Perbadanan Insurans Deposit Malaysia

Protecting Your Insurance And Deposits In Malaysia

RESPONSE TO THE CONSULTATION PAPER ON DIFFERENTIAL PREMIUM SYSTEMS FRAMEWORK

ISSUE DATE : 30 SEPTEMBER 2007

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BACKGROUND

1. PIDM issued a consultation paper on the Differential Premium Systems ("DPS") framework and the related draft regulations for public consultation on 3 May 2007. Comments were received from member institutions, Bank Negara Malaysia and Rating Agency Malaysia during the two-month consultation period ending 2 July 2007. As part of the consultation process, PIDM is publicly disclosing its response on the comments received.

OVERVIEW OF COMMENTS RECEIVED

2. The majority of respondents have provided significant support to the DPS framework in differentiating risk profile for premium assessment purpose. The majority of comments received were related to further enhancing the proposed DPS framework and we thank respondents for their suggestions.

3. The vast majority of respondents agreed that the proposed methodology of a combined quantitative and qualitative criteria approach provides objectivity and transparency. They also agreed with the proposed criteria and their respective weightages, number of premium categories, treatment for new members and amalgamations, transition period, submission and reporting reference date, treatment for insufficient quantitative information, filing resubmission requirements, and appeal process.

4. After assessing the specific suggestions received in the context of the Malaysian banking system, Management recommends incorporating the following changes into the original DPS framework:

   (a) The leverage ratio be excluded from the capital criteria and its score be distributed equally to the scores for risk-weighted capital ratio and core capital ratio;

   (b) The threshold for the maximum score of the core capital ratio criterion is to be reduced and a consistent threshold interval will be applied for each score range;

   (c) The profitability criteria will be computed based on profit before tax;

   (d) The thresholds for the return on risk-weighted assets have been refined to enhance its effectiveness in differentiating members according to their risk profile;

(e) The composition of the aggregate sector asset concentration ratio is revised to capture loans by sector only and loans for purchase of transport vehicle and residential property within the household sector shall be provided by members; and

(f) A transition period will be introduced for a one year period. The quantitative score will be adjusted upward by 20% subject to member's total quantitative score not exceeding 60. In addition, the premium rate applicable to premium category 4 will be the same as that of premium category 3.

5. PIDM also takes note of the suggestion to incorporate further criteria into the DPS framework. In view of data limitations and availability, such criteria can only be considered in future revisions of the DPS framework. Similarly, PIDM is aware of the implications of Basel II and FRS 139 and will continuously review the framework on a yearly basis to ensure that it remains effective and relevant.

6. PIDM has also considered other suggestions such as reporting reference date and certification of submission by external auditors and has decided to maintain the proposals unchanged on the grounds of comparability and the need for independent validation of information.

7. A summary of the DPS criteria, measures and scores is attached in Appendix 1 and the detailed comments and responses are attached in Appendix 2.

MOVING FORWARD

8. PIDM appreciates the comments received in response to its consultation paper. We have incorporated the above noted changes into the draft regulations, which will be forwarded to the Treasury Solicitor and the Attorney General's Chambers as part of the legislative process. As part of this process, there may be amendments or refinements to the draft regulations. Such regulations are subject to the approval of the Minister of Finance, and the public will be informed through PIDM's website once the regulations come into force. PIDM will also issue guidelines on the DPS framework to assist members to compute and submit the required quantitative information.

Perbadanan Insurans Deposit Malaysia
30 September 2007

Appendix 1

SUMMARY OF CRITERIA, MEASURES AND SCORES (AS AMENDED)

