



Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

**CONSULTATION PAPER ON
CRITERIA FOR QUALIFIED THIRD PARTY**

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Ref No	DI/CP13/2011	Issued on	26 August 2011
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TABLE OF CONTENTS

1. INTRODUCTION	1
2. BACKGROUND AND PURPOSE	1
3. QUALIFIED THIRD PARTY	2
4. OBJECTIVE	3
5. THE CONSULTATION PROCESS.....	3
6. PROPOSED CRITERIA FOR QUALIFIED THIRD PARTY	4
7. RESPONSES.....	6

Ref No	DI/CP13/2011	Issued on	26 August 2011
TITLE	CONSULTATION PAPER ON CRITERIA FOR QUALIFIED THIRD PARTY		

1. INTRODUCTION

- 1.1 The Bank of International Settlement's final report titled "Report and Recommendations of the Cross-border Bank Resolution Group" issued in March 2010 ("the BIS Report") amongst others, recommended the following:

"National resolution authorities should have the legal authority to temporarily delay immediate operation of contractual early termination clauses in order to complete a transfer of certain financial market contracts to another sound financial institution, a bridge financial institution or other public entity. Where a transfer is not available, authorities should ensure that contractual rights to terminate, net, and apply pledged collateral are preserved. Relevant laws should be amended, where necessary, to allow a short delay in the operations of such termination clauses in order to promote the continuity of market functions."

(extract from Recommendation 9)

2. BACKGROUND AND PURPOSE

- 2.1 The Malaysia Deposit Insurance Corporation Act 2011 ("PIDM Act") allows Perbadanan Insurans Deposit Malaysia ("PIDM") to temporarily suspend ("temporary suspension period") the right of the counterparty to a qualified financial agreement ("QFA")ⁱ from terminating the agreement under the following circumstances:

- (a) pursuant to subsection 115(3) of the PIDM Act, upon the assumption of control of a failing member institution ("MI") by PIDM or its appointed person or upon the appointment of a receiver over a failing MI; or
- (b) pursuant to subsections 180(1) and 180(2) of the PIDM Act, upon the appointment of a conservator over an Affected Person ("AP").ⁱⁱ

- 2.2 During the temporary suspension period, PIDM may do the following:

- (a) with regard to MIs, transfer or declare in writing that it will transfer QFAs to a bridge institution or a qualified third party ("QTP"). The effect of the transfer is that the QFAs may only be terminated against the bridge institution or the QTP in accordance with its terms, as if the agreement had always been with the bridge institution or QTP, and not the failing MI; and



Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

Ref No	DI/CP13/2011	Issued on	26 August 2011
TITLE	CONSULTATION PAPER ON CRITERIA FOR QUALIFIED THIRD PARTY		

- (b) with regard to the AP, consent to the transfer of such agreements to a QTP. Where PIDM consents to such transfer, neither the transfer nor the appointment of the conservator can be construed as giving rise to the right of the counterparty to terminate the QFAs, exercise any right of set off under the QFAs, or exercise any remedy or right against the AP or its assets.

There will be no “cherry picking” of the QFAs by PIDM for purposes of the transfer.

- 2.3 If the QFAs are not transferred within the temporary suspension period, the counterparty may then exercise its rights in accordance with the terms of the agreements.

3. QUALIFIED THIRD PARTY

- 3.1 PIDM issued a Consultation Paper on 30 June 2010 (“the 2010 Consultation Paper”)ⁱⁱⁱ that, amongst others, proposed for the ability for PIDM to transfer qualified financial transactions (as referred to in the 2010 Consultation Paper) to QTPs in the PIDM Act.
- 3.2 On the proposal to transfer the qualified financial transactions to a QTP, several respondents to the 2010 Consultation Paper requested that the criteria for QTP be provided to the industry for consultation prior to them being published in the Gazette.
- 3.3 The ability for PIDM to transfer QFAs to QTP is now part of the PIDM Act, and subsection 2(1) of the PIDM Act defines QTP as “a corporation that meets such criteria as may be prescribed by the Corporation”.
- 3.4 In its response^{iv} to the feedback on the 2010 Consultation Paper, PIDM responded that it will carry out relevant consultations prior to the implementation of the criteria for QTP.



Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

Ref No	DI/CP13/2011	Issued on	26 August 2011
TITLE	CONSULTATION PAPER ON CRITERIA FOR QUALIFIED THIRD PARTY		

4. OBJECTIVE

- 4.1 The objective of this consultation paper is to seek views and comments on the proposed criteria for QTP.
- 4.2 The discussion in Section 6 sets out the proposed criteria for the parties to whom the QFAs may be transferred in the following situations:
- (a) where PIDM or its appointed person assumes control of a failing MI pursuant to paragraph 99(1)(c) or a receiver is appointed in respect of a failing MI pursuant to paragraph 99(1)(d) of the PIDM Act; and
 - (b) where PIDM appoints a conservator over an AP pursuant to subsection 161(1) of the PIDM Act.

5. THE CONSULTATION PROCESS

- 5.1 PIDM hereby invites written comments from interested parties on the proposals and issues raised in this consultation paper.
- 5.2 Written comments should be submitted no later than 15 September 2011 to:

General Manager
Intervention and Failure Resolution Division
Perbadanan Insurans Deposit Malaysia
Level 12, Quill 7
No. 9, Jalan Stesen Sentral 5
Kuala Lumpur Sentral
50470 Kuala Lumpur

Please mark "CP on QTP" on the top left hand corner of the envelope.

Enquiries : (03) 2173 7483 (Mr. Shrithar Nagalingam); or
(03) 2173 7410 (Ms. Peggie Tang)
Email : gtp@pidm.gov.my

- 5.3 Your comments may be made public by PIDM. If you do not want any of your comments to be made public, please indicate accordingly in your response.



Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

Ref No	DI/CP13/2011	Issued on	26 August 2011
TITLE	CONSULTATION PAPER ON CRITERIA FOR QUALIFIED THIRD PARTY		

6. PROPOSED CRITERIA FOR QUALIFIED THIRD PARTY

Proposed Criteria in Relation to Member Institutions

6.1 A QTP which would be eligible to assume QFAs from a failing MI may be any one of the following entities:

- (a) an institution licensed under the Banking And Financial Institutions Act 1989, the Islamic Banking Act 1983, the Insurance Act 1996, the Takaful Act 1984 or the Development Financial Institutions Act 2002; or
- (b) a foreign financial institution; or
- (c) a public entity or an entity which the Government of Malaysia or PIDM has provided guarantees for the performance of the QFAs.

6.2 The rationale for the respective proposed criterion is set out below:

- (a) **An institution licensed under the Banking And Financial Institutions Act 1989, the Islamic Banking Act 1983, the Insurance Act 1996, the Takaful Act 1984 or the Development Financial Institutions Act 2002**

PIDM envisages that QFAs that have been entered into by the failing MI may be packaged together with the sale of the MI's other assets and liabilities during the resolution process. Local licensed institutions are likely to be a category of candidates interested to acquire assets and liabilities (including QFAs) of failing institutions. A licensed institution for this purpose would include an existing licensed institution or an entity which Bank Negara Malaysia has agreed to license as a licensed institution.

- (b) **A foreign financial institution**

This criterion will allow PIDM to transfer QFAs (e.g. non Malaysian Ringgit denominated derivatives) to foreign financial institutions that do not have licensed operations in Malaysia, in the event that such transfer is deemed appropriate to avert an adverse impact to the stability of the Malaysian financial system.

Ref No	DI/CP13/2011	Issued on	26 August 2011
TITLE	CONSULTATION PAPER ON CRITERIA FOR QUALIFIED THIRD PARTY		

(c) A public entity or an entity which the Government of Malaysia or PIDM has provided guarantees for the performance of the QFAs

Similar to the rationale in point (b) above, this criterion is to cater for the situation where the QFAs need to be transferred in order to avert an adverse impact to the Malaysian financial system caused by the unwinding of the QFAs of the failing MI.

