BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Capital Adequacy Framework for Islamic Banks (Capital Components)

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PART A OVERVIEW

1. Introduction

1.1. Regulatory capital requirements seek to ensure that risk exposures of an Islamic 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 an Islamic 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 Capital Adequacy Framework for Islamic Banks sets out the approach for computing regulatory capital adequacy ratios, as well as the levels of those ratios at which Islamic banking institutions are required to operate at. The framework has been developed based on internationally-agreed standards on capital adequacy promulgated by the Basel Committee on Banking Supervision (BCBS).

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 *Capital Adequacy Framework for Islamic Bank (Risk-Weighted Assets)* which details out the requirements for computing risk-weighted assets.

2. Applicability

2.1. The framework is applicable to;

i. Islamic banks licensed under section 3(4) of the Islamic Banking Act 1983 (IBA); and

ii. Banking institutions carrying on Islamic banking or financial business under section 124 of the Banking and Financial Institutions Act 1989 (BAFIA) in accordance with the Guidelines on *Skim Perbankan Islam*.

For the purpose of this framework, the institutions above are hereafter referred to as "Islamic banking institutions".

3. Legal provisions

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

4. Issuance date

4.1. The Capital Adequacy Framework for Islamic Banks was first issued on 4 August 1989, with amendments and additional requirements introduced subsequently. This document was last updated on 28 November 2012.

5. Effective date

5.1. The requirements in this document take effect on 1 January 2013, and are subject to the transition arrangements as set out in paragraphs 36.1 to 36.17.

6. Level of application

6.1. An Islamic banking institution is required to comply with the Capital Adequacy Framework for Islamic Banks at the following levels:

i. entity level[1], referring to the global operations of the Islamic banking institution (i.e. including its overseas branch operations) on a stand-alone basis, and including its Labuan banking subsidiary; and

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[1] Also referred to as the "solo" or "stand-alone" level.

ii. consolidated level, which includes entities covered under the entity level requirement, and the consolidation[2] of all subsidiaries[3], except takaful subsidiaries which shall be deducted in the calculation of Common Equity Tier 1 Capital[4].

6.2. Where consolidation of the subsidiaries required under paragraph 6.1(ii) is not feasible[5], Islamic banking institutions may instead, seek the Bank's approval to:

i. in the case of financial entities, deduct such investments in accordance with paragraph 30.2; and

ii. in the case of non-financial entities, apply a risk weight of 1250% to such investments in accordance with paragraphs 2.51, 3.4 and 3.179 of the *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets).*

6.3. Banking institutions referred to in paragraph 2.1(ii) are required to comply with this framework in respect of its Islamic banking or financial business (hereafter referred to as *Skim Perbankan Islam* (SPI)), as if the SPI is a standalone Islamic bank[6].

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

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2 In accordance with Malaysian Financial Reporting Standards (MFRS).

3 Financial and non-financial subsidiaries. A financial entity refers to any entity, whether incorporated in Malaysia or otherwise, engaged substantively in, or acquiring holdings in other entities engaged substantively in, any of the following activities: banking, provision of credit, 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 30.2.

5 E.g. where non-consolidation for regulatory capital purposes is otherwise required by law.

6 This requirement is similarly stipulated under paragraph 6.3 of the Capital Adequacy Framework (Capital Components)

PART B GENERAL REQUIREMENTS

7. Capital adequacy ratios

7.1. An Islamic banking institution shall calculate its Common Equity Tier 1 (CET1) Capital, Tier 1 Capital 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. $$\text{Total Capital Ratio} = \frac{\text{Total Capital}}{\text{Total RWA}}$$

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

i. CET1 Capital as defined in paragraph 10.1;

ii. Tier 1 Capital shall be the sum of CET1 Capital and Additional Tier 1 Capital as defined in paragraph 11.1; and

iii. Total Capital shall be the sum of Tier 1 Capital and Tier 2 Capital as defined in paragraph 12.1.

7.3. Total risk-weighted assets (RWA) shall be calculated as the sum of credit RWA, market RWA, operational RWA, and large exposure risk requirements as determined in accordance with the *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)*[7].

The sum of the above shall be further adjusted to take into account any profit-sharing investment accounts (PSIA) recognised as a risk absorbent for capital

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

adequacy purposes, in the manner stipulated under the *Guidelines on Recognition and Measurement of PSIA as Risk Absorbent*.

7.4. Any exposures which are deducted in the calculation of CET1, Tier 1, and Total Capital shall not be subject to any further capital charges in the computation of RWA.

8. Minimum capital adequacy requirements

8.1. Islamic 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%

8.2. 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 36.1.

8.3. The Bank may, in writing, specify higher minimum capital adequacy requirements for a banking institution, having regard to the specific risk profile of the Islamic banking institution.

9. Capital buffer requirements

9.1. An Islamic banking institution is required to hold additional capital buffers above the minimum CET1 Capital, Tier 1 Capital and Total Capital adequacy levels[8] set forth under paragraph 8.1 or 8.3. These buffers, collectively referred to as

[8] Assuming a zero countercyclical capital buffer, Islamic banking institutions shall operate above CET1 Capital, Tier 1 Capital and Total Capital levels of 7%, 8.5% and 10.5%. For example, an Islamic 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 (e.g. dividends, share buybacks, discretionary payments).

the Buffer Requirement, comprise:

i. a Capital Conservation Buffer[9] of 2.5% of total RWA; and

ii. a Countercyclical Capital Buffer[10] ranging between 0% and 2.5% of total RWA, determined as the weighted-average of the prevailing countercyclical capital buffer requirements applied in the jurisdictions in which the Islamic banking institution has credit exposures[11].

9.2. The capital buffer requirements under paragraph 9.1(i) and (ii) will take full effect in 2019. The capital buffer requirements applicable before 2019 are set forth in paragraphs 36.2 and 36.3.

9.3. The Bank may, in writing, specify an additional buffer requirement for an Islamic banking institution, having regard to the specific risk profile of the Islamic banking institution.

Note: The Bank expects to detail out capital buffer requirements 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. the Pillar 2 Internal Capital Adequacy Assessment Process).

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

[10] 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.

