Muzakarah on Failure Resolution of Islamic Financial Institutions

PIDM
Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

Session 01

Introduction to Resolution

Resolution Tools

Encik Melvin Lim

Head of Intervention and Resolution Complex Member Institutions, PIDM

TABLE OF CONTENTS

Muzakarah on Failure Resolution of Islamic Financial Institutions

TABLE OF CONTENTS

Muzakarah on Failure Resolution of Islamic Financial Institutions

PIDM is one of the key players within the financial safety net in ensuring financial system stability …

Muzakarah
on Failure Resolution of Islamic Financial Institutions

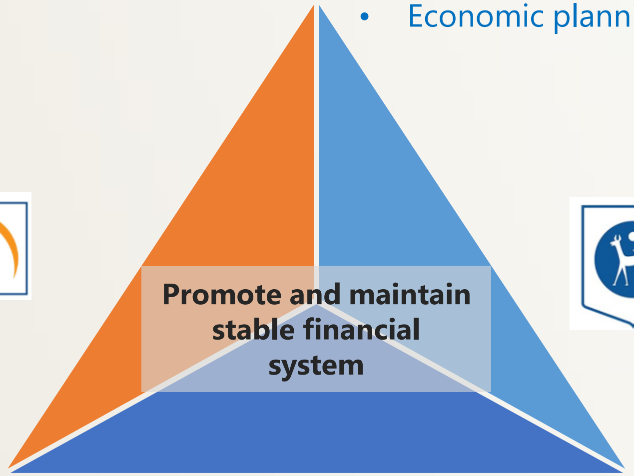
MOF

- Fiscal and monetary policies
- Treasury functions
- Economic planning

Financial Consumer Protection Authority

PIDM

- Administers DIS & TIPS
- Promotes public confidence
- On-going risk assessment of MIs
- Early intervention & resolution toolkit



Central Bank, Supervisor and Main Regulator

- Monetary policy
- Liquidity support
- Prudential regulations
- Supervision & monitoring

MDIC is an Integrated Financial Consumer Protection Authority for Depositors and Policyholders

Financial system stability:

Well-defined roles, responsibilities and accountabilities of the safety net players in ensuring financial system stability

PIDM's roles are to protect consumers in case of a MI failure, incentivise sound risk management and promote financial system stability

PIDM is required to act in such manner as to minimise costs to the financial system

Mandate

System Administration

- Deposit Insurance System (DIS).
- Takaful and Insurance Benefits Protection System (TIPS).

Protection

- Insurance against the loss of part or all deposits.
- Protection against the loss of part or all takaful or insurance benefits.

Financial System Stability

- Promote or contribute to the stability of the financial system.
- Provide incentives for sound risk management in the financial system.

Establish an effective regime for the resolution of its member banks and insurers

Recovery & Resolution Planning (RRP), jointly implemented by BNM and PIDM, to promote financial system stability

Muzakarah on Failure Resolution of Islamic Financial Institutions

Continuum of Stress

	Business As Usual (BAU)	Recovery	Resolution
	Within MI's risk appetite	Beyond MI's risk appetite, but within its financial capacity	Beyond MI's financial capacity
	BAU Risks Management actions	**'Tipping point A'** Beyond which recovery is possible	**'Tipping point B'** Beyond which recovery is no longer possible
Risk management & contingency plans	***BCP, ICAAP & ILAAP*** *(by MIs under supervision of BNM)*	***Recovery Planning (RCP)*** *(by MI under supervision of BNM)*	***Resolution Planning (RSP)*** *(by PIDM with support from MI)*
		Menu of "Recovery options" Management actions	**Provide the implementation details of the resolution strategy**
	Expected losses Incorporated into annual planning "base-case" scenarios **Unexpected losses** Identified through stress testing using scenario analysis of varying severities	***Recovery actions are implemented by Management when trigger points are reached to restore long term viability during severe stress***	***To minimise disruption and impact to the financial system and to preserve value of the institution***

Existing guidelines in place for BAU risk management & contingency planning ←

→ RRP to be implemented as part of regulatory agenda to strengthen financial system stability and resilience

PIDM Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

PIDM's preferred resolution strategy for the DTMs is a transfer strategy as it aims to ensure continuity of critical functions, minimize impact to financial system, preserve value and public confidence

Muzakarah on Failure Resolution of Islamic Financial Institutions

		As needed	
"Transfer-ready" PRS*	➜	**Alternative PRS**	***PIDM, while consulting BNM***
Conduct feasibility assessment	➜	**Prepare remediation plan**	***DTM (in consultation with PIDM)***
		As needed	
Conduct credibility & horizontal assessments	➜	**Determine ex-ante measures (if any)**	***PIDM & BNM***

* refers to Preferred Resolution Strategy

What does it mean to be "transfer-ready"?

