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This concept paper outlines proposals to strengthen capital adequacy standards for banking institutions in Malaysia, in line with the requirements set forth under Basel III*, focusing primarily on measures to raise the quality, consistency and transparency of regulatory capital.

Bank Negara Malaysia (the Bank) invites written comments on this concept paper, including suggestions for particular issues/areas to be clarified/elaborated further and any alternative proposals that the Bank should consider. To facilitate the Bank's assessment, please support each comment with a clear rationale, accompanying evidence or illustration, as appropriate.

Additional instructions for banking institutions

1. In addition to providing general feedback, banking institutions are required to respond to the specific questions set out throughout this concept paper.
2. Banking institutions are required to compute their capital ratios (at both entity^ and consolidated levels) for their 31 March 2012 financial position using the reporting template provided.

Responses shall be submitted to the Bank by 20 July 2012:

Pengarah
Jabatan Dasar Kewangan Pruden
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur
Email: basel3@bnm.gov.my

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

^ The Islamic banking operations of a banking institution licensed under the BAFIA need not report at the level of the Islamic banking operations.

PART A OVERVIEW

1. Introduction

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

1.2. The Risk-Weighted Capital Adequacy Framework, applicable to commercial and investment banks, and the Capital Adequacy Framework for Islamic Banks set out the approach for computing regulatory capital adequacy ratios, as well as the levels of those ratios at which they are required to operate at. These frameworks have been developed based on internationally-agreed standards on capital adequacy promulgated by the Basel Committee on Banking Supervision and the Islamic Financial Services Board.

1.3. This document sets out the general requirements concerning regulatory capital adequacy, and the components of eligible regulatory capital. It shall be read together with the respective documents[1] detailing out the requirements for computing risk-weighted assets, which characterise the risk profile of a banking institution.

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[1] *Risk-Weighted Capital Adequacy Framework (Basel II – Risk-Weighted Assets Computation)* and *Capital Adequacy Framework for Islamic Banks*.

2. Applicability

2.1. The framework is applicable to all banking institutions licensed under the Banking and Financial Institutions Act 1989 (BAFIA) and all Islamic banks licensed under section 3(4) of the Islamic Banking Act 1983 (IBA). These institutions are hereafter referred to as "banking institutions".

3. Legal provisions

3.1. The framework is issued pursuant to section 37 of the BAFIA and section 53A of the IBA.

4. Effective date

4.1. The capital adequacy framework was first issued on 4 August 1989, with amendments and additional requirements introduced subsequently.

4.2. This document was last updated on 25 May 2012 for implementation effective 1 January 2013, and subject to the transition arrangements set out in paragraphs 34.1 to 34.15.

5. Level of application

5.1. A banking institution is required to comply with the Risk-Weighted Capital Adequacy Framework or Capital Adequacy Framework for Islamic Banks, as applicable, at the following levels:

i. entity level[2], referring to the global operations of the banking institution (i.e. including its overseas branch operations) on a stand-alone basis, and including its Labuan banking subsidiary; and

ii. consolidated level, which includes entities covered under the entity level requirement, and the consolidation of all subsidiaries[3], except insurance and takaful subsidiaries which shall be deducted in the calculation of Common Equity Tier 1 Capital[4].

5.2. Where consolidation of other entities required under paragraph 5.1(ii) is not feasible, banking institutions may instead, seek the Bank's approval[5] to:

i. in the case of financial entities, deduct such investments in accordance with paragraph 29; and

ii. in the case of non-financial entities, apply a risk weight of 1250% to such investments.

5.3. The Islamic banking operations of a banking institution licensed under the BAFIA shall also comply with the Capital Adequacy Framework for Islamic Banks at the level of the Islamic banking operations, as if it were a standalone Islamic bank.

5.4. The above treatment, as well as that applicable for other investments, is summarised in Appendix 1.

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2 Also referred to as the "solo" or "stand-alone" level.

3 Financial and non-financial subsidiaries. A financial entity refers to any entity, whether incorporated in Malaysia or otherwise, engaged substantively in any of the following activities: banking, securities broking, fund management, asset management, leasing and factoring and similar activities that are ancillary to the conduct of these activities.

4 In accordance with paragraph 29.2.

5 Approval will only be considered in cases where there are considerable operational challenges in applying the Bank's capital requirements on a consolidated basis, or where non-consolidation for regulatory capital purposes is otherwise required by law.

Question 1

Apart from Labuan, are there other jurisdictions in which the liabilities of banking subsidiaries are explicitly guaranteed (whether by law or otherwise) by your banking institution?

Question 2

What are some of the operational challenges that may be anticipated in consolidating subsidiaries of your banking institutions for regulatory capital purposes?

PART B GENERAL REQUIREMENTS

6. Capital adequacy ratios

6.1. A banking institution shall calculate its Common Equity Tier 1 (CET1), Tier 1 and Total Capital Ratios in the following manner:

i. $$\text{CET1 Capital Ratio} = \frac{\text{Common Equity Tier 1 Capital}}{\text{Total RWA}}$$

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

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

6.2. The numerators of the capital adequacy ratios are defined as follows:

i. Common Equity Tier 1 (CET1) Capital as defined in paragraph 9.1;

ii. Tier 1 Capital shall be the sum of CET1 Capital and Additional Tier 1 Capital as defined in paragraph 10.1; and

iii. Total Capital shall be the sum of Tier 1 Capital and Tier 2 Capital as defined in paragraph 11.1.

6.3. Total risk-weighted assets (RWA) shall be calculated as the sum of credit risk-weighted assets, market risk-weighted assets, operational risk-weighted assets, and large exposure risk requirements as determined in accordance with the *Risk-Weighted Capital Adequacy Framework (Basel II – Risk-Weighted Assets Computation) and* the *Capital Adequacy Framework for Islamic Banks* [6]*.*

[6] For the avoidance of doubt, for purposes of consolidated level capital, a banking institution shall apply the Bank's rules for calculating risk-weighted assets for an overseas subsidiary's risk exposures, and not the capital rules of the host supervisor.

The sum of the above shall be further adjusted to take into account profit-sharing investment accounts (PSIA) recognised as a risk absorbent for capital adequacy purposes, in the manner stipulated under the *Guidelines on Recognition and Measurement of PSIA as Risk Absorbent*.

7. Minimum capital adequacy requirements

7.1. Banking institutions are required to maintain, at all times, the following minimum capital adequacy ratios:

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

7.2. The above minimum capital adequacy requirements will take effect on 1 January 2015. The minimum capital adequacy requirements applicable in 2013 and 2014 are set forth in paragraph 34.1.

8. Capital buffer requirements

8.1. A banking institution is required to hold additional capital buffers above the minimum CET1, Tier 1 and Total Capital adequacy levels[7] set forth under paragraph 7.1. These buffers, collectively referred to as the Buffer Requirement, comprise of:

i. a Capital Conservation Buffer[8] of 2.5% of total RWA; and

ii. a Countercyclical Capital Buffer[9] ranging between 0% and 2.5% of total RWA, determined as the weighted-average of the prevailing

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7 Assuming a zero countercyclical capital buffer, banking institutions shall operate above CET1, Tier 1 and Total Capital levels of 7%, 8.5% and 10.5%. For example, a banking institution with a CET1 Capital Ratio of 8% and no Additional Tier 1 Capital or Tier 2 Capital would meet all minimum capital adequacy requirements, but would have a zero capital buffer, and would therefore be subject to the 100% constraint on capital distributions.

8 The Capital Conservation Buffer is intended to encourage the build up of capital buffers by individual banking institutions during normal times that can be drawn down during stress periods.

9 The Countercyclical Capital Buffer is intended to protect the banking sector as a whole from systemic risk that is often developed during an economic upswing when aggregate credit growth tends to be excessive.

countercyclical capital buffer requirements applied in the jurisdictions in which the banking institution has credit exposures[10].

