BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Domestic Systemically Important Banks Framework

Applicable to:
1. Licensed banks
2. Licensed investment banks
3. Licensed Islamic banks
4. Financial holding companies
5. Prescribed development financial institutions

Issued on: 5 February 2020

BNM/RH/PD 028-107

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GLOSSARY

BCBS	Basel Committee on Banking Supervision
CET1	Common Equity Tier 1
DFIA	Development Financial Institutions Act 2002
D-SIB	Domestic systemically important bank
FVOCI	Fair Value through Other Comprehensive Income
FVPTL	Fair Value through Profit or Loss
FSA	Financial Services Act 2013
G-SIB	Global systemically important bank
HLA	higher loss absorbency
HQLA	high-quality liquid assets
IBA	indicator-based measurement approach
IFSA	Islamic Financial Services Act 2013
OTC	over-the-counter
PIDM	Perbadanan Insurans Deposit Malaysia
SFTs	securities financing transactions

PART A OVERVIEW

1 Introduction

1.1 The transformation of the Malaysian financial landscape in recent years has resulted in deeper interlinkages between the domestic banking system and other intermediaries in the financial system. Financial groups are also expanding regionally across a wide range of activities and markets.

1.2 These developments underscore the need to ensure that the existing regulatory framework and policy tools are continuously enhanced to address the risks posed by the banking system to the stability of the Malaysian financial system and the wider economy.

1.3 In particular, there is a greater need to identify and manage risks posed by systemically important financial institutions. These institutions, hereafter referred to as D-SIBs, are financial institutions whose distress or disorderly failure may cause significant disruption and result in spillovers to the domestic financial system and the wider economy.

1.4 Against this backdrop, the Bank's D-SIB policy framework, developed in line with the principles[1] outlined by the BCBS, aims to strengthen the resilience of the Malaysian banking system and address the following elements –

(a) regulatory requirements and policy measures that may be applicable to D-SIBs, such as the HLA requirement;
(b) intensity of supervisory oversight by the Bank; and
(c) macroprudential surveillance activities of the Bank.

1.5 This policy document sets out the HLA and reporting requirements applicable to financial institutions along with the assessment methodology employed to identify D-SIBs in Malaysia. The Bank at its discretion may impose additional requirements and policy measures as deemed appropriate by the Bank to manage risks posed by D-SIBs.

[1] BCBS, *A framework for dealing with domestic systemically important banks*, October 2012 (https://www.bis.org/publ/bcbs233.htm).

2 Applicability

2.1 This policy document is applicable to all financial institutions as defined in paragraph 5.2.

3 Legal provisions

3.1 This policy document is issued pursuant to –
(a) sections 47(1), 143(2) and 266 of the FSA;
(b) sections 57(1), 155(2) and 277 of the IFSA; and
(c) sections 41(1), 116(1) and 126 of the DFIA.

4 Effective date

4.1 This policy document comes into effect on 5 February 2020, subject to the transitional arrangements as set out in paragraphs 10.7 and 10.8.

5 Interpretation

5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the FSA, IFSA and DFIA, as the case may be, unless otherwise defined in this policy document.

5.2 For the purpose of this policy document –

“S” denotes a standard, an obligation, requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement action;

“G” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted;

“apex entity” refers to a financial institution that is not a subsidiary of another financial institution;

“banking institution” refers to –
(a) a licensed bank;
(b) a licensed investment bank;
(c) a licensed Islamic bank, except for a licensed international Islamic bank; and
(d) a prescribed development financial institution;
as the case may be;

“financial group” refers to a banking institution or a financial holding company and the group of related corporations under such banking institution or financial holding company;

“financial holding company” refers to a financial holding company approved by the Bank pursuant to section 112(3) of the FSA or section 124(3) of the IFSA, as the case may be, and holds investment directly or indirectly in corporations that are engaged predominantly in banking business;

“financial institution” refers to a banking institution or a financial holding company, with total assets[2] equal to or exceeding RM 30 billion, as the case may be;

“HLA requirement” refers to the capital surcharge imposed on D-SIBs above the minimum regulatory requirement to increase its going-concern loss absorbency capacity.

6 Related legal instruments and policy documents

6.1 This policy document must be read together with other relevant legal instruments and policy documents that have been issued by the Bank, in particular those listed in Appendix 1.

7 Policy documents and circulars superseded

7.1 This policy document supersedes the *Domestic Systemically Important Banks Framework Survey* issued on 10 October 2016.

[2] Refers to the quarterly average amount of financial institutions’ consolidated total assets in a calendar year.

PART B POLICY REQUIREMENTS

8 Level of application

S 8.1 The requirements set out in this policy document shall apply to financial institutions on a consolidated basis. This includes the consolidation of all subsidiaries, except insurance and/or takaful subsidiaries[3].

