

# Malaysia's Experience on Regulatory and Supervisory Oversight

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# Outline

- Financial sector trends and developments in Malaysia
- Implications for regulatory & supervisory approach
- Key elements of current regulatory and supervisory framework
  - Supporting infrastructure
  - Macro and micro-surveillance
  - Crisis management
  - Financial capability
  - Supervisory coordination and cooperation



# Financial system stronger since Asian financial crisis

Holistic approach addressed immediate needs, while strengthening foundation for long term stability

## Institutional arrangements established to stabilise banking industry

- Danaharta removed NPLs from banking system, Danamodal facilitated recapitalisation of affected banks & CDRC facilitated voluntary debt work-outs for corporates
- All three been wound up
- Total cost at < 5% of GDP

## Prudential framework strengthened

- Prudential limits and provisioning policies tightened
- Corporate governance strengthened
- Increased focus on risk management
- Improved surveillance mechanisms & financial transparency

## Structural elements also strengthened

- Merger exercise to consolidate fragmented banking sector
  - 71 institutions consolidated into 10 banking groups
  - Capital size increased from USD2m - 3b to USD0.5b – 4b
- Capital market intermediaries rationalised



# Successful restructuring enabled Malaysia to focus on medium and long term development

- Strengthened legal, regulatory and supervisory framework for financial institutions
- Emphasis on capacity building measures
- Diversification of financing structure with enhanced role for bond and equity markets
- Financing new growth areas e.g. DFIs, venture capital, agriculture insurance

## Financial Sector Master Plan

Bank Negara Malaysia

## Capital Market Master Plan

Securities Commission

2001

2003

### Phase 1

Strengthen domestic capacity, and develop strategic and nascent sectors

2004

2005

### Phase 2

Intensify competitive pressure in the domestic market and gradually liberalise market access

2006 -2007

2010

### Phase 3

Assimilate into global market. Introduce new foreign competition. Enhance international positioning in areas of competitive advantage



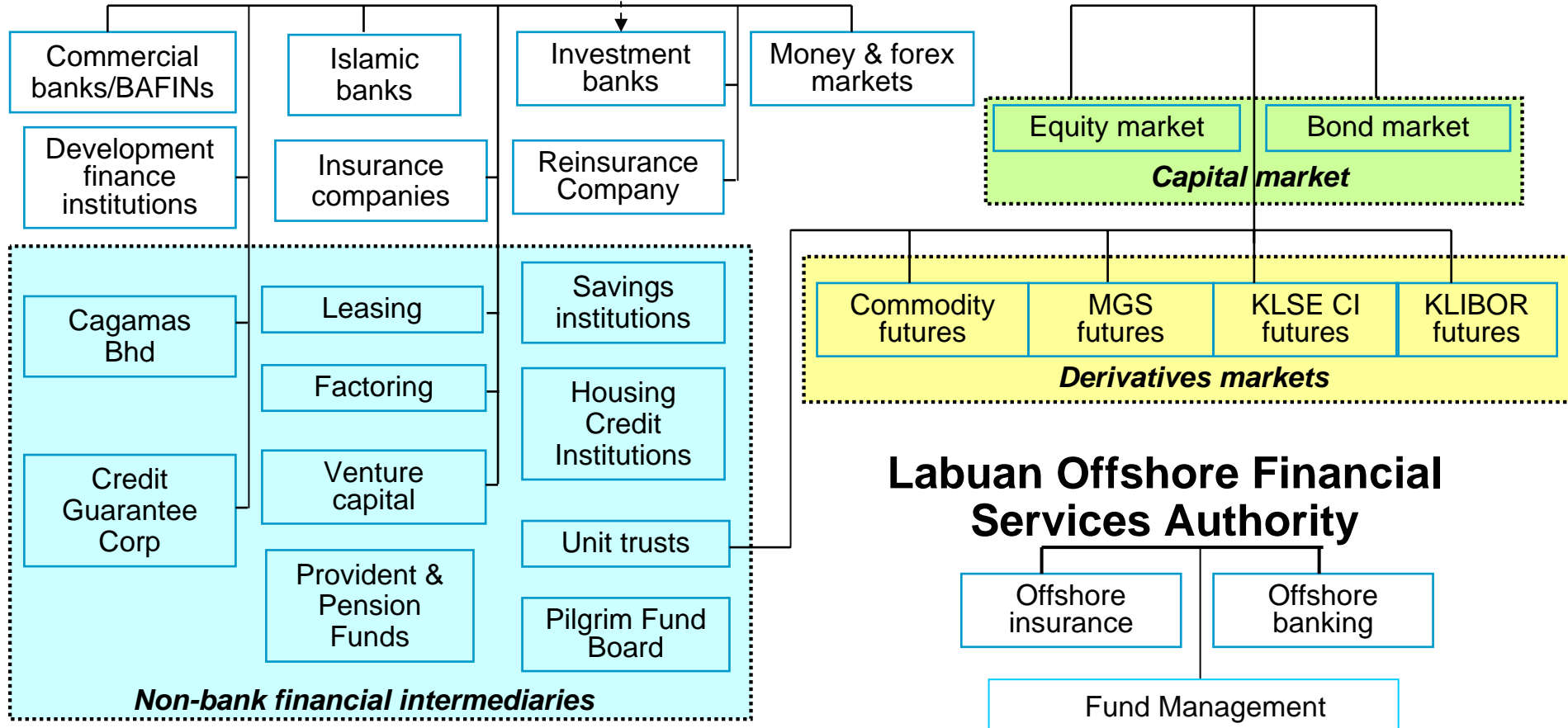
# Broad-based financial system in place...

