication. The reporting institution may or may not be the syndication manager. It should be noted that other types of credit facilities like leasing and bridging facilities may also be granted on a syndicated basis. For such syndications, the loans should be reported as Leasing Receivables, Bridging Loans and so on. The term "syndicated loans/financing" include only those syndicated facilities which are not included elsewhere.

(f) Factoring Receivables

Refers to the outstanding amount of receivables of a reporting institution arising from purchases of the book debts, normally trade receivables, of other persons. Include outstanding purchases, which allow recourse to the loan originator

(g) Personal Loans

Refers to a type of term loan granted by a reporting institution to individuals (i.e. Bumi, Non-Bumi and Foreign individuals) for non-specified personal purposes, for a fixed period (of one year or more) with a fixed repayment schedule. Exclude other types of loans or credit facilities to individual which are included elsewhere (e.g. overdraft, housing loan, etc.). This item should not be confused with the item Loans for Personal use that is meant to include all types of loans/financing (including overdrafts) granted to private individuals for non-specified purposes. The amount reported for item Personal Loans should not exceed that for item Loans for Personal Use.

(h) Housing Loans

Refers to the outstanding amount of loans/financing granted by a reporting institution to individuals (other than the staff of the institution) and other persons (if any) for the purchase of residential property. The "house" may be already occupied or semi-completed, or about to be built. The term "house" here includes flat units, condominium units and any other structure by whatever name called, which have been or would be constructed for human dwelling purposes. Exclude structures which are intended for storage of goods and equipment, or which are classifiable as commercial property (e.g. shops, factories, office). The amount of such loans should only include that amount of housing loans sold to Cagamas Berhad with recourse of the conventional banking operations.

Note:

(a) Islamic housing loans sold to Cagamas Berhad with recourse is reported separately under Housing Loans Sold to Cagamas.

(b) The amount reported for item Housing Loans should not exceed that for item Loans that includes all types of loans granted to purchase residential property, including housing loans and other term loans.

(i) Other Term Loans nie

Refers to the Term Loans which are not classified elsewhere.

# Appendices

## Appendix 1

### The RWCR requirement on Islamic banking window

**1. Capital Adequacy**

- The SPI[41] DFIs are required to observe a minimum capital adequacy requirement for Islamic banking portfolios in addition to the existing compliance on a consolidated basis, through separate compliance requirement for the Islamic banking portfolio that involve reallocation of current capital funds into the Islamic Banking Fund.
- The SPI DFIs are required to observe a minimum core capital ratio (CCR) of 4% and a minimum RWCR of 8% for Islamic banking portfolios, subject to a minimum Islamic Banking Fund (IBF) or whichever is higher. In addition, DFIs are required to disclose separately CCR and RWCR of Islamic banking portfolios in the institution's financial statements in addition to the consolidated CCR and RWCR. Please refer to the following illustration on the reallocation of capital:

[41] SPI refers to Islamic banking scheme provided by DFIs to conduct banking business based on Islamic principles

## Illustration: Reallocation of capital

| SPI DFIs | Core Capital* | | Capital Base* | | RWCR* | |
|---|---|---|---|---|---|---|
| | Consol.** | Islamic Banking | Consol.** | Islamic Banking | Consol.** | Islamic Banking |
| DFI A | 4,486,457 | 88,397 | 4,654,908 | 103,897 | 37,116,017 | 2,154,049 |
| DFI B | 1,705,427 | 31,945 | 2,287,416 | 56,445 | 17,354,366 | 1,809,459 |
| DFI C | 290,026 | 6,211 | 318,064 | 8,219 | 2,012,535 | 144,062 |
| | **CCR (%)** | | **RWCR (%)** | | **Required reallocation to IBF to comply with min. CCR of 4%*** | **Required reallocation to IBF to comply with min. RWCR of 8%*** |
| | **Consol.**** | **Islamic Banking** | **Consol.**** | **Islamic Banking** | | |
| DFI A | 12.08 | 4.10 | 12.54 | 4.82 | - | 68,427 |
| DFI B | 9.82 | 1.77 | 13.18 | 3.12 | 40,433 | 88,312 |
| DFI C | 14.41 | 4.31 | 15.80 | 5.71 | - | 3,306 |

Notes:

* Figures are in RM'000

** Consol. refers to consolidated figures

## 2. Islamic Banking Fund (IBF)

- IBF is specifically established to fund the operations of SPI. DFIs are required to maintain an IBF with a minimum requirement of **RM20 million**, which is part of the RM300 million absolute minimum capital.
- The IBF must be segregated from the capital designated for conventional banking operations and shall not be used for conventional banking operations.