8.2. The above capital buffer requirements will take full effect in 2019. The capital buffer requirements applicable before 2019 are set forth in paragraphs 34.2 and 34.3.

Note: The Bank expects to detail out the requirements of this Part before 2016, providing further guidance on how the Capital Conservation Buffer and Countercyclical Capital Buffer requirements would be operationalised, including the approach to determining the weighted-average of the countercyclical capital buffer requirements for cross-border exposures, elements subject to restrictions on distributions (e.g. cash dividends and other discretionary distributions) and the interactions of the buffers with other supervisory processes (e.g. approval of dividends, the Pillar 2 Internal Capital Adequacy Assessment Process).

Question 3

Do you have any preliminary comments on the capital buffer requirements, as set out by the Basel Committee*^?

* Paragraphs 122 to 150 of the Basel III rules text.

^ *Guidance for national authorities operating the countercyclical capital buffer*, Basel Committee on Banking Supervision, December 2010.

[10] As announced by the relevant national authority.

PART C COMPONENTS OF CAPITAL

9. Common Equity Tier 1 Capital

9.1. Common Equity Tier 1 (CET1) Capital shall consist of the following:

i. ordinary shares issued by the banking institution that meet the criteria specified in paragraph 12.1;

ii. share premium resulting from the issue of ordinary shares;

iii. retained earnings net of any interim and/or final dividend proposed/declared [11] and any quarterly interim losses. Any interim profits may be included in CET1 Capital, subject to a review by the banking institution's external auditors[12];

iv. other disclosed reserves[13, 14];

v. qualifying minority interest[15], as determined under paragraph 15.1; and

vi. regulatory adjustments applied in the calculation of CET1 Capital, as determined in Part E.

Question 4

Paragraph 9.1(iii) requires that retained earnings be reported net of any interim losses as computed at the end of each financial quarter. As a matter of prudence however, banking institutions should ideally reflect any resulting interim losses if the statement of profit and loss (including those prepared for management reporting purposes) is prepared on a more frequent basis (e.g. monthly). Do you anticipate any potential operational challenges associated with the reporting of such interim losses?

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[11] For the avoidance of doubt, a proposed/declared dividend is deducted upon receiving approval of the Bank or when the liability to pay a dividend has been recognised, whichever is earlier.

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

[13] Disclosed reserves including other accumulated comprehensive income, but excluding share premium.

[14] As computed at the end of each financial quarter.

[15] I.e. CET1 capital instruments issued by consolidated subsidiaries of the banking institution held by third parties.

10. Additional Tier 1 Capital

10.1. Additional Tier 1 Capital shall consist of the following:

i. Additional Tier 1 capital instruments issued by the banking institution that meet the criteria specified in paragraph 13.1, and are not included in CET1 Capital;

ii. share premium resulting from the issue of instruments referred to in paragraph 10.1(i)[16];

iii. qualifying CET1 and Additional Tier 1 capital instruments issued by consolidated subsidiaries of the banking institution held by third parties, as determined under paragraph 15.2; and

iv. regulatory adjustments applied in the calculation of Additional Tier 1 Capital, as determined in Part E.

11. Tier 2 Capital

11.1. Tier 2 Capital shall consist of the following:

i. Tier 2 capital instruments issued by the banking institution that fulfill the criteria specified in paragraph 14.1, and are not included in Tier 1 Capital;

ii. share premium resulting from the issue of instruments referred to in paragraph 11.1(i)[17];

iii. qualifying CET1, Additional Tier 1 and Tier 2 capital instruments issued by consolidated subsidiaries of the banking institution held by third parties, as determined under paragraph 15.3;

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

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

iv. loan/financing loss provisions:

a. surplus eligible provisions[18] over expected losses[19], subject to a maximum of 0.6% of total credit risk-weighted assets determined under the Internal Ratings-Based approach for credit risk; and

b. collective impairment provisions and regulatory reserves, to the extent that they are not ascribed to loans/financing classified as impaired, subject to a maximum of 1.25% of total credit risk-weighted assets determined under the Standardised Approach for credit risk; and

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

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[18] In accordance with paragraphs 3.227 to 3.229 of the *Risk-Weighted Capital Adequacy Framework (Basel II – Risk-Weighted Assets Computation),* and paragraphs 3.211 to 3.213 of the *Capital Adequacy Framework for Islamic Banks*.

[19] In accordance with paragraphs 3.216 to 3.226 of the *Risk-Weighted Capital Adequacy Framework (Basel II – Risk-Weighted Assets Computation),* and paragraphs 3.200 to 3.210 of the *Capital Adequacy Framework for Islamic Banks.*

PART D CRITERIA FOR INCLUSION IN CAPITAL

12. Ordinary shares

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

i. it is directly issued and paid-up[20];

ii. it represents the most subordinated claim in liquidation of the banking institution;

iii. ordinary shares absorb the first and proportionately greatest share of any losses as they occur[21], and each ordinary share absorbs losses on a going concern basis proportionately and pari passu with all ordinary shares;

iv. the paid-up amount is neither secured nor covered by a guarantee of the banking institution or an affiliated entity[22] or subject to any other arrangement that legally or economically enhances the seniority of the claim;

v. principal is perpetual and never repaid outside of liquidation[23];

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

---

[20] Where an instrument is paid-up by way of issuance of shares and not by cash (e.g. payment for the take-over of another company in the form of ordinary shares), a banking institution is required to obtain prior written approval of the Bank to include in capital the shares issued.

[21] For the avoidance of doubt, the requirement for a permanent write-off feature in capital instruments as set out in paragraph 31.1(ii) does not negate this criterion being met by ordinary shares.

[22] An affiliate is defined as a company that controls, or is controlled by, or is under common control with, the banking institution. Control of a company is defined as (1) ownership, control, or holding with power to vote 20% or more of a class of voting securities of the company; or (2) consolidation of the company for financial reporting purposes.

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

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

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

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

x. the paid-up amount is recognised as equity capital for determining balance sheet insolvency;

xi. the paid-up amount is classified as equity under Malaysian Financial Reporting Standards;

xii. ordinary shares are clearly and separately disclosed on the banking institution's balance sheet;

xiii. the banking institution does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the statutory contractual terms provide any feature which might give rise to such an expectation; and

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

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

12.3. Neither the banking institution nor an affiliated party over which it exercises control or significant influence can purchase the ordinary shares, nor can the banking institution directly or indirectly have financed the purchase of the ordinary share, failing which the regulatory adjustments as set out in paragraph 28 shall apply.

Question 5

Please highlight any current internal policies and practices concerning ordinary shares issued by your banking institution (e.g. dividend/share-buy-back policies, investor relations practices) which do not meet the criteria for inclusion.

