



**GUIDELINES ON BANKING AND ISLAMIC BANKING
CAPITAL ADEQUACY FRAMEWORK
(CAPITAL COMPONENTS)**

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1.0 Introduction

- 1.1 Regulatory capital requirements seek to ensure that risk exposures of a Labuan bank are backed by an adequate amount of high-quality capital which absorbs losses on a going concern basis. This ensures the continuing ability of a Labuan bank 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 may be used to meet claims in liquidation.
- 1.2 The *Guidelines on Banking and Islamic Banking Capital Adequacy Framework (Capital Components)* (the Guidelines) set out the general requirements concerning regulatory capital adequacy, the capital adequacy ratios that Labuan banks are required to maintain and the components of eligible regulatory capital under the Banking Capital Adequacy Framework (BCAF) and Islamic Banking Capital Adequacy Framework (iBCAF). The BCAF and iBCAF have been developed based on internationally agreed standards on capital adequacy promulgated by the Basel Committee on Banking Supervision (BCBS) and the Islamic Financial Services Board (IFSB).
- 1.3 The Guidelines constitute components of the capital adequacy ratio requirements and are to be read together with the following guidelines:
- (i) *Guidelines on Banking and Islamic Banking Capital Adequacy Framework (Credit Risk)*;
 - (ii) *Guidelines on Banking and Islamic Banking Capital Adequacy Framework (Operational Risk)*; and
 - (iii) *Guidelines on Banking and Islamic Banking Capital Adequacy Framework (Risk-Weighted Assets)*.

2.0 Applicability

2.1 The Guidelines are applicable to all Labuan banks as listed below:

- (i) Labuan banks and Labuan investment banks licensed under Part VI of the Labuan Financial Services and Securities Act 2010 (LFSSA);
- (ii) Labuan Islamic banks and Labuan Islamic investment banks licensed under Part VI of the Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA); and
- (iii) Labuan banks and Labuan investment banks undertaking Labuan Islamic banking business or Labuan Islamic investment banking business approved under Part VI of the LIFSSA.

Under the Guidelines, the term “Labuan bank(s)” refers collectively to all Labuan banking licensees as specified under paragraph 2.1.

2.2 For the avoidance of doubt, the Guidelines are not applicable to Labuan banks operating as branches.

2.3 Effective 1 July 2027, the following guidelines shall no longer be applicable to Labuan banks:

- (i) *Guidelines on Risk-Weighted Capital Adequacy* issued on 23 April 1997;
- (ii) *Guidelines on Risk-Weighted Capital Adequacy* issued on 29 September 1997;
- (iii) *Guidelines on Risk-Weighted Capital Ratio (RWCR) for Subsidiary Banks* issued on 10 March 2006;
- (iv) *Guidelines on RWCR for Subsidiary Banks* issued on 7 July 2009;
- (v) *Banking Capital Adequacy Framework: Guidelines on Capital Components* issued on 30 December 2016; and
- (vi) *Banking Capital Adequacy Framework: Guidelines on Risk Weighted Assets* issued on 30 December 2016.

3.0 Legal Provision

- 3.1 The Guidelines are issued pursuant to Section 4A of the Labuan Financial Services Authority Act 1996 (LFSAA) for the purpose of specifying the maintenance of capital adequacy ratio under Section 94 of the LFSSA and Section 69 of the LIFSSA.
- 3.2 Any person who fails to comply with the Guidelines may be subject to enforcement actions which include an administrative penalty under Section 36B and Section 36G of the LFSAA and/or other enforcement action provided under the LFSAA, or other applicable laws governed by Labuan FSA.

4.0 Effective Date

- 4.1 The Guidelines will come into effect on **1 July 2027** and would remain effective and applicable unless amended or revoked.

5.0 Level of Application

- 5.1 A Labuan bank is required to comply with the Guidelines at the following levels:
- (i) entity level¹, referring to the global operations of the Labuan bank (i.e. including its overseas branch operations) on a stand-alone basis; and
 - (ii) consolidated level, which includes entities covered under the entity level requirement and the consolidation² of all financial and non-financial subsidiaries, except insurance/takaful subsidiaries which shall be deducted in the calculation of Common Equity Tier 1 Capital³.
- 5.2 Where consolidation of the subsidiaries required under paragraph 5.1(ii) is not feasible⁴, Labuan bank may instead, seek Labuan FSA's approval to:
- (i) in the case of financial subsidiary, deduct such investments in accordance with paragraph 27.2; and

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

² In accordance with the international acceptable accounting standards as stipulated in the *Directive on Financial Reporting Standards for Labuan Financial Institutions* issued by Labuan FSA.

³ In accordance with paragraph 27.2.

⁴ For example, where non-consolidation for regulatory capital purposes is otherwise required by law.

- (ii) in the case of non-financial subsidiary, apply a risk weight of 1250% to such investments in accordance with paragraphs 21.4 of the *Guidelines on Banking and Islamic Banking Capital Adequacy Framework (Credit Risk)*.

5.3 A summary of the general treatments referred to in paragraphs 5.1 to 5.2, as well as that applicable for other equity investments, is set out in **Appendix I**.

PART A GENERAL REQUIREMENTS

6.0 Capital Adequacy Ratios

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

$$\text{CET1 Capital Ratio} = \frac{\text{CET1 Capital}}{\text{Total RWA}}$$

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

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

6.2 For the purpose of paragraph 6.1:

- (i) the numerators of the capital adequacy ratios are defined in accordance with the following:
 - (a) CET1 Capital as defined in paragraph 9.1;
 - (b) Tier 1 Capital shall be the sum of CET1 Capital and Additional Tier 1 (AT1) Capital as defined in paragraph 10.1; and
 - (c) Total Capital shall be the sum of Tier 1 Capital and Tier 2 Capital as defined in paragraph 11.1;
- (ii) 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 relevant guidelines in relation to risk-weighted assets.
- (iii) where applicable, the sum of credit and market RWA in paragraph 6.2(ii) shall be further adjusted for investment accounts⁵ which are recognised as a risk absorbent.