## FINANCIAL INSTITUTIONS

## FINANCIAL MARKETS

### Bank Negara Malaysia

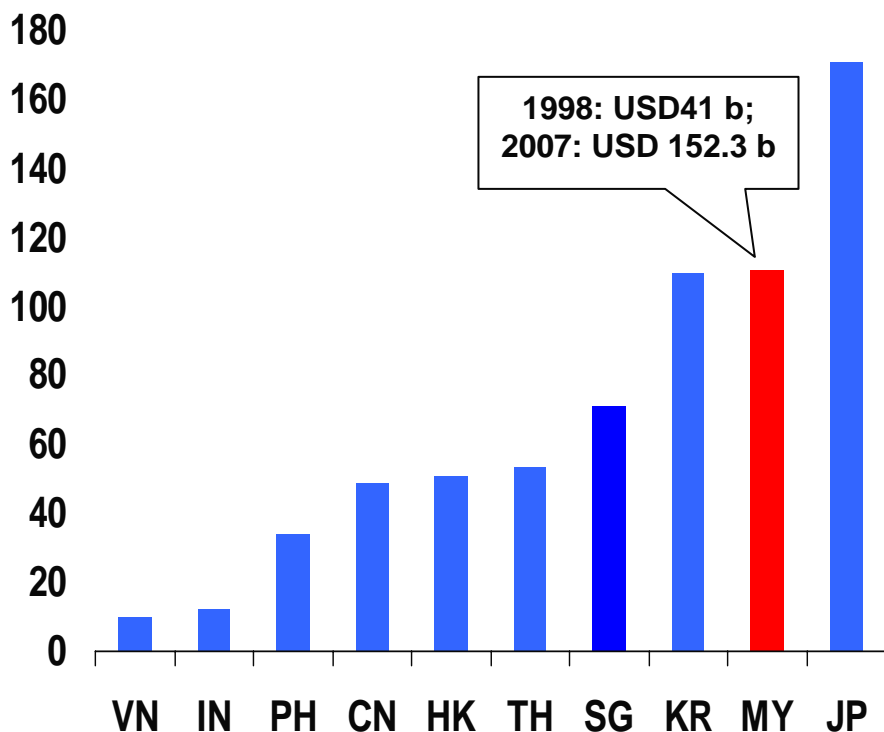
### Securities Commission



## ...supported by a well-developed bond market

### Malaysia's position

(Size of Bond Market in % GDP)



Source: Asian Bonds online, Sep 2007

- In terms of relative size to GDP, Malaysia ranked second after Japan
- Total bonds outstanding increased at average annual rate of 12.2% since 1998, underpinned by steady y-o-y increase in bond issuances
- Initiatives to develop bond market has improved liquidity, diversified product base, issuers and investors, enhanced price discovery and supporting infrastructure
- Private > public sector bonds with increasing sukuk issuances
  - PDS outstanding increased from 24.0% of GDP at end 1997 to 37.5% now
  - sukuk: 62.2% of total PDS
- Financing raised through bond market (including public finance) accounts for 40.8% of total financing (pre-crisis: 31.7%)



# Current trends shaping financial landscape

## Global financial integration

- Growing volume of cross-border capital flows
- Increased activities of foreign banks in national markets
- Greater regional presence by domestic banks

## Growing importance of market-based finance

- Increasing volume of financing raised through capital markets than banks
- Banks, in turn, have shifted towards more treasury-based activities

## Financial innovations

- Rapid growth of financial products, services and channels
- Significant growth of derivatives
- Growing significance of Islamic finance

## Deregulation & liberalisation

- Financial conglomeration & consolidation
- Larger and more complex financial institutions
- New business models



## ... with implications for financial regulation

- Enhancing role of market discipline
- Attaining cross-sector & cross-border consistency
- Aligning prudential regulations with integrated risk management approaches
- More rigorous monitoring & control of systemic risk
- More effective coordination & information exchange
- Reducing excessive cost of regulation in segmented & overlapping jurisdictions