13. Additional Tier 1 capital instruments

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

i. the instrument is issued and paid-up;

ii. the instrument is subordinated to depositors, general creditors and other holders of subordinated debt of the banking institution;

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

iv. the instrument is perpetual, and shall therefore not have a maturity date, step-up features or other incentives for the banking institution to redeem the instrument[24];

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

v. the instrument may be callable at the initiative of the banking institution only after a minimum of five years, subject to the following conditions:

   a. the exercise of a call option must receive prior written approval of the Bank;

   b. the banking institution must not do anything which creates an expectation that the call will be exercised; and

   c. the call option must not be exercised unless:

      i. the called instrument is replaced with capital of the same or better quality, and the replacement of this capital is done at conditions which are sustainable for the income capacity of the banking institution[25]; or

      ii. the banking institution demonstrates to the satisfaction of the Bank that its capital position is and can be sustained well above the capital adequacy requirements and capital buffer requirements, as outlined in paragraphs 7 and 8 respectively, after the call option is exercised;

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

vii. dividends/coupons must be paid out of distributable items, and such distributions must meet the following conditions:

   a. distributions/payments shall be at the full discretion of the banking institution at all times[26];

   b. cancellation of discretionary payments must not constitute an event of default;

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

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

c. the banking institution must have full access to cancelled payments to meet obligations as they fall due[27]; and

d. cancellation of distributions/payments must not impose restrictions on the banking institution except in relation to distributions to ordinary shareholders;

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

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

x. the provisions governing the instrument require the instrument to be written-off[28], or the instrument to be converted into ordinary shares, if the consolidated or entity level CET1 Capital Ratio of the banking institution[29] falls below a pre-specified level, which shall be no lower than 5.125%. The amount to be written-off or converted into ordinary shares must be the full principal value of the instrument;

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

xii. if the instrument is issued out of a special purpose vehicle[30], proceeds must be immediately available without limitation to the banking institution in a form which meets or exceeds all of the other criteria for inclusion in Additional Tier 1 Capital;

---

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

28 For Islamic banks, only conversion into ordinary shares is allowed as explained in paragraph 31.3.

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

30 I.e. not out of a holding company or an operating entity set up to conduct business with clients with the intention of earning a profit in its own right.

xiii. the provisions governing the issuance of the capital instrument require the instrument to be written-off, or the instrument to be converted into ordinary shares, at the point of non-viability, as determined by the requirements set forth in paragraphs 30.1 and 30.2. The amount to be written-off or converted into ordinary shares must be the full principal value of the instrument; and

xiv. for Islamic banks, the instrument shall be structured using unrestricted equity-based contracts (i.e. *Musharakah* or *Mudarabah*), in addition to meeting other Shariah requirements.

13.2. Neither the banking institution nor an affiliated party over which it exercises control or significant influence can purchase the Additional Tier 1 instrument, nor can the banking institution directly or indirectly have financed its purchase, failing which the regulatory adjustments as set out in paragraph 28 shall apply.

14. Tier 2 capital instruments

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

i. the instrument is issued and paid-up;

ii. the instrument is subordinated to depositors and general creditors of the banking institution;

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

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

v. the instrument may be callable at the initiative of the banking institution only after a minimum of five years, subject to the following conditions:

   a. the exercise of a call option must receive prior written approval of the Bank;

   b. the banking institution must not do anything which creates an expectation that the call will be exercised[31]; and

   c. the call option must not be exercised unless:

      i. the called instrument is replaced with capital of the same or better quality, and the replacement of this capital is done at conditions which are sustainable for the income capacity of the banking institution[32]; or

      ii. the banking institution demonstrates that its capital position is well above the capital adequacy requirements and capital buffer requirements, as outlined in paragraphs 7 and 8 respectively, after the call option is exercised;

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

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

viii. if the instrument is issued out of a special purpose vehicle[33], proceeds must be immediately available without limitation to the banking institution in a form which meets or exceeds all of the other criteria for inclusion in Tier 2 Capital;

---

[31] An option to call the instrument after five years but prior to the start of the amortisation period will not be viewed as an incentive to redeem as long as the banking institution does not do anything that creates an expectation that the call will be exercised at that point.

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

[33] I.e. not out of a holding company or an operating entity set up to conduct business with clients with the intention of earning a profit in its own right.

ix. the provisions governing the issuance of the capital instrument require the instrument to be written-off[34], or the instrument to be converted into ordinary shares, at the point of non-viability, as determined by the requirements set forth in paragraphs 30.1 and 30.2. The amount to be written-off or converted into ordinary shares must be the full principal value of the instrument;

x. for Islamic banks, the provisions governing the instrument require the instrument to be converted into ordinary shares if the consolidated or entity level CET1 Capital Ratio of the Islamic bank[35] falls below a pre-specified level, which shall be no lower than 4.5%. The amount to be converted into ordinary shares must be the full principal value of the instrument; and

xi. for Islamic banks, the instrument shall be structured using exchange contracts that are asset-based[36] (e.g. *Ijarah* or *Murabahah*), in addition to meeting other Shariah requirements.

14.2. In the final four years of its contractual maturity, the instrument will be gradually derecognised from Tier 2 Capital on a straight line basis:

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

14.3. Neither the banking institution nor an affiliated party over which it exercises control or significant influence can purchase the Tier 2 instrument, nor can the banking institution directly or indirectly have financed its purchase, failing which the regulatory adjustments as set out in paragraph 28 shall apply.

---

[34] Refer to footnote 28.
[35] Refer to footnote 29.
[36] And not asset-backed.

Question 6 (for Islamic banks)

In respect of the requirement set out in paragraph 14.1(xi),

(i) what are the potential operational challenges that an Islamic bank may face in complying with the requirements?

(ii) other than *Ijarah* and *Murabahah* contracts, please identify and justify other types of exchange contracts that could be used in structuring Tier 2 capital instruments.

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

15.1. Minority interest arising from the issue of ordinary shares by a fully consolidated banking subsidiary [37], [38] of the banking institution may be recognised in consolidated CET1 Capital if the ordinary share giving rise to the minority interest, if issued by the banking institution itself, meets the criteria for inclusion in CET1 Capital[39]. The amount of minority interest that will be recognised in consolidated CET1 Capital under paragraph 9.1(v) shall be calculated as follows:

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

where:

A total qualifying minority interest[40] based on the above criteria

B surplus CET1 Capital of the subsidiary, which shall be the greater of the following:

---

[37] A banking subsidiary in this paragraph shall mean to only include a deposit-taking entity that is subject to minimum prudential standards and level of supervision by an authority that subscribes to the Core Principles for Effective Banking Supervision promulgated by the Basel Committee on Banking Supervision. For the avoidance of doubt, this precludes the inclusion of any capital issued to third parties by non-banking subsidiaries, such as leasing, factoring or fund management companies, in consolidated CET1 Capital.

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

[39] Accordingly, all references to the term "banking institution" in paragraph 12 shall mean to refer to any "fully-consolidated banking subsidiary" for purposes of this paragraph.

[40] Including associated reserves, but prior to the application of regulatory adjustments.

I. CET1 Capital of the subsidiary[41] minus 7.0%[42] of the subsidiary's total risk-weighted assets calculated at the entity level; or

II. CET1 Capital of the subsidiary minus 7.0% of the portion of the banking institution's consolidated risk-weighted assets relating to that subsidiary.

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

15.2. Tier 1 capital instruments issued by a fully consolidated subsidiary[43, 44] of the banking institution and held by third parties may be recognised in consolidated Tier 1 Capital if the instrument, if issued by the banking institution itself, meets the criteria for inclusion in CET1 or Additional Tier 1 Capital[45]. The amount of this capital that will be recognised in consolidated Tier 1 Capital is calculated as follows:

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

where:

A total qualifying Tier 1 capital instruments (i.e. CET1 and Additional Tier 1) of the subsidiary issued to third parties based on the above criteria

B surplus Tier 1 Capital of the subsidiary, which shall be the greater of the following:

I. Tier 1 Capital of the subsidiary[46] minus 8.5%[47] of the subsidiary's total risk-weighted assets calculated at the entity level; or

---

41 Including associated reserves and regulatory adjustments.

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

43 For the avoidance of doubt, this includes both banking and non-banking subsidiaries.

44 Refer to footnote 38.

45 Accordingly, all references to the term "banking institution" in paragraphs 12 and 13 shall mean to refer to any "fully-consolidated subsidiary of the banking institution" for purposes of this paragraph. For example, the early redemption of an instrument by a subsidiary shall be subject to the Bank's approval, in addition to that of the relevant host supervisor.

46 Refer to footnote 41.

47 Corresponding to the minimum Tier 1 capital requirement of 6% plus the capital conservation buffer of 2.5%.

II. Tier 1 Capital of the subsidiary minus 8.5% of the portion of the banking institution's consolidated risk-weighted assets relating to that subsidiary.