⁵ For the avoidance of doubt, any committed but unfunded investment accounts (where actual cash has yet to be received from the Investment Account Holder) shall not qualify as risk absorbent.

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

7.0 Minimum Capital Adequacy Requirements

7.1 Labuan banks shall hold and maintain, at all times, the following minimum capital adequacy ratios:

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

7.2 Notwithstanding paragraph 7.1, where Labuan FSA specifies in writing a higher minimum capital adequacy ratio for a Labuan bank after having regard to the specific risk profile of the Labuan bank, the Labuan bank shall hold and maintain such higher minimum capital adequacy ratio.

8.0 Capital Buffer Requirements

8.1 Labuan banks shall hold and maintain capital buffers, as specified by Labuan FSA, in the form of CET1 Capital above the minimum CET1 Capital, Tier 1 Capital and Total Capital adequacy levels set out in paragraph 7.1 or 7.2 respectively⁶. The capital buffers shall comprise the sum of the following:

- (i) a Capital Conservation Buffer (CCB)⁷ of 2.5%; and
- (ii) a Countercyclical Buffer (CCyB)⁸, determined as the weighted average of the prevailing CCyB rates applied in the jurisdictions in which Labuan bank has credit exposures.

6 For the avoidance of doubt, a Labuan bank's CET1 Capital shall first be used to meet the minimum ratios before the remainder can count towards its capital buffers. For example, a Labuan bank with 8% CET1 Capital Ratio and which does not have any AT1 or Tier 2 capital instruments would meet all minimum capital adequacy requirements but would not meet the capital buffer requirements.

7 The CCB is intended to encourage the build-up of capital buffers by Labuan banking during normal times that can be drawn down during stress periods.

8 The CCyB is intended to protect the Labuan banking sector as a whole from the build-up of systemic risk during an economic upswing when aggregate credit growth tends to be excessive.

Capital Conservation Buffer

- 8.2 For the purpose of paragraph 8.1(i), capital distribution constraints will be imposed on a Labuan bank when its capital levels fall within this range. Labuan banks will be able to conduct business as normal when their capital levels fall into the conservation range as they experience losses. The constraints imposed are limited to capital distributions only and do not affect the ability of the Labuan bank to operate.
- 8.3 The table below shows the minimum capital conservation ratios a Labuan bank must meet at various levels of the CET1 Capital Ratios. The applicable capital conservation ratios must be recalculated at each distribution date.

CET1 Capital Ratio	Minimum Capital Conservation Ratio (as a percentage of earnings)
Within 1st quartile of buffer: 4.5% - 5.125%	100%
Within 2nd quartile of buffer: > 5.125% - 5.75%	80%
Within 3rd quartile of buffer: > 5.75% - 6.375%	60%
Within 4th quartile of buffer: > 6.375% - 7%	40%
Above top of buffer: > 7%	0%

For example, a Labuan bank with a CET1 Capital Ratio in the range of 5.125% to 5.75% is required to conserve 80% of its earnings in the subsequent payment period (i.e. payout no more than 20% in terms of dividends and share buybacks).

- 8.4 For the purpose of paragraphs 8.2 and 8.3:
- (i) items considered to be distributions include dividends, share buybacks and discretionary payments on AT1 capital instruments. Payments that do not result in a depletion of CET1, which may for example include certain scrip dividends, are not considered distributions.

The distribution restrictions do not apply to dividends which satisfy all three of the following conditions:

- (a) the dividends cannot legally be cancelled by the Labuan bank;
 - (b) the dividends have already been removed from CET1; and
 - (c) the dividends were declared in line with the applicable capital conservation ratios at the time of declaration.
- (ii) earnings are defined as distributable profits calculated prior to the deduction of elements subject to the restriction on distributions. Earnings are calculated after the tax which would have been reported had none of the distributable items been paid. As such, any tax impact of making such distributions are reversed out. Where the Labuan bank does not have positive earnings and has a CET1 Capital Ratio less than 7% (or higher if the CCB has been expanded by CCyB), it would be restricted from making positive net distributions.

8.5 Labuan bank may make payments in excess of the constraints imposed, provided that it raises capital in the private sector equal to the amount above the constraint which it wishes to distribute. This would need to be discussed with Labuan FSA⁹ as part of the capital planning process and Labuan FSA may specify any further conditions and restrictions.

8.6 Labuan FSA may also impose time limits on Labuan bank operating within the buffer range or other conditions related to the rebuilding of the buffers. Labuan bank must demonstrate to the satisfaction of Labuan FSA that its capital plan seeks to rebuild buffers over an appropriate timeframe.

Countercyclical Buffer

8.7 For the purpose of paragraph 8.1(ii):

- (i) the CCyB to be maintained by Labuan bank shall be calculated as follows:

$$\frac{\sum_C (RWA_C \times CCyB_C)}{\sum_C RWA_C}$$

9 This refers to the Labuan FSA's relationship manager that supervises the Labuan bank.

where—

RWA_c the sum of the following private sector credit exposures:

- (a) RWA in respect of the private sector credit exposures¹⁰ in the banking book in jurisdiction c; and
- (b) RWA equivalent for trading book capital charges for specific risk, incremental risk charges (i.e. default and migration risks) and securitisation¹⁰ in jurisdiction c;

$CCyB_c$ the prevailing CCyB rate applied in jurisdiction c;

c jurisdictions in which Labuan bank has private sector credit exposures;

- (ii) in determining the jurisdiction to which a private sector credit exposure relates, Labuan banks shall use an ultimate risk basis where possible¹¹;
- (iii) Labuan banks shall calculate the CCyB based on the prevailing CCyB rate at the date from which the rate applies, as announced by the relevant national authority;
- (iv) where the prevailing CCyB rate applied in a jurisdiction is more than 2.5%, the CCyB rate for that jurisdiction is capped at 2.5% for the purpose of calculating the Labuan bank's CCyB, unless specified otherwise by Labuan FSA; and
- (v) if the national authority of the jurisdiction has yet to announce the CCyB rate, the rate applicable for that jurisdiction is deemed to be 0%.

