Malayan Banking Berhad

Brunei Darussalam Branch

Basel II Pillar 3 Disclosure

For the financial year ended 31 December 2018

Contents

Malayan Banking Berhad – Brunei Darussalam Branch

Basel II Pillar 3 Disclosure

I. OVERVIEW

The Pillar 3 Disclosure for the financial year ended 31 December 2018 for Malayan Banking Berhad – Brunei Darussalam Branch ("Maybank" or the "Branch") is in accordance with Autoriti Monetari Brunei Darussalam Branch's ("AMBD") Guidelines on Pillar 3 Public Disclosure Requirements, which are the equivalent of that issued by the Basel Committee on Banking Supervision ("BCBS") entitled International Convergence of Capital Measurement and Capital Standards (commonly referred to as Basel II).

Following the methodology employed by the Malayan Banking Berhad ("Head Office" or the "Group"), the Branch adopts the following approaches in determining the capital requirements of Pillar 1 in accordance with AMBD's Guidelines on Capital Adequacy Framework (Basel II – Risk-Weighted Assets):
• Credit Risk –Standardised Approach ("SA") and will migrate to the Internal Ratings-Based ("IRB") approaches progressively.
• Market Risk – Standardised Approach ("SA").
• Operational Risk – Basic Indicator Approach ("BIA").

LOCATION OF DISCLOSURE

The Pillar 3 Disclosure will be made available to the public upon request via hard copy or electronically.

II. CAPITAL MANAGEMENT

The Branch's approach to capital management is to ensure that the Branch maintains adequate level of capital necessary to support its business and growth and to meet regulatory capital requirements at all times.

Branch's capital planning and assessment process is guided by Branch's Capital Management Framework Branch are required to develop own Capital Management Framework based on the overarching principles of the Group Framework but take into account the nature of business, risk profile and the local operating environment. This will ensure that capital is managed on an integrated approach and in compliance with all internal and external regulatory requirements across the Maybank Group.

The Capital Management Framework is to be reviewed and updated either on annual basis or whenever necessary to reflect changes in policies, governance or regulatory environment, amongst others.

III. RISK MANAGEMENT FRAMEWORK

The Group's risk management approach, which is followed by the Branch, is underpinned by a sound and robust Integrated Risk Management Framework, which is constantly enhanced to remain relevant and resilient ahead of the versatile global risk landscape and changes in regulatory requirements, and leading practices in ensuring effective management of risk. The key principles are broadly described below:

Principles	Description
Establish risk appetite & strategy	The risk appetite is approved by the Head Office's Board, which articulates the nature, type and level of risk the Branch is willing to assume.

Assign adequate capital	The approach to capital management is driven by strategic objectives and accounts for the relevant regulatory, economic and commercial environment in which the Branch operates.
Ensure proper governance and oversight function	There is a clear, effective and robust Branch governance structure with well-defined, transparent and consistent lines of responsibility established within the Branch.
Promote strong risk culture	Institutionalisation of a strong risk culture that supports and provides appropriate standards and incentives for professional and responsible behaviour.
Implement sound risk frameworks, policies and procedures	Implementation of integrated risk frameworks, policies and procedures to ensure that risk management practices and processes are effective at all levels.
Execute strong risk management practices and processes	Robust risk management processes are in place to actively identify, measure, control, monitor and report risks inherent in all products and activities undertaken by the Branch.
Ensure sufficient resources and system infrastructure	Ensure sufficient resources, infrastructure and techniques are established to enable effective risk management.

RISK APPETITE

The Group's risk appetite is an integral component of the Group's robust risk management framework and is driven by both top-down Board leadership and bottom-up involvement of management at all levels. Our risk appetite enables the Board and Senior Management to communicate, understand and assess the types and levels of risk that the Group is willing to accept in pursuit of its business and strategic goals while taking into consideration constraints under stressed environment.

The risk appetite is integrated into the strategic planning process, and remains dynamic and responsive to the changing internal and external drivers such as market conditions, stakeholder's expectations and internal capabilities. In addition, the budgeting process is aligned to the risk appetite in ensuring that projected revenues arising from business transactions are consistent with the risk profile established. Our risk appetite also provides a consistent structure in understanding risk and is embedded in day-to-day business activities and decisions throughout the Group.

Guided by these principles, our risk appetite is articulated through a set of Risk Appetite Statements for all material risks across the Group and Branch to ultimately balance the strategic objectives of the Group.