# Shift in regulatory approach to adapt to changing market realities...

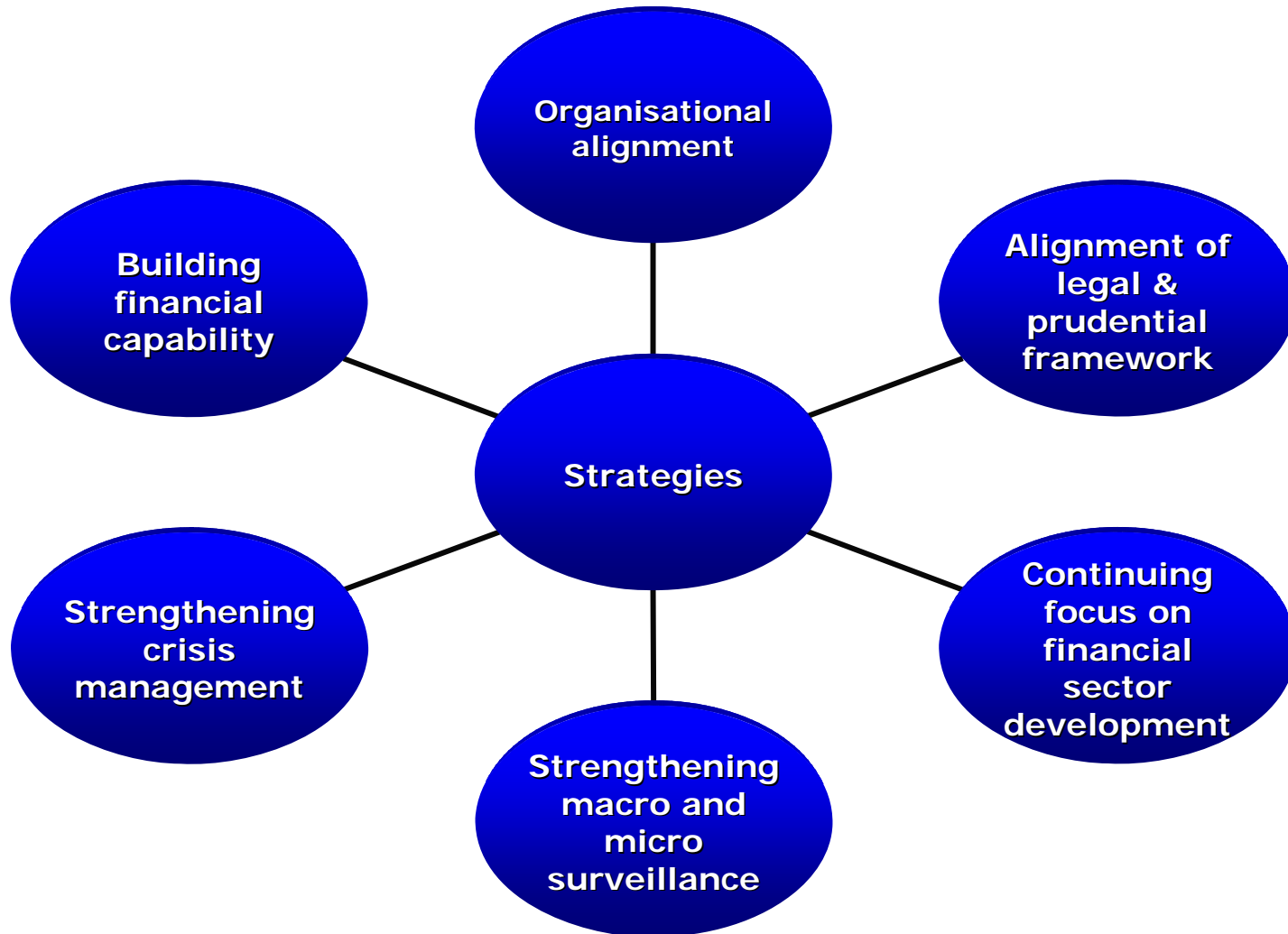
Explicit and narrow operating boundaries

- Highly prescriptive rules & regulations
- One-size fits all regime
- Compliance-focused and silo approach to supervision