[11] As announced by the relevant national authority.

PART C COMPONENTS OF CAPITAL

10. Common Equity Tier 1 Capital

10.1. CET1 Capital shall consist of the following:

i. ordinary shares issued by the Islamic banking institution that meet the criteria specified in paragraph 13.1;

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

iii. retained earnings net of any interim and/or final dividend declared[12] and any interim losses. Any quarterly interim profits may be included in CET1 Capital, subject to a review/audit by the Islamic banking institution's external auditors[13];

iv. other disclosed reserves[14];

v. qualifying minority interest[15], as determined under paragraph 16.1; and

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

10.2. The CET1 Capital of a SPI shall consist of the following:

i. Islamic Banking Funds (IBF) which consists of an allocation of the entity's CET1 to fund the SPI and CET1 Capital generated within the SPI; and

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

11. Additional Tier 1 Capital

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

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[12] In accordance with applicable MFRS.

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

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

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

i. Additional Tier 1 capital instruments issued by the Islamic banking institution[16] that meet the criteria specified in paragraph 14.1, and are not included in CET1 Capital;

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

iii. qualifying CET1 and Additional Tier 1 capital instruments issued by consolidated subsidiaries of the Islamic banking institution and held by third parties, as determined under paragraph 16.2; and

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

12. Tier 2 Capital

12.1. Tier 2 Capital shall consist of the following:

i. Tier 2 capital instruments issued by the Islamic banking institution[18] that meet the criteria specified in paragraph 15.1, and are not included in Tier 1 Capital;

ii. share premium resulting from the issue of instruments referred to in paragraph 12.1(i)[19];

iii. qualifying CET1, Additional Tier 1 and Tier 2 capital instruments issued by consolidated subsidiaries of the Islamic banking institution and held by third parties, as determined under paragraph 16.3;

iv. financing loss provisions[20]:

a. surplus eligible provisions[21] over expected losses[22], subject to a

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[16] For the purpose of paragraph 6.3, allocation of a banking institution's Additional Tier 1 capital instruments, if any, which are not issued specifically for the purpose of the SPI shall not be recognised as regulatory capital for the SPI.

[17] 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.

[18] For the purpose of paragraph 6.3, allocation of a banking institution's Tier 2 capital instruments, if any, which are not issued specifically for the purpose of the SPI, shall not be recognised as regulatory capital for the SPI.

[19] 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.

[20] The provisions should be gross of tax effects.

maximum of 0.6% of total credit RWA 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 financing classified as impaired, subject to a maximum of 1.25% of total credit RWA 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.

[21] In accordance with paragraphs 3.211 to 3.213 of the *Capital Adequacy Framework for Islamic Bank (Risk-Weighted Assets)*.

[22] In accordance with paragraphs 3.200 to 3.210 of the *Capital Adequacy Framework for Islamic Bank (Risk-Weighted Assets).*

PART D CRITERIA FOR INCLUSION IN CAPITAL

13. Ordinary shares

13.1. 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[23];

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

iii. ordinary shares absorb the first and proportionately greatest share of any losses as they occur[24], 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 Islamic banking institution or an affiliated entity[25] 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[26];

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);

vii. distributions are paid out of distributable items (including retained

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

[24] For the avoidance of doubt, the requirement for a permanent write-off feature in capital instruments as set out in paragraph 33.1(ii) does not negate this criterion being met by ordinary shares.

[25] 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.

[26] 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.

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 Islamic 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 (MFRS);

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

xiii. the Islamic 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 Islamic 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.

13.2. In instances where an Islamic 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.

13.3. Neither the Islamic banking institution nor an affiliated party over which it exercises control or significant influence can purchase the ordinary shares, nor can the Islamic banking institution directly or indirectly have financed the purchase of the ordinary share, failing which the regulatory adjustments as set out in paragraph 29 shall apply.

14. Additional Tier 1 capital instruments

14.1. 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 Islamic banking institution;

iii. the instrument is neither secured nor covered by a guarantee of the Islamic 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 Islamic banking institution;

iv. the instrument is perpetual, and shall therefore not have a maturity date, step-up features or other incentives for the Islamic banking institution to redeem the instrument[27];

v. the instrument may be callable at the initiative of the Islamic 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 Islamic 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

[27] 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.

or better quality, and the replacement of this capital is done at conditions which are sustainable for the income capacity of the Islamic banking institution[28]; or

ii. the Islamic banking institution demonstrates to the satisfaction of the Bank that its capital position is and can be sustained well above the minimum capital adequacy requirements and capital buffer requirements, as outlined in paragraphs 8 and 9 respectively, after the call option is exercised;

vi. any repayment of principal[29], other than through the exercise of a call option, (e.g. through repurchase) must be with the prior written approval of the Bank and the Islamic 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 Islamic banking institution at all times[30,31];

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

c. the Islamic banking institution must have full access to cancelled payments to meet obligations as they fall due[32]; and

d. cancellation of distributions/payments must not impose restrictions on the Islamic 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

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28 Replacement issues can be concurrent with, but not after the instrument is called.

29 Repayments due to tax or regulatory events are permitted subject to the assessment by the Bank that the banking institution was not in a position to anticipate the event at issuance.

30 Features such as "dividend pushers" are prohibited. An instrument with a dividend pusher obliges the issuing Islamic 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.

31 Any waived distributions/payments are non-cumulative i.e. are not required to, and must not, be made up by the Islamic banking institution at a later date.

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

the credit standing of the Islamic 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 converted[33] into ordinary shares, if the consolidated or entity level CET1 Capital Ratio of the Islamic banking institution[34] falls below a pre-specified level, which shall be no lower than 5.125%. The aggregate amount to be converted into ordinary shares for all these instruments, on breaching the trigger level, must at least be the amount needed to immediately restore the consolidated and entity level CET1 Capital Ratio of the Islamic banking institution to 5.75%[35]. If this is not possible, then the full principal value of the instrument must be converted into ordinary shares;

xi. the instrument cannot have any features that hinder recapitalisation, such as provisions that require the Islamic 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 (SPV)[36], proceeds must be immediately available without limitation to the Islamic banking institution in a form which meets or exceeds all of the other criteria for inclusion in Additional Tier 1 Capital[37];

xiii. the provisions governing the issuance of the capital instrument require the instrument to be converted[38] into ordinary shares, at the point of

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[33] Subject to paragraph 33.3.

