



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Transitional Arrangements for Regulatory Capital Treatment of Accounting Provisions for Development Financial Institutions

Applicable to:
Prescribed development financial institutions

Issued on: 9 December 2020

BNM/RH/PD 035-7

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PART A OVERVIEW

1 Introduction

- 1.1 This policy document sets out the transitional arrangements for regulatory capital treatment of accounting provisions.
- 1.2 Prescribed development financial institutions (DFIs) which elect to apply the transitional arrangements are allowed to add back a portion of the Stage 1 and Stage 2 provisions for expected credit losses (ECL) to Tier 1 capital over a four-year period from financial year beginning 2020 or a three-year period from financial year beginning 2021.
- 1.3 The transitional arrangements are consistent with the guidance issued by the Basel Committee on Banking Supervision on *“Regulatory treatment of accounting provisions – interim approach and transitional arrangement”* (March 2017) and *“Measures to reflect the impact of Covid-19”* (April 2020).

2 Applicability

- 2.1 This policy document is applicable to a DFI under the Development Financial Institutions Act 2002 (DFIA) that provides a written notification to the Bank in accordance with paragraphs 7.1 and 7.2.

3 Legal Provisions

- 3.1 The requirements in this policy document are specified pursuant to sections 41(1) and 116(1) of the DFIA.
- 3.2 The guidance in this policy document is issued pursuant to section 126 of the DFIA.

4 Effective date

- 4.1 This policy document comes into effect on 9 December 2020.

5 Interpretation

- 5.1 The terms and expression used in this policy document shall have the same meanings assigned to them in the DFIA and the policy document on *Capital Framework for Development Financial Institutions* issued on 22 February 2008 and as amended on 27 March 2018, unless otherwise defined in this policy document.
- 5.2 For the purpose of this policy document—
- “**S**” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement actions;
- “**G**” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted.

6 Related legal instruments and policy documents

- 6.1 This policy document must be read together with other relevant legal instruments and policy documents that have been issued by the Bank, in particular the policy document on *Capital Framework for Development Financial Institutions* issued on 22 February 2008 and as amended on 27 March 2018.

PART B TRANSITIONAL ARRANGEMENTS

7 Transitional arrangements for DFIs

Provisions for expected credit losses (ECL)

- S** 7.1 Where a DFI elects to apply the transitional arrangements as specified in paragraphs 7.5 to 7.8¹, the DFI shall submit a one-time written notification to the Bank containing the following information:
- (a) indication of its election –
 - (i) latest by 31 December 2020, where the transitional arrangements are applied for four financial years beginning on or after 1 January 2020; or
 - (ii) at least fourteen calendar days before the transitional arrangements are first applied, where the transitional arrangements are applied for three financial years beginning on or after 1 January 2021; and
 - (b) the intended first reporting period of the application of the transitional arrangements.
- S** 7.2 A DFI shall directly direct any application or notification under this policy document to–
- Pengarah
Jabatan Penyeliaan Perbankan
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur
- S** 7.3 Once a written notification has been submitted to the Bank under paragraph 7.1, a DFI shall apply the transitional arrangements throughout the four financial years or three financial years.
- S** 7.4 Notwithstanding paragraph 7.3, a DFI must obtain the Bank's prior written approval to disapply the transitional arrangements during the transitional period. In making the application, the DFI must clearly demonstrate that the transitional arrangements are no longer appropriate under exceptional circumstances.
- S** 7.5 A DFI is allowed to add back the amount of loss allowance measured at an amount equal to 12-month and lifetime expected credit losses to the extent they

¹ For the avoidance of doubt, the decision to apply the transitional arrangements may be made separately by each banking entity within a financial group.

are ascribed to non-credit-impaired exposures (hereinafter referred to as Stage 1 and Stage 2 provisions) to Tier 1 Capital.

- S** 7.6 The amount of Stage 1 and Stage 2 provisions to be added back to Tier 1 Capital shall be calculated as follows:

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

where—

Add-back Amount of Stage 1 and Stage 2 provisions eligible to be added back to Tier 1 Capital as at reporting date

Provision_{Current} Total Stage 1 and Stage 2 provisions as at reporting date

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

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

F Add-back factor for reporting financial year, as follows:

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

- S** 7.7 A DFI shall include the amount of Stage 1 and Stage 2 provisions not eligible to be added back to Tier 1 Capital in the calculation of Tier 2 Capital in accordance with paragraph 8.7(v) of the policy document on *Capital Framework for Development Financial Institution*.

- S** 7.8 A DFI applying the transitional arrangements shall disclose the following in its annual financial statement;

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

- (i) the capital ratios computed in accordance with the transitional arrangements; and
 - (ii) the capital ratios had the transitional arrangements not been applied.
- (c) where the Bank grants approval under paragraph 7.4, the decision to disapply the transitional arrangements.

- G** 7.9 An illustration of the transitional arrangements specified in paragraphs 7.6 to 7.7 is provided in Appendix 1.