RISK GOVERNANCE AND OVERSIGHT

The risk governance model provides a formalised, transparent and effective governance structure that promotes active involvement from the Board and Senior Management in the risk management process to ensure a uniform view of risk across the Group and Branch. The governance model aims to place accountability and ownership whilst facilitating an appropriate level of independence and segregation of duties between the three lines of defence.

The risk governance structure is premised on the three lines of defence and clearly defines the lines of authority, roles and responsibilities to efficiently manage risk across the Group and Branch.

INDEPENDENT GROUP RISK FUNCTION

Group Risk provides oversight of risk management on an enterprise-wide level through the establishment of the Group's risk strategies, frameworks and policies with independent assessment and monitoring of all risks challenges.

The key pillars of Group Risk functions are as below:

- Provides close support and oversight within key businesses and countries in managing day-to-day risk.

- Drives and manages specific risk areas on an enterprise-wide level for a holistic risk view within the Group and Branch.
- Supports sustainable and quality asset growth with optimal returns.

IV. CREDIT RISK

Credit risk is the risk of loss of principal or income arising from the failure of an obligor or counterparty to perform their contractual obligations in accordance with agreed terms.

REGULATORY CAPITAL REQUIREMENT

Amongst the various risk types, the Branch engages in, credit risk continues to attract the largest regulatory capital requirement.

MANAGEMENT OF CREDIT RISK

Corporate credit risks are assessed by business units, where each customer is assigned a credit rating based on the assessment of relevant qualitative and quantitative factors including the customer's financial position, future cash flows, types of facilities and securities offered. These credits are then evaluated and approved by a party independent of the originator.

Reviews are conducted at least once a year with updated information on the customer's financial position, market position, industry and economic conditions, and conduct of account. Corrective actions are taken when the accounts show signs of credit deterioration.

The Branch manages its credit risk using a two-pronged approach:
- Managing the Credit Risk; and
- Managing the Credit Portfolio.

Retail credit exposures are managed on a programme basis. Credit programmes are assessed jointly between credit risk and business units. Reviews on the credit programmes are conducted at least once a year to assess the performances of the portfolios.

Credit approving authorities and committee structures are in place to ensure appropriate underwriting standards are enforced consistently throughout the Group and Branch level.

Management of Concentration Risk

Concentration risk can materialise from excessive exposures to a single counterparty and persons connected to it, a particular instrument or a particular market segment/sector.

In managing large exposures and to avoid undue concentration of credit risk in its loans and financing portfolio, the Branch has emplaced, amongst others, limits and related lending guidelines for:
- Business segments;
- Economic sectors;
- Single customer groups;
- Banks and Non-Bank Financial Institutions ("NBFIs") and
- Collaterals.

Reviews of the said limits and related lending guidelines are undertaken on a periodic basis, whereupon any emerging concentration risks are addressed accordingly. Any exception to the limits and lending guidelines would be subject to approvals from higher credit authorities.

Asset Quality Management

The Branch has dedicated teams to effectively manage vulnerable corporate and consumer credits. Special attention is given to these vulnerable credits where more frequent and intensive reviews are performed in order to prevent further deterioration or, where necessary, accelerate remedial actions.

The Group's credit approving process encompasses pre-approval evaluation, approval and post-approval evaluation. Group Risk is responsible for developing, enhancing and communicating effective and consistent credit risk management policies, tools and methodologies across the Group. The Branch is to ensure appropriate standards are in place to identify, measure, control, monitor and report such risks.

In view that the authority limits are directly related to the risk levels of the borrower and the transaction, a Risk-Based Authority Limit structure is implemented based on the Expected Loss principle and internally-developed Credit Risk Rating System.

Table 1 presents the geographic analysis and distribution of credit exposures under both the Standardized Approach and IRB Approach for the Branch.

Table 2 presents the credit risk exposures by various industries for the Branch.

Table 3 presents the credit risk exposures by maturity periods of one year or less, one to five years and over five years for the Branch.