8.8 The countercyclical buffer requirement to which a Labuan bank is subject is implemented through an extension of the CCB described in paragraphs 8.2 to 8.6. Labuan banks will be subject to restrictions on distributions if they do not meet the requirement.

10 This excludes exposures to sovereigns, central banks, non-federal public sector entities, multilateral development banks and banking institutions as defined in the *Guidelines on Banking and Islamic Banking Capital Adequacy Framework (Credit Risk)*. However, this shall include exposures to non-bank financial entities and public sector entities that are risk-weighted based on their external ratings similar to corporates.

11 For allocation of exposures to a multinational company, a Labuan bank shall, to the best of the Labuan bank's knowledge and information, determine where the risk ultimately lies and not allocate exposures solely on the basis of where the exposure is booked.

- 8.9 The table below shows the minimum capital conservation ratios a Labuan bank must meet at various levels of the CET1 Capital Ratio.

CET1 Capital Ratio	Minimum Capital Conservation Ratio (as a percentage of earnings)
Within 1st quartile of buffer	100%
Within 2nd quartile of buffer	80%
Within 3rd quartile of buffer	60%
Within 4th quartile of buffer	40%
Above top of buffer	0%

When the countercyclical capital buffer is zero in all of the regions to which a Labuan bank has private sector credit exposures, the capital levels and restrictions set out in the table are the same as those set out in paragraphs 8.2 to 8.6.

- 8.10 For illustrative purposes, the following table sets out the conservation ratios a Labuan bank must meet at various levels of CET1 capital if the Labuan bank is subject to a 2.5% CCyB requirement.

CET1 Capital Ratio	Minimum Capital Conservation Ratio (as a percentage of earnings)
4.5% - 5.75%	100%
> 5.75% - 7%	80%
> 7% - 8.25%	60%
> 8.25% - 9.5%	40%
> 9.5%	0%

- 8.11 For the avoidance of doubt, paragraphs 8.2, 8.4, 8.5 and 8.6 apply to a Labuan bank which is subject to CCyB.

PART B COMPONENTS OF CAPITAL

9.0 Common Equity Tier 1 Capital

9.1 CET1 Capital shall consist of the following:

- (i) ordinary shares issued by the Labuan bank that meet the criteria specified in paragraph 12.1;
- (ii) share premium resulting from the issue of ordinary shares;
- (iii) retained earnings net of any interim and/or final dividend declared¹² and any interim losses. Any quarterly interim profits may be included in CET1 Capital, subject to a review/audit by the Labuan bank's external auditors¹³;
- (iv) other disclosed reserves¹⁴;
- (v) qualifying minority interest, as determined under paragraph 15.2; and
- (vi) regulatory adjustments applied in the calculation of CET1 Capital, as determined in Part D.

10.0 Additional Tier 1 Capital

10.1 AT1 Capital shall consist of the following:

- (i) AT1 capital instruments issued by the Labuan bank that meet the criteria specified in paragraph 13.1, and are not included in CET1 Capital;
- (ii) share premium resulting from the issue of instruments referred to in paragraph 10.1(i)¹⁵;

¹² In accordance with the international acceptable accounting standards as stipulated in the *Directive on Financial Reporting Standards for Labuan Financial Institutions* issued by Labuan FSA.

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

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

¹⁵ Share premium that is not eligible for inclusion in CET1 Capital will only be permitted to be included in AT1 Capital if the shares giving rise to the stock surplus are permitted to be included in AT1 Capital.

- (iii) qualifying CET1 and AT1 capital instruments issued by consolidated subsidiaries of the Labuan bank and held by third parties, as determined under paragraph 15.4; and
- (iv) regulatory adjustments applied in the calculation of AT1 Capital, as determined in Part D.

11.0 Tier 2 Capital

11.1 Tier 2 Capital shall consist of the following:

- (i) Tier 2 capital instruments issued by the Labuan bank that meet the criteria specified in paragraph 14.1, and are not included in Tier 1 Capital;
- (ii) share premium resulting from the issue of instruments referred to in paragraph 11.1(i)¹⁶;
- (iii) qualifying CET1, AT1 and Tier 2 capital instruments issued by consolidated subsidiaries of the Labuan bank and held by third parties, as determined under paragraph 15.6;
- (iv) loss provisions¹⁷ (i.e. general provisions which refer to (a) loss allowance measured at an amount equal to 12-month and lifetime expected credit losses¹⁸; and (b) regulatory reserves, to the extent they are ascribed to non-credit-impaired exposures) 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 D.

¹⁶ 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.

¹⁷ The provisions should be gross of tax effects.

¹⁸ Refer to relevant acceptable FRSs. For the avoidance of doubt, these provisions are also commonly known as Stage 1 and Stage 2 provisions respectively.

PART C CRITERIA FOR INCLUSION IN CAPITAL

12.0 Ordinary Shares

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

- (i) it is directly issued and paid-up;
- (ii) it represents the most subordinated claim in liquidation of the Labuan bank;
- (iii) ordinary shares absorb the first and proportionately greatest share of any losses as they occur, 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 Labuan bank or an affiliated entity¹⁹ 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 liquidation²⁰;
- (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 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 Labuan bank 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;

¹⁹ An affiliate is defined as a company that controls, or is controlled by, or is under common control with, the Labuan bank. Control of a company is defined as (1) ownership, control, or holding with power to vote 10% or more of a class of voting securities of the company; or (2) consolidation of the company for financial reporting purposes.

²⁰ Except for discretionary repurchases or other means of capital reduction arrangements allowable under relevant laws and regulations. Repayment of principal shall also be subject to the prior written approval of Labuan FSA.

- (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 the international acceptable accounting standards as stipulated in the *Directive on Financial Reporting Standards for Labuan Financial Institutions* issued by Labuan FSA (referred to as “the acceptable FRSs”);
- (xii) ordinary shares are clearly and separately disclosed on the Labuan bank’s balance sheet;
- (xiii) Labuan bank 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;
- (xiv) the purchase of ordinary share is not directly or indirectly funded by the Labuan bank;
- (xv) the ordinary share is not purchased by the Labuan bank or its affiliated party over which it exercises control or significant influence; and
- (xvi) the ordinary share is only issued with the approval of the shareholders of Labuan bank, either given directly by shareholders or, if permitted by law, given by the board of directors or by other persons duly authorised by the shareholders.