A transfer to a public entity is in line with the recommendation of the BIS Report which states that *“national resolution authorities should have the legal authority to temporarily delay immediate operation of contractual early termination clauses in order to complete a transfer of certain financial market contracts to another sound financial institution, a bridge financial institution or other public entity”*.

The criterion also caters for the transfer to an entity where the Government of Malaysia or PIDM has provided guarantees for the performance of the QFAs – this may include an asset management company assuming the operating assets of the failing MI.

Feedback Required No.1:

We welcome your feedback with regard to the proposed criteria for QTP in relation to MIs as set out above.

Proposed Criteria in Relation to Affected Persons

- 6.3 Any party who is willing to assume the QFAs of the APs would be eligible to do so.
- 6.4 The rationale for the proposed criterion is that the type of QFAs entered into by APs can be very diverse depending on the nature of the business that the APs are involved in.

Feedback Required No. 2:

We welcome your feedback on how the proposed criterion for QTP in relation to APs could be further defined given the diverse nature of the QFAs that APs may be exposed to.

Feedback Required No. 3:

We welcome your feedback on the scope of agreements of MIs and APs that are subjected to the potential transfer to a QTP.

7. RESPONSES

7.1 The views and comments of interested parties are sought in relation to the proposals and issues above.

Perbadanan Insurans Deposit Malaysia
26 August 2011

ⁱ QFA is defined in section 115 of the PIDM Act and includes:

- (a) a derivative, whether to be settled by payment or delivery, that
 - (i) trades on a derivative, futures or options exchange or board or other regulated market; or
 - (ii) is the subject of recurrent dealings in over-the-counter derivatives, securities or commodities markets;
- (b) an agreement to:
 - (i) borrow or lend securities or commodities, including an agreement to transfer securities or commodities under which the borrower may repay the loan with other securities or commodities, cash or cash equivalents;
 - (ii) clear or settle securities, futures, options or derivatives transactions; or
 - (iii) act as a depository for securities;
- (c) a repurchase, reverse repurchase or buy-sell back agreement with respect to securities or commodities;
- (d) a margin loan in so far as it is in respect of a securities account or futures account maintained by a financial intermediary;
- (e) any combination of agreements referred to in any of paragraphs (a) to (d);
- (f) a master agreement in so far as it is in respect of an agreement referred to in any of paragraphs (a) to (e);
- (g) a master agreement in so far as it is in respect of a master agreement referred to paragraph (f);
- (h) a guarantee of, or an indemnity or reimbursement obligation with respect to, the liabilities under an agreement referred to in any of paragraphs (a) to (g); and
- (i) an agreement relating to financial collateral, including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to an agreement referred to in any of paragraphs (a) to (h).



Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

Ref No	DI/CP13/2011	Issued on	26 August 2011
TITLE	CONSULTATION PAPER ON CRITERIA FOR QUALIFIED THIRD PARTY		

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- ii Under section 2(1) of the PIDM Act, “affected person” means:
- (a) any company owing a duty or liability under an Islamic financing facility or a conventional credit facility to the Corporation or any subsidiary of the Corporation, whether present or future, or whether vested or contingent;
 - (b) any subsidiary of the company referred to in paragraph (a);
 - (c) any company which has provided security for the performance of or discharge of a duty or liability owed by the primary affected person to the Corporation or any subsidiary of the Corporation, whether present or future, or whether vested or contingent; or
 - (d) any company where at least five percent of its share capital has been charged, pledged or mortgaged by any person to secure the performance of or discharge of a duty or liability owed by the primary affected person to the Corporation or any subsidiary of the Corporation, whether present or future, or whether vested or contingent,
- and does not include a member institution.
- iii Consultation Paper on Proposed Amendments to the Malaysia Deposit Insurance Corporation Act 2005 Affecting Certain Financial Transactions.
- iv Response on the Consultation Paper on Proposed Amendments to the Malaysia Deposit Insurance Corporation Act 2005 Affecting Certain Financial Transactions dated 29 March 2011.