Table 1: Disclosure on Credit Risk Exposure – Geographical Analysis for the Branch

Exposure Class	Brunei (BND'000)
As at 31 December 2018 **Exempted Exposures (Standardized Approach)**	
Sovereigns/Central Banks	64,557
Corporates	3,801
Regulatory Retail	114,791
Residential Mortgages	3,274
Other Assets	4,798
Total Standardized Approach	**191,221**
Exposures under the IRB Approach	
Corporate Exposures	132,151
Total IRB Approach	132,151
Total Standardized and IRB Approaches	323,372

Table 2: Disclosure on Credit Risk Exposure - Industry Analysis for the Branch

Exposure Class	Agriculture BND'000	Mining & Quarrying BND'000	Manufacturing BND'000	Construction BND'000	Electricity, Gas & Water Supply BND'000	Wholesale, Retail Trade, Restaurants & Hotels BND'000	Finance, Insurance, Real Estate & Business BND'000	Transport, Storage & Communication BND'000	Education, Health & Others BND'000	Household BND'000	Others BND'000	Total BND'000
As at 31 Dec 2018 **Exempted Exposures (Standardized Approach)**												
Sovereigns/Central Banks	-	-	-	-	-	-	-	-	-	-	64,557	64,557
Corporates	-	-	3	727	-	147	2,725	-	199	-	-	3,801
Regulatory Retail	-	-	232	29,132	-	2,866	-	-	4,807	77,754	-	114,791
Residential Mortgages	-	-	-	-	-	-	-	-	-	3,274	-	3,274
Other Assets	-	-	-	-	-	-	-	-	-	-	4,798	4,798
Total Standardized Approach	-	-	235	29,859	-	3,013	2,725	-	5,006	81,028	69,355	191,221
Exposures under the IRB Approach												
Corporate Exposures	4,555	-	6,893	37,139	-	68,894	4,996	617	9,057	-	-	132,151
Total IRB Approach	4,555		6,893	37,139		68,894	4,996	617	9,057	-	-	132,151
Total Standardized and IRB Approaches	4,555	-	9,853	66,996	-	71,907	4,996	617	14,063	81,028	69,356	323,372

Table 3: Disclosure on Credit Risk Exposure – Maturity Analysis for the Branch

Exposure Class	One year or less BND'000	One to five years BND'000	Over five years BND'000	Total BND'000
As at 31 December 2018				
Exempted Exposures (Standardised Approach)				
Sovereigns/Central Banks	10,230	54,327	-	64,557
Corporates	2,389	702	711	3,802
Regulatory Retail	2,992	17,483	94,316	114,791
Residential Mortgages	-	2,060	1,213	3,273
Other Assets	-	4,798	-	4,798
Total Standardised Approach	15,611	79,370	96,240	191,221
Exposures under the IRB Approach				
Corporate Exposures	59,856	53,474	18,821	132,151
Total IRB Approach	59,856	53,474	18,821	132,151
Total Standardised and IRB Approaches	75,467	132,844	115,061	323,372

BASEL II REQUIREMENTS

In line with Basel II requirements for capital adequacy purposes, the parameters are calibrated to a full economic cycle experience to reflect the long-run, cycle-neutral estimations:

- **Probability of Default ("PD")**

PD represents the probability of a borrower defaulting within the next 12 months. The first level estimation is based on portfolio's Observed Default Rate of the more recent years' data.

- **Loss Given Default ("LGD")**

LGD measures the economic loss the bank would incur in the event of a borrower defaulting. Among others, it takes into account post default pathways, cure probability, direct and indirect costs associated with the workout, recoveries from borrower and collateral liquidation.

For Basel II purpose, LGD is calibrated to loss experiences during period of economic crisis whereby for most portfolios, the estimated loss during crisis years is expected to be higher than that during normal economic period. The crisis period LGD, known as Downturn LGD, is used as an input for RWA calculation.

- **Exposure at Default ("EAD")**

EAD is linked to facility risk, namely the expected gross exposure of a facility should a borrower default. The "race-to-default" is captured by Credit Conversion Factor ("CCF"), which should reflect the expected increase in exposure amount due to additional drawdown by a borrower facing financial difficulties leading to default.

CREDIT IMPAIRMENT POLICY AND CLASSIFICATION AND IMPAIRMENT PROVISIONS FOR LOANS AND ADVANCES

Refer to Note 3.4 of the Financial Statements for the accounting policies and accounting estimates on impairment assessment for loans and advances. The disclosures on reconciliation of impairment/allowance can be found in Note 29.5.7 of the Financial Statements.

This credit impairment policy is applicable to the Branch.

Table 4 provides details on impaired and loans for the Branch.