Examples of transfer-ready elements

- Sufficient and accurate information on a timely manner – e.g. assets, liabilities, terms of separation and collateral information and etc., to support critical assessments
- Management information system – enhance valuation capability
- Legal – contractual, structural, intellectual property ownership/rights
- Execution risks – resources, market capacity, expertise
- Suitability and availability of buyers – appetite, interests
- Operational dependency and continuity, ensuring no separability issues – e.g. impediments arising from intra groups, 3rd parties, tax and other financial dependencies

An overview of the recovery planning options involving transfer

Muzakarah on Failure Resolution of Islamic Financial Institutions

Recovery Planning - Transfer options

- Sale of banking subsidiaries
- Sale of financial services entities (i.e. asset management, nominees)
- Sale of insurance entities
- Sale of overseas branches
- Sale of loan/financing portfolio (distressed/non-distressed)
- Sale of business lines

ASSET MANAGEMENT

PIDM's considerations when executing a sale of business for an Islamic DTM

Muzakarah on Failure Resolution of Islamic Financial Institutions

In executing a sale of business for an Islamic DTMs, PIDM will consider the following:

- **Interdependencies between Islamic bank and Conventional bank/parent** [Operational(critical shared services), Financial(capital, liquidity), Business (Islamic products sold at conventional bank)]
- **Transferability issues** (assets, liabilities, client assets, Islamic contracts)
- **Consent** (shareholders, depositors, investment accounts holders)
- **Terms of sale** (price, timing to completion, etc)

TABLE OF CONTENTS

Muzakarah
on Failure Resolution of Islamic Financial Institutions

PIDM is empowered with broad intervention and resolution powers to fulfill its mandates…

PRE-EMPTIVE POWERS

- For purpose of reducing or averting a risk to the financial system or a threatened loss to PIDM; or
- For the purpose of or in connection with the implementation of any resolution actions.

SPECIAL EXAMINATION POWERS

- Powers that allow for detailed assessment and investigation to be undertaken early when the member institution shows signs of distress. These powers are fundamental in facilitating PIDM's readiness to determine and implement an intervention & resolution action.

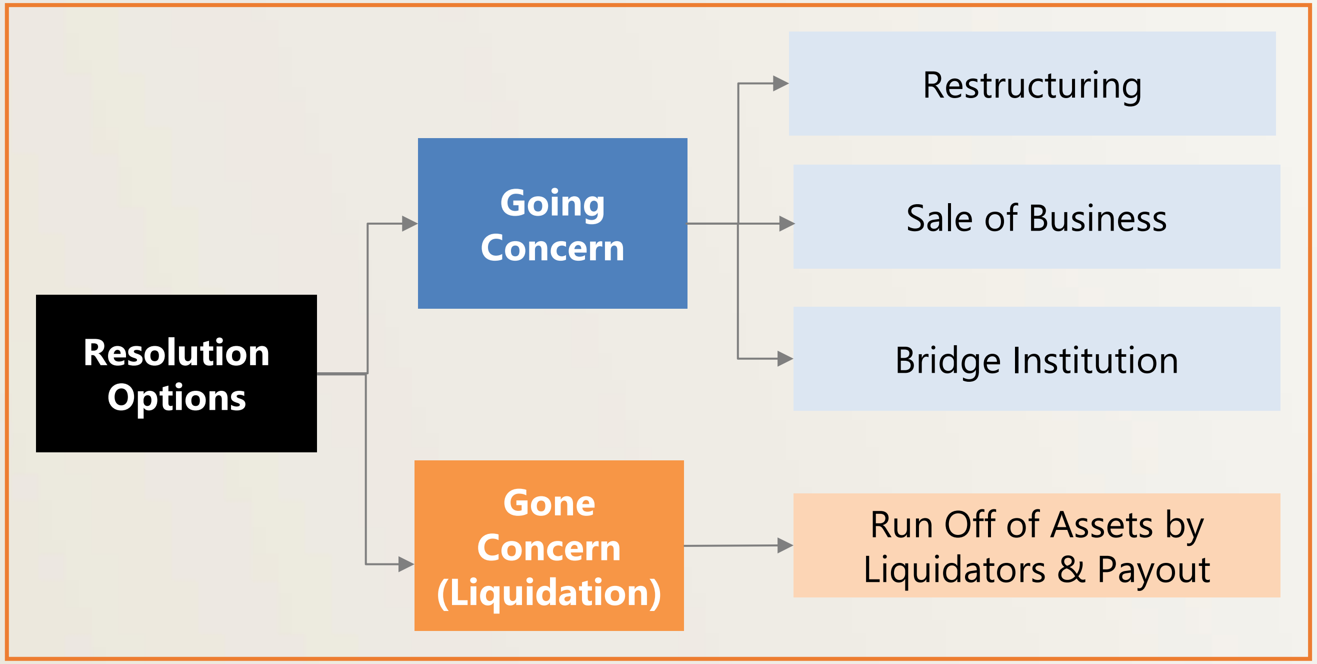
Upon declaration by BNM that the MI is non-viable…