S 8.2 For a financial group comprising multiple financial institutions operating in Malaysia, paragraph 8.1 shall apply to the apex entity of the financial group, either a financial holding company or a banking institution, as the case maybe.

S 8.3 The Bank at its discretion may require a financial institution to additionally comply with the policy requirements as specified by the Bank at the entity level[4] whereupon the financial institution shall comply with such requirements.

9 Overview of assessment methodology

G 9.1 An IBA will be adopted by the Bank to identify D-SIBs. The assessment of systemic importance will also incorporate additional information via a supervisory overlay process (explained further in Appendix 2).

G 9.2 Under the IBA, a financial institution's systemic importance will be assessed in terms of the impact of distress or failure of the financial institution on the domestic financial system and economy. Indicators are selected across three categories of systemic importance namely –

(a) size;
(b) interconnectedness; and
(c) substitutability.

G 9.3 An overall score[5] will be computed for each financial institution by the Bank. A financial institution with an overall score exceeding a pre-determined cut-off threshold[6] will be designated as a D-SIB by the Bank, subject to any modification made through the supervisory overlay process.

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[3] In accordance with the Bank's *Capital Adequacy Framework (Capital Components)* and *Capital Adequacy Framework for Islamic Banks (Capital Components)*.

[4] Refers to the global operations of the financial institution (i.e. including its overseas branch operations) on a stand-alone basis, and including its Labuan banking subsidiary. Also referred to as the "solo" or "stand-alone" level.

[5] Equivalent to sum of weighted market share for each indicator across all categories of systemic importance in basis points (bps). A financial institution's overall score ranges from 0 - 10,000bps. In a hypothetical scenario comprising one financial institution in the financial system, that financial institution would score 10,000bps under the IBA. For further details, refer to BCBS, The G-SIB assessment methodology - score calculation, November 2014 (https://www.bis.org/bcbs/publ/d296.htm).

[6] The cut-off threshold is calibrated with reference to the distribution of financial institutions' overall scores and cluster analysis. For further details, refer to Appendix 2.

G 9.4 The list of D-SIBs will be reviewed on an annual basis. The Bank may also review the list as and when deemed necessary if there are major structural changes in the banking system e.g. a merger or significant restructuring exercise by financial institutions.

G 9.5 Following such review, the Bank will communicate any revisions to the list of D-SIB by the end of the third quarter of every calendar year.

G 9.6 The assessment methodology and corresponding policy requirements will be reviewed by the Bank every three years to ensure the policy framework takes into account developments in approaches to assess systemic importance and structural changes in the domestic banking system.

10 Higher loss absorbency requirement

G 10.1 The HLA requirement for D-SIBs aims to reduce the probability of a D-SIB's failure by increasing its going-concern capital buffers.

G 10.2 The calibration of the HLA requirement for D-SIBs in Malaysia by the Bank incorporates the following considerations –

(a) results from an assessment based on the Expected Impact Approach[7], where the level of HLA is set as the amount of additional capital required to be held by a D-SIB to reduce its expected system-wide impact of failure as compared to that of a non-DSIB;

(b) structural characteristics of the Malaysian banking system such as size of banking system relative to domestic economy; and

(c) the levels of HLA prescribed by the BCBS for G-SIBs and peer economies for D-SIBs in their jurisdiction.

S 10.3 A financial institution except for a prescribed development financial institution, which has been, designated as a D-SIB by the Bank under paragraph 9.3 shall hold and maintain capital buffers to meet the HLA requirement –

(a) at the consolidated level;

(b) in the form of CET1 Capital[8]; and

(c) in the manner set out in paragraphs 10.5, 10.7 and 10.8.

For the purpose of paragraph 10.3, the capital buffers shall be above the minimum CET1 Capital Ratio, Tier 1 Capital Ratio, and Total Capital Ratio requirements as well as other capital buffer requirements as set out in the Bank's *Capital Adequacy Framework (Capital Components)* and *Capital Adequacy Framework for Islamic Banks (Capital Components).*

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[7] For further details, refer to Annex 2 of BCBS, *Global systemically important banks: revised assessment methodology and the higher loss absorbency requirement,* July 2018 (https://www.bis.org/bcbs/publ/d445.htm).

[8] As defined in the Bank's *Capital Adequacy Framework (Capital Components)* and *Capital Adequacy Framework for Islamic Banks (Capital Components).*

S 10.4 Unless otherwise specified by the Bank, a prescribed development financial institution designated as a D-SIB by the Bank under paragraph 9.3 shall hold and maintain capital buffers to meet the HLA requirement –

(a) at the consolidated level;
(b) in the form of Tier 1 Capital[9]; and
(c) in the manner set out in paragraphs 10.5, 10.7 and 10.8.