## Appendix 2

**Illustration on limit of IT1 capital instruments**

| Capital structure of a DFI: | RM' million | |
|---|---|---|
| Reserves | 27 | |
| Common equity | 40 | |
| Non-cumulative perpetual preference shares (NCPPS) | 20 | |
| Minority interest of a consolidated subsidiary | 3 | |
| Goodwill | (5) | |
| Innovative Tier 1 instruments | 15 | → 15/100 = 15% |
| Total Tier 1 | 100 | |

In other words, the amount allowable as IT1 is the amount of Tier 1 capital (before the inclusion of IT1 capital, and net of goodwill) multiplied by 17.65% (whereby 17.65% =15%/85%). As per the example above, it is RM85m x 17.65% = RM15m.

## Appendix 3

### Illustration for determining the swap spread

1. Determining the swap spread:

| | | |
|---|---|---|
| INITIAL | | |
| Index basis (10-year MGS*) | 5.0% | Swap spread of 0.5% |
| Credit spread | 2.0% | |
| Coupon rate | 7.0% | |
| | | |
| STEPPED-UP | | |
| Index basis (10-year MYR swap rate) | 5.5% | |
| Adjusted credit spread to achieve initial rate of 7.0% | 1.5% | |
| Coupon rate | 7.0% | |

2. Calculating new coupon rate (Stepped-up)

| | |
|---|---|
| Index basis (10-year MYR swap rate) | 5.5% |
| Initial Credit spread | 2.0% |
| | 7.5% |
| Step-up (100 b.p) | 1.0% |
| | 8.5% |
| Less: Swap spread | (0.5%) |
| Stepped-up coupon rate | 8.0% |

* Index basis and figures used are for illustration purposes only

## Appendix 4

### Example 1 – Computation of risk weighted capital requirement for a portfolio of derivative contracts

***Transaction I***

Type of instrument : 8 Year Fixed-to-floating Cross Currency Interest Rate Swap (CCIRS)
Notional principal amount : RM1,000,000
Current date of report : 31 December 1997
Maturity date : 31 December 2000
Remaining maturity : 3 years
Replacement cost : RM350,000 (+ve)

***Transaction II***

Type of instrument : 6 Year Fixed-to-floating Interest Rate Swap (IRS)
Notional principal amount : RM1,000,000
Current date of report : 31 December 1997
Maturity date : 31 December 2002
Remaining maturity : 5 years
Replacement cost : RM200,000 (-ve)

| Type of instrument | CCIRS | IRS | Total |
|---|---|---|---|
| Credit equivalent exposure = positive replacement cost + potential future exposure | 350,000 + {1,000,000 x (2% + 7%)}<br>=350,000 + 90,000<br>=440,000 | 0 + {1,000,000 x (4%)}<br>= 0 + 40,000<br>= 40,000 | 480,000 |
| Risk-weighted asset (assume risk-weight of 50%) | 440,000 x 50%<br>= 220,000 | 40,000 x 50%<br>= 20,000 | 240,000 |
| Capital requirement (8%) | 220,000 x 8%<br>=17,600 | 20,000 x 8%<br>=1,600 | 19,200 |

**Example 2 – Calculation of residual maturity (for forward rate agreements and over-the-counter interest rate contracts of similar nature which are settled in cash on start date)**

A 3-month forward rate agreement for delivery in June 1997

```
1/1/97 (transaction date)                      start date

+---------+---------+---------+---------+---------+---------+---------+---------+--------+------>months
0         1         2         3         4         5         6         7         8        9

<-------- remaining contract period -----------------------> <- underlying tenor ------->

<-------- residual maturity for purpose of Table 1 ------------------------------------>
```

# Appendix 5

## Credit derivatives – requirements for effective risk transfer

1. For capital adequacy purposes, DFIs will only be regarded as having purchased protection if the credit risk of the reference asset has been transferred to the protection seller. Where DFIs have sold protection using a credit derivative, it should be assumed that 100 per cent of the credit risk is purchased irrespective of the range of credit events specified. The following are conditions for regulatory recognition of credit derivatives as risk mitigants, offered or transacted by DFIs:
   - i) Credit protection is legally binding, irrevocable & unconditional;
   - ii) Explicitly referenced to specific exposures and pool of exposures;
   - iii) Direct and non-contingent claim on protection seller;
   - iv) Credit risk transfer must not violate the terms and conditions relating to the reference asset;
   - v) Identity of party who decides credit event has occurred clearly defined;
   - vi) Cash settlement option is subject to robust valuation methods and processes;
   - vii) The right or ability to transfer the deliverable obligation is not impeded under the physical settlement option;
   - viii) For unfunded protection, the protection seller and the reference entity should be entities that do not belong to the same group; and
   - ix) Absence of any type of mismatch between the underlying credit risk and the credit protection.
2. In certain credit derivative transactions, it is difficult to achieve an effective hedge, as prescribed under condition (ix), due to the existence of mismatches and materiality thresholds. Hence, suitable adjustments shall be made to the extent of credit protection recognisable on account of such mismatches or thresholds, in accordance with **Appendix 6** on Limitations to Risk Transfer.