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

12.3 For the purpose of paragraph 12.1(i) where an instrument is paid-up by way of issuance of shares and not by cash (e.g. payment for take-over of another company in the form of ordinary shares), a Labuan bank is required to obtain

the prior written approval of Labuan FSA to include the shares issued as regulatory capital.

13.0 Additional Tier 1 Capital Instruments

13.1 An instrument shall qualify as an AT1 capital instrument if it meets all the following criteria:

- (i) it the instrument is issued and paid-up;
- (ii) the instrument is subordinated to depositors, general creditors and other holders of subordinated debt of the Labuan bank;
- (iii) the instrument is neither secured nor covered by a guarantee of the Labuan bank 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 Labuan bank;
- (iv) the instrument is perpetual, and shall therefore not have a maturity date, step-up features or other incentives for the Labuan bank to redeem the instrument²¹;
- (v) the instrument may be callable at the initiative of the Labuan bank 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 Labuan FSA;
 - (b) the Labuan bank must not do anything which creates an expectation that the call will be exercised; and
 - (c) the call option must not be exercised unless:

²¹ 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.

- (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 Labuan bank²²; or
 - (ii) the Labuan bank demonstrates to the satisfaction of Labuan FSA that its capital position is and can be sustained well above the minimum capital adequacy requirements and capital buffer requirements as outlined in paragraphs 7.0 and 8.0 respectively, after the call option is exercised;
- (vi) any repayment of principal²³, other than through the exercise of a call option, (e.g. through repurchase) must be with the prior written approval of Labuan FSA and the Labuan bank 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 Labuan bank at all times^{24,25};
 - (b) cancellation of discretionary payments must not constitute an event of default;
 - (c) the Labuan bank must have full access to cancelled payments to meet obligations as they fall due²⁶; and
 - (d) cancellation of distributions/payments must not impose restrictions on the Labuan bank except in relation to distributions to ordinary shareholders;

²² Replacement issues may be concurrent with, but not after the instrument is called.

²³ Repayments due to tax or regulatory events are permitted subject to the assessment by Labuan FSA that the Labuan bank was not in a position to anticipate the event at issuance.

²⁴ Features such as "dividend pushers" are prohibited. An instrument with a dividend pusher obliges the issuing Labuan bank to make a dividend/coupon payment on the instrument if it has made a payment on another (typically more junior) capital instrument or share.

²⁵ Any waived distributions/payments are non-cumulative i.e. are not required to, and must not, be made up by the Labuan bank at a later date.

²⁶ Any structuring of bonus payment to make up for unpaid dividends is also prohibited.

- (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 Labuan bank 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 instrument cannot have any features that hinder recapitalisation, such as provisions that require the Labuan bank to compensate investors if a new instrument is issued at a lower price during a specified time frame;
- (xi) if the instrument is issued out of a special purpose vehicle (SPV), proceeds must be immediately available without limitation to the Labuan bank in a form which meets or exceeds all of the other criteria for inclusion in AT1 Capital²⁷;
- (xii) the purchase of the instruments is not directly or indirectly funded by the Labuan bank;
- (xiii) the instrument is not purchased by the Labuan bank or its affiliated party over which it exercises control or significant influence; and
- (xiv) For Labuan Islamic bank, Labuan Islamic investment bank, Labuan bank undertaking Labuan Islamic banking business and Labuan investment bank undertaking Labuan Islamic investment banking business, 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.

²⁷ For the avoidance of doubt, a capital instrument, issued out of an SPV must satisfy the requirements under paragraph 15.7 to qualify as AT1 Capital or Tier 2 Capital (as applicable).

14.0 Tier 2 Capital Instruments

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

- (i) the instrument is issued and paid-up;
- (ii) the instrument is subordinated to depositors, general creditors and other holders of subordinated debt of the Labuan bank;
- (iii) the instrument is neither secured nor covered by a guarantee of the Labuan bank 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 Labuan bank;
- (iv) the instrument has an original maturity of at least five years, and there are no step-up features or other incentives for the Labuan bank to redeem the instrument;
- (v) the instrument may be callable at the initiative of the Labuan bank 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 Labuan FSA;
 - (b) the Labuan bank must not do anything which creates an expectation that the call will be exercised²⁸; 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 Labuan bank²⁹; or
 - (ii) the Labuan bank demonstrates that its capital position is well above the minimum capital adequacy requirements and

²⁸ 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 Labuan bank does not do anything that creates an expectation that the call will be exercised at that point.

²⁹ Replacement issues may be concurrent with, but not after the instrument is called.

capital buffer requirements, as outlined in paragraphs 7.0 and 8.0 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 Labuan FSA and the Labuan bank 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 Labuan bank 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 Labuan bank in a form which meets or exceeds all of the other criteria for inclusion in Tier 2 Capital²⁷;
- (x) the purchase of the instruments is not directly or indirectly funded by the Labuan bank; and
- (xi) the instrument is not purchased by the Labuan bank or its affiliated party over which it exercises control and significant influence.

14.2 In the final four years of its contractual maturity, a Labuan bank shall gradually derecognise the instrument from Tier 2 Capital on a straight line basis as follows:

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

15.0 Minority Interest and Capital Instruments Issued Out of Consolidated Subsidiaries and Held by Third Parties

- 15.1 Where the minority interest arising from the issue of ordinary shares by a fully consolidated banking subsidiary^{30,31} of the Labuan bank is recognised in consolidated CET1 Capital of the Labuan bank, the ordinary shares giving rise to the minority interest shall meet the criteria for inclusion in CET1 Capital³².
- 15.2 For the purpose of paragraph 15.1, the amount of minority interest that will be recognised in consolidated CET1 Capital under paragraph 9.1(v) shall be calculated as follows:

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

where:

- A total qualifying minority interest³³
- B surplus CET1 Capital of the subsidiary, calculated as CET1 Capital of the subsidiary³⁴ minus the lower of the following:
- (i) 7.0%³⁵ of the subsidiary's total RWA calculated at the entity level; or
 - (ii) 7.0% of the portion of the Labuan bank's consolidated RWA relating to that subsidiary
- C percentage of CET1 Capital of the subsidiary held by minority shareholders

³⁰ A banking subsidiary in this paragraph shall mean to only include a deposit-taking entity that is subject to minimum prudential standards and level of supervision by an authority that subscribes to the *Core Principles for Effective Banking Supervision* promulgated by the BCBS. For the avoidance of doubt, this excludes the inclusion of any capital issued to third parties by non-banking subsidiaries, such as leasing, factoring or fund management companies.