Table 4: Impaired and Past Due Loans, Advances and Financing and Allowances – Industry Analysis for the Branch

	Impaired Loans, Advances and Financing BND'000	Past Due Loans BND'000	ECL BND'000
As at 31 December 2018			
Agriculture	-	-	4
Manufacturing	-	-	28
Construction	7,800	853	4,253
Wholesale, retail trade, restaurants & hotels	2,477	-	2,165
Finance, insurance, real estate & business	-	-	120
Transport, storage & communication	-	-	5
Education, health & others	304	61	190
Household	13,498	4,242	2,676
Others	-	-	-
Total	**24,079**	**5,156**	**9,440**

CREDIT RISK MITIGATION

The Branch takes a holistic approach when granting credit facilities and do so very much based on the repayment capacity of the borrower, rather than placing the credit risk mitigation as a primary source of repayment. As a fundamental credit principle, the Branch generally does not grant facilities solely on the basis of collaterals provided. Credit facilities are granted based on the credit standing of the borrower, source of repayment and debt servicing ability.

Depending on a customer's credit standing and the type of product, facilities may be provided on an unsecured basis. Nevertheless, collateral is taken whenever possible to mitigate the credit risk assumed. The Branch's general policy is to promote the use of credit risk mitigation, justified by commercial prudence and good practice as well as capital efficiency. The value of collateral taken is also monitored periodically. The frequency of valuation depends on the type, liquidity and volatility of the collateral value. The main types of collateral taken by the Branch include cash, property, commercial, industrial, marketable instruments, bank guarantees, land, stand-by letter of credit and assigned insurance policies. For IRB purposes, personal guarantees are not recognised as an eligible credit risk protection.

Corporate guarantees are often obtained when the borrower's credit worthiness is not sufficient to accommodate an extension of credit. To recognise the effects of guarantees under the FIRB Approach, the Branch adopts the Probability of Default substitution approach whereby exposures guaranteed by an eligible guarantor will utilise the PD of the guarantor in the computation of its capital requirement.

As a general rule-of-thumb, the following eligibility criteria must be met before the collateral can be accepted for IRB purposes:

- **Legal Certainty**
  The documentation must be legally binding and enforceable in all relevant jurisdictions.

- **Material Positive Correlation**
  The value of the collateral must not be significantly affected by the deterioration of the borrower's credit worthiness.

• **Third-party Custodian**
The collateral that is held by a third-party custodian must be segregated from the custodian's own assets.

Tables 5 show the credit risk mitigation analysis under the Standardized Approach for the Branch. Whilst Tables 6 show the credit risk mitigation analysis under the IRB Approach.

Table 5: Disclosure on Credit Risk Mitigation Analysis (Standardized Approach) for the Branch

Exposure Class	Exposures before CRM BND'000	Exposures Covered by Guarantees/ Credit Derivatives BND'000	Exposures Covered by Eligible Financial Collateral BND'000	Exposures Covered by Other Eligible Collateral BND'000
As at 31 December 2018				
On-Balance Sheet Exposures				
Sovereigns/Central Banks	64,557	-	-	-
Banks, Development Financial Institutions & MDBs	245,030	-	-	-
Corporates	904	-	-	1,000
Regulatory Retail	113,148	-	162	208,369
Residential Mortgages	3,274	-	-	3,508
Other Assets	6,570	-	-	-
Total On-Balance Sheet Exposures	433,483	-	162	212,877
Off-Balance Sheet Exposures				
Corporates	3,650	-	-	-
Regulatory Retail	34	-	-	-
Total for Off-Balance Sheet Exposures	3,684	-	-	-
Total On and Off-Balance Sheet Exposures	437,167	-	162	212,877

Table 6: Disclosure on Credit Risk Mitigation Analysis (IRB Approach) for the Branch

Exposure Class	Exposures before CRM BND'000	Exposures Covered by Guarantees/ Credit Derivatives BND'000	Exposures Covered by Eligible Financial Collateral BND'000	Exposures Covered by Other Eligible Collateral BND'000
As at 31 December 2018				
On-Balance Sheet Exposures				
Corporate Exposures	89,121	-	4,025	60,101
Total On-Balance Sheet Exposures	89,121	-	4,025	60,101
Corporate Exposures	17,436	-		
Total for Off-Balance Sheet Exposures	17,436	-	-	-
Total On and Off-Balance Sheet Exposures	106,557	-	4,025	60,101

V. MARKET RISK

Market risk is the risk of financial loss where the value of the Branch's assets and liabilities could be adversely affected by changes in market variables such as interest rates, securities prices and foreign exchange rates. Market liquidity risk is the risk of financial loss caused by inability to secure market transactions at the required volume or price levels as a result of market turbulence or lack of trading liquidity.