CRITERIA AND SCORE RANGE	SCORE	MAXIMUM SCORE
Quantitative Criteria		***60***
Capital Quantitative Criteria:		**20**
Risk-Weighted Capital Ratio (“RWCR”)		10
RWCR ≥ 12%	10	
RWCR ≥ 10% but < 12%	6	
RWCR ≥ 8% but < 10%	3	
RWCR < 8%	0	
Core Capital Ratio (“CCR”)		10
CCR ≥ 8%	10	
CCR ≥ 6% but < 8%	6	
CCR ≥ 4% but < 6%	3	
CCR < 4%	0	
Other Quantitative Criteria:		
Profitability		**15**
Return on Risk-Weighted Assets (“RORWA”)		8
RORWA ≥ 3.25%	8	
RORWA ≥ 2.5% but < 3.25%	6	
RORWA ≥ 1.75% but < 2.5%	4	
RORWA ≥ 1% but < 1.75%	2	
RORWA < 1%	0	
Mean Adjusted Return Volatility (“MARV”)		7
MARV ≥ 0 but < 0.3	7	
MARV > 0.3 but ≤ 0.7	4	
MARV > 0.7 or < 0	0	
Efficiency		**5**
Efficiency Ratio (“ER”)		5
ER ≤ 35%	5	
ER > 35% but ≤ 45%	3	
ER > 45%	0	

CRITERIA AND SCORE RANGE	SCORE	MAXIMUM SCORE
Asset Quality		**10**
Net NPLs To Capital Base Ratio ("N/CB")		5
N/CB ≤ 20%	5	
N/CB > 20% but ≤ 40%	3	
N/CB > 40% but ≤ 60%	1	
N/CB > 60%	0	
Gross NPLs and Loans In Arrears To Gross Loans Ratio ("GNL/GL")		5
GNL/GL ≤ 6%	5	
GNL/GL > 6% but ≤ 12%	3	
GNL/GL > 12%	1	
Asset Concentration		**5**
Aggregate Sector Asset Concentration Ratio ("ASAC"); and Residential Property Asset Concentration Ratio ("RPAC")		5
ASAC < 150% and RPAC < 240%	5	
ASAC < 150% and RPAC ≥ 240%	4	
ASAC ≥ 150% but < 300% and RPAC < 240%	3	
ASAC ≥ 150% but < 300% and RPAC ≥ 240%	2	
ASAC ≥ 300% and RPAC < 240%	1	
ASAC ≥ 300% and RPAC ≥ 240%	0	
Asset Growth		**5**
Risk-Weighted Assets To Total Assets Ratio ("RWA/TA"); and Total Asset Growth Ratio ("TAG")		5
RWA/TA < 70% and TAG < 20%	5	
RWA/TA < 70% and TAG ≥ 20%	3	
RWA/TA ≥ 70% and TAG < 20%	1	
RWA/TA ≥ 70% and TAG ≥ 20%	0	

CRITERIA AND SCORE RANGE	SCORE	MAXIMUM SCORE
Qualitative Criteria		***40***
Supervisory Rating ("SR")		**35**
SR of 1 or equivalent	35	
SR of 2 or equivalent	28	
SR of 3 or equivalent	14	
SR of 4 or equivalent	0	
Other Information		**5**
No circumstances that represent a threat to the safety and soundness of the member	5	
Circumstances may materially affect the safety and soundness of the member	3	
Circumstances materially affect the safety and soundness of the member	0	
TOTAL		**100**

Appendix 2

TABLE 1: COMMENTS INCORPORATED INTO THE DPS FRAMEWORK

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	Several respondents expressed concerns that since there are differences between conventional and Islamic banking businesses, different score range should be established for the conventional DPS and Islamic DPS. ***Quantitative Criteria*** **<u>Core Capital Ratio (CCR)</u>** For CCR, several respondents proposed that the requirement to obtain the maximum score should be reduced from 10% to 8% to avoid penalizing member institutions ("members") with efficient capital mix whereas one respondent recommended that the score range for second and third category should be consistent.	**<u>Agreed</u>** The framework has considered the differences between conventional and Islamic banking businesses. **<u>Agreed</u>** PIDM has adjusted the score range for CCR where the threshold for the maximum score is reduced and a consistent threshold interval is applied for each score range.