RESOLUTION POWERS

- Wide toolkit to resolve troubled non-viable financial institutions in a manner to minimise costs to financial system

Once BNM issues the non-viability notice, PIDM may exercise its wide range of resolution powers - Going Concern and Gone Concern …

Resolution does not necessarily mean liquidation… For PIDM, the key to effective and orderly resolution is to ensure continuity of critical functions to minimise contagion effects and systemic disruptions in the financial system during crisis



Resolution objectives:

1. Ensure continuity of critical economic functions provided by the troubled Member Institution to avoid adverse effects on financial stability
2. Minimise systemic risks and severe disruptions to the financial system
3. Minimise loss to financial system
4. Maintain public confidence

PIDM adopts a twin track approach in evaluating its Intervention and Resolution options that minimise costs to the financial system

TABLE OF CONTENTS

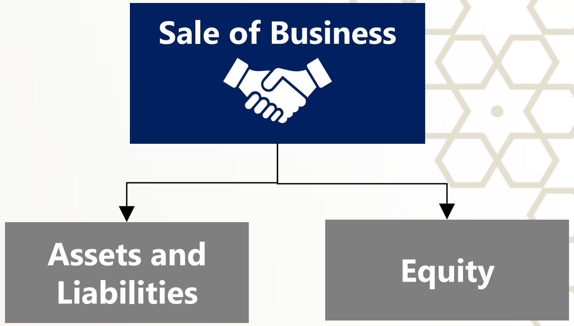
Sale of Business involves the sale of either assets and liabilities or shares of a member institution to a third-party acquirer by PIDM

Muzakarah on Failure Resolution of Islamic Financial Institutions

Ideally, the most suitable resolution strategy depends on the structure, financial and operational dependencies, as well as idiosyncrasies of the MI. A going concern will be preferred if it is practicable to execute. It preserves value better. The key benefits of sale of business it is a **private sector solution and minimizes disruption to the financial system.**

1	**Franchise Value**	• Preserve/ monetise value.
2	**Private sector solution**	• Retain assets and liabilities within the private sectors.
3	**Depositor protection**	• Acquirer to assume, at a minimum, all insured deposits.
4	**Banking and financial services industry stability**	• Avoid major disruptions to or withdrawal of services.

#Note: Sale of Business is also known as Purchase and Assumption



Accordingly, PIDM's resolution planning focuses on 'transfer-ready'. Being transfer ready improves the ability to affect a transfer both at BAU and at resolution.

Sale of Business involves the sale of either assets and liabilities or shares of a member institution to a third-party acquirer by PIDM

Muzakarah on Failure Resolution of Islamic Financial Institutions

PIDM

"sweeteners", e.g. loss-sharing agreements, guarantees, financing,, et

Non-Viable MI

Sale of Business, either of Assets and Liabilities / Equity

Buyer
- Both available and eligible
- Compliance with other authorities (e.g. Bursa/SC)

Assets and Liabilities

Total Sale of Assets and Liabilities

Partial Sale of Assets and Liabilities

*<u>*For assets and liabilities transfer-approvals required from:</u>*
- *Minister*
- *High Court*
- *Foreign authorities (if assets and liabilities are in foreign jurisdictions, where applicable)*

Equity

**Consent of shareholders required unless invoke compulsory share transfer powers*

Islamic Bank Specificities to consider in a Sale of Business:
- Transferability
- Consent
- Terms of Sale
- Others?

The sale of shares involves the sale of shares of the non-viable MI

Muzakarah
on Failure Resolution of Islamic Financial Institutions

The role of PIDM in facilitating a sale includes the **sweeteners that PIDM may offer to the potential acquirer.**

Non-Viable MI		MI, Post Sale of Shares
Existing Shareholders	→	New Shareholders
Depositors	→	Depositors
Financial Customers	→	Financial Customers
Investment Account Holders	→	Investment Account Holders

Sale of Shares

- Shares are transferred to investors
- New shareholders take over
- If no consent from existing shareholders, PIDM will invoke compulsory share transfer power.