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

The capital that will be recognised in consolidated Additional Tier 1 Capital under paragraph 10.1(iii) shall exclude amounts recognised in consolidated CET1 Capital as calculated under paragraph 15.1.

15.3. Total capital instruments issued by a fully consolidated subsidiary[48, 49] of the banking institution and held by third parties may be recognised in consolidated Total Capital if the instrument, if issued by the banking institution itself, meets the criteria for inclusion in CET1, Additional Tier 1 or Tier 2 Capital[50]. The amount of this capital that will be recognised in consolidated Total Capital is calculated as follows:

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

where:

A total qualifying capital instruments (i.e. CET1, Additional Tier 1 and Tier 2) of the subsidiary issued to third parties based on the above criteria

B surplus Total Capital of the subsidiary, which shall be the greater of the following:

I. Total Capital of the subsidiary[51] minus 10.5%[52] of the subsidiary's total risk-weighted assets calculated at the entity level; or

II. Total Capital of the subsidiary minus 10.5% of the portion of the banking institution's consolidated risk-weighted assets relating to

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48 For the avoidance of doubt, this includes both banking and non-banking subsidiaries.

49 Refer to footnote 38.

50 Accordingly, all references to the term "banking institution" in paragraphs 12, 13 and 14 shall mean to refer to any "fully-consolidated subsidiary of the banking institution" for purposes of this paragraph.

51 Including associated reserves and regulatory adjustments.

52 Corresponding to the minimum Total Capital requirement of 8% plus the capital conservation buffer of 2.5%.

that subsidiary.

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

The capital that will be recognised in consolidated Tier 2 under paragraph 11.1(iii) shall exclude amounts recognised in consolidated CET1 as calculated under paragraph 15.1 and amounts recognised in consolidated Additional Tier 1 as calculated under paragraph 15.2.

15.4. Capital issued to third parties out of a special purpose vehicle (SPV) may be included in entity and consolidated level Additional Tier 1 or Tier 2 Capital, as if the banking institution had issued the capital directly to third parties, only if[53]:

i. the SPV is domiciled in Malaysia[54];

ii. the SPV is controlled and managed by the banking institution, and would, in accordance with Malaysian Financial Reporting Standards, be fully consolidated;

iii. the SPV is set up for the sole purpose of the capital issuance for the banking institution[55] and does not conduct any other business or activity;

iv. the SPV has no external creditors at any time;

v. the entire proceeds from the capital issuance through the SPV[56] shall be immediately available without limitation to the banking institution in a

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[53] For the avoidance of doubt, an Additional Tier 1 and Tier 2 capital instrument issued out of an SPV pursuant to this paragraph is not subject to the treatment set out under paragraphs 15.2 and 15.3. In cases where capital of a fully consolidated subsidiary of the banking institution has been issued to third parties through an SPV, such capital may, subject to the requirements of this paragraph, be treated as if the subsidiary itself had issued it directly to third parties and may be included in the consolidated Additional Tier 1 or Tier 2 in accordance with the treatment outlined in paragraphs 15.2 and 15.3.

[54] Including Labuan.

[55] In addition, an SPV may be established to issue tranches of one instrument where the only change in the terms and conditions of the tranches is a variation in distribution or payments to be made on the instrument. An SPV must not issue different forms of an instrument even if they belong to the same category of capital instruments.

[56] This does not preclude the use of the proceeds to fund assets that relate to the operation of the SPV to the extent that they are de minimis.

form which meets or exceeds all of the criteria for inclusion in Additional Tier 1 or Tier 2 Capital, as appropriate;

vi. the provisions governing the issuance of the instruments issued by the SPV and the banking institution shall substantially be the same (e.g. maturity), and accordingly, the capital instrument issued by the SPV shall meet all the relevant criteria (as required under paragraph 13.1 for Additional Tier 1 and paragraph 14.1 for Tier 2) for inclusion as if the banking institution itself were to issue the instrument[57, 58].

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

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[57] For example, if an SPV issues a Tier 2 capital instrument to investors and upstreams the proceeds by investing in a Tier 1 capital instrument issued by the banking institution, the transaction will be recognised in Tier 2 Capital.

[58] In the case of capital instruments issued by Islamic banks based on exchange contracts through an SPV (e.g. *Murabahah* or *Ijarah*) or using any other indirect structure (e.g. Commodity *Murabahah*), the contracts between the Islamic bank and the SPV or any parties involved shall be structured in a manner which in combination meets or exceeds the criteria for inclusion in capital. For example, any purchase undertaking shall be designed in a manner that does not legally or economically enhance the seniority of capital issued.

PART E REGULATORY ADJUSTMENTS

16. Goodwill and other intangibles

16.1. Goodwill, including any goodwill included in the valuation of significant capital investments in unconsolidated entities, and all other intangibles[59] must be deducted in the calculation of CET1 Capital. The full amount shall be deducted net of any associated deferred tax liability that would be extinguished if the intangible asset becomes impaired or is derecognised under Malaysian Financial Reporting Standards.

16.2. For the avoidance of doubt, negative goodwill shall not be added back in the calculation of CET1 Capital.

17. Deferred tax assets and liabilities

17.1. Deferred tax assets (DTAs) that rely on the future profitability of the banking institution[60] to be realised shall be deducted in the calculation of CET1 Capital[61]. In this regard, a DTA may be netted with its associated deferred tax liability (DTL) only if the DTA and DTL relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority. DTLs permitted to be netted against DTAs shall exclude amounts that have been netted against the deduction of goodwill, intangibles and defined benefit pension assets.

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[59] As defined under Malaysian Financial Reporting Standards. This shall include mortgage servicing rights, if any.

[60] Or the profitability of the banking group for consolidated reporting.

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

17.2. For the avoidance of doubt, net DTLs shall not be added back in the calculation of CET1 Capital.

18. Property revaluation gains/losses

18.1. The amount of cumulative unrealised gains arising from the changes in the fair value or revaluation of land and buildings[62] shall be treated as follows:

i. cumulative unrealised gains shall be deducted in the calculation of CET1 Capital; and

ii. 45% of the cumulative unrealised gains shall be added back in Tier 2 Capital.

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

18.3. For the purpose of recognition of cumulative unrealised gains in Tier 2 Capital in accordance with paragraph 18.1(ii) the valuation of land and buildings shall be certified by an independent professional valuer at least once every three years[63] or where there is evidence that the value has been or is likely to be substantially impaired.

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[62] Referring to the revaluation gains of properties that are subject to the *Revaluation Model* under MFRS 116 *Property, Plant and Equipment,* and the *Fair Value Model* under MFRS 140 *Investment Property*. In addition, any recognition of revaluation gains of property in the retained earnings arising from the application of MFRS1 *First-Time Adoption of Malaysian Financial Reporting Standards* are also subject to this treatment.

[63] For the avoidance of doubt, recognition of revaluation gains of property in the retained earnings arising from the application of MFRS1 *First-Time Adoption of Malaysian Financial Reporting Standards* is only subject to a one-off certification by an independent professional valuer.

19. Cumulative gains/losses of financial instruments classified as "available-for-sale" or "designated at fair value"

19.1. 55% of cumulative unrealised gains arising from the changes in fair value of financial instruments, other than loans/financing and receivables, classified as "available-for-sale" shall be deducted in the calculation of CET1 Capital.

19.2. For loans/financing and receivables classified as "available-for-sale" or "designated at fair value", the amount of unrealised gains arising from the changes in fair value shall be fully deducted in the calculation of CET1 Capital.

19.3. For the avoidance of doubt, the amount of cumulative unrealised losses arising from the changes in fair value of financial instruments, including loans/financing and receivables, classified as "available-for-sale" shall be fully recognised in the calculation of CET1 Capital.