[34] As disclosed in its published financial reports/statements or in Pillar 3 disclosures.

[35] Accordingly, for the purpose of paragraph 6.3, if the consolidated or entity or SPI level CET1 Capital Ratio of a banking institution falls below 5.125%, the aggregate amount to be converted into ordinary shares must at least be the amount needed to immediately restore the consolidated, entity, or SPI level CET1 Capital Ratio of the banking institution to 5.75%.

[36] i.e. the instrument is not issued 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.

[37] For the avoidance of doubt, a capital instrument, issued out of an SPV must satisfy the requirements under paragraph 16.4 to qualify as Additional Tier 1 Capital or Tier 2 Capital (as applicable).

[38] Subject to paragraph 33.3.

non-viability, as determined by the requirements set forth in paragraphs 32.1 to 32.4. The amount to be converted into ordinary shares must be the full principal value of the instrument; and

xiv. the instrument issued shall be structured using unrestricted non-exchange based contracts (e.g. *Musharakah, Mudarabah or Wakalah*), in addition to meeting other Shariah requirements.

14.2. Neither the Islamic banking institution nor an affiliated party over which it exercises control or significant influence can purchase the Additional Tier 1 capital instrument, nor can the Islamic banking institution directly or indirectly have financed its purchase, failing which the regulatory adjustments as set out in paragraph 29 shall apply.

15. Tier 2 capital instruments

15.1. 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 Islamic banking institution;

iii. the instrument is neither secured nor covered by a guarantee of the Islamic 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 Islamic 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 Islamic banking institution to redeem the instrument;

v. the instrument may be callable at the initiative of the Islamic 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 Islamic banking institution must not do anything which creates an expectation that the call will be exercised[39]; 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 Islamic banking institution[40]; or

ii. the Islamic banking institution demonstrates that its capital position is well above the minimum capital adequacy requirements and capital buffer requirements, as outlined in paragraphs 8 and 9 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 the prior written approval of the Bank and the Islamic banking institution shall not assume or create market expectations that approval will be given;

vii. 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;

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 Islamic banking institution or any of its affiliated entities;

ix. if the instrument is issued out of an SPV, proceeds must be immediately available without limitation to the Islamic banking institution in a form which meets or exceeds all of the other criteria for inclusion in Tier 2 Capital[37];

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[39] An option to call the instrument after five years but prior to the start of, or during, the period in which the instrument will be gradually derecognised 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.

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

x. the provisions governing the issuance of the capital instrument require the instrument to be written-off[41], or the instrument to be converted into ordinary shares, at the point of non-viability, as determined by the requirements set forth in paragraphs 32.1 to 32.4. The amount to be written-off or converted into ordinary shares must be the full principal value of the instrument.

15.2. 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 ≤ 4	80%
2 < x ≤ 3	60%
1 < x ≤ 2	40%
x ≤ 1	20%

15.3. Neither the Islamic banking institution nor an affiliated party over which it exercises control or significant influence can purchase the Tier 2 capital instrument, nor can the banking institution directly or indirectly have financed its purchase, failing which the regulatory adjustments as set out in paragraph 29 shall apply.

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

16.1. Minority interest arising from the issue of ordinary shares by a fully consolidated Islamic banking subsidiary[42,43] of the Islamic banking institution may be recognised in consolidated CET1 Capital if the ordinary share giving rise to the minority interest, if issued by the Islamic banking institution itself,

41 Subject to paragraph 33.3.

42 An Islamic 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 BCBS. 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.

43 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.

meets the criteria for inclusion in CET1 Capital[44]. The amount of minority interest that will be recognised in consolidated CET1 Capital under paragraph 10.1(v) shall be calculated as follows:

$$\boxed{A - (B \times C)}$$

where:

A total qualifying minority interest[45]

B surplus CET1 Capital of the subsidiary, calculated as CET1 Capital of the subsidiary[46] minus the lower of the following:

I. 7.0%[47] of the subsidiary's total RWA calculated at the entity level; or

II. 7.0% of the portion of the Islamic banking institution's consolidated RWA relating to that subsidiary.

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

16.2. Tier 1 capital instruments issued by a fully consolidated subsidiary[48, 43] of the Islamic banking institution and held by third parties may be recognised in consolidated Tier 1 Capital if the instrument, if issued by the Islamic banking institution itself, meets the criteria for inclusion in CET1 Capital or Additional Tier 1 Capital[49, 50]. The amount of this capital that will be recognised in consolidated Tier 1 Capital is calculated as follows:

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44 Accordingly, all references to the term "Islamic banking institution" in paragraph 13 shall mean to refer to any "fully-consolidated banking subsidiary" for purposes of this paragraph.

45 Including associated reserves, but prior to the application of regulatory adjustments.

46 Including associated reserves and regulatory adjustments.

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

48 For the avoidance of doubt, this includes both Islamic banking and non-banking subsidiaries, but excludes takaful subsidiaries and other subsidiaries which are not consolidated for regulatory purposes.

49 Accordingly, all references to the term "Islamic banking institution" in paragraphs 13 and 14 shall mean to refer to any "fully-consolidated subsidiary of the Islamic 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.

50 Islamic banks can recognise Shariah-compliant capital instruments issued by subsidiaries in other jurisdictions based on the Shariah views in the respective jurisdictions, unless specifically disallowed by the Bank.

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

where:

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

B surplus Tier 1 Capital of the subsidiary, calculated as Tier 1 Capital of the subsidiary[46] minus the lower of the following:

I. 8.5%[51] of the subsidiary's total RWA calculated at the entity level; or

II. 8.5% of the portion of the Islamic banking institution's consolidated RWA 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 11.1(iii) shall exclude amounts recognised in consolidated CET1 Capital as calculated under paragraph 16.1.