³¹ Where a fully-consolidated subsidiary of a Labuan bank 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.

³² For the purpose of this paragraph, any reference to the term "Labuan bank" in paragraph 12.0 shall mean to refer to any "fully-consolidated banking subsidiary of the Labuan bank".

³³ Including associated reserves, but prior to the application of regulatory adjustments.

³⁴ Including associated reserves and regulatory adjustments.

³⁵ Corresponding to the minimum CET1 capital requirement of 4.5% plus the CCB of 2.5%.

15.3 Where Tier 1 capital instruments issued by a fully consolidated subsidiary^{31,36} of the Labuan bank and held by third parties are recognised in consolidated Tier 1 Capital of the Labuan bank, the instruments shall meet the criteria for inclusion in CET1 Capital or AT1 Capital^{37,38}.

15.4 For the purpose of paragraph 15.3, the amount of such capital that will be recognised in consolidated Tier 1 Capital shall be calculated as follows:

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

where:

- A total qualifying Tier 1 capital instruments (i.e. CET1 and AT1) of the subsidiary issued to third parties³³
- B surplus Tier 1 Capital of the subsidiary, calculated as Tier 1 Capital of the subsidiary³⁴ minus the lower of the following:
 - (i) 8.5%³⁹ of the subsidiary's total RWA calculated at the entity level; or
 - (ii) 8.5% of the portion of the Labuan bank'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 AT1 Capital under paragraph 10.1(iii) shall exclude amounts recognised in consolidated CET1 Capital as calculated under paragraph 15.2.

³⁶ For the avoidance of doubt, this includes both banking and non-banking subsidiaries, but excludes insurance/takaful subsidiaries and other subsidiaries which are not consolidated for regulatory purposes.

³⁷ For the purpose of this paragraph, any references to the term "Labuan bank" in paragraphs 12.0 and 13.0 shall mean to refer to any "fully-consolidated subsidiary of the Labuan bank" for purposes of this paragraph. For example, the early redemption of an instrument by a subsidiary shall be subject to the Labuan FSA's approval, in addition to that of the relevant host supervisor.

³⁸ A Labuan bank may recognise Shariah-compliant capital instruments issued by subsidiaries in other jurisdictions based on the Shariah views in the respective jurisdictions, unless specifically disallowed by Labuan FSA.

³⁹ Corresponding to the minimum Tier 1 capital requirement of 6% plus the CCB of 2.5%.

15.5 Where total capital instruments issued by a fully consolidated subsidiary^{31,36} of the Labuan bank and held by third parties are recognised in consolidated Total Capital of the Labuan bank, the instruments shall meet the criteria for inclusion in CET1 Capital, AT1 Capital or Tier 2 Capital^{38,40}.

15.6 For the purpose of paragraph 15.5, the amount of such capital that will be recognised in consolidated Total Capital shall be calculated as follows:

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

where:

- A total qualifying capital instruments (i.e. CET1, AT1 and Tier 2) of the subsidiary issued to third parties³³
- B surplus Total Capital of the subsidiary, calculated as Total Capital of the subsidiary³⁴ minus the lower of the following:
 - (i) 10.5%⁴¹ of the subsidiary's total RWA calculated at the entity level; or
 - (ii) 10.5% of the portion of the Labuan bank'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 11.1(iii) shall exclude amounts recognised in consolidated CET1 Capital as calculated under paragraph 15.2 and amounts recognised in consolidated AT1 Capital as calculated under paragraph 15.4.

⁴⁰ For the purpose of this paragraph, any reference to the term "Labuan bank" in paragraphs 12.0, 13.0 and 14.0 shall mean to refer to any "fully-consolidated subsidiary of the Labuan bank".

⁴¹ Corresponding to the minimum Total Capital requirement of 8% plus the CCB of 2.5%.

15.7 Where the capital instruments issued to third parties out of an SPV are included in the entity and consolidated level AT1 Capital or Tier 2 Capital of the Labuan bank⁴²:

- (i) the SPV must be domiciled in Malaysia⁴³;
- (ii) the SPV must be controlled⁴⁴ and managed by the Labuan bank, and would, in accordance with the acceptable FRSs, be fully consolidated;
- (iii) the SPV must be set up for the sole purpose of the capital issuance for the Labuan bank⁴⁵ and does not conduct any other business or activity;
- (iv) the SPV must not have external creditors at any time⁴⁶;
- (v) the entire proceeds from the capital issuance through the SPV⁴⁷ must be immediately available without limitation to the Labuan bank in a form which meets or exceeds all of the criteria for inclusion in AT1 or Tier 2 Capital, as applicable; and
- (vi) the provisions governing the issuance of the instruments issued by the SPV and the Labuan bank must substantially be the same (e.g. maturity), and accordingly, the capital instrument issued by the SPV must meet all the relevant criteria (as required under paragraph 13.1 for AT1 Capital and paragraph 14.1 for Tier 2 Capital) for inclusion as if the Labuan bank itself were to issue the instrument^{48,49}.

⁴² For the avoidance of doubt, an AT1 and Tier 2 capital instrument issued out of an SPV pursuant to this paragraph is not subject to the treatment set out in paragraphs 15.4 and 15.6.

⁴³ Including Labuan.

⁴⁴ Use of an independent SPV is allowed in structures that require the use of such SPVs, which includes the issuance of Islamic capital instruments structured using the exchange-based contracts (e.g. *Murabahah* or *Ijarah*).