Question 7

Please provide a breakdown of unrealised gains and losses of AFS securities according to type (i.e. loans, debt securities and equities) and level (i.e. Level 1, Level 2 and Level 3) in the reporting template (under the tab "AddInfo").

20. Profit equalisation reserve

20.1. The portion of profit equalisation reserve attributable to Islamic banking operations shall be deducted in the calculation of CET1 Capital[64].

[64] In accordance with paragraph 5.9 of the *Guidelines on Profit Equalisation Reserve*.

21. Cash flow hedge reserve

21.1. The amount of the cash flow hedge reserve[65] that relates to the hedging of items that are not fair valued on the balance sheet (including projected cash flows) shall be derecognised in the calculation of CET1 Capital. In this regard, positive amounts shall be deducted and negative amounts shall be added back in the calculation of CET1 Capital.

22. Regulatory reserve for loans/financing

22.1. The amount of regulatory reserve attributable to loans/financing maintained in accordance with paragraph 13.1 of the guidelines on *Classification and Impairment Provisions for Loans/Financing* shall be deducted in the calculation of CET1 Capital[66].

23. Shortfall of eligible provisions to expected losses

23.1. Where the banking institution has adopted the Internal Ratings-Based approach for credit risk, any shortfall of eligible provisions[67] to expected losses[68] shall be deducted in the calculation of CET1 Capital. The full amount shall be deducted and shall not be reduced by any tax effects that could be expected to occur if provisions were to rise to the level of expected losses.

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

66 Loan loss provisions are partially recognised in Tier 2 as set out in paragraph 11.1(iv)(b).

67 In accordance with paragraphs 3.227 to 3.229 of the the *Risk-Weighted Capital Adequacy Framework (Basel II – Risk-Weighted Assets Computation),* and paragraphs 3.211 to 3.213 of the *Capital Adequacy Framework for Islamic Banks*.

68 In accordance with paragraphs 3.216 to 3.226 of the the *Risk-Weighted Capital Adequacy Framework (Basel II – Risk-Weighted Assets Computation),* and paragraphs 3.200 to 3.210 of the *Capital Adequacy Framework for Islamic Banks.*

24. Valuation adjustments

24.1. The amount arising from the valuation adjustments computed in accordance with paragraphs 5.19 and 5.20 of the *Risk-Weighted Capital Adequacy Framework (Basel II – Risk-Weighted Assets Computation)* and paragraphs 5.18 and 5.19 of the *Capital Adequacy Framework for Islamic Banks*, shall be deducted in the calculation of CET1 Capital.

25. Increases in equity capital resulting from a securitisation transaction

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

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

26.1. All unrealised fair value gains and losses on financial liabilities that are due to changes in the banking institution's own credit risk[69] shall be derecognised in the calculation of CET1 Capital. In this regard, positive amounts shall be deducted and negative amounts shall be added back in the calculation of CET1 Capital.

27. Defined benefit pension fund assets and liabilities

27.1. For each defined benefit pension fund that is an asset on the balance sheet, the asset shall be deducted in the calculation of CET1 Capital net of any associated deferred tax liability which would be extinguished if the asset

[69] Or the own credit risk of the banking group for consolidated reporting.

becomes impaired or derecognised under Malaysian Financial Reporting Standards. The amount of defined benefit pension fund liabilities, as included on the balance sheet, shall be fully recognised in the calculation of CET1 Capital.

27.2. Assets in the fund to which the banking institution has unrestricted and unfettered access may, with the prior written approval of the Bank, offset the deduction. Such offsetting assets shall be risk-weighted as if they were owned directly by the banking institution[70].

28. Investments in own capital instruments

28.1. All direct, indirect[71] and synthetic[72] holdings of a banking institution's own capital instruments[73] in the trading and banking book[74], including any own capital instruments which the banking institution is contractually obliged to purchase and any other financing[75] provided for the purpose of purchasing own capital instruments, will be deducted in the calculation of capital. In

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

71 Indirect holdings are exposures or parts of exposures that, if a direct holding loses its value, will result in a loss to the banking institution substantially equivalent to the loss in value of the direct holding. An indirect holding arises when a banking institution invests in an unconsolidated intermediate entity that has an exposure to the capital of an unconsolidated financial or insurance/takaful entity and thus gains an exposure to the capital of that financial or insurance/takaful entity.

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

73 Including treasury stock.

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

75 Both funded or unfunded (e.g. guarantees) exposures.

applying the deductions, banking institutions must deduct the investment from the same component of capital for which it would qualify[76].

28.2. In instances where a banking institution has an indirect exposure to an own capital instrument (e.g. through an investment in a collective investment scheme or holdings of an index security), the banking institution shall look through the holdings to determine their underlying holdings of capital[77].

28.3. For the purpose of paragraph 28.1, gross long positions may be netted against short positions in the same underlying exposure only if the short positions involve no counterparty risk. In the case of an index security, the banking institution may only net a gross long position against a short position only if it is in the same underlying index. In such an instance, the short position may involve counterparty risk, which will be subject to the relevant counterparty credit risk charge as calculated in accordance with Appendix VIII of *Risk-Weighted Capital Adequacy Framework (Basel II – Risk-Weighted Assets Computation)*, and Appendix VI of the *Capital Adequacy Framework for Islamic Banks*.

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[76] Unless already derecognised under Malaysian Financial Reporting Standards.

[77] If the banking institution finds it operationally burdensome to look through the holdings of an index security, the banking institution may, with the prior written approval of the Bank, use a conservative estimate. The methodology for the estimate shall demonstrate that in no case will the actual exposure be higher than the estimated exposure. The full value shall be deducted in instances where this requirement cannot be met.

29. Investments in the capital of unconsolidated financial and insurance/takaful entities[78]

29.1. Investments in the capital instruments of unconsolidated financial[79] and insurance/takaful entities shall:

i. include direct, indirect and synthetic holdings of capital instruments. Banking institutions shall look through indirect exposures (e.g. through an investment in a collective investment scheme or holdings of an index security) to determine their underlying holdings of capital[80];

ii. refer to the net long positions in both the banking book and trading book[81]. In this regard, the gross long position can be offset against the short position in the same underlying exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year[82];

iii. include underwriting positions held longer than five working days[83]; and

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

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

79 For the purpose of paragraphs 29.1 to 29.4, this shall include financial entities, as defined in footnote 3, and their holding companies.

80 Refer to footnote 77.

81 Refer to footnote 74.

82 Any counterparty credit risk associated with short positions used to offset long positions shall remain included in the calculation of risk-weighted assets.

83 For the avoidance of doubt, underwriting positions held for five working days or less (including pre-issuance underwriting obligations) shall be risk-weighted.

29.2. The investments in the capital instruments of unconsolidated financial and insurance/takaful entities, as set forth under paragraph 29.1, shall be deducted in the calculation of capital as follows:

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

ii. where the issuing entity is an affiliate of the banking institution, the entire amount of investments in capital instruments; and

iii. where the banking institution does not own more than 10% of the issued ordinary share capital of a non-affiliated issuing entity, the amount of all capital instruments held in excess of 10% of the banking institution's common equity[84].

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

29.3. In applying the deductions under paragraph 29.2, a banking institution shall apply the corresponding deduction approach by deducting an investment from the same component of capital for which the capital would qualify if it was issued by the banking institution itself. In applying the corresponding deduction approach,

i. if the capital instrument of the entity in which the banking institution has invested in does not meet the criteria for inclusion in CET1 Capital, Additional Tier 1 Capital, or Tier 2 Capital of the banking institution, the capital is to be considered as an ordinary share for purposes of this

[84] The common equity for purposes of calculating the 10% threshold shall be calculated after applying the regulatory adjustments set out in paragraphs 16 to 28 above to the sum of items set out in paragraphs 9.1(i) to (v).

regulatory adjustment[85] and thus deducted in the calculation of CET1 Capital; and

ii. if a deduction is required from a particular tier of capital and the banking institution does not have enough of that tier of capital to satisfy that deduction, the shortfall shall be deducted from the next higher tier of capital[86].