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	**<u>Leverage Ratio (LR)</u>** Several respondents expressed concerns that LR might penalize members that invest in significant low risk assets even though the members have achieved the industry threshold for a well-capitalized institution. Furthermore, it was suggested that LR should be excluded as it does not take into account the risk characteristics of assets and CCR should be sufficient in this regard. **<u>Return on Risk Weighted Assets (RORWA)</u>** It was proposed that RORWA should be based on profit before tax in view of the presence of deferred tax assets, which might create distortion and render non-comparability among members. In addition, thresholds for RORWA should be set at smaller intervals, i.e. 0.25% or 0.5% as the ratio is not sensitive to variation in return due to the large asset base. Thresholds may be too high compared to industry average in 2005, i.e. 1.91% for conventional banks and 1.14% for Islamic banks.	**<u>Agreed</u>** PIDM agrees with the proposal to exclude the leverage ratio. The score of 4 for leverage ratio has been distributed equally to the scores for RWCR and CCR. **<u>Agreed</u>** Both RORWA and mean adjusted return volatility (MARV) shall be computed based on profit before tax. The thresholds for RORWA have also been refined in order to address the issue of members with large asset bases.

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	**<u>Aggregate Sector Asset Concentration</u>** It was suggested that a combination of loans by sectors and loans by purpose results in duplication in total loan amount. For example, it was stated that an extension of credit for the purpose of constructing a commercial building to a corporate entity whose business activity is in the manufacturing sector would be reported as lending to the manufacturing sector and also for the purpose of a non-residential property by purpose.	**<u>Agreed</u>** There is a need to minimize the potential of 'double counting' in order to better measure concentration using this approach. Aggregate sector asset concentration will be measured based on loans by sector only. Members shall provide the breakdown of loans for purchase of residential property and for purchase of transport vehicles within the household sector. The calculation of excess for each sector and the thresholds for each score range remains unchanged.
	Qualitative Criteria **<u>Other Information Criteria</u>** Several respondents proposed that the components of qualitative criteria should be listed down to enable members to manage and improve their scores and the assessment of the qualitative approach has to be transparent to the members. It would also benefit the members if PIDM were to provide clear guidelines on the qualitative criteria and to give more specific criteria to members to enable them to improve.	**<u>Agreed</u>** The other information criteria will be assessed based on defined information sources to provide an objective assessment of material threat on the financial soundness of members.

Topic and Issues	Comments Received	PIDM's Responses
Transition Period Based on your experiences and systems' capabilities, is one-year transition period appropriate for you to adjust to the requirements of DPS? If no, please provide comments (with supporting rationale or evidence) on: (a) Transition period (b) Transitional process	The majority of the respondents agreed with a one-year transition period, while several respondents proposed a transition period of two years, with an upward adjustment ranging between 5% and 20% or higher in the second year because IT resources are tied up with Basel II and FRS 139 projects and to enable members to have adequate time to adjust to the DPS requirements.	**Agreed** A one-year transition period will be provided and the total quantitative score of each member shall be adjusted upward by 20% subject to member's total quantitative score not exceeding 60. Furthermore, the premium rate applicable to premium category 4 shall be applied with the same premium rate as that of premium category 3 to provide members time to adjust to the DPS.

TABLE 2: COMMENTS TO BE CONSIDERED IN FUTURE REVIEWS OF THE DPS FRAMEWORK

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	***Quantitative Criteria*** It was suggested that for quantitative criteria, liquidity risk should be taken into account as it is closely related to bank run and deposit insurance. A respondent commented that scoring may not be appropriately capturing risk of members operating under a universal banking model **Capital:** According to one respondent, in respect of determining the capital base of the conventional banking operations, it is noted in the worksheet that the capital base is a straight forward deduction of the capital of the Islamic banking operations from the capital of the total banking operations. This has inevitably distorted the capital base of the conventional banking operations. In reality, when injecting capital to the Islamic "subsidiary", members are conscious not to inject excessive capital in view of the flexibility of PSIA. The respondent suggested that the formula used for the computation of capital base to be reviewed.	**<u>Agreed/ Future Review</u>** PIDM has considered introducing liquidity risk but in view of data availability, this criterion will be considered and introduced in the future revisions. PIDM takes note of the suggestion and will consider this point further in future revisions. **<u>Agreed/ Future Review</u>** The formula used for computation of the capital base will be reviewed in future.

