

Response to feedback received

Capital Adequacy Framework (Standardised Approach for Credit Risk)

Introduction

The Bank issued today the policy document on Capital Adequacy Framework (Standardised Approach for Credit Risk) for financial institutions. This policy document incorporates the proposals from the exposure draft issued on 20 January 2023, and has taken into consideration feedback received during the consultation period.

The Bank received responses from 52 respondents during the consultation period. Respondents were broadly supportive of the proposed requirements in the exposure draft.

This document comprises the Bank's responses to key feedback received during the consultation period. Other comments and suggestions for clarification, where relevant, have been incorporated in the policy document.

Bank Negara Malaysia

14 June 2024

A. Real estate

1. Regulatory real estate: Value of property used for computing Financing-To-Value (FTV) ratio must be maintained at the value at origination.

Feedback received

Some respondents highlighted that maintaining the value of property at origination is not consistent with banks' practice in managing collateral for risk management and loan loss provisioning purposes. These respondents requested to retain the requirement under the Capital Adequacy Framework (Basel II – Risk-Weighted Assets) and Capital Adequacy Framework for Islamic Banks (Basel II – Risk-Weighted Assets) policy documents to annually recompute the FTV ratios for capital computation for residential real estate.

The Bank's response

- 1.1 A crucial element of the Basel III revisions is to ensure that the risk weights assigned to real estate exposures are commensurate with the financial risk of the exposures. Therefore, a prudent approach is to measure the financial risk of the exposure based on the repayment of the financing and the value of the property at origination, instead of taking into account fluctuations in property value which may be cyclical in nature.
- 1.2 The prescribed risk-weight tables under the Basel III requirements have more granular risk-weights relative to the Basel II standards. This provides more avenues for banks to move across the FTV buckets as repayments are received. As part of this recalibration, the Bank has also adjusted the risk weight for residential real estate exposures with FTV exceeding 90%, from 100% risk weight to 90% risk weight. Collectively, these requirements would generally benefit FIs. Hence, the Bank will retain the requirement to maintain the value of property at origination for the purpose of calculating the FTV ratio.
- 1.3 In computing the FTV ratio, FIs are also required to comply with the requirements on collateral valuation stipulated in the Bank's Credit Risk policy document.

B. Land Acquisition, Development and Construction (Land ADC) exposures

2. Land ADC exposures

Feedback received

Some respondents highlighted there is merit to allow a lower risk weight of 100% for a subset of Land ADC exposures that meets the qualifying criteria as outlined by BCBS. This approach recognises FIs' risk mitigation measures to differentiate high quality Land ADC exposures against other Land ADC exposures i.e., land acquisition and other financing.

The Bank's response

- 3.1 ADC exposures attract a higher risk weight, commensurate with the risk they pose to FIs. The exposure draft also explored the introduction of a subset of land ADC exposures that may be of lower risk to FIs, based on the land ADC financing arrangements that are present in Malaysia.
- 3.2 In view of the feedback provided and several engagements with FIs, the Bank has provided an avenue for FIs to recognise higher quality ADC exposures at a 100% risk weight if the ADC project achieves specified FTV and pre-sales thresholds as stated in paragraph 23.19 of this policy document. These thresholds set an appropriate level of mitigation to safeguard against the financial risk posed by ADC exposures.

C. Cross-currency mismatch

3. Applicability for cross-currency mismatch exposures

Feedback received

Respondents have highlighted operational challenges to identify existing exposures to unhedged retail and residential real estate exposures to individuals where the financing currency is different from the currency of the obligor's source of income. These respondents viewed that a disproportionate effort would need to be expended to go through existing voluminous retail and residential real estate exposures to update and validate each obligor's source of income, with potentially immaterial impact to capital. In addition, FIs have already in place risk mitigation measures to manage the potentially higher risk of financing to individuals where there is currency mismatch at the underwriting stage, such as income or financing haircuts and lower margin of advance.

The Bank's response

- 3.1 The Bank recognises that individuals may have more limited avenues in managing their currency risk. This could pose additional risks to FIs when there is volatility between the financing currency and the currency of the obligor's source of income. In this regard, consistent with the international standards, a multiplier of 1.5 to risk weights (up to a ceiling of 150%) will continue to apply to unhedged retail and residential real estate exposures to individuals where the financing currency is different from the currency of the obligor's source of income. Thus, the Bank will apply the multiplier of 1.5 to qualifying individual financing with currency mismatch.
- 3.2 However, in view of the immaterial size of cross-currency mismatch exposures for Malaysian banks (as validated in the submissions of banks), the Bank has decided to apply this requirement prospectively on new financing after the policy document effective date, as specified in paragraph 24.1 of this policy document. This is also consistent with the practices of some jurisdictions to minimise regulatory burden on banks.