⁴⁵ 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.

⁴⁶ Nonetheless, this does not preclude miscellaneous creditors (e.g. tax authorities, administrators) to the extent that they are *de minimis*.

⁴⁷ 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*.

⁴⁸ 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 Labuan bank, the transaction will be recognised in Tier 2 Capital.

⁴⁹ In the case of issuance of Islamic capital instruments structured using the exchange-based contracts through an SPV (e.g. *Murabahah* or *Ijarah*) or any other indirect structures (e.g. *Commodity Murabahah*), the contracts between the Labuan bank and the SPV or any parties involved shall be structured in a manner which in combination meets or exceeds the criteria for inclusion in capital. For example, any purchase undertaking shall be designed in a manner that does not legally or economically enhance the seniority of capital issued.

- 15.8 Where the capital instruments are issued to third parties through an SPV via a fully consolidated subsidiary of the Labuan bank⁵⁰ and included in the Labuan bank's consolidated AT1 Capital or Tier 2 Capital in accordance with the treatment outlined in paragraphs 15.4 and 15.6, such capital instruments shall be subject to the requirements in paragraph 15.7, as if the subsidiary itself had issued the capital instruments directly to the third parties.
- 15.9 An illustration of the treatment for minority interest and capital instruments issued out of consolidated subsidiaries held by third parties is provided in **Appendix II**.

⁵⁰ The SPV must be controlled and managed by the fully consolidated subsidiary except as mentioned in footnote 44.

PART D REGULATORY ADJUSTMENTS

16.0 Goodwill and Other Intangibles

- 16.1 Goodwill, including bargain purchase gain⁵¹ and any goodwill included in the valuation of significant capital investments in unconsolidated entities, and all other intangibles⁵² 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 acceptable FRSs.
- 16.2 Bargain purchase gains shall not be recognised in the calculation of CET1 Capital.

17.0 Deferred Tax Assets and Liabilities

- 17.1 Deferred tax assets (DTAs) that rely on the future profitability of the Labuan bank to be realised shall be deducted in the calculation of CET1 Capital⁵³. 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.
- 17.2 Net DTLs shall not be added back in the calculation of CET1 Capital.

⁵¹ Bargain purchase gain is also known as negative goodwill.

⁵² As defined under the relevant acceptable FRSs. This shall include mortgage servicing rights, if any, but exclude right-of-use (ROU) assets, where the underlying asset being leased is a tangible asset

⁵³ An over installment 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 Labuan bank, it shall be assigned the relevant sovereign risk weighting.

18.0 Property Revaluation Gains/Losses

18.1 The amount of cumulative unrealised gains arising from the changes in the fair value or revaluation of land and buildings⁵⁴ 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 Capital⁵⁵.

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

18.3 For the purpose of recognition of cumulative unrealised gains in Tier 2 Capital in accordance with paragraph 18.1(ii), the valuation of land and buildings shall be certified by an independent professional valuer at least once every three years⁵⁶ or where there is evidence that the value has been or is likely to be substantially impaired.

19.0 Cumulative Gains/Losses of Financial Instruments Measured at Fair Value through Other Comprehensive Income or Designated at Fair Value

19.1 55% of cumulative unrealised gains arising from changes in the fair value of financial instruments measured at fair value through other comprehensive income, other than loans/financing and receivables, shall be deducted in the calculation of CET1 Capital.

19.2 For loans/financing and receivables measured at fair value through other comprehensive income or designated at fair value, the amount of unrealised

⁵⁴ Referring to the revaluation gains of properties that are subject to the acceptable FRSS. In addition, any recognition of revaluation gains of property in the retained earnings arising from the application of these FRSS are also subject to this treatment.

⁵⁵ 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.

⁵⁶ For the avoidance of doubt, recognition of revaluation gains of property in the retained earnings arising from the application of the acceptable FRSS where only subject to a one-off certification by an independent professional valuer.

gains arising from changes in the fair value shall be fully deducted in the calculation of CET1 Capital.

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

20.0 Cash Flow Hedge Reserve

- 20.1 The amount of the cash flow hedge reserve⁵⁷ that relates to the hedging of items that are not fair valued on the balance sheet (including projected cash flows) shall be derecognised in the calculation of CET1 Capital. In this regard, positive amounts shall be deducted and negative amounts shall be added back in the calculation of CET1 Capital.

21.0 Regulatory Reserve

- 21.1 The amount of regulatory reserve maintained shall be deducted in the calculation of CET1 Capital.⁵⁸

22.0 Valuation Adjustments

- 22.1 The amount arising from the valuation adjustments computed in accordance with paragraphs 4.13 and 4.14 of the *Guidelines on Banking and Islamic Banking Capital Adequacy Framework (Risk-Weighted Assets)* that exceed the valuation adjustments made under the acceptable FRSs shall be deducted in the calculation of CET1 Capital.

23.0 Increase in Equity Capital Resulting from a Securitisation Transaction

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

⁵⁷ 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.

⁵⁸ Recognition of regulatory reserve in Tier 2 Capital is set out in paragraph 11.1(iv)(b).

24.0 Cumulative Gains/Losses due to Changes in Own Credit Risk on Fair Valued Liabilities

- 24.1 All unrealised fair value gains and losses on financial liabilities that are due to changes in the Labuan bank's own credit risk 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.
- 24.2 In addition, all accounting valuation adjustments on derivatives liabilities that are due to changes in the Labuan bank's own credit risk shall be derecognised in the calculation of CET1 Capital. The offsetting between valuation adjustments that are due to changes in the Labuan bank's own credit risk and those arising from the counterparties' credit risk is not allowed.

25.0 Defined Benefit Pension Fund Assets and Liabilities

- 25.1 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 the acceptable FRSs. The amount of defined benefit pension fund liabilities, as included on the balance sheet, shall be fully recognised in the calculation of CET1 Capital.
- 25.2 A Labuan bank shall seek a prior written approval of Labuan FSA before the assets in the fund to which the Labuan bank has unrestricted and unfettered access can be used to offset the deduction.
- 25.3 For the purpose of paragraph 25.2, such offsetting assets shall be risk-weighted as if they were owned directly by the Labuan bank⁵⁹.