16.3. Total capital instruments issued by a fully consolidated subsidiary[48, 43] of the Islamic banking institution and held by third parties may be recognised in consolidated Total Capital if the instrument, if issued by the Islamic banking institution itself, meets the criteria for inclusion in CET1 Capital, Additional Tier 1 Capital or Tier 2 Capital[52]. 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, calculated as Total Capital of

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

[52] Accordingly, all references to the term "Islamic banking institution" in paragraphs 13, 14 and 15 shall mean to refer to any "fully-consolidated subsidiary of the Islamic banking institution" for purposes of this paragraph.

the subsidiary[46] minus the lower of the following:

I. 10.5%[53] of the subsidiary's total RWA calculated at the entity level; or

II. 10.5% of the portion of the Islamic banking institution's consolidated RWA relating to that subsidiary.

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

The capital that will be recognised in consolidated Tier 2 Capital under paragraph 12.1(iii) shall exclude amounts recognised in consolidated CET1 Capital as calculated under paragraph 16.1 and amounts recognised in consolidated Additional Tier 1 Capital as calculated under paragraph 16.2.

16.4. Capital issued to third parties out of an SPV may be included in entity and consolidated level Additional Tier 1 Capital or Tier 2 Capital, as if the Islamic banking institution had issued the capital directly to third parties, only if[54]:

i. the SPV is domiciled in Malaysia[55];

ii. the SPV is controlled and managed by the Islamic banking institution, and would, in accordance with MFRS, be fully consolidated. However, use of independent SPVs is allowed in structures which requires the use of such SPVs, which includes the issuance of Islamic capital instruments based on exchange contracts (e.g *Murabahah* or *Ijarah*);

iii. the SPV is set up for the sole purpose of the capital issuance for the Islamic banking institution[56] and does not conduct any other business or activity;

iv. the SPV has no external creditors at any time[57];

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

54 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 16.2 and 16.3.

55 Including Labuan.

56 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.

57 Nonetheless, this does not preclude miscellaneous creditors (e.g. tax authorities, administrators) to the extent that they are de minimis.

v. the entire proceeds from the capital issuance through the SPV[58] shall be immediately available without limitation to the Islamic banking institution in a form which meets or exceeds all of the criteria for inclusion in Additional Tier 1 or Tier 2 Capital, as applicable;

vi. the provisions governing the issuance of the instruments issued by the SPV and the Islamic 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 14.1 for Additional Tier 1 Capital and paragraph 15.1 for Tier 2 Capital) for inclusion as if the Islamic banking institution itself were to issue the instrument[59, 60].

16.5. In cases where the capital has been issued to third parties through an SPV via a fully consolidated subsidiary of the Islamic banking institution[61], such capital may, subject to the requirements in paragraph 16.4, be treated as if the subsidiary itself had issued it directly to the third parties and may be included in the Islamic banking institution's consolidated Additional Tier 1 Capital or Tier 2 Capital in accordance with the treatment outlined in paragraph 16.2 and 16.3.

16.6. 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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58 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.

59 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.

60 In the case of issuance of Islamic capital instruments 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 banking institution 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.

61 The SPV must be controlled and managed by the fully consolidated subsidiary, except as mentioned in paragraph 16.4(ii).

PART E REGULATORY ADJUSTMENTS

17. Goodwill and other intangibles

17.1. Goodwill, including any goodwill included in the valuation of significant capital investments in unconsolidated entities, and all other intangibles[62] 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 the relevant MFRS.

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

18. Deferred tax assets and liabilities

18.1. Deferred tax assets (DTAs) that rely on the future profitability of the Islamic banking institution[63] to be realised shall be deducted in the calculation of CET1 Capital[64]. In this regard, a DTA may be netted against 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.

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

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[62] As defined under MFRS. This shall include mortgage servicing rights, if any.

[63] Or the profitability of the Islamic banking institution and its consolidated subsidiaries for consolidated reporting.

[64] 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 Islamic banking institution, it shall be assigned the relevant sovereign risk weighting.

of CET1 Capital.

19. Property revaluation gains/losses

19.1. The amount of cumulative unrealised gains arising from the changes in the fair value or revaluation of land and buildings[65] 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 the calculation of Tier 2 Capital[66].

19.2. 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.

19.3. For the purpose of recognition of cumulative unrealised gains in Tier 2 Capital in accordance with paragraph 19.1(ii) the valuation of land and buildings shall be certified by an independent professional valuer at least once every three years[67] or where there is evidence that the value has been or is likely to be substantially impaired.

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[65] 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.

[66] For the avoidance of doubt, any impairment charge or accumulated amortisation/depreciation against any land and buildings is not netted against unrealised gains from any other land and buildings.

[67] 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.

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

20.1. 55% of cumulative unrealised gains arising from the changes in fair value of financial instruments, other than financing and receivables, classified as "available-for-sale" shall be deducted in the calculation of CET1 Capital.

20.2. For 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.

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

21. Profit equalisation reserve (PER)

21.1. The portion of PER attributable to an Islamic banking institution (ie. shareholder's portion of PER) shall be fully deducted in the calculation of CET1 Capital[68].

22. Cash flow hedge reserve

22.1. The amount of the cash flow hedge reserve[69] 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

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

[69] 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.

in the calculation of CET1 Capital.

23. Regulatory reserve for financing

23.1. The amount of regulatory reserve attributable to 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[70].

24. Shortfall of eligible provisions to expected losses

24.1. Where the Islamic banking institution has adopted the Internal Ratings-Based approach for credit risk, any shortfall of eligible provisions[71] to expected losses[72] 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.

25. Valuation adjustments

25.1. The amount arising from the valuation adjustments computed in accordance with paragraphs 5.18 and 5.19 of the *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)* that exceed the valuation adjustments made under MFRS shall be deducted in the calculation of CET1 Capital.

26. Increases in equity capital resulting from a securitisation transaction

26.1. Any increase in equity capital resulting from a securitisation transaction, such

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[70] Financing loss provisions are partially recognised in Tier 2 Capital as set out in paragraph 12.1(iv)(b).

[71] In accordance with paragraphs 3.211 to 3.213 of the *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)*.

[72] In accordance with paragraphs 3.200 to 3.210 of the *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets).*

as that associated with expected future margin income resulting in a gain-on-sale, shall be deducted in the calculation of CET1 Capital.