29.4. The amount of capital holdings which is not deducted under paragraph 29.2(iii) shall continue to be risk weighted[87]. For the application of risk weighting, the amount of the holdings must be allocated on a pro-rata basis between those held below and those held above the threshold.

Question 8

What are the operational challenges that your banking institution may face in identifying affiliated entities based on the definition provided in footnote 22.

Question 9

For purposes of determining the relevant tier in which deductions shall be carried out under the "corresponding deduction approach", are there any difficulties anticipated in determining the regulatory status of the investment exposures (e.g. with respect to instruments issued by non-Malaysian banking institutions, as well as insurance/takaful entities)?

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

86 For example, if a banking institution does not have enough Additional Tier 1 Capital to meet the deductions, the shortfall will be deducted from CET1 Capital.

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

Changes to the risk-weighted assets calculation for items formerly deducted from capital

In addition to the above regulatory adjustments, the following items, deducted from Tier 2 under the existing capital frameworks, will be subject to a 1250% risk weight:

(i) securitisation exposures currently subject to deduction, with the exception of any increase in equity capital resulting from a securitisation transaction which will continue to be deducted;

(ii) expected losses for equity exposures derived under the PD/LGD approach determined under the Internal Ratings-Based approach for credit risk;

(iii) non-payment/delivery on non-DvP and non-PvP transactions; and

(iv) non-financial commercial subsidiaries.

PART F OTHER REQUIREMENTS

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

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

i. the Bank notifies the banking institution in writing that the Bank is of the opinion that a write-off or conversion is necessary, without which the banking institution would cease to be viable; or

ii. the Bank publicly announces that a decision has been made by the Bank, the Malaysia Deposit Insurance Corporation (PIDM), or any other federal or state government in Malaysia, to provide a capital injection or equivalent support to a banking institution, without which the banking institution would cease to be viable.

For the avoidance of doubt, the Bank shall have the full discretion to elect not to require a write-off or conversion when a trigger event has occurred. Even if the option is not exercised, holders of the banking institution's Additional Tier 1 and Tier 2 capital instruments may still be exposed to losses from the resolution of the banking institution, which in the case of PIDM member institutions is undertaken by PIDM pursuant to powers provided under the Malaysia Deposit Insurance Corporation Act 2011.

30.2. For purposes of recognising capital at the consolidated level, the provisions governing the issuance of an Additional Tier 1 or Tier 2 capital instrument issued by a subsidiary (apart from a banking subsidiary regulated by the Bank) and held by third party investors as set out under paragraphs 10.1(iii)

and 11.1(iii)[88] shall also contain clauses that require the instrument, at the option of the Bank, to be written-off, or the instrument to be converted into ordinary shares upon the occurrence of the trigger event described in paragraph 30.1.

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

31.1. In respect of the requirement under paragraphs 13.1(x), 13.1(xiii), and 14.1(ix) for a capital instrument that can be written-off:

i. the write-off shall fully reduce:
   a. the claim of the instrument in liquidation;
   b. the amount re-paid when a call option is exercised; and
   c. coupon or dividend payments on the instrument;

ii. the write-off shall be permanent; and

iii. the provisions governing the issuance of the instrument must specify that a write-off shall not constitute an event of default for that capital instrument or trigger cross-default clauses.

31.2. In respect of the requirement under paragraphs 13.1(x), 13.1(xiii), 14.1(ix), and 14.1(x) for a capital instrument that can be converted into ordinary shares:

i. the banking institution must maintain at all times all prior authorisation necessary to immediately issue the relevant number of shares specified in the provisions governing the issuance of the instrument should the trigger event occur[89];

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[88] E.g. overseas subsidiaries of Malaysian banking groups.

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

ii. the conversion formula for determining the number of ordinary shares received upon conversion of the instrument must be determined in advance in the provisions governing the issuance of the instrument and must include a cap on the maximum number of ordinary shares that holders will receive upon conversion;

iii. the offering documents and other marketing literature of the capital instrument shall contain cautionary statements that highlight the possibility that certain investors may not be permitted to fully exercise their rights as shareholders, or may be required to pare down their holdings in shares, upon conversion to comply with legal and regulatory requirements;

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

v. for purposes of paragraph 30.2, any ordinary shares arising from the conversion may be the ordinary shares of either the issuing banking institution, parent company or any other affiliated entity, including any successor in resolution; and

vi. the provisions governing the issuance of the instrument must specify that a conversion shall not constitute an event of default for that instrument or trigger cross-default clauses.

31.3. For Islamic banks, only conversion into ordinary shares is allowed for purposes of applying the requirements of paragraphs 13.1(x), 13.1(xiii), 14.1(ix) and 14.1(x).

Question 10

To what extent would your banking institution be able to obtain the list of investors of its outstanding Additional Tier 1 and Tier 2 capital instruments at any point in time? Please elaborate on the time and effort required to obtain this information, as well as any other associated challenges (e.g. legal, operational).

Question 11

In general, Additional Tier 1 and Tier 2 capital instruments shall be fully converted into common equity or written-off whenever the relevant trigger points are met. Nonetheless, there may be circumstances in which a full conversion or write-off for all instruments would not be necessary to secure/maintain the viability of the banking institution.

To what extent is it possible to structure Additional Tier 1 and/or Tier 2 capital instruments that have features that provide for:

(i) a partial conversion/write-off of an instrument, such that the aggregate amount (as may be determined by the Bank) to be converted/written-off would be just sufficient to restore the banking institution's capital to levels above the trigger points (e.g. 5.125% CET1 for Additional Tier 1 capital instruments), rather than for the full face value of the instrument to be converted/written-of; and/or

(ii) a ranking for the conversion/write-off of instruments, whereby certain instruments within a particular tier, or tiers of instruments, are converted/written-off, before others (e.g. Additional Tier 1 instruments to be fully converted/written-off before Tier 2 instruments are converted/written-off),

in a manner that allows for loss absorption to work effectively, while preserving the hierarchy of investors and ensuring that Additional Tier 1 and Tier 2 investors are not subject to a more than proportionate amount of losses?

Question 12

For instruments which convert into common equity, please list down all the necessary approvals/authorisations required (including from shareholders), at the point of issuance and at the point of conversion. Please also identify any potential operational and legal impediments that may hinder the process of getting such approvals/authorisations or hinder the conversion of Additional Tier 1 and Tier 2 capital instruments into common equity in a timely manner.

Question 13

How would conversion into unlisted shares affect the feasibility of issuing capital instruments for your institution?

Question 14

Please identify potential circumstances (other than that due to Shariah considerations) where an Additional Tier 1 or Tier 2 capital instrument is not capable of being converted into common equity upon a trigger event.

Question 15

In order to facilitate the implementation of shareholding rules (e.g. section 45 of the BAFIA), paragraph 31.2(ii) requires that capital instruments with conversion features include a cap (as determined by the issuing banking institution) on the maximum number of ordinary shares that investors will receive upon conversion. Such a cap allows the maximum dilution of shareholdings to be readily quantifiable in advance. The Bank is also considering the need to further specify a regulatory limit (over-and-above the cap to be determined by each individual banking institution).

(i) In what form, and at what level, should this limit be? As a baseline proposal, the Bank is considering allowing investors of capital instruments to, for each instrument converted, receive a number of ordinary shares not exceeding the ratio of the price of the instrument at issue divided by 50% of the ordinary share at the time of issue of the capital instrument:

- Should the regulatory cap be increased or reduced (and if so, why), bearing in mind the need to balance between the interests of ordinary shareholders and investors of capital instruments?
- Should the regulatory cap be referenced against the price of the instruments at the time of issue as proposed (which would provide greater certainty in terms of the extent of dilution on an *ex ante* basis), or at the point of conversion (which would result in investors being compensated at

levels more representative of the net worth of the banking institution at the point of conversion)?