- *There is no change to the others. All remain in the same entity that has failed.*
- *The new shareholders to take over and run/revive the bank*
- *There is no stub in this case.*

Islamic Bank Specificities (BAU vs Recovery vs Resolution):

- Transferability of shares
- Terms of Sale –e.g. Price
- Consent of Shareholders

The sale of assets and liabilities involves the MI's assets and liabilities including its loan financing assets, its subsidiaries, etc

The role of PIDM in facilitating a sale includes the **sweeteners that PIDM may offer to the potential acquirer.**

POST TRANSFER OF ASSETS AND LIABILITIES

Non-Viable MI

- Existing Shareholders → New Shareholders
- Depositors → Depositors
- Financial Customers → Financial Customers
- Investment Account Holders → Investment Account Holders

Acquirer + **Stub of Non-Viable MI**

Acquirer:

- **Depositors**
  - *Likely to be transferred to the acquiring entity*
- **Financial Customers**
  - *Likely to be transferred to the acquiring entity (where the assets are good)*
- **Investment Account Holders**
  - *Likely to be transferred to the acquiring entity*
  - *Avoid major disruptions to or withdrawal of services.*

Stub of Non-Viable MI:

- **New Shareholders**
  - *Will be left in the stub of the failed member bank*
- **Residuals**

Islamic Bank Specificities (BAU vs Recovery vs Resolution):

- Transferability of assets and liabilities
- Terms of Sale –e.g. Price
- Consent of Shareholders, Depositors, Creditors, Fin Customers

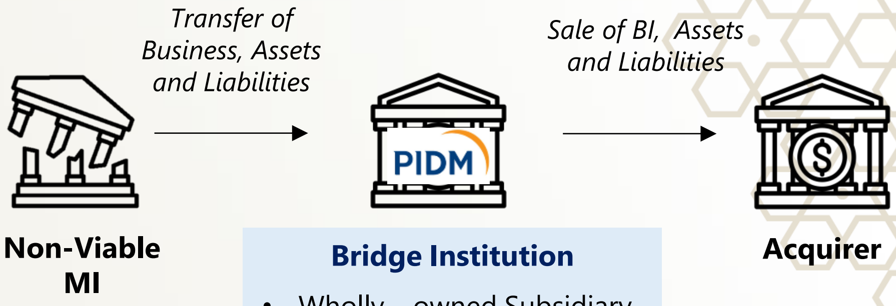
Muzakarah on Failure Resolution of Islamic Financial Institutions

TABLE OF CONTENTS

Bridge institution involves the acquisition of assets & liabilities from the nonviable member institution, operating the Bank in the interim and the eventual sale to the successful acquirer

- Similar to sale of business; instead of 3rd party acquirer in a sale of business, in BI, the sale is to PIDM's subsidiary - the BI.
- To ensure the continuity of essential services and functions by requiring the failed MI to continue to provide such services to the bridge institution
- Some of the terms of transfer may differ in a BI compared to a sale of business

1 Franchise Value	• Preserve/ monetise value.
2 Depositor Protection	• BI to assume, at a minimum, all insured deposits.
3 Banking and Financial Services	• Avoid major disruptions to or withdrawal of services.



Bridge Institution

- Wholly – owned Subsidiary of PIDM
- Designation valid for 2 years unless extended

1. PIDM may transfer asset or liability or cause a transfer back to the member institution of any asset or liability as PIDM may deem necessary
2. Purchase considerations

TABLE OF CONTENTS

Muzakarah on Failure Resolution of Islamic Financial Institutions

Liquidation involves winding up failing member institutions where insured deposits will be reimbursed by PIDM while failing member institution's business and assets will be liquidated by the liquidator.

Muzakarah
on Failure Resolution of Islamic Financial Institutions

KEY FEATURES	OUTCOME
1. MI is liquidated through court process 2. Liquidator has statutory objectives and is appointed to administer the liquidation process 3. Powers of liquidator is defined by law, granted by Court or consented by Committee of Inspection	• Dissolution of the MI • Realisation of assets. • **Proceeds paid to creditors based on priority of payment / creditors hierarchy.** • **Any surplus distributed to shareholders.** • **Separate hierarchy of claims for IAHs**

1. Cost & expenses of the winding up (subsection 292(1)(a) of the companies Act 1965) AND Preferential debts (subsection 2. 292(1)(b) to (f) of the Companies Act 1965) & debts due and claim owing to the Government (Section 10 of Government Proceedings Act 1956)
2. Islamic deposit (to prescribe the order of priority for payments of different categories of Islamic deposits)
3. Unsecured liabilities
4. Shareholders

1. Cost & expenses of the winding up (subsection 292(1)(a) of the Companies Act 1965) AND Federal tax (subsection 292(1)*(f)* of the Companies Act 1965)
2. Outstanding costs or expenses of the investment accounts;
3. Any profit, fees, gains or other remuneration due to the licensed Islamic bank
4. Investment account holders.

Thank You