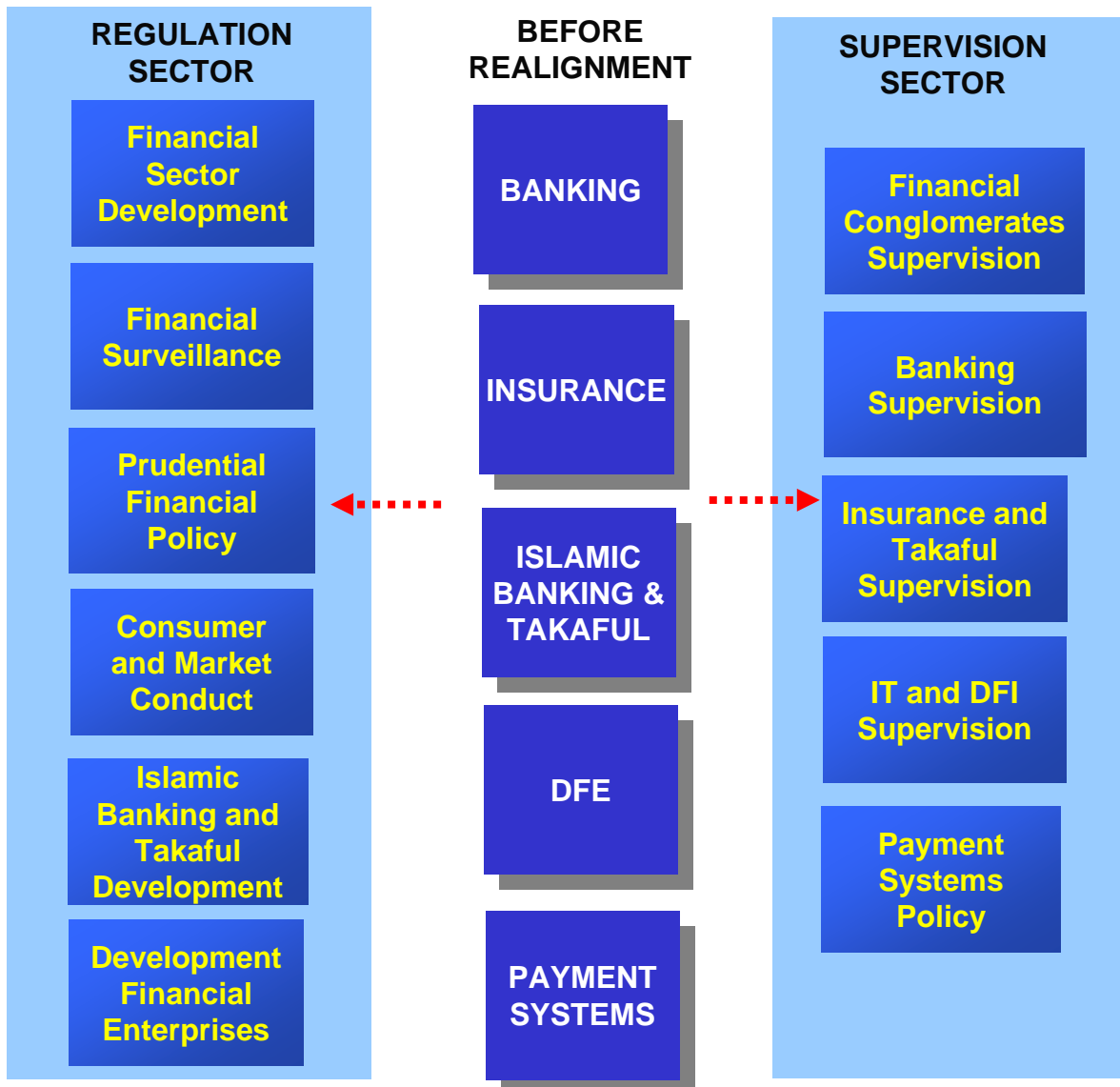
Broader & less rigid environment

- Greater responsibility on institutions to manage risk exposures
- Principle-based & differentiated regulation & supervision
- Strengthened safeguards to contain systemic risk
- Greater reliance on market discipline
- Consultative approach in formulation of prudential policies

# Ensuring consistent prudential framework, sound supporting infrastructure and organisational alignment



# Realignment of regulatory and supervisory functions



- Sectoral to functional organisation
- More comprehensive view & cohesive approach to development of financial system
- Ensure clear distinction between prudential regulation & developmental objectives
- Sharpen focus on risk management with greater consistency in management of similar risks
- Reduce overlaps & duplication
- Enable more efficient use of regulatory resources