⁵⁹ This treatment addresses the concern that assets arising from pension funds may not be capable of being withdrawn and used for the protection of depositors and other creditors of a Labuan bank. The concern is that their only value stems from a reduction in future payments into the fund. The treatment allows for Labuan banks 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.

26.0 Investments in Own Capital Instruments

- 26.1 All direct, indirect⁶⁰ and synthetic⁶¹ holdings of a Labuan bank's own capital instruments⁶² in the trading and banking book⁶³, including any own capital instruments which the Labuan bank is contractually obliged to purchase and any other loans/financing⁶⁴ provided for the purpose of purchasing own capital instruments, shall be deducted in the calculation of capital. In applying the deductions, Labuan banks must deduct the investment from the same component of capital for which it would qualify⁶⁵.
- 26.2 In instances where a Labuan bank 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 Labuan bank shall look through the holdings to determine their underlying holdings of capital⁶⁶.
- 26.3 For the purpose of paragraph 26.1, gross long positions may be netted against gross short positions in the same underlying exposure only if the short positions involve no counterparty risk⁶⁷. In the case of an index security, where a gross long position is netted against a short position, both positions must be 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

⁶⁰ Indirect holdings are exposures or parts of exposures that, if a direct holding loses its value, will result in a loss to the Labuan bank substantially equivalent to the loss in value of the direct holding. An indirect holding may arise when the Labuan bank invests in an unconsolidated intermediate entity that has an exposure to the capital of the Labuan bank itself.

⁶¹ A synthetic holding may arise when a Labuan bank invests in an instrument where the value of the instrument is directly linked to the value of the capital of the Labuan bank itself.

⁶² Including treasury stock.

⁶³ 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.

⁶⁴ Both funded and unfunded (e.g. guarantees) exposures.

⁶⁵ Unless already derecognised under the relevant acceptable FRSs.

⁶⁶ If the Labuan bank finds it operationally impractical to look through the holdings of an index security, the Labuan bank may 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, and the estimation should be updated at least annually to reflect the best estimates of the exposure. The full value shall be deducted in instances where this requirement cannot be met.

⁶⁷ This includes netting positions in cash instruments and derivatives over the same underlying exposures.

charge as calculated in accordance with **Appendix II** of *Guidelines on Banking and Islamic Banking Capital Adequacy Framework (Risk-Weighted Assets)*.

27.0 Investments in the Capital of Unconsolidated Financial and Insurance/Takaful Entities

27.1 Investments in the capital instruments of unconsolidated financial⁶⁸, and insurance/takaful entities shall:

- (i) include direct, indirect⁶⁹ and synthetic⁷⁰ holdings of capital instruments. A Labuan bank 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 capital⁶⁶;
- (ii) refer to the net long positions⁶⁷ in both the banking book and trading book⁶³. In this regard, the gross long position can be offset against the short position in the same underlying exposure where the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year⁷¹;
- (iii) include underwriting positions held longer than five working days after the issuance date of the capital instruments⁷²; and
- (iv) with the prior written approval of Labuan FSA and subject to conditions that Labuan FSA may specify (including the period of exclusion), exclude certain investments where these have been made in the context of

⁶⁸ These refer to investments in entities outside the scope of regulatory consolidation, namely those that have not been consolidated at all or have not been consolidated in such a way as to result in their assets being included in the calculation of risk-weighted assets. For the avoidance of doubt, this shall only include investments in financial and insurance/takaful subsidiaries for entity level reporting.

⁶⁹ An indirect holding may arise when a Labuan bank invests in an unconsolidated intermediate entity that has an exposure to the capital of an unconsolidated financial or insurance/takaful entity and thus gains an exposure to the capital of that financial or insurance/takaful entity.

⁷⁰ A synthetic holding may arise when a Labuan bank invests in an instrument where the value of the instrument is directly linked to the value of the capital of an unconsolidated financial or insurance/takaful entity.

⁷¹ Any counterparty credit risk associated with short positions used to offset long positions shall remain included in the calculation of RWA.

⁷² For the avoidance of doubt, underwriting positions held for five working days or less (including pre-issuance underwriting obligations and undrawn amount of an underwriting facility) shall be risk-weighted.

resolving or providing financial assistance to reorganise a distressed institution.

27.2 The investments in the capital instruments of unconsolidated financial and insurance/takaful entities, as set forth under paragraph 27.1, shall be deducted in the calculation of capital as follows:

- (i) where the Labuan banks 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 Labuan banks¹⁷, the entire amount of investments in capital instruments; and
- (iii) where the Labuan banks does not own more than 10%⁷³ 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 Labuan banks common equity⁷⁴.

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

27.3 In applying the deductions under paragraph 27.2, a Labuan bank shall apply the corresponding deduction approach by deducting an investment from the same component of capital for which the capital would qualify if it was issued by the Labuan bank itself. In applying the corresponding deduction approach, if the capital instrument of the entity in which the Labuan bank has invested in does not meet the criteria for inclusion in CET1 Capital, AT1 Capital, or Tier 2 Capital of the Labuan bank, the capital is to be considered as an ordinary share

⁷³ This includes the scenario where the Labuan bank does not own any issued ordinary share capital of the issuing entity.

⁷⁴ The common equity for purposes of calculating the 10% threshold shall be calculated after applying the regulatory adjustments set out in paragraphs 16.0 to 26.0 to the sum of items set out in paragraphs 9.1(i) to (v).

for purposes of this regulatory adjustment⁷⁵ and thus deducted in the calculation of CET1 Capital.

- 27.4 The amount of capital holdings which is not deducted under paragraph 27.2(iii) shall continue to be risk-weighted⁷⁶. 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.

28.0 Other Regulatory Adjustments

- 28.1 In applying the regulatory adjustments against a particular tier of capital and if the Labuan banks 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 capital⁷⁷.
- 28.2 Where Labuan FSA specifies in writing a specific regulatory adjustment in this framework in respect of a Labuan bank after having regard to the specific risk profile of the Labuan bank, the Labuan bank shall comply with such adjustment.