Non-traded market risk is primarily inherent risk arising from banking book activities. The major risk classes are interest rate risk in the banking book and foreign exchange risk.

The Branch is not exposed in 2018 and 2017 to significant market risk except on its government sukuks.

FOREIGN EXCHANGE RISK

Foreign exchange risk is the risk to earnings and economic value of foreign currency assets, liabilities and financial derivatives caused by fluctuations in foreign exchange rates.

The Branch's foreign exchange exposures comprise non-trading foreign exchange exposure principally derived from interbranch nostro accounts. The Branch is not exposed to foreign exchange risk for Singapore Dollar (SGD) due to the currency Interchanged Agreement between Singapore and Brunei which interchange the two currencies at par.

Foreign exchange risk is managed through policies and risk limits approved by the Asset and Liability Committee (ALCO). The limits, such as exposure by currency are independently monitored by Middle Office (MO). A summary of quantitative data about the Branch's net exposure to major foreign currencies is provided below, followed by a sensitivity analysis (assuming all other risk variables remain constant):

	GBP	USD	Others	Total
As at 31 December 2018				
Financial assets				
Group balances receivable	27	870	95	992
Financial liabilities				
Group balances payable	-	-	12	12

A 10% strengthening of BND against the foreign currencies as at year end, would have increased (decreased) profit or loss by B$ 98 thousand. No impact would result on the Branch's equity balance as a result of this change in foreign currency rates. The analysis assumes that all other variables, in particular interest rates, remain constant.

A 10% weakening of BND against the foreign currencies as at year end would have had the equal but opposite effect on the amounts shown above, on the basis that all other variables remain constant.

INTEREST RATE RISK

Interest rate risk is the risk to both earnings and capital arising from adverse movement in interest rates.

As at 31 December 2018, the interest rate profile of the Branch's interest-bearing financial instruments is as follows:

	2018 BND '000
Fixed-rate assets	215,948
Floating-rate assets	200,813
Fixed-rate liabilities	(345,015)
	71,746

The Branch does not account for any fixed rate financial assets and liabilities at fair value through profit or loss. Therefore a change in interest rates at the reporting dates would not affect profit or loss for fixed rate financial instruments.

At the reporting date, an increase of 100 basis points in interest rates would have increased profit or loss by B$2,035 thousand for variable rate financial instruments. A decrease of 100 basis points in interest rates would have the opposite effect on profit or loss. This analysis assumes that all other variables remain constant.

EQUITY POSITION IN THE BANKING BOOK

The Branch is not exposed to equity price risk as there are no equity investments carried in the books.

VI. OPERATIONAL RISK

Operational risk is one of the principal risks in the overall Risk Management Framework and defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events (this includes legal risk, but excluded strategic and reputational risk.

The table below outlines the definition of the four (4) casual categories of operational risk:

Casual Categories	Definition
People	Risks resulting from staff defaulting in expected behavior or the organization being ineffective/inefficient in the management of its human capital.
Process	Risks resulting from inadequate/failed internal business processes or transaction process flows.
System	Risks resulting from inadequate or defaulting IT/communication systems, or the unavailability or integrity of data.
External Events	Risks resulting from events and actions from outside the organisation's immediate control having negative impact on the business.

Operational risk incidents that occurred may have different financial impact as illustrated belowL

Impact Type	Definition
Actual Loss	• Financial loss is incurred (either by a third part cost, or by writing-off a provision) and/or provision for loss is made, impacting the profit and loss account.
Potential Loss	• Potential loss is a conservative estimate of the loss amount but the actual loss has yet to be determined.
Near Miss	• Financial loss was averted by controls or mitigating actions for an operational risk incident.

Group Operational Risk Management strategy provides the overall principles, philosophy , objectives and goals for the management of operational risk.

The key components of the Group's ORM strategy are as follows:

(i) ORM Methodology Design Principles
(ii) Operational Risk Appetite

Under the Basel II rules, the Branch has adopted the Basic Indicator Approach to operational risk which the charge for operational risk may be expressed as follows:

$\boldsymbol{KBIA}$= [$\boldsymbol{\Sigma GI1 \ldots n}$ × $\boldsymbol{\alpha}$]/$\boldsymbol{n}$
where:
$KBIA$ = the capital charge under the Basic Indicator Approach
GI = annual gross income, where positive, over the previous three years
N = number of the previous three years for which gross income is positive
α = 15%