- Should the regulatory cap take a different form altogether?

(ii) What are other mechanisms which can allow for conversion into ordinary shares in an effective manner, while ensuring that regulatory shareholding rules can be enforced on an ongoing basis?

32. Disclosure requirements

32.1. Banking institutions are required to make available on their websites the full terms and conditions[90] of all instruments included in regulatory capital[91].

Note: The Bank expects to detail out the Pillar 3 disclosure requirements in 2013, providing further guidance on how banking institutions comply with the requirement of paragraph 91 of the Basel III rules.

Question 16

What are the legal and operational considerations that may impede banking institutions from disclosing the full terms and conditions of capital instruments on their websites?

Question 17

The Basel Committee has published a consultation paper on Pillar 3 disclosure requirements* concerning the definition of capital rules. Does your institution have any preliminary concerns or comments on these proposals?

* *Definition of capital disclosure requirements*, Basel Committee on Banking Supervision, December 2011.

[90] Including any other relevant pricing supplements.

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

33. Regulatory process and submission requirements

33.1. A banking institution is required to obtain the Bank's written approval prior to issuance of regulatory capital by the banking institution, or issuance to third parties out of a special purpose vehicle in Additional Tier 1 Capital or Tier 2 Capital [92]. An application must be supplemented with the following:

i. a confirmation of compliance by the Chief Executive Officer that the proposed capital instruments comply with all the criteria for inclusion in capital set out in paragraphs 12 and 13;

ii. indicative (or where available, final[93]) offering documents;

iii. for the purpose of ensuring compliance with the requirements set out under paragraphs 30 and 31, an external legal opinion:

a. confirming that write-off or conversion into common equity at the relevant trigger point is enforceable under the banking institution's articles of association, and relevant company and/or securities law;

b. confirming that write-off or conversion into common equity at the relevant trigger point does not constitute an event of default for that instrument or trigger cross-default clauses; and

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

Regulatory approval may be sought for an individual issuance, or for an issuance programme. Approval for an issuance programme allows subsequent issuances under the programme to be deemed approved for recognition to the extent that the criteria for inclusion in capital continues to be

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

93 A banking institution must provide the Bank, as soon as practicable, final offering documents.

met. Banking institutions are however required to notify the Bank prior to subsequent issuances under the approved programme.

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

33.3. In addition to the requirements set forth under paragraphs 33.1 and 33.2, the Bank may require the banking institution to provide an external legal opinion from a firm of the Bank's choice, and at the banking institution's expense, confirming that the instrument complies with all relevant criteria for inclusion in capital.

33.4. A banking institution is required to obtain the Bank's written approval prior to making any planned reduction in its capital[94], including capital instruments issued out of consolidated subsidiaries held by third parties recognised under paragraphs 9.1(v), 10.1(iii) and 11.1(iii). The banking institution is required to demonstrate, through its capital plans, that the planned reduction of capital results in capital levels remaining well above the minimum capital adequacy and capital buffer requirements, and consistent with its risk profile and business plans.

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

33.5. Regulatory applications shall be directed to:

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

34. Transitional arrangements

Capital adequacy requirements and capital buffer requirements

34.1. The following minimum capital adequacy ratios shall apply in 2013 and 2014, in place of the minimum levels set out in paragraph 7.1:

Calendar year	CET1 Capital Ratio	Tier 1 Capital Ratio	Total Capital Ratio
2013	3.5%	4.5%	8.0%
2014	4.0%	5.5%	8.0%

34.2. The following capital conservation buffers shall apply before 2019, in place of the amount set out in paragraph 8.1(i):

Calendar year	Capital Conservation Buffer
2015 and before	0%
2016	0.625%
2017	1.25%
2018	1.875%

34.3. The countercyclical capital buffer applicable to a banking institution, if any, before 2019 shall be determined in the manner set out in paragraph 8.1(ii), but subject to the following scaling factors:

Calendar year	Scaling factor
2015 and before	0%
2016	25%
2017	50%
2018	75%

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

34.4. The following paragraphs describe the transition arrangements for instruments recognised as capital under the existing framework prior to 1 January 2013. For the avoidance of doubt, instruments issued in excess of the limits allowed for recognition prior to 1 January 2013 (e.g. Tier 2 Capital limited to 50% of Tier 1 Capital) will not be eligible for the gradual phasing-out treatment. Nevertheless, such instruments will be allowed to be fully recognised (i.e. without limitation) on and after 1 January 2013 if they meet all the criteria for inclusion set out in paragraphs 13 and 14, and have received the written approval of the Bank pursuant to paragraphs 33.1 to 33.5.

34.5. Additional Tier 1 and Tier 2 capital instruments issued on, or before, 16 December 2011[95], excluding those which have call features and incentives to be redeemed, will be subject to the following transitional arrangements:

i. a capital instrument meeting all the relevant criteria for inclusion[96] will continue to be fully recognised; and

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

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

i. a capital instrument with an effective maturity date[97] on, or before, 16 December 2011 that remains not called after its effective maturity date:

   a. will continue to be fully recognised if it meets all the relevant criteria for inclusion on a forward looking basis[98]; or

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95 As indicated in paragraph 2.3 of the Bank's circular *Implementation of Basel III* dated 16 December 2011.

96 Paragraphs 13 and 14 for Additional Tier 1 and Tier 2 capital instruments respectively.

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

98 From the effective maturity date and thereafter.

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

ii. a capital instrument with an effective maturity date between, and including, 17 December 2011 and 31 December 2012 that remains not called after its effective maturity date:

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

b. will be subject to the gradual phase-out treatment if it meets all the relevant criteria for inclusion, with the exception of the items set forth in paragraph 34.8, on a forward looking basis; and

c. with the exception of the items set forth in paragraph 34.8, will be derecognised if it does not meet all other relevant criteria for inclusion, on a forward looking basis.

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

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

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

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

i. a capital instrument meeting all the relevant criteria for inclusion will continue to be fully recognised;

ii. a capital instrument meeting all the relevant criteria for inclusion, with the exception of the items set forth in paragraph 34.8, will subject to the gradual phase-out treatment; and

iii. with the exception of the items set forth in paragraph 34.8, a capital instrument not meeting all other relevant criteria for inclusion, will be derecognised.

34.8. Additional Tier 1 and Tier 2 capital instruments with an effective maturity date, or issued between, and including, 17 December 2011 and 31 December 2012 which comply with the criteria for inclusion set forth by the Basel Committee[99], but which do not meet the additional criteria specified by the Bank, will continue to be recognised after 1 January 2013, subject to the gradual phase-out treatment[100]. These are:

i. paragraphs 13.1(xiii) and 13.1(xiv) for an Additional Tier 1 capital instrument, and paragraph 13.1(x) concerning Additional Tier 1 capital instruments classified as an equity under Malaysian Financial Reporting Standards; and

ii. paragraphs 14.1(ix), 14.1(x), and 14.1(xi) for a Tier 2 capital instrument.

34.9. The gradual phase-out treatment referred to in paragraphs 34.5 to 34.7 will allow for a limited recognition of certain capital instruments previously recognised but no longer meeting the criteria for inclusion in Additional Tier 1 and Tier 2, eventually resulting in such instruments fully derecognised by 1 January 2022. The treatment for the limited recognition is as follows:

i. Determine the base for the phase-out treatment, which shall be the total amounts of Additional Tier 1 and Tier 2[101] instruments outstanding on 1 January 2013 eligible for the gradual phase-out treatment, counted separately;

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99 *Basel III: A global regulatory framework for more resilient banks and banking systems*, December 2010.