⁷⁵ 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.

⁷⁶ 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.

⁷⁷ For example, if a Labuan bank does not have enough AT1 Capital to meet the deductions, the shortfall will be deducted in the calculation of CET1 Capital.

PART E OTHER REQUIREMENTS

29.0 Disclosure Requirements

29.1 The full terms and conditions⁷⁸ of all AT1 and Tier 2 capital instruments included in regulatory capital⁷⁹ shall be made available for inspection by Labuan FSA at all times.

30.0 Regulatory Process and Submission Requirements

30.1 A Labuan bank is required to obtain the Labuan FSA's written approval prior to issuance of regulatory capital by the Labuan banks, or issuance to third parties out of an SPV and included in entity and consolidated level AT1 Capital or Tier 2 Capital. An application must be supplemented with the following:

- (i) a confirmation of compliance by the Principal Officer that the proposed capital instruments comply with all the criteria for inclusion in capital as set out in paragraphs 13.0 and 14.0⁸⁰;
- (ii) indicative issue and offering documents (e.g. prospectus, offering circular, pricing supplement, information memorandum, trust deed, loan/financing agreement) and as soon as practicable, the final issue and offering documents.

30.2 For the purpose of paragraph 30.1, a Labuan bank shall seek Labuan FSA's approval for either an individual issuance or an issuance programme. Approval for an issuance programme allows subsequent issuances under the programmed to be deemed approved for recognition to the extent that the criteria for inclusion in capital continues to be met. A Labuan bank is however required to notify Labuan FSA prior to subsequent issuances under the approved programme.

⁷⁸ Including any other relevant pricing supplements.

⁷⁹ 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.

⁸⁰ 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.

- 30.3 A Labuan bank must seek Labuan FSA's written approval prior to any subsequent modification of the terms and conditions of an instrument that may affect its eligibility as regulatory capital.
- 30.4 A Labuan bank shall notify Labuan FSA of any capital instrument issued out of foreign subsidiaries to third parties that is included in consolidated CET1 Capital, AT1 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 issue and offering documents. Likewise, for Labuan bank which operates as subsidiary belonging to foreign parent, it must notify Labuan FSA if it issues a capital instrument which is included in its parents' consolidated AT1 Capital or Tier 2 Capital.
- 30.5 In addition to the requirements set forth under paragraphs 30.1 and 30.4, where a Labuan bank is required to provide Labuan FSA with an external legal opinion confirming that the instrument complies with all relevant criteria for inclusion in capital from a law firm of Labuan FSA's choice, the Labuan bank shall provide Labuan FSA with such legal opinion and the related expenses shall be borne by the Labuan bank.
- 30.6 A Labuan bank is required to obtain Labuan FSA's written approval prior to making any planned reduction in its capital⁸¹, including capital instruments issued out of consolidated subsidiaries and held by third parties recognised under paragraphs 9.1(v), 10.1(iii) and 11.1(iii). The Labuan bank 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.

⁸¹ This includes a share buy-back or an early redemption, repurchase or repayment of a capital instrument, including through the exercise of a call option.

30.7 A Labuan bank should direct any regulatory application under the Guidelines to:

Director
Supervision Department
Labuan Financial Services Authority
Level 17, Main Office Tower,
Financial Park Complex
Jalan Merdeka
87000 Federal Territory of Labuan, Malaysia

Telephone no: 03 8873 2000
Facsimile no: 03 8873 2209
Email: sed@labuanfsa.gov.my

31.0 Statistical Reporting Requirements

31.1 A Labuan bank shall submit periodic reports on its capital adequacy ratios using the reporting templates provided by Labuan FSA.

Labuan Financial Services Authority

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APPENDICES

APPENDIX I General Treatment of Equity Investments

Type of Investment		Treatment	
		At the entity level	At the consolidated level
Banks and other financial entities excluding insurance/takaful companies	Subsidiaries	Paragraph 27.0	Consolidate, or deduct from CET1 Capital if allowed under paragraph 5.2
	Others	Paragraph 27.0	
Insurance/takaful companies	Subsidiaries	Paragraph 27.0	
	Others		
Other commercial entities	Subsidiaries	Risk-weight at 1250% ⁸²	Consolidate, or risk-weight at 1250% ⁸² if allowed under paragraph 5.2
	Others	Risk-weight in accordance with <i>Guidelines on Banking and Islamic Banking Capital Adequacy Framework (Credit Risk)</i>	

⁸² In accordance with paragraph 21.4 of *Guidelines on Banking and Islamic Banking Capital Adequacy Framework (Credit Risk)*.

APPENDIX II General Illustrative Example on Minority Interest and Capital Instruments Issued Out of Consolidated Subsidiaries Held by Third Parties

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

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

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

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

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

Consolidated balance sheet	
Assets	
Loans/Financing to customers	250
Liabilities and equity	
Depositors	197
Tier 2 issued by subsidiary to third parties	6
Tier 2 issued by parent company	10
AT1 issued by subsidiary to third parties	1
AT1 issued by parent company	7
Common equity issued by subsidiary to third parties (i.e. minority interest)	3
Common equity issued by parent company	26

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

Minimum and surplus capital of Bank S		
	Minimum plus CCB	Surplus
CET1	7.0 (= 7.0% of 100)	3.0 (=10 – 7.0)
Tier 1	8.5 (= 8.5% of 100)	6.5 (=10 + 5 – 8.5)
TC	10.5 (= 10.5% of 100)	12.5 (=10 + 5 + 8 – 10.5)

The following table illustrates how to calculate the amount of capital issued by Bank S to include in consolidated capital, following the calculation method set out in paragraph 15.0:

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
Tier 1	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. AT1 is calculated as the difference between CET1 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
Tier 1	33	2.27	35.27
Tier 2	10	2.30	12.30
TC	43	4.57	47.57

APPENDIX III Capital Conservation Buffer Phase-in Arrangements

	1 July 2027	1 July 2028	1 July 2029
Capital Conservation Buffer	0.625%	1.25%	2.5%