# Alignment of legal and prudential framework

## Legislation

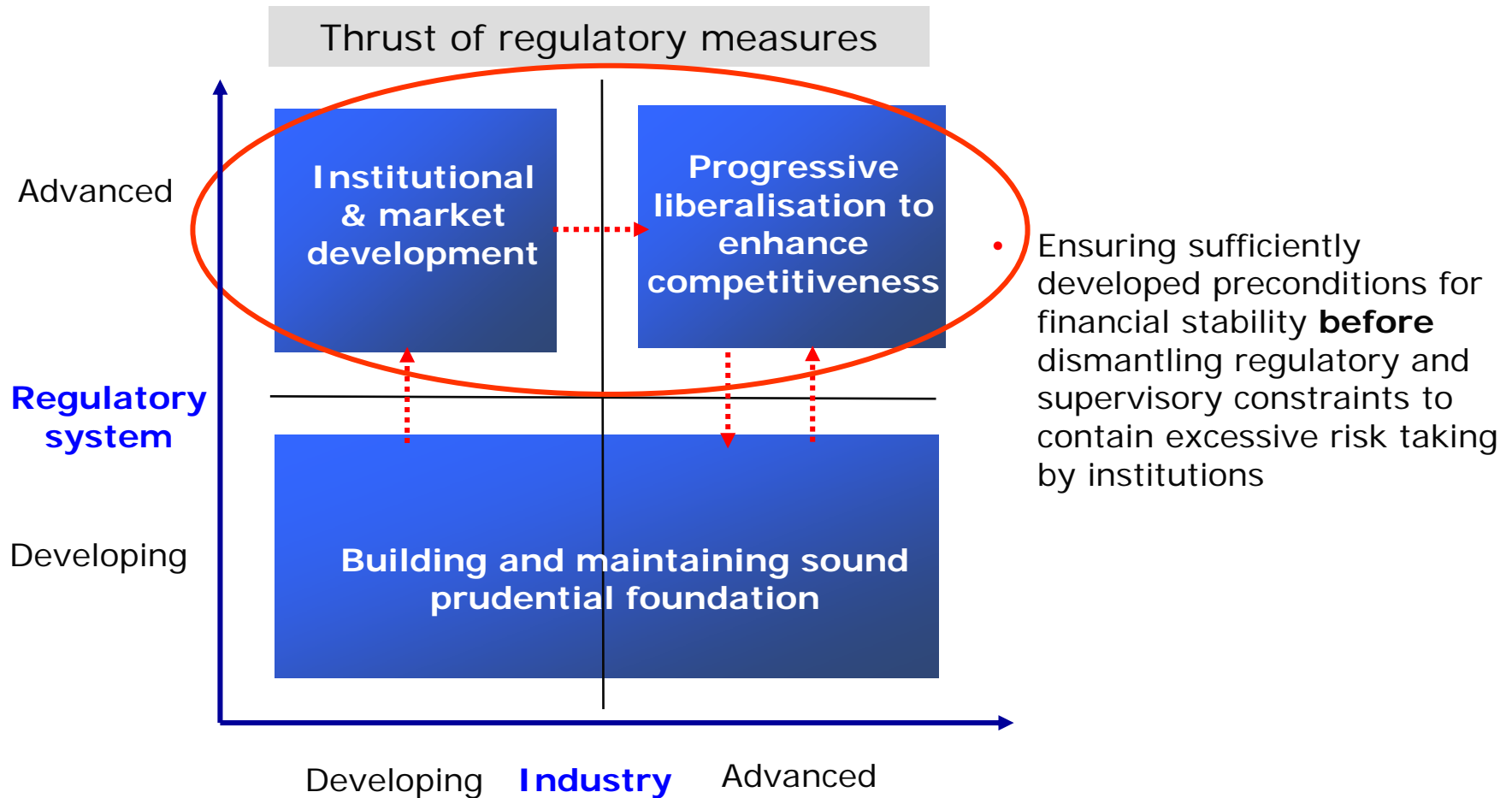
- Ensuring sound legal basis for evolving prudential regulations in new risk areas
- More responsive legal framework aligned with principles-based regulatory approach
- Expanded enforcement & supervisory intervention powers
- Strengthened provisions on market conduct
- Greater cross-sector consistency

## Prudential framework

- Implementation of Basel II (2008 for SA and 2010 for IRB)
- Strengthened supervisory expectations regarding corporate governance, risk management and internal controls
- More robust financial reporting & disclosure standards to reinforce market-based discipline
- Strengthened AML/CFT regime
- Rationalisation of prudential limits to address similar risks in consistent manner
- More differentiated regulatory regime which reinforces incentives for sound risk management
- Framework on consolidated supervision



# Continuing focus on financial sector development ...with appropriate sequencing of regulatory measures



# ...as well as development of Islamic finance as viable alternative to support growth

## Holistic approach to development of Islamic finance

### Develop infrastructure

- Increase number and diversity of domestic & foreign players to stimulate competition
- Develop and deepen money, capital & equity markets
- Build intellectual and human capital
- Islamic deposit insurance