For the purpose of paragraph 10.4, the capital buffers shall be above the minimum Risk Weighted Capital Ratio requirement as set out in the Bank's *Capital Framework for Development Financial Institutions.*

S 10.5 The HLA requirement applicable to designated D-SIBs shall correspond to the financial institutions' bucket[10] placement (refer to Table 1), unless otherwise specified by the Bank.

Table 1 – HLA requirement for D-SIBs

Bucket	HLA requirement (as % of risk-weighted assets)
3 (empty)	2.0
2	1.0
1	0.5

G 10.6 An empty bucket attracting a higher HLA requirement will be maintained above the current highest populated bucket to disincentivise D-SIBs from further increasing their systemic importance. If the empty bucket becomes populated in the future, an additional bucket with a higher HLA requirement will be added.

S 10.7 Where a financial institution is required to comply with the HLA requirement due to –

(a) its designation as a D-SIB; or
(b) a migration to a higher bucket for D-SIB (e.g. from Bucket 1 to Bucket 2);

the HLA requirement shall become applicable to such financial institution within 12 months upon notification by the Bank, unless otherwise specified by the Bank.

S 10.8 Where a financial institution is required to comply with a lower (or nil) HLA requirement than its current HLA requirement due to –

(a) cessation of its D-SIB status; or
(b) a migration to a lower bucket (e.g. Bucket 2 to Bucket 1);

the revised HLA requirement shall become applicable to such financial institution immediately upon notification by the Bank, unless otherwise specified by the Bank.

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[9] As defined in the Bank's *Capital Framework for Development Financial Institutions.*
[10] For further details on the bucketing approach, please refer to Appendix 2.

PART C REPORTING REQUIREMENTS

11 Submission requirements

S 11.1 A financial institution must prepare and submit the data set out in the D-SIB reporting template in Appendix 4a ("Requested Data") in accordance to the interpretations set out in Appendix 4b at the consolidated level.

S 11.2 A financial institution must submit the Requested Data in accordance with instructions set out in Appendix 5 via the Integrated Submission Platform, which is a web-based application set up by the Bank.

S 11.3 The first submission of the Requested Data shall be for period ending 31 December 2019. A financial institution must submit the completed reporting template no later than 31 March 2020. Thereafter, a financial institution must submit the Requested Data according to the reporting requirements set out in Table 2.

Table 2 – Reporting requirements

Reporting level	Reporting frequency	Reporting deadline
Consolidated	Annual	90 calendar days after 31 December every calendar year

S 11.4 For avoidance of doubt, only one reporting template is required to be submitted to the Bank by each financial group for a particular reporting period.

APPENDIX 1 RELATED LEGAL INSTRUMENTS AND POLICY DOCUMENTS

1. Capital Adequacy Framework (Capital Components)
2. Capital Adequacy Framework for Islamic Banks (Capital Components)
3. Capital Framework for Development Financial Institutions
4. Capital Adequacy Framework (Basel II – Risk-Weighted Assets)
5. Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)
6. Liquidity Coverage Ratio
7. External Sector Statistics (ESS) System Submission of International Transactions and External Position Information
8. Definition of Small and Medium Enterprises (SMEs)

APPENDIX 2 ASSESSMENT METHODOLOGY

1 Assessment methodology

Indicator-based measurement approach (IBA)

1.1 The IBA aims to measure domestic systemic impact arising from the distress or failure of a financial institution. In assessing suitability of indicators for use in the IBA, the Bank considers the following –

(a) indicators that –

(i) relate to factors that contribute to a financial institution's systemic impact;

(ii) reflect critical functions[11]; and

(iii) capture material exposures/activities of a financial institution;

(b) consistency with the overall regulatory framework and policy objectives of the Bank; and

(c) supervisory overlay process, which supplements the IBA.

Size

1.2 The impact of a financial institution's distress or failure is likely to cause greater disruption to the domestic financial system and economy if the financial institution is large and its activities comprise a significant share of the domestic financial system and economy.

1.3 The following indicators are used to measure the size of a financial institution –

(a) total assets; and

(b) total off-balance sheet exposures (credit-equivalent).

Interconnectedness

1.4 As financial institutions operate in an increasingly interconnected financial system, distress originating from one financial institution can generate broader spillovers and increase the likelihood of distress in other financial institutions. Thus, a financial institution's systemic importance is likely to be positively related to its interconnectedness in the financial system.

1.5 The following indicators are used to assess the interconnectedness of a financial institution with other parts of the financial system –

(a) total intra-financial system assets;

(b) total intra-financial system liabilities; and

(c) total securities outstanding.

[11] Refer to underlying operations, activities or services that are performed by a financial institution for third parties where the failure or discontinuance of such functions would likely lead to the disruption of services that are essential for the functioning of the real economy and financial stability.

