Malaysia

Kadir Andri & Partners

Capital adequacy requirements update

The central bank of Malaysia, Bank Negara Malaysia (BNM), issued an updated Capital Adequacy Framework for Islamic banks (capital components) on November 28 2012, which took effect on January 1 2013 (Framework). The Framework will be in line with the international standards on capital adequacy promulgated by the Basel Committee on Banking Supervision and the revised Basel Capital Accord.

Although the Framework took effect on January 1 2013, there are certain requirements that are subject to transition arrangements, including the minimum capital adequacy requirements and the capital buffer requirements. These will only take full effect on January 1 2015 and in 2019 respectively.

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The Framework added another requirement for additional Tier 1 capital instruments and Tier 2 capital instruments. The provisions governing such issuances will contain clauses that require the instrument to be written off, or converted into ordinary shares, upon the occurrence of non-viability or trigger event, which will be the earlier of the following: (i) the relevant Malaysian authority notifies in writing that they are 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 BNM, the Malaysia Deposit Insurance Corporation 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.

In view of the above additional requirement, the Islamic banking institution, when applying for the approval of BNM, must supplement the application with external confirmations including an accounting firm's confirmation that the write-off or conversion generates CET1 capital under the Malaysian Financial Reporting Standards at the point of non-viability or trigger event. The institution must also supply a legal opinion on potential impediments to the write-off or the conversion of the instrument into ordinary shares at the point of non-viability or trigger event, and how they have been resolved.

Though the requirement is to highlight potential impediments and how they have been resolved, there may be impediments that may not or cannot be resolved; therefore, specific qualifications in respect of such impediments should be included for the legal opinion to be issued.

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