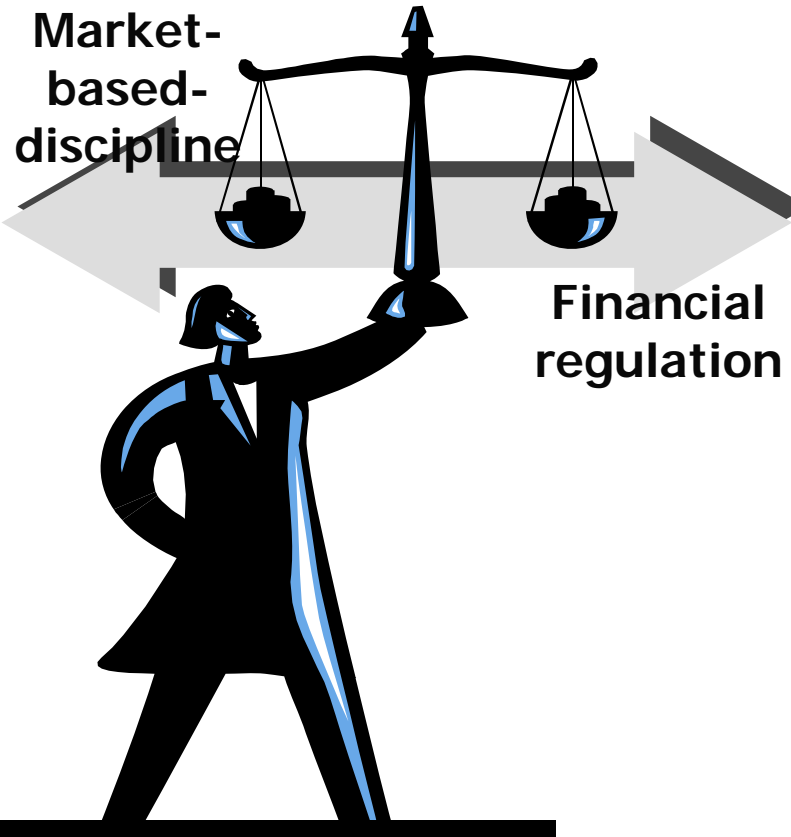
### Develop legal & regulatory framework

- Strengthen Shariah framework
- Establish effective legal structure
- Enhance risk management
- Setting international standards through Islamic Financial Services Board (IFSB)



# Managing policy trade offs remains a challenge...

- Innovation & efficiency
- Competition
- Improved consumer outcomes



- Balanced growth
- Strong domestic institutions
- Inclusive financial participation

# Surveillance is more forward looking...

Current Effort  Ongoing trend analysis  
To determine the strength and identify emerging vulnerabilities