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	**<u>Risk Weighted Capital Ratio (RWCR)</u>** Several respondents proposed that capital criteria have to take into consideration BNM's regulatory implementation timeline on Basel II for RWCR. When some members move to Basel II standardized approach in 2008, the basis of computing risk weighted assets will not be consistent across all members. One respondent expressed concern that calculation of Islamic bank's RWCR is different from a conventional bank. **<u>Efficiency Ratio</u>** One respondent commented that conventional and Islamic DPS should have different threshold levels for scoring to reflect the different levels of efficiency of the industry. **<u>Mean Adjusted Return Volatility</u>** One respondent recommended that PIDM could allow special adjustments to profits if volatility is due to merger activities or introduction of new accounting standards.	**<u>Agreed/ Future Review</u>** PIDM is aware of the implications of Basel II on the capital adequacy measurement of members. The capital adequacy criteria will be reviewed once financial information is available for analysis. PIDM agrees that there are differences in the capital calculation of Islamic and conventional banking businesses. PIDM will amend its systems when the capital adequacy standard for Islamic banks is implemented and information is available for analysis. **<u>Agreed/ Future Review</u>** Due to similarities in the current cost structure, the same thresholds levels are used to score Islamic and conventional banks. PIDM will review this ratio on an on-going basis. **<u>Agreed/ Future Review</u>** With regard to data fluctuations as a result of new accounting standards, PIDM will assess the impact and review the DPS framework accordingly when new standards are implemented.

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	**Asset Quality** One respondent recommended that PIDM includes asset classes other than loans in measuring asset quality. **Asset Concentration** Other comments received from several respondents: (1) The proposed methodology to measure concentration risk may not be a good reflection of the risk that members face. In particular, Islamic banks have high exposure to certain asset classes, e.g. purchase of transport vehicle, which may not necessarily indicate high credit concentration risk. Instead, this high concentration risk to fixed rate financing could pose major market risk concern, rather than credit risk. (2) The criterion is only confined to lending exposures which may not truly represent members' assets. PIDM may consider incorporating the total exposure of all income generating assets, in particular lending and treasury assets in measuring concentration risk. (3) The potential losses that members may incur arising from being overly exposed to selected sectors are dependent on the business strategies and models they adopt. The respondent suggested that PIDM should include an adjustment to account for the level of riskiness of the exposures and hence, the potential losses.	**Agreed/ Future Review** Due to data limitations, these asset classes were excluded in the current framework. PIDM will review the system to include asset classes other than loans when relevant information is available for analysis. **Agreed/ Future Review** PIDM agrees with the suggestions on measuring concentration risk of Islamic banks and treasury assets as well as an adjustment to account for different business models. PIDM will take into account these suggestions for future enhancement when data is collectable for these measures and sufficient empirical evidence is available.

TABLE 3: COMMENTS NOT RESULTING IN CHANGES TO THE DPS FRAMEWORK

Topic and Issues	Comments Received	PIDM's Responses
Weightage for Quantitative and Qualitative Criteria What are your comments on the proposed weightage, with larger weightage assigned to the quantitative criteria?	While majority of the respondents agreed in principle with the proposed weightage assigned to quantitative and qualitative criteria, some respondents proposed larger weightage to be assigned to quantitative criteria.	**No Change** Based on the analysis conducted, the proposed weightage assigned to quantitative and qualitative criteria reflects the overall risk profile of members and are best practice standards.
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	A respondent proposed that only those members that have insurable deposits of more than RM250,000 will have to comply with the DPS framework submissions. One respondent commented that in Islamic window environment, quite often the actual cost of operation for example support services, branches and other delivery channels expenses are not legally charged to the Islamic window. It would result in the Islamic window being shown more profitable. A proper "charged-out" module would only be in placed when a separate Islamic entity is set up.	**No Change** The framework is developed based on a set of principles, including equitability and transparency where the framework will be applied to all members regardless of their size or their insured deposit base. Members should establish internal policies to allocate costs appropriately between conventional and Islamic banking operations within a bank.