100 Refer to footnote 95.

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

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

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

iii. To the extent an instrument is redeemed, or its recognition in capital is amortised, after 1 January 2013, the nominal amount serving as the base is not reduced[102].

34.10. For the avoidance of doubt, CET1 capital instruments, regardless of issuance date, and Additional Tier 1 and Tier 2 capital instruments issued after 1 January 2013 do not qualify for any of the transition arrangements described above.

34.11. The above treatment is summarised in Appendix 3, while an illustration of the gradual phase-out treatment is provided in Appendix 4.

34.12. A banking institution must, prior to 14 January 2013, notify the Bank of the following:

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

i. for instruments subject to the gradual phase-out treatment, the name of the issuance/programme, nominal amount and first available call date, as well as a calculation of the base amounts on 1 January 2013 specified in paragraph 34.9(i); and

ii. for instruments which meet all the relevant criteria for inclusion on a forward looking basis (including ordinary shares), a confirmation of compliance by the Chief Executive Officer[103].

The notification shall be directed to:

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

Question 18

Please list down the details of all Tier 1 and Tier 2 capital instruments issued by your banking institution (including instruments issued by consolidated subsidiaries for consolidated reporting purposes) that are outstanding on 31 March 2012 in the reporting template (under the tab "AddInfo").

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

34.13. The treatment of minority interest and capital instruments issued out of subsidiaries and held by third parties, as outlined in paragraph 15, will not be phased-in. The surplus capital attributable to third parties that is no longer eligible for the inclusion capital shall be excluded in full from the corresponding tier of capital starting from 1 January 2013.

[103] A confirmation of compliance under this paragraph will not be required to the extent that the Bank's written approval had already been obtained pursuant to paragraphs 33.1 to 33.5.

Regulatory adjustments

34.14. Regulatory adjustments specified under paragraphs 29.2(i) and (ii) will be phased-in as follows:

Calendar year	Portion to be deducted using the corresponding deduction approach
2013	0%
2014	20%
2015	40%
2016	60%
2017	80%
2018	100%

The remaining portion of regulatory adjustments not deducted from CET1 Capital or Additional Tier 1 Capital using the corresponding deduction approach shall be deducted from Tier 2 Capital[104]. Any shortfall shall be deducted from the next higher tier of capital.

34.15. All other regulatory adjustments, as set out in Part E, will fully apply in the calculation of capital starting from 1 January 2013.

[104] For 2013, the regulatory adjustments in paragraphs 29.2(i) and (ii) will be fully deducted in the calculation of Tier 2 Capital.

APPENDICES

Appendix 1 General treatment of equity investments

Type of investment		Treatment	
		At the entity level	At the consolidated level
Banks and other financial entities excluding insurance and takaful companies	Subsidiaries	Paragraph 29	Consolidate, or deduct from CET1 if allowed under paragraph 5.2
	Others	Paragraph 29	
Insurance and takaful companies	Subsidiaries	Paragraph 29	
	Others		
Other commercial entities	Subsidiaries	Risk-weight at 1250%	Consolidate, or risk-weight at 1250% if allowed under paragraph 5.2
	Others	Risk-weight in accordance with trading or banking book treatment	

Appendix 2 Illustrative example on minority interest and capital instruments issued out of consolidated subsidiaries held by third parties

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

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

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

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

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

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

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

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

The following table illustrates how to calculate the amount of capital issued by Bank S to include in consolidated capital, following the calculation procedure set out in paragraph 15:

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

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

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

Appendix 3 Transitional arrangements for capital instruments

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

	Issuance date		
	On or before 16 December 2011[1]	**Between 17 December 2011 and 31 December 2012**[2]	**On or after 1 January 2013**
Meets all criteria	Recognised	Recognised	Recognised
Meets all criteria except for those set forth in paragraph 34.8	Gradually phased-out	Gradually phased-out	Derecognised
Other than those set forth in paragraph 34.8, does not fully meet criteria	Gradually phased-out	Derecognised	Derecognised

[1] Paragraph 34.5.
[2] Paragraph 34.7.

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

	Effective maturity date			
	On or before 16 December 2011[3]	**Between 17 December 2011 and 31 December 2012[4]**	**On or after 1 January 2013[5]**	
			Prior to effective maturity date	**After effective maturity date**
Meets all criteria	Recognised	Recognised	Gradually phased-out	Recognised
Meets all criteria except for those set forth in paragraph 34.8	Gradually phased-out	Gradually phased-out	Gradually phased-out	Derecognised
Other than those set forth in paragraph 34.8, does not fully meet criteria	Gradually phased-out	Derecognised	Gradually phased-out	Derecognised

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

[3] Paragraph 34.6(i).
[4] Paragraph 34.6(ii).
[5] Paragraph 34.6(iii).

Appendix 4 Illustrative example on the gradual phase-out treatment

Scenario 1: No capital instrument is redeemed[1], or is called, during the transition period. Some Tier 2 capital instruments are amortised before 1 January 2013.

- On 1 January 2013, Bank A has RM150 m Additional Tier 1 and RM350 m Tier 2 capital instruments, of which RM250 m is in the last 3 years of its amortisation period. All these capital instruments qualify for the phase-out treatment.

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

Calendar year	Additional Tier 1 capital		Tier 2 capital		
	Cap[3]	Amount recognised	Cap	Outstanding amount[4]	Amount recognised[5]
2013	135	135	225	250	225
2014	120	120	200	200	200
2015	105	105	175	150	150
2016	90	90	150	100	100
2017	75	75	125	100	100
2018	60	60	100	100	100
2019	45	45	75	100	75
2020	30	30	50	100	50
2021	15	15	25	100	25
2022	0	0	0	100	0

1 Based on contractual maturity.
2 Paragraph 34.9(i)
3 Paragraphs 34.9(ii) and (iii)
4 The outstanding amount for individual capital instrument shall continue to be amortised at a rate of 20% per year.
5 Amount recognised under the gradual phase-out treatment is the lower of the aggregate cap and the amount outstanding.

Scenario 2: Some capital instruments are called, and some capital instruments are amortised within the transition period.

- On 1 January 2013, Bank A has RM150 m Additional Tier 1 and RM450 m Tier 2 capital instruments. All these capital instruments qualify for the phase-out treatment.
- RM35 m of Additional Tier 1 capital instrument is called on 30 June 2016.
- RM70 m of Additional Tier 1 capital instrument was issued before 16 December 2011 and is not called on its effective maturity date, 31 July 2018. Based on a forward looking basis, the instrument does not meet all requirements in paragraph 13.
- RM20 m of Additional Tier 1 capital instrument was issued before 16 December 2011 and is not called on its effective maturity date, 31 August 2020. Based on a forward looking basis, the instrument meets all requirements in paragraph 13.
- RM400 m of Tier 2 capital instrument starts its last 5 years to maturity in 2015.

Base for Additional Tier 1 capital outstanding @ 1 January 2013	Base for Tier 2 capital outstanding @ 1 January 2013
150	450

Calendar year	Additional Tier 1 capital			Tier 2 capital		
	Cap	Outstanding amount	Amount recognised	Cap	Outstanding amount	Amount recognised
2013	135	150	135	405	450	405
2014	120	150	120	360	450	360
2015	105	150	105	315	450	315
2016	90	115[6]	90	270	370	270
2017	75	115	75	225	290	225
2018	60	45	45	180	210	180
2019	45	45	45	135	130	130
2020	30	25[7]	25	90	50	50
2021	15	25	15	45	50	45
2022	0	25	0	0	50	0

[6] The outstanding amount shall exclude the amount of instruments that have been called.

[7] Although the amount of RM20 m will be removed from the outstanding amount for phase-out calculation, this shall be recognised as fully eligible for Additional Tier 1 capital.