EX-POST  Going forward  EX-ANTE

Determining current resilience /stress level

- To assess and quantify the resilience of the banking system at a point in time

Stress index

- To describe the stress levels of banking system in a single measure

Future Crisis / Stress Level Prediction

- To identify possibility of a crisis occurring within a specified timeframe

Stress Index

- To forecast potential stress level for the next period

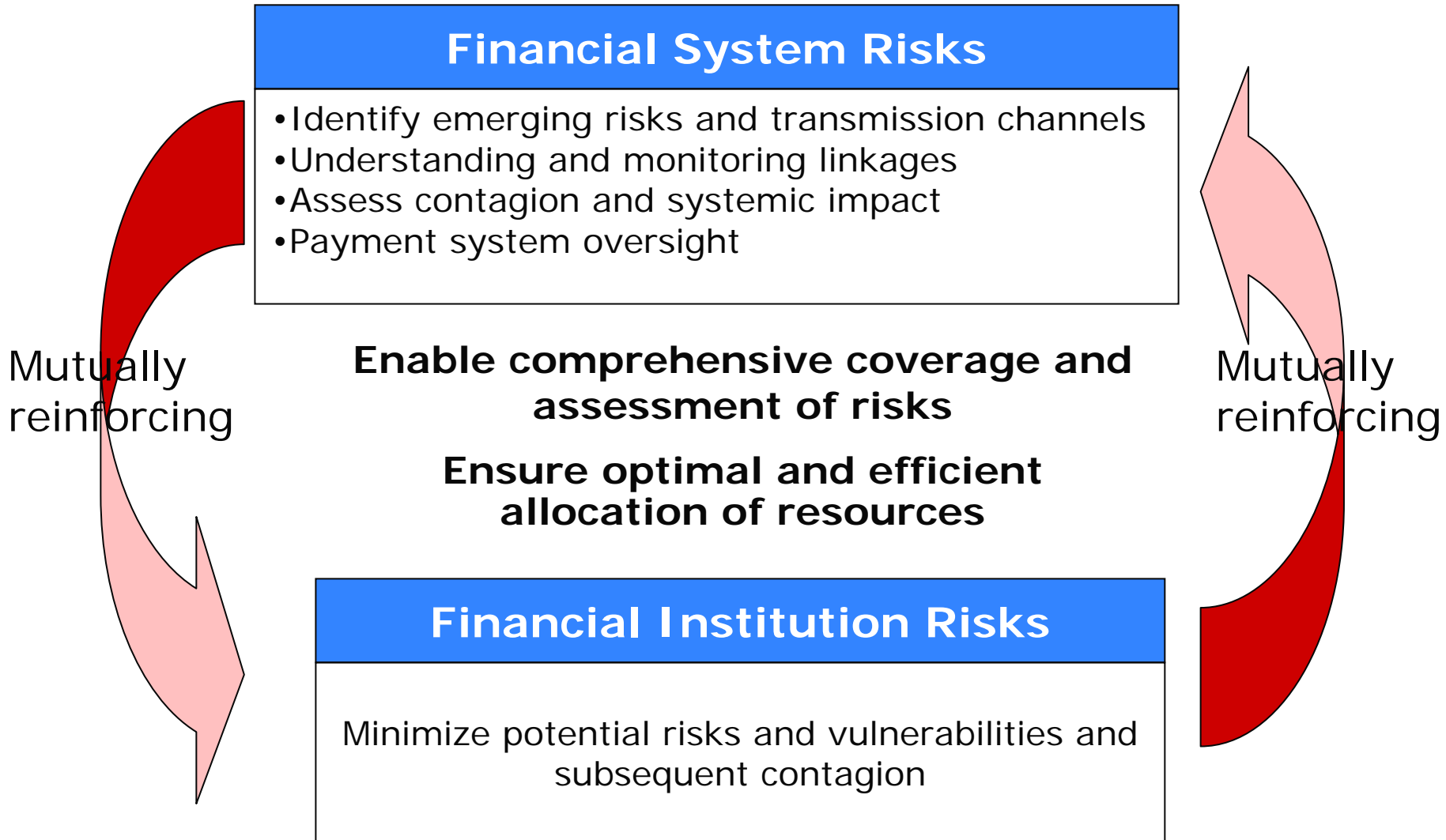
Stress Test

- To assess capacity of industry/ institutions to withstand potential adverse movements





# ...supported by more dynamic and integrated macro and micro surveillance



# Approach to supervisory risk assessment

1

**Significant activities**

**Inherent Risks**

2

**Quality of Risk Management & Oversight**

3

**Overall Net Risks**

4

**Capital & Earnings**

5

**Overall Composite Risk & Direction for risk over 12-mth horizon**

6

**Reporting & Intervention**

- Credit
- Market
- Operational
- Liquidity
- Insurance
- Legal & Regulatory
- Rate of return (for Islamic finance)
- Equity investment (for Islamic finance)

## **Static analytical tools**

Trend analysis  
Quantitative financial soundness indicators

## **Supervisory framework**

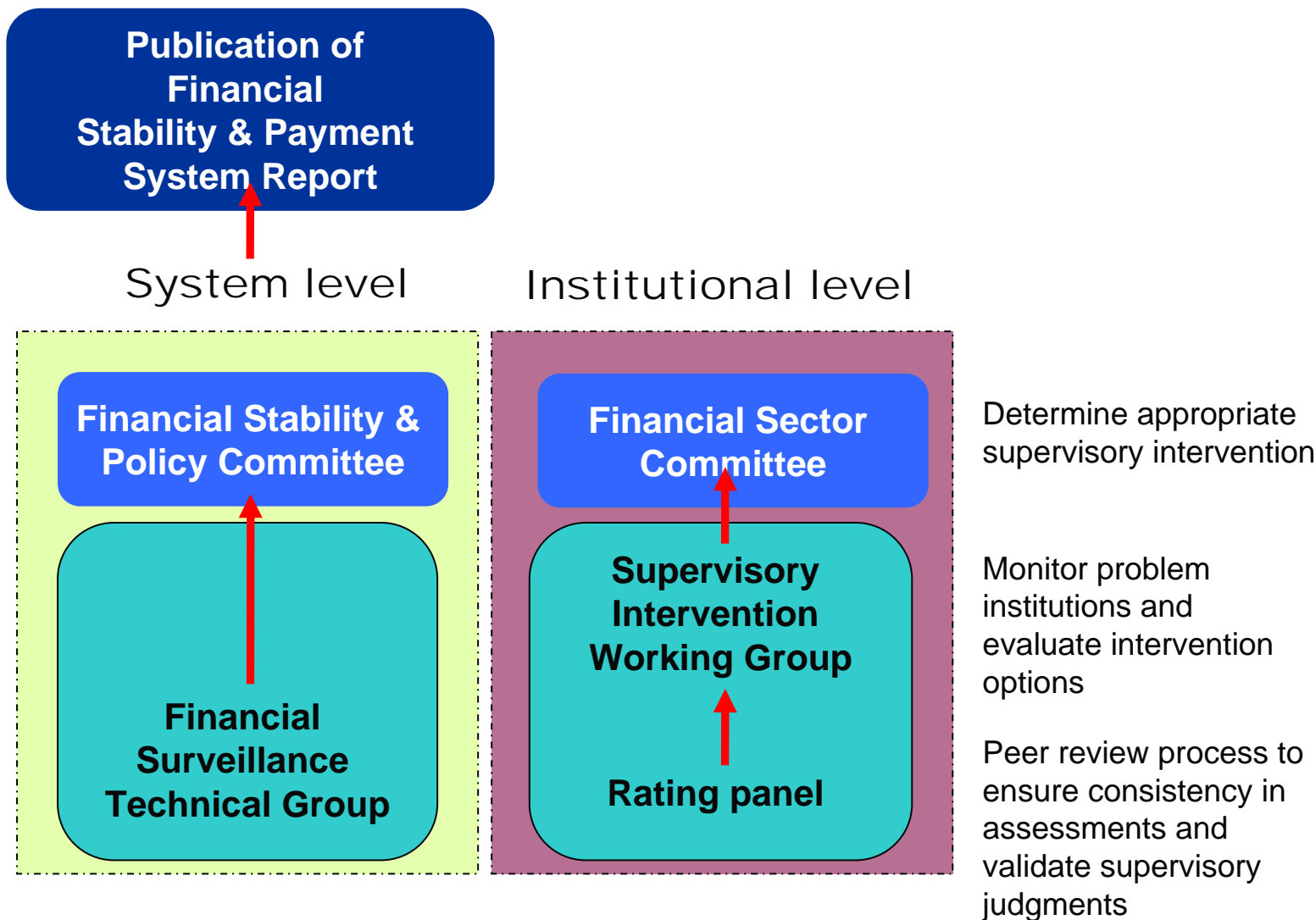
Risk based & consolidated supervisory framework  
Timely intervention