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	**Capital:** One respondent proposed that capital criteria should include capital backing and financial support by a parent company. One respondent commented that as capital criteria are given a score of 20, a member with high capital will have high score. However, this does not improve members' risk management framework or lending practices as any inadequacies in this area cannot be compensated by injecting additional capital. **Risk Weighted Capital Ratio (RWCR)** Another respondent suggested that the maximum score range for RWCR should be set at more than or equal to 10% rather than 12% as BNM's minimum RWCR requirement is set at 8% and a higher capital ratio may result in overcapitalization at the expense of capital efficiency. The maximum score range for core capital ratio and leverage ratio should also be adjusted accordingly.	**No Change** The qualitative aspects of capital are being assessed under BNM's supervisory rating criteria. The effectiveness of capital management and risk management practices of members are addressed under the supervisory rating criteria. **No Change** Capital adequacy is the last line of defence before losses impact the deposit insurance fund. Hence, it is crucial that a sufficient capital buffer level is established. The DPS rewards members who are well capitalized and differentiates these members that meet only the minimum capital requirements. The proposed threshold for RWCR is established based on international best practice standards and current industry average levels.

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	**Profitability:** Another respondent sought clarification on the definition of extraordinary items. The member provided an example, proposing that if a member adopts more stringent provisioning policy than GP3 and took a massive provision charge in a particular year, this should be considered as extraordinary and adjusted for in arriving at the profit for deposit insurance purpose.	**<u>No Change</u>** Extraordinary items do not include additional provisions made as provisioning is operational in nature.
	<u>Efficiency Ratio</u> One respondent expressed concerns that the efficiency ratio penalizes members who have a large investment banking franchise due to higher personnel costs and infrastructure costs. The member proposed that efficiency ratio could be replaced with return on equity ratio.	**<u>No Change</u>** PIDM aims to measure a member's ability to optimally deploy resources to generate income. An efficient member will be able to utilize its personnel and infrastructure to enhance its earnings. Efficiency ratio cannot be substituted by return on equity (ROE) ratio as ROE measures the rate of return on the ownership interest or shareholders' equity. Efficiency ratios are used widely and internationally.
	Another respondent mentioned that cost to income ratio is only one of the indicators to gauge the member's management and business efficiency. In the current dynamic banking environment where capacity enhancement is essential in meeting challenges, there is a continuous need for investment in IT and human capital. These expenditures would lead to higher overhead costs in the immediate term but the positive impact of such investments could only be seen in the longer term. Therefore, cost to income ratio (as at figure)	Investments in IT and human capital are an on-going process and it is an industry-wide practice. As the score range is established based on industry average, it is unlikely that any members will be adversely affected.

Topic and Issues	Comments Received	PIDM's Responses
	may provide disincentives for members to invest to cater for their future needs.	
Criteria	**Asset Quality**	**No Change**
(a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	One respondent commented that assets should also include commitments and contingencies as there are members whose strategy is to focus on fee based transactions and risk management activities.	In the proposed DPS, the asset quality ratio does not include commitments and contingencies due to data limitations.
	One respondent commented that there is a duplication of ratios that measure related type of data, e.g. the asset quality is better measured by 'net non-performing loans (NPLs) to capital base ratio' compared to 'gross NPLs and loans in arrears to gross loans ratio'. By having both ratios, members that have high NPLs would be penalized twice on the same risk area.	The criteria are different measures of Asset Quality. Net NPLs to capital base ratio has taken into account the collateral value of non-performing loans. The ratio aims to measure the ability of a member's capital in absorbing possible further deterioration in asset quality. On the other hand, gross NPLs and loans in arrears to gross loans ratio aims to provide an indication of potential loan impairment if vulnerable performing loans were to turn non-performing.
	One respondent expressed concern that the net NPLs to capital base ratio discriminates members that practice prudent provisioning for NPL as capital base will be reduced by the provisioning amount .	PIDM noted the comments. Prudent provisioning practices and credit risk management of members are considered under the supervisory rating criteria.