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

27.1. All unrealised fair value gains and losses on financial liabilities that are due to changes in the Islamic banking institution's own credit risk [73] 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.

27.2. In addition, all accounting valuation adjustments on derivatives liabilities that are due to changes in the Islamic banking institution's own credit risk shall be derecognised in the calculation of CET1 Capital. For the avoidance of doubt, the offsetting between valuation adjustments that are due to changes in the Islamic banking institution's own credit risk and those arising from the counterparties' credit risk is not allowed.

28. Defined benefit pension fund assets and liabilities

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

28.2. Assets in the fund to which the Islamic banking institution has unrestricted and unfettered access may, with the prior written approval of the Bank, offset the

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

deduction. Such offsetting assets shall be risk weighted as if they were owned directly by the Islamic banking institution[74].

29. Investments in own capital instruments

29.1. All direct, indirect[75] and synthetic[76] holdings of an Islamic banking institution's own capital instruments[77] in the trading and banking book[78], including any own capital instruments which the Islamic banking institution is contractually obliged to purchase and any other financing[79] provided for the purpose of purchasing own capital instruments, will be deducted in the calculation of capital. In applying the deductions, Islamic banking institutions must deduct the investment from the same component of capital for which it would qualify[80].

29.2. In instances where an Islamic banking institution has an indirect exposure to its own capital instrument (e.g. through an investment in a collective investment scheme or holdings of an index security), the Islamic banking institution shall look through the holdings to determine their underlying holdings of capital[81].

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74 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 an Islamic banking institution. The concern is that their only value stems from a reduction in future payments into the fund. The treatment allows for Islamic 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.

75 Indirect holdings are exposures or parts of exposures that, if a direct holding loses its value, will result in a loss to the Islamic banking institution substantially equivalent to the loss in value of the direct holding. An indirect holding may arise when the Islamic banking institution invests in an unconsolidated intermediate entity that has an exposure to the capital of the Islamic banking institution itself.

76 A synthetic holding may arise when an Islamic banking institution invests in an instrument where the value of the instrument is directly linked to the value of the capital of the Islamic banking institution itself.

77 Including treasury stock.

78 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.

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

80 Unless already derecognised under the relevant MFRS.

81 If the Islamic banking institution finds it operationally burdensome to look through the holdings of an index security, the Islamic 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.

29.3. For the purpose of paragraph 29.1, gross long positions may be netted against gross short positions in the same underlying exposure only if the short positions involve no counterparty risk[82]. In the case of an index security, the Islamic 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 VI of *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)*.

30. Investments in the capital of unconsolidated financial and takaful entities[83]

30.1. Investments in the capital instruments of unconsolidated financial[84] and takaful entities shall:

i. include direct, indirect[85] and synthetic[86] holdings of capital instruments. An Islamic banking institution shall look through indirect exposures (e.g. through an investment in a collective investment scheme or holdings of an index security) to determine its underlying holdings of capital[81];

ii. refer to the net long positions[82] in both the banking book and trading book[78]. 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

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[82] This includes netting positions in cash instruments and derivatives over the same underlying exposures.

[83] 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 takaful subsidiaries for entity level reporting.

[84] For the purpose of paragraphs 30.1 to 30.4, this shall include financial entities, as defined in footnote 3, and their holding companies.

[85] An indirect holding may arise when an Islamic banking institution invests in an unconsolidated intermediate entity that has an exposure to the capital of an unconsolidated financial or takaful entity and thus gains an exposure to the capital of that financial or takaful entity.

[86] A synthetic holding may arise when an Islamic 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 takaful entity.

residual maturity of at least one year[87];

iii. include underwriting positions held longer than five working days[88]; 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.

30.2. The investments in the capital instruments of unconsolidated financial and takaful entities, as set forth under paragraph 30.1, shall be deducted in the calculation of capital as follows:

i. where the Islamic 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 Islamic banking institution[25], the entire amount of investments in capital instruments; and

iii. where the Islamic 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 Islamic banking institution's common equity[89].

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 an Islamic banking institution be deducted.

30.3. In applying the deductions under paragraph 30.2, an Islamic 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

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87 Any counterparty credit risk associated with short positions used to offset long positions shall remain included in the calculation of RWA.

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

89 The common equity for purposes of calculating the 10% threshold shall be calculated after applying the regulatory adjustments set out in paragraphs 17 to 29 above to the sum of items set out in paragraphs 10.1(i) to (v).

issued by the Islamic banking institution itself. In applying the corresponding deduction approach, if the capital instrument of the entity in which the Islamic 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 Islamic banking institution, the capital is to be considered as an ordinary share for purposes of this regulatory adjustment[90] and thus deducted in the calculation of CET1 Capital.

30.4. The amount of capital holdings which is not deducted under paragraph 30.2(iii) shall continue to be risk weighted[91]. 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.

31. Other requirements

31.1. In applying the regulatory adjustments against a particular tier of capital and if the Islamic banking institution does not have enough of that tier of capital to satisfy the deduction, any shortfall shall be deducted in the calculation of the next higher tier of capital[92].

31.2. The Bank may, in writing, adjust a specific regulatory adjustment in this framework in respect of an Islamic banking institution, having regard to the specific risk profile of the Islamic banking institution.

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90 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.

91 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.

92 For example, if an Islamic banking institution does not have enough Additional Tier 1 Capital to meet the deductions, the shortfall will be deducted in the calculation of CET1 Capital.

PART F OTHER REQUIREMENTS

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

32.1. 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 Relevant Malaysian Authority notifies the Islamic banking institution in writing that the Relevant Malaysian Authority is of the opinion that a write-off or conversion is necessary, without which the Islamic banking institution would cease to be viable; or

ii. the Relevant Malaysian Authority 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 an Islamic banking institution, without which the Islamic banking institution would cease to be viable.

32.2. For the purposes of paragraph 32.1 and 32.4, the Relevant Malaysian Authority shall refer to the following:

i. the Bank, jointly with PIDM, where an Islamic banking institution is a *member institution*, as prescribed under the Malaysia Deposit Insurance Corporation Act 2011[93]; or

ii. the Bank, where an Islamic banking institution is not a member institution.