Substitutability

1.6 Substitutability indicators aim to reflect a financial institution's degree of substitutability or lack thereof, in a particular business line and as a service provider in relation to the provision of critical functions. The greater a financial institution's role as a market participant and a client service provider, the greater the risk of significant disruption following its failure given the limited capacity and ability of other financial institutions to address the service gaps in a timely manner.

1.7 The scope of substitutability indicators shall be limited to a financial institution's domestic operations i.e. Malaysian activities/exposures. This is due to the higher relevance of financial institutions' domestic activities in assessing systemic impact from the disruption of services to the domestic financial system and economy.

1.8 The following indicators are used to assess the substitutability of a financial institution –
(a) total deposits accepted from non-financial institution customers;
(b) total loans extended to non-financial institution customers;
(c) value and volume of payments and settlement activities[12];
(d) total assets under custody; and
(e) underwriting activity.

Table 3 – IBA indicators and weights

Category (weights)	**Indicator**	**Indicator weights**
(a) Size (40%)	• Total assets	20%
	• Total off-balance sheet exposures (credit-equivalent)	20%
(b) Interconnected-ness (30%)	• Total intra-financial system assets	10%
	• Total intra-financial system liabilities	10%
	• Total securities outstanding	10%
(c) Substitutability (30%)	• Total deposits accepted from non-financial institution customers	6%
	• Total loans extended to non-financial institution customers	6%
	• Value and volume of domestic payments and settlement activities	6%
	• Total assets under custody	6%
	• Underwriting activity	6%

12 Refers to a financial institution's transaction value and volume in (i) RENTAS activities and (ii) selected retail payment activities (e.g. Interbank GIRO).

Bucketing approach

1.9 D-SIBs shall be grouped into buckets (i.e. clusters) by the Bank based on their degree of systemic importance as reflected by the overall scores derived from the IBA.

1.10 The bucketing approach facilitates the application of policy measures that are commensurate with a D-SIB's degree of systemic importance.

1.11 The number of buckets and calibration of corresponding bucket thresholds are determined by–
- (a) distribution of financial institutions' overall scores derived from IBA;
- (b) outcome of cluster analysis; and
- (c) reference to the BCBS G-SIB and D-SIB frameworks as well as D-SIB frameworks of other jurisdictions.

Supervisory overlay

1.12 The supervisory overlay process ensures that the assessment of systemic importance by the Bank incorporates information that may not be easily quantified or fully captured by the IBA thus mitigating limitations often associated with a purely quantitative-based assessment. Such an approach is consistent with international best practice in identifying systemically important banks at the global and national level by BCBS and national authorities, respectively.

1.13 The supervisory overlay process will focus on the impact of failure or distress of a financial institution on the domestic financial system and economy and not based on their probability of distress or failure. It will incorporate information including but not limited to financial institutions':
- (a) market share in a particular product or market segment;
- (b) performance of critical functions not taken into account in the IBA;
- (c) business, structural and operational complexity as well as degree of resolvability; and
- (d) ongoing or anticipated business restructuring, merger and acquisition plans.

1.14 To better inform supervisory judgement, ancillary indicators covering specific areas of systemic importance such as those outlined in paragraph 1.13 shall be collected as part of the reporting requirements (refer to Appendix 3). The list of ancillary indicators is non-exhaustive and shall be updated by the Bank on a periodic basis in line with developments in the domestic banking system and insights gathered from the ongoing supervision of financial institutions. The ancillary indicators shall also be used by the Bank to inform future refinements to the assessment methodology.

1.15 The supervisory overlay process shall be used to refine the list of potential D-SIBs identified by the IBA and may result in:

(a) changes to a financial institution being included to the final list of D-SIBs; and/or

(b) a financial institution being assigned to a different bucket.

It is expected that these changes would be rare given the ongoing process to review and refine the IBA assessment methodology by the Bank referred to in paragraph 9.6.

APPENDIX 3 ANCILLARY INDICATORS

1. Total net revenue
2. Total foreign revenue
3. Total cross-jurisdictional claims
4. Total cross-jurisdictional liabilities
5. Aggregate gross amount of OTC derivatives outstanding cleared through a central counterparty and settled bilaterally
6. Total amount of deposits guaranteed by PIDM
7. Total securities measured at FVTPL and FVOCI that do not qualify as HQLA
8. Total Level 3 assets
9. Total securities held at amortised cost that do not qualify as HQLA
10. Gross value of cash provided and gross fair value of securities provided in SFTs
11. Gross value of cash borrowed and gross fair value of securities borrowed in SFTs
12. Gross positive fair value of OTC derivatives transactions
13. Gross negative fair value of OTC derivatives transactions
14. Total trading volume
15. Number of deposit accounts of non-financial institution customers