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	**<u>Asset Concentration</u>** One respondent proposed that for Islamic banking institutions, loan by sector need to be adjusted, i.e. add back financing sold to Cagamas (FSTC) to ensure comparability between conventional and Islamic banking. Under conventional banking, the loan outstanding is reported at gross, i.e. before deduction of loan sold to Cagamas (LSTC), whereas under Islamic banking, financing sold to Cagamas (FSTC) is reported as an off balance sheet item. As loan by sector is extracted from Report on Domestic Assets and Liabilities (Monthly), all the figures have deducted FSTC. Thus, the aggregate sector asset concentration ratio will be distorted especially when an Islamic bank has a large amount of outstanding financing sold to Cagamas.	**<u>No Change</u>** Due to the differences between Islamic and conventional operations, DPS framework measures both operations separately. The financing sold to Cagamas is deemed as outright sale and is not part of total financing as compared to conventional banking where it is deemed as collateralized lending.

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	**<u>Asset Growth</u>** One respondent proposed that this ratio should be dispensed or PIDM should consider a matrix scoring method, i.e. members with significant asset growth (> 20%) but with very low risk assets (< 50%) will be accorded highest score. This ratio penalizes members with high asset growth due to growth in non-risky assets e.g. government bonds or interbank market and growth through merger activities. ***Qualitative Criteria*** One respondent mentioned that the criteria set for qualitative criteria should not 'overlap' those under quantitative criteria. Several respondents suggested that ratings by rating agencies, general bank ratings history and outlook changes should be considered as part of qualitative criteria in addition to supervisory rating and other information. A member further proposed that ratings by rating agencies should be assigned a score of 5, with 30 assigned to supervisory ratings.	**<u>No Change</u>** As explained in the consultation paper, PIDM is concerned with excessive growth and high exposure in risky assets. The quality of assets and credit risk management is being assessed under the BNM's supervisory rating component. **<u>No Change</u>** Quantitative criteria are objective and allow members to understand and manage their profiles. The objective of qualitative criteria is to ensure that the systems contain forward looking criteria, such as compliance with sound risk management policies and governance standards. Rating agencies' ratings, general bank ratings history and outlook changes are part of the other information criteria.

Topic and Issues	Comments Received	PIDM's Responses
Criteria (a) Whether the proposed quantitative and qualitative criteria are appropriate. (b) Suggestions on whether any other criteria should be included or excluded. (c) Whether the weightage assigned to each criterion is appropriate.	**<u>Supervisory Rating</u>** Several respondents expressed concerns that the weightage assigned to supervisory rating criteria is heavy. Use of supervisory rating may be 'double-counting' and members will be doubly penalized as the ratings are also based on financial conditions and capital adequacy. According to one respondent, ratings provided to PIDM by BNM should also be forwarded to members in order for them to seek clarification with BNM, if required.	**<u>No Change</u>** The supervisory rating criterion is a critical component as the supervisors conduct assessments on the overall safety and soundness of members. BNM already informs members of their supervisory rating before submitting them to PIDM.
Premium Category (a) Number of premium categories (b) Range of scores determining each category	Several respondents proposed that the number of premium category should be increased to five from the current four. With five premium categories, one respondent proposed that the lowest score range should be less than 20, while two respondents proposed that it should be less than 40. This is to allow for better spread in the premium categories while providing incentive to members. One respondent proposed a premium category of five with each score range being standardized at 10 points, with the score ranging from 80 to 50, whereas some respondents proposed a premium category of four and that the score range for category two and three should be standardized to 15 points.	**<u>No Change</u>** The number of premium category determined by PIDM is meant to effectively differentiate members into appropriate risk categories as well as to provide an incentive for members to adopt sound risk management practices. The score of 50 is the minimum score based on international standards and practices in other jurisdictions. The proposed score range and premium categories were established based on extensive analysis on members' data and reflect the overall risk profiles of members.