32.3. In assessing whether an Islamic banking institution would cease to be viable in accordance to paragraph 32.1, the Relevant Malaysian Authority may consider, among others, whether any of the following circumstances exist in respect of the Islamic banking institution[94]:

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[93] As defined in section 2 of the Malaysia Deposit Insurance Corporation Act 2011.

[94] The circumstances may be mutually exclusive and should not be viewed as an exhaustive list.

i. the Islamic banking institution fails to follow any directive of compliance issued by the Bank, which is necessary to preserve or restore its financial soundness;

ii. the Islamic banking institution fails to meet all or any of its financial obligations as they fall due, that may significantly impair its capital position;

iii. the capital of the Islamic banking institution has reached a level or is eroding in a manner that may detrimentally affect its depositors, creditors or the public, and the Islamic banking institution is unable to recapitalise on its own;

iv. the Islamic banking institution's assets are insufficient to provide protection to its depositors and creditors;

v. the Islamic banking institution has lost the confidence of depositors and the public; or

vi. any other state of affairs exists in respect of the Islamic banking institution that would put the interest of the depositors or creditors of the Islamic banking institution at risk.

For the avoidance of doubt, the Relevant Malaysian Authority shall have the full discretion to elect not to require a write-off or conversion when the Islamic banking institution has ceased, or is about to cease, to be viable or when a capital injection or equivalent support has been provided. Even if the option is not exercised, holders of the Islamic banking institution's Additional Tier 1 and Tier 2 capital instruments may still be exposed to losses from the resolution of the Islamic banking institution.

32.4. Where the 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[95] is included as capital at the consolidated level, the provisions governing the issuance shall also contain clauses that require the instrument, at the option of the Relevant Malaysian Authority, to be written-off, or the

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[95] For example, overseas subsidiaries of Malaysian banking groups.

instrument to be converted into ordinary shares upon the occurrence of the trigger event described in paragraph 32.1.

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

33.1. In respect of the requirement under 15.1(x), for a capital instrument that can be written-off:

i. the write-off shall 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;

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; and

iv. the write-off must generate CET1 Capital under MFRS and the instrument will only receive recognition in Tier 2 Capital up to the minimum level of CET1 Capital generated by a full write-off of the instrument.

33.2. In respect of the requirement under paragraphs 14.1(x), 14.1(xiii), and 15.1(x) for a capital instrument that can be converted into ordinary shares:

i. the Islamic 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[96,97];

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96 The contractual terms of the instrument therefore need to be formulated within perimeters permitted under company law and the Islamic banking institution’s memorandum and articles of association. Where necessary, an Islamic 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.

97 For the purposes of paragraph 6.3, the amount of Islamic Additional Tier 1 and Tier 2 capital instruments converted into ordinary shares, must immediately be reallocated into the SPI in the form of Islamic Banking Fund (IBF).

ii. the conversion formula and/or ratio 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 the purpose of paragraph 32.4, any ordinary shares arising from the conversion may be the ordinary shares of either the issuing Islamic banking institution, parent company or any other affiliated entity, including any successor in resolution, that are Shariah-compliant[98];

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; and

vii. the conversion must generate CET1 Capital under MFRS and the instrument will only receive recognition in Additional Tier 1 Capital or Tier 2 Capital up to the minimum level of CET1 Capital generated by a full conversion of the instrument.

33.3. In applying the requirements under paragraphs 14.1(x), 14.1(xiii) and 15.1(x), only conversion into ordinary shares is allowed for capital instruments using unrestricted non-exchange-based contracts (e.g. *Musyarakah, Mudarabah* or *Wakalah*). For the avoidance of doubt, capital instruments structured using

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[98] Notwithstanding this requirement for purposes of paragraph 6.3, conversion can be made into ordinary shares of the banking institution (which is licensed under BAFIA) as the entity has a SPI operations.

exchange-based contracts (e.g. *Murabahah*, *Tawarruq* or *Ijarah*)[99] can either be written-off or converted into ordinary shares. Where the provisions governing the instrument require the instrument to be written-off, the write-off mechanism shall be in accordance with Appendix 5[100].

33.4. In respect of the requirement under paragraph 14.1(x), an Islamic banking institution may provide for a hierarchy of conversion among Additional Tier 1 capital instruments, where certain instruments are converted before others in the event of a partial conversion. The terms governing such hierarchy shall be clearly stipulated and provided for in the issue and offering documents. In the event where no hierarchy is provided, all Additional Tier 1 capital instruments shall absorb losses proportionately.

34. Disclosure requirements

34.1. The full terms and conditions[101,102] of all Additional Tier 1 and Tier 2 capital instruments included in regulatory capital[103] shall be made available on the Islamic banking institution's website.

35. Regulatory process and submission requirements

35.1. An Islamic banking institution is required to obtain the Bank's written approval prior to issuance of regulatory capital by the Islamic banking institution, or issuance to third parties out of an SPV and included in entity and consolidated level Additional Tier 1 Capital or Tier 2 Capital[104]. An application must be supplemented with the following:

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[99] For the purpose of applying the requirement under paragraph 15.1(x).

[100] Usage of mechanisms other than those specified in Appendix 5 shall be subject to prior written approval from the Bank.

[101] Including any other relevant pricing supplements.

[102] For the purposes of paragraph 6.3, the terms and conditions shall clearly provide that the conversion is into ordinary shares of the entity which operates the SPI.

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

[104] An Islamic banking institution must also seek the Bank's written approval prior to any subsequent

i. a confirmation of compliance by the Chief Executive Officer that the proposed capital instruments comply with all the criteria for inclusion in capital as set out in paragraphs 14 and 15[105], as well as paragraphs 32 and 33;

ii. indicative (and where available, final[106]) issue and offering documents;

iii. for the purpose of ensuring compliance with the requirements set out under paragraphs 32 and 33, an external legal opinion:

   a. confirming that write-off or conversion into common equity at the relevant trigger point is enforceable under the Islamic banking institution's memorandum and 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;

   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; and

   d. confirming that the hierarchy provided for in paragraphs 33.4 does not impede the ability of the capital instruments to be immediately converted or written-off.

iv. a confirmation from an external accounting firm that write-off or conversion generates CET1 Capital under MFRS at the relevant trigger point.

v. for the purpose of ensuring compliance with Shariah requirements, the Chairman of the Shariah Committee shall submit:

   a. a confirmation that the write-off mechanism is Shariah-compliant, if other than the mechanism in Appendix 5 is used; and

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modification of the terms and conditions of an instrument that may affect its eligibility as regulatory capital.