## Appendix 6

### Credit derivatives – limitations to risk transfer

#### Asset Mismatch

1. Asset mismatch[42] will arise if the underlying asset is different from the reference obligation (in case of cash settlement) or deliverable obligation (in case of physical settlement).
2. Where a DFI has purchased protection using a credit derivative and the reference obligation, or deliverable obligation, is different from the underlying asset, the amount of protection provided by the credit derivative may not be sufficient to constitute an effective hedge.
3. Credit derivative transaction requiring physical settlement - if the underlying asset is a deliverable obligation under the terms of the credit derivative contract, the DFI will be regarded as having purchased protection only if the credit event payment fully compensates any potential loss in the underlying asset. Where this is not the case, the rules relating to credit derivatives requiring cash settlement below, will apply.
4. Credit derivative transaction requiring cash settlement - a DFI may recognise the protection acquired as an effective hedge if the following criteria are met:
   i) the underlying asset and the reference obligation are obligations of the same reference entity or the underlying asset is an obligation of an entity that is unconditionally and irrevocably guaranteed by the reference entity to the credit derivative contract;
   ii) the underlying asset is an obligation under the terms of the credit derivative contract; and
   iii) the reference obligation is ranked pari passu or lower, in seniority of claim, relative to the underlying asset.

[42] For example, a credit derivative referenced to the credit quality of a corporate bond (i.e. the reference asset) may be used to offset the credit exposure on a loan (i.e. the underlying asset) to the same obligor. In such cases, the protection available to the protection buyer may be lost or diminished if the underlying asset defaults without a corresponding credit event in the reference asset, or if the post default residual value of the reference asset is higher than that of the underlying asset.

**Maturity Mismatch**

5. Where a DFI has purchased protection using a credit derivative and the maturity of the credit derivative contract is less than the maturity of the reference asset, the amount of protection that is recognised for capital adequacy purposes must be reduced. The amount of this reduction depends on the residual maturity of the credit derivative relative to the residual maturity of the underlying exposure.
6. For example, in the case of a 10-year exposure hedged by a credit derivative with a residual maturity of 9 years, 90% of the exposure may be risk-weighted on the basis of the protection seller, with the remaining 10% risk weighted on the basis of the underlying exposure.
7. At the minimum, the credit derivative would need to have a residual maturity of at least one year to apply this treatment, failing which, the positions are considered as unhedged.
8. Where a DFI has sold protection using a credit derivative, the tenor of the exposure to be reported shall be the remaining tenor of the credit derivative contract.

**Currency Mismatch**

9. Where the credit derivative is denominated in a different currency from the reference asset, the amount of credit protection recognised is reduced by 8% to take account of the contingent foreign currency risk.
10. The 8%, which reflects the potential fluctuation in the value of protection, is currently used for calculating capital charges of foreign exchange risk (standardised approach) under the market risk regime.
11. Since the protection will vary with currency movements, the foreign currency positions of credit derivatives should be revalued at least monthly.
12. The Bank may consider waiving the 8% discount factor where:
    - i) A DFI can demonstrate that it has hedged the contingent foreign currency risk; or

ii) The foreign currency positions of credit derivatives are revalued daily and protection is recognised only to the extent of the revalued amount. Foreign currency positions created by credit derivatives should also be recorded when measuring the capital requirement for the DFI's market risk exposure.

13. For a DFI that acts as an intermediary for credit derivatives, complete offsetting of the credit risk is allowed if the long and short positions are back-to-back and identical in all respects. However, the DFI is still required to hold capital against the counterparty acting as the Protection Seller, according to the latter's risk weight.

**Materiality Threshold**

14. The size and nature of any materiality thresholds specified in the credit derivative contract may also reduce the amount of credit risk transferred from the protection buyer to the protection seller. Materiality thresholds require a given level of loss to occur before the credit derivative is triggered. If these thresholds are set too high, it is possible that a significant loss could be incurred on the reference asset without a credit event payment being made. In these cases, the degree of risk transfer is significantly limited. Consequently, the products are ineligible for guarantee treatment by the protection seller and the protection buyer would be required to continue to hold capital against the reference asset, i.e. the protection buyer cannot reduce the risk weight of the reference asset to that of the protection seller.

15. When determining the amount of protection sold by the credit derivative, the protection seller should assume that any materiality thresholds written into the credit derivative contract do not reduce the acquired credit risk.