Topic and Issues	Comments Received	PIDM's Responses
	One respondent commented that PIDM could consider scoring based on group data.	The scoring is based on information of individual member entities rather than group because only the member entity is covered under the deposit insurance system.
New Member and Amalgamation (a) New Member (b) Amalgamation	Majority of the respondents agreed with the proposal for new member and amalgamation. One respondent proposed that for an amalgamation, the score of the mean adjusted return volatility and total asset growth ratio should be excluded from the total score and score for these criteria will be derived by using the proportionate approach. Another respondent recommended that new members should only be automatically categorized in the lowest premium category for the first year and subject to normal assessment for the following assessment years, whereas several respondents proposed that new members should be automatically categorized in the lowest premium category for the first three years because certain criteria require three years of data and the start up costs for infrastructure can be substantial which will affect profitability and efficiency.	**<u>No Change</u>** In relation to the significant fluctuations in quantitative data as a result of amalgamation or restructuring, certain ratios are measured using a moving average of three years data which effectively even-out fluctuations. The consultation paper proposed that new members will be automatically categorized in the lowest premium category for two years given their relatively low level of risk exposure. By the third year, they will have the available data required to calculate the quantitative criteria.

Topic and Issues	Comments Received	PIDM's Responses
Transition Period Based on your experiences and systems' capabilities, is one-year transition period appropriate for you to adjust to the requirements of DPS? If no, please provide comments (with supporting rationale or evidence) on: (d) Transition period (e) Transitional process	One respondent agreed with the one-year transition period but recommended implementation of DPS in 2009 whereas another respondent proposed that while the rating scores can be submitted on a trial basis, implementation of the DPS should be deferred to 2010 because of implementation of Basel II and members need time to adapt to the DPS framework and adjust their risk profiles accordingly. One respondent suggested that PIDM should review members who are at borderline cases on a case by case basis after 2008, while another respondent proposed that there should be an option for any members to choose to extend for another year to provide flexibility and sufficient time for them to adapt.	**<u>No Change</u>** It is PIDM's stated policy to establish a DPS to replace the current flat-rate premium system by 2008. The transition period and process should provide ample time for members to adjust their financial performance and operations according to DPS requirements. The system should be applied on all members rather than providing options to members as DPS has been developed based on principles of equitability and transparency.
Reporting Reference Date What are your comments on the proposed reporting reference date? Please provide suggestions if you disagree with the proposal. For members whose financial year end is not 31 December, what are your comments about calculating quantitative information based on calendar year end information as at 31 December?	Several respondents proposed that quantitative criteria should be calculated based on financial year end results as it is audited by external auditors, of which one respondent suggested the following alternatives for members whose financial year end is not 31 December: (1) Submission deadlines should be adjusted accordingly if financial year end results are used for calculating quantitative criteria. (2) Half-yearly results of the member should be used whereby external auditor has performed a limited review.	**<u>No Change</u>** The proposal of adjusting reporting reference date based on members financial year end would result in comparability issues between members. Furthermore, most members currently adopt a 31 December financial year end.

Topic and Issues	Comments Received	PIDM's Responses
	Several respondents expressed concerns that it is unfair and not economical for certain members whose financial year end is not 31 December as they will have to incur additional costs and resources because external auditor will need to do two certifications, i.e. on 31 December for submission to PIDM and on financial year end for annual audit. They also proposed that if quantitative information has to be calculated based on calendar year end information as at 31 December, PIDM should: (1) Allow internal auditors to validate as they are independent from management, report directly to the Audit Executive Committee and are subject to BNM Guidelines. (2) For members whose financial year end is not 31 December, they should be allowed to incorporate the profit to December in the capital base for RWCR and CCR computation on a proforma basis based on review by internal auditor.	The information submitted to PIDM for purpose of the DPS requires the certification of external auditors to ensure the independence and reliability of the information. The cost associated with having external auditors validate the DPS reporting to PIDM should be minimum. With respect to the recommendation for members whose financial year end is not 31 December should be allowed to incorporate the profit to December in the capital base for RWCR and CCR computation on a proforma basis, PIDM is of the view that the profit to December can only be incorporated into the capital base for RWCR and CCR for half year profits when they have obtained consent from BNM.
Submission Dates What are your comments on the proposed submission dates and requirements? Please provide suggestions if you disagree with the proposal.	Most of the respondents agreed that members shall be required to submit quantitative information to PIDM by 30 April of an assessment year. One respondent suggested a period of four months from the reporting reference date if reference date is based on financial year end of members.	**No Change** With regard to the proposed 31 May as submission date, the majority of members has 31 December as year end and would be able to submit information to PIDM by 30 April. The rationale of setting the submission date on 30 April is to enable PIDM to validate the information submitted by members, to inform members about the premium category and rates as well as to provide ample time for