105 This should include an annexe that sets out to demonstrate compliance with the applicable requirements by making references to the relevant parts of the offering documents.

106 An Islamic banking institution must provide the Bank, as soon as practicable, final offering documents (e.g. prospectus, offering circular, pricing supplement, information memorandum, trust deed, financing agreement).

b. an explanation of the salient features of the Shariah contract and Shariah-compliant mechanisms[107] used in structuring the capital instrument, if not already provided in the terms and conditions.

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

35.2. An Islamic banking institution shall notify the Bank of any capital instrument issued out of foreign subsidiaries to third parties that is included in consolidated CET1 Capital, 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 Islamic banking institutions, the Islamic 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 (any of) its non-Malaysian parent(s).

35.3. In addition to the requirements set forth under paragraphs 35.1 and 35.2, the Bank may require the Islamic banking institution to provide an external legal opinion from a firm of the Bank's choice, and at the Islamic banking institution's expense, confirming that the instrument complies with all relevant criteria for inclusion in capital.

35.4. An Islamic banking institution is required to obtain the Bank's written approval prior to making any planned reduction in its capital[108], including capital

[107] For example, the mechanisms used for profit smoothening, redemption of principal amount, subordination of capital instruments and loss absorption requirements.

[108] This includes a share buy back or an early redemption, repurchase or repayment of a capital

instruments issued out of consolidated subsidiaries and held by third parties recognised under paragraphs 10.1(v), 11.1(iii) and 12.1(iii). The Islamic 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 requirements and capital buffer requirements, and consistent with its risk profile and business plans.

35.5. 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

36. Transitional arrangements

Capital adequacy requirements and capital buffer requirements

36.1. The following minimum capital adequacy ratios shall apply in 2013 and 2014, in place of the minimum levels set out in paragraph 8.1:

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%

36.2. The following capital conservation buffers shall apply before 2019, in place of the amount set out in paragraph 9.1(i):

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

36.3. The countercyclical capital buffer applicable to an Islamic banking institution, if any, before 2019 shall be determined in the manner set out in paragraph 9.1(ii),

instrument, including through the exercise of a call option.

but subject to the following scaling factors:

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

36.4. Any capital buffer requirement under paragraph 9.3 will be subject to transitional arrangements, as specified by the Bank.

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

36.5. 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 14 and 15, and have received the written approval of the Bank pursuant to paragraph 35.1.

36.6. Additional Tier 1 and Tier 2 capital instruments issued on, or before, 16 December 2011[109], 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[110] 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.

36.7. Additional Tier 1 and Tier 2 capital instruments issued on, or before, 16

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

[110] Paragraphs 14 and 15 for Additional Tier 1 and Tier 2 capital instruments respectively.

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[111] 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[112]; or
   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 36.9, on a forward looking basis; and
   c. with the exception of the items set forth in paragraph 36.9, 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.

36.8. Additional Tier 1 and Tier 2 capital instruments issued between, and including,

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[111] The first date of the incentive to be redeemed (e.g. step-up) that a capital instrument may have.
[112] From the effective maturity date and thereafter.

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[113];

ii. a capital instrument meeting all the relevant criteria for inclusion, with the exception of the items set forth in paragraph 36.9, will subject to the gradual phase-out treatment; and

iii. with the exception of the items set forth in paragraph 36.9, a capital instrument not meeting all other relevant criteria for inclusion, will be derecognised.

36.9. 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[114], 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[109]. These are:

i. paragraphs 14.1(xiii) and 14.1(xiv) for an Additional Tier 1 capital instrument, and paragraph 14.1(x) concerning Additional Tier 1 capital instruments classified as an equity under MFRS; and

ii. paragraphs 15.1(x) for a Tier 2 capital instrument.

36.10. The gradual phase-out treatment referred to in paragraphs 36.6 to 36.8 will allow for a limited recognition of certain capital instruments previously recognised but no longer meeting the criteria for inclusion in Additional Tier 1 Capital and Tier 2 Capital, eventually resulting in such instruments fully derecognised by 1 January 2022. The treatment for the limited recognition is as

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[113] For the avoidance of doubt, any Additional Tier 1 Capital and Tier 2 Capital instruments issued on, or before, 31 December 2012 and approved by the Bank to be complied with the requirements in the *Concept Paper – Risk-Weighted Capital Adequacy Framework and Capital Adequacy Framework for Islamic Banks (General Requirements and Capital Components), dated 25 May 2012,* will continue to be deemed as fully compliant and will continue to be fully recognised.

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

follows:

i. Determine the base for the phase-out treatment, which shall be the total amounts of Additional Tier 1 and Tier 2 [115] capital instruments outstanding on 1 January 2013 eligible for the gradual phase-out treatment, counted separately;

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 Capital 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 derecognised, after 1 January 2013, the nominal amount serving as the base is not reduced[116].

36.11. For the avoidance of doubt, CET1 capital instruments, regardless of issuance date, do not qualify for any of the transition arrangements described above.

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

[115] 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.

[116] Individual Tier 2 capital instruments will also continue to be derecognised 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.

36.13. An Islamic banking institution must, prior to 14 January 2013, submit to the Bank a list of instruments eligible for the gradual phase-out treatment, which shall include the name(s) of the issuance(s)/programme(s), nominal amount and first available call date, as well as a calculation of the base amounts on 1 January 2013 specified in paragraph 36.10(i).

The list shall be submitted to:

Pengarah
Jabatan Penyeliaan Konglomerat Kewangan or
Jabatan Penyeliaan Perbankan (as applicable)
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur
(A soft copy of the list must also be emailed to: basel3@bnm.gov.my)

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

36.14. The treatment of minority interest and capital instruments issued out of subsidiaries and held by third parties, as outlined in paragraph 16, will not be phased-in. The surplus capital attributable to third parties that is no longer eligible for inclusion in capital shall be excluded in full from the corresponding tier of capital starting from 1 January 2013.