8 Reporting requirements

- S** 8.1 A DFI shall submit periodic reports on its capital adequacy ratios using the reporting templates provided by the Bank.
- S** 8.2 A DFI shall submit the electronic copy of the reporting templates through STATsmart Submission module as specified in the policy document on *STATsmart Reporting Requirements on Data Submission for Reporting Entities*. Unless otherwise specified by the Bank, submission of the printed copy of the reporting templates is not required.
- S** 8.3 Where a DFI elects to apply the transitional arrangements as set out in paragraphs 7.5 to 7.8, the DFI shall–
- (a) complete two reporting forms “Capital Framework for Development Financial Institutions” on requirements–
 - (i) computed in accordance with the transitional arrangements; and
 - (ii) had the transitional arrangements not been applied; and
 - (b) in respect of paragraph 8.3(a)(i), report the add-back amount under Tier 1 Capital worksheet.

APPENDICES

Appendix 1 Illustration of transitional arrangements for provisions for expected credit losses (ECLs)

Scenario 1: Bank A, with 31 December financial year-end, -has elected to apply the transitional arrangements for four financial years. Bank A intends to apply the transitional arrangements starting from the reporting period as at 31 December 2020.

- On 1 January 2020 (base reference date), Bank A has–
 - RM100 million Stage 1 and Stage 2 provisions; and
 - RM125 million of total general provisions, of which RM25 million are regulatory reserves.

- As at 31 December 2020–
 - the amount of Stage 1 and Stage 2 provisions increased to RM150 million; and
 - the total general provisions increased to RM175 million, of which RM25 million are regulatory reserves

- As at 31 December 2022–
 - the amount of Stage 1 and Stage 2 provisions increased to RM200 million; and
 - the total general provisions increased to RM250 million, of which RM50 million are regulatory reserves.

For reporting period as at 31 December 2020, the amount of Stage 1 and Stage 2 provisions eligible to be added back to Tier 1 Capital is computed as follows:

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

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

For the avoidance of doubt, the total general provisions of RM125 million (as at 1 January 2020) continues to be allowed to be added to Tier 2 Capital.

For reporting period as at 31 December 2022, the amount of Stage 1 and Stage 2 provisions eligible to be added back to Tier 1 Capital is computed as follows:

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

The amount eligible to be added back to Tier 2 Capital shall comprise² the following:

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

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

Appendix 2 Implementation guidance on expected credit losses (ECLs)

1. **Can a DFI carrying on *Skim Perbankan Islam* (SPI) choose to apply the ECL transitional arrangements at the level of the SPI and not apply the transitional arrangements to the DFI at the entity level?**

[Paragraph 6.1 and Appendix 1 of the policy document on *Capital Framework for Development Financial Institutions*]

No, the DFI must apply the transitional arrangements at entity level.

2. **Where a DFI elects to apply the ECL transitional arrangements for three financial years, can the financial institution apply the requirements retrospectively for financial year beginning 2020?**

[Paragraph 7.1]

No.

3. **Where the Stage 1 and Stage 2 provisions are eligible to be added back to Tier 1 Capital, are the associated deferred tax assets excluded from the amount to be deducted from Tier 1 Capital?**

[Paragraph 7.6 of this policy document] and paragraph 8.11 of the policy document on *Capital Framework for Development Financial Institutions*]

No. A DFIs shall continue to deduct the full amount of the deferred tax assets in the calculation of Tier 1 Capital.

4. **A DFI elects to apply the transition arrangements for four financial years and intends to start applying from the reporting period, for example, as at 31 December 2020. Should the DFI recalculate its capital ratios and resubmit the statistical reports for the previous reporting periods?**

[Paragraphs 7.6 and 8.3]

No. A DFI shall apply the transitional arrangements prospectively as illustrated below:

Financial year-end	First reporting period	Reporting period
December	31 December 2020	<ul style="list-style-type: none"> For monthly reporting, from 31 December 2020

		<ul style="list-style-type: none"> For quarterly reporting, from 4Q 2020 position i.e. quarter ended 31 December 2020
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**5. Which capital ratios should a DFI report for the purpose of financial reporting?
[Paragraph 7.8]**

Where a DFI elects to apply the transitional arrangements, the disclosure in the financial statement shall be the capital ratios computed in accordance with the transitional arrangements i.e. after adding back the Stage 1 and Stage 2 provisions allowed under the transitional arrangements.

**6. How do the transitional arrangements apply to other regulatory requirements for example Single Counterparty Exposure Limit?
[Paragraph 7.8]**

A DFI shall apply the capital ratios computed in accordance with the transitional arrangements for the purpose of compliance with other regulatory requirements.

7. In the case of the provisions eligible to be added back to Tier 1 Capital, can a DFI include this amount as part of the distributable retained earnings?

Consistent with the aim of conserving buffers to support intermediation activities, the Bank generally does not expect the application of the temporary regulatory flexibilities provided to financial institutions in response to COVID-19 to result in an increase in discretionary distribution of earnings including dividends, share buybacks and bonus payments.