Topic and Issues	Comments Received	PIDM's Responses
	Several respondents proposed 31 May as this will allow sufficient time to ensure data integrity. They added that PIDM should not impose premium surcharge without giving members opportunity to rectify the situation within a reasonable time frame if the delay is due to uncontrollable event.	members to pay their premiums due by 31 May each year. Members may submit an appeal to PIDM if there are changes in the information submitted to PIDM after the submission deadline of 15 May.
Filing Resubmission PIDM would appreciate your comments on the proposal for filing resubmission.	Majority of the respondents agreed with the proposal where they will be rated based on information submitted by 15 May of an assessment year. The following are other alternatives provided by several respondents: (1) The period between notification of score to members (15 May) and payment to PIDM (31 May) should be lengthen to three weeks instead of two weeks to allow sufficient time for members to seek clarification. (2) Filing resubmission should be allowed from 16 May onwards as PIDM will notify members by 15 May of their scores and premium categories. (3) 30 June. (4) 31 July.	**<u>No Change</u>** With respect to extending the period between notification of score and payment to PIDM, the two-week period allows adequate time for members to pay their premiums. In terms of a proposal to provide a grace period of one month or an extension of up to one week after the submission dateline, this should not be necessary as the proposed two-week period should be sufficient for members to submit any amended information. Additionally, information submitted for DPS would have been audited by external auditors and validated by CEO and CFO, which will substantially reduce the likelihood of filing inaccurate information.

Topic and Issues	Comments Received	PIDM's Responses
Appeal Process What are your comments on the proposed appeal process?	 Majority of the respondents are in agreement with the proposal for appeal process, while several respondents proposed the following alternative timeframes: (1) The deadline should be extended to six months instead of three months as the premium computation would be subject to supervisors' examination who may request changes during the year of assessment. (2) Appeal should be allowed before 31 May so that the actual premium can be paid to PIDM. (3) 31 July.	**<u>No Change</u>** With respect to the alternative dates proposed, PIDM aims to review and respond to members' appeal as soon as possible upon receiving the request in writing. The proposed deadline of 30 September is the final date that PIDM will complete all appeals. As members will be informed of their premium category and premium rate by 15 May of an assessment year, ample time has been provided for members to submit their appeals as well as for PIDM to respond to any appeal.
Other Issues	 Another respondent sought clarification on whether the deposits of new subsidiary (Islamic subsidiary) for the period prior to the submission of first return will be covered by insurance should anything unforeseen happen between the commencement of business and submission of the first return. One respondent expressed concerns that as PIDM does not have the discretion to adjust any scores arbitrarily, the DPS framework may not allow PIDM to have sufficient flexibilities to consider exceptional cases.	**<u>No Change</u>** With respect to an enquiry on whether the deposits of a new subsidiary (Islamic subsidiary) for the period prior to the submission of first return will be covered by insurance, PIDM confirms that the provisions of the PIDM Act provides for such matters. PIDM emphasizes that the framework is developed based on the principles that it should be applied equitably to all members and no discretion on the part of PIDM will be allowed to adjust any scores arbitrarily. Thus, the DPS and scores are issued in the form of regulations thereby minimising any possibility of forbearance or arbitrary adjustments.

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Other Issues	According to one respondent, since BNM imposes penalties on inaccurate reporting to the Financial Institutions Statistical System, the Corporation should consider abolishing the provision related to imposing premium surcharge on members that do not comply with information integrity requirements. One respondent requested for an exclusion of securing all deposits which is taken on the concept of Al Mudharabah due to contradiction of the practice against the spirit of Al Mudharabah. The respondent commented that under subsection 49(1) of the MDIC Act, PIDM is required to provide separate coverage for Islamic and conventional deposits placed with a member.	The purpose of premium surcharge is to ensure data integrity and encourage best practices among the members. In relation to the suggestion to exclude all deposits taken on the concept of Al Mudharabah from being insured by PIDM, the PIDM Act provides for such coverage.