Regulatory adjustments

36.15. Regulatory adjustments specified under paragraphs 30.2(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 in the calculation of CET1 Capital or Additional Tier 1 Capital using the corresponding deduction approach shall be deducted in the calculation of Tier 2 Capital[117]. Any shortfall shall be deducted in the calculation of the next higher tier of capital.

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

Disclosure requirements

36.17. The disclosure requirement, as set out in paragraph 34.1 will fully apply starting from 1 January 2014.

[117] For 2013, the regulatory adjustments in paragraphs 30.2(i) and (ii) will be fully deducted in the calculation of Tier 2 Capital.

APPENDICES

Appendix 1 General treatment of equity investments

<table>
<tr><th colspan="2" rowspan="2">Type of investment</th><th colspan="2">Treatment</th></tr>
<tr><th>At the entity level</th><th>At the consolidated level</th></tr>
<tr><td rowspan="2">Islamic Banks and other financial entities excluding takaful operators</td><td>Subsidiaries</td><td>Paragraph 30</td><td>Consolidate, or deduct from CET1 Capital if allowed under paragraph 6.2</td></tr>
<tr><td>Others</td><td colspan="2">Paragraph 30</td></tr>
<tr><td rowspan="2">Takaful operators</td><td>Subsidiaries</td><td colspan="2" rowspan="2">Paragraph 30</td></tr>
<tr><td>Others</td></tr>
<tr><td rowspan="2">Other commercial entities</td><td>Subsidiaries</td><td>Risk-weight at 1250%[118]</td><td>Consolidate, or risk-weight at 1250%[116] if allowed under paragraph 6.2</td></tr>
<tr><td>Others</td><td colspan="2">Risk-weight in accordance with Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)</td></tr>
</table>

118 In accordance with paragraph 2.51, 3.4 and 3.179 of *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets).*

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

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

Islamic Bank P balance sheet		Islamic Bank S balance sheet	
Assets		**Assets**	
Financing to customers	100	Financing 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 Islamic Bank P shows that in addition to its financing to customers, it owns 70% of the ordinary shares of Islamic Bank S, 80% of the Additional Tier 1 Capital of Islamic Bank S and 25% of the Tier 2 Capital of Islamic Bank S. The ownership of the capital of Islamic Bank S is therefore as follows:

Capital issued by Islamic Bank S			
	Amount issued to parent (Islamic 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	
Financing 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, Islamic Bank S is assumed to have risk-weighted assets of 100. In this example, the minimum capital requirements of Islamic Bank S and the subsidiary's contribution to the consolidated requirements are the same since Islamic Bank S does not have any financing to Islamic 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 Islamic 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 Islamic Bank S to include in consolidated capital, following the calculation procedure set out in paragraph 16:

Islamic 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[119]	**Between 17 December 2011 and 31 December 2012**[120]	**On, or after, 1 January 2013**
Meets all criteria	Recognised	Recognised	Recognised
Meets all criteria except for those set forth in paragraph 36.9	Gradually phased-out	Gradually phased-out	Derecognised
Other than those set forth in paragraph 36.9, does not fully meet criteria	Gradually phased-out	Derecognised	Derecognised

[119] Paragraph 36.6.
[120] Paragraph 36.8.

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[121]	**Between 17 December 2011 and 31 December 2012**[122]	**On, or after, 1 January 2013**[123]	
			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 36.9	Gradually phased-out	Gradually phased-out	Gradually phased-out	Derecognised
Other than those set forth in paragraph 36.9, does not fully meet criteria	Gradually phased-out	Derecognised	Gradually phased-out	Derecognised

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

[121] Paragraph 36.7(i).
[122] Paragraph 36.7(ii).
[123] Paragraph 36.7(iii).

Appendix 4 Illustrative example on the gradual phase-out treatment

Scenario 1: No capital instrument is redeemed[124], or is called, during the transition period. Some Tier 2 capital instruments start the last four years of their contractual maturity before 1 January 2013.

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

Base for Additional Tier 1 capital instruments outstanding[125] on 1 January 2013	Base for Tier 2 capital instruments outstanding on 1 January 2013
150	100 + [250*(0.6)] = 250

Calendar year	Additional Tier 1 capital instruments (millions)		Tier 2 capital instruments (millions)		
	Cap[126]	Amount recognised	Cap	Nominal outstanding amount[127]	Amount recognised[128]
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

124 Based on contractual maturity.
125 Paragraph 36.10(i).
126 Paragraphs 36.10(ii) and (iii).
127 The outstanding amount for individual capital instrument shall continue to be amortised at a rate of 20% per year.
128 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, Islamic 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 14.
- 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 14.
- RM400 m of Tier 2 capital instrument starts its last four years to maturity in 2015.

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

Calendar year	Additional Tier 1 capital instruments (millions)			Tier 2 capital instruments (millions)		
	Cap	Nominal outstanding amount	Amount recognised	Cap	Nominal 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[129]	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[130]	25	90	50	50
2021	15	25	15	45	50	45
2022	0	25	0	0	50	0

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

[130] 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 instrument.

Appendix 5 Write-off mechanism for Tier 2 capital instruments structured using exchange-based contracts

Contracts	Write-off mechanism
Murabahah, Tawarruq	Write-off can be achieved through either of the following: i. Investor (as creditor) undertakes to waive his rights on debts at the point of non-viability, via a *Wa'ad*; or ii. Investor (as creditor) agrees to waive his rights on debts at the point of non-viability in the legal documentations[131].
Ijarah	Write-off can be achieved subject to the following: i. Investor (as lessor) agrees to waive his rights on accrued rental at the point of non-viability as provided in the legal documentations[131] with the lessee; and ii. Investor (as lessor) undertakes to transfer his ownership over the underlying asset (beneficial or otherwise) to the lessee without consideration, via a *Wa'ad*

[131] The waiver or transfer should be placed in the appropriate legal documentations (e.g. issue and offering documents, sale and purchase agreement, lease agreement).