## **Forward-looking tools**

Stress testing  
Early warning system



# Strengthened internal governance structure and process



## Building supervisory capacity is a key priority

**Culture of Excellence**

**Effective Human Capital Management**

**Enhanced operational efficiency**

- Competency assessments to ensure right talent at right place
- Development of specialists
- Improvements to performance-management system
- Investments in learning infrastructure and systems
- ICT enhancements



# More robust crisis management with strengthened safety net...



Perbadanan Insurans Deposit Malaysia  
Malaysia Deposit Insurance Corporation

- Malaysian Deposit Insurance Corporation established in August 2005
  - Explicit guarantee to depositors: RM60,000 per depositor per member institution
  - Dual and equivalent protection for Islamic and conventional deposits
  - Backed by least-cost resolution powers retained from Danaharta Act
  - Differential risk-based premium systems to reinforce sound risk management
- Ongoing initiatives to put in place a comprehensive and integrated crisis management (CM) framework
  - CM Team, communication, business continuity plan
  - At regional level, arrangements for CM under the EMEAP Monetary & Financial Stability Committee (MFSC)



# More effective supervisory coordination and cooperation

...to ensure cross-sector consistency, enhance surveillance and support Basel II implementation

- MOUs with domestic (SC, PIDM) and foreign supervisory authorities
  - Surveillance
  - Policy consultation
  - Coordination of regulatory and supervisory processes
  
- Ensuring efficient and effective implementation of Basel II
  - Establishing reliance on home/host review/approval processes
  - Facilitating functionality and scale for internal models by promoting greater consistency in treatment between supervisors (e.g. treatment of Pillar 2 risks and diversification benefits)
  - Minimising regulatory costs associated with different implementation timing in different jurisdictions



# Building financial capability to reinforce market discipline and pre-empt risk

- Consumer activism to reinforce market discipline
  - Enhance level & quality of service
  - More informed decisions
  - Ensure efficient financial intermediation
- BankingInfo and InsuranceInfo
  - Information booklets
  - Comparative Tables
- Credit Counseling and Debt Management Agency
  - Facilitate debt restructuring
  - Provide advice on financial and money management
  - Complement consumer education efforts



# Today, significantly stronger and more competitive financial sector promotes continued financial stability and sustainable economic growth

- Key financial indicators strengthened across the board
- Nine domestic banking groups with strong capitalisation
- More effective and competitive in meeting economic needs
  - Wide array of products and services
  - Large presence of world class foreign banks (30% market share of assets)
- Robust risk management practices and infrastructure
  - Supported by stronger credit culture and governance structure
  - Centralised Credit Reference Information System (CCRIS)
- Strong growth & enhanced contribution of financial sector to economy

	1997/98	Sept. '07
RWCR	10.5%	13.1%
Net NPL Ratio 3-month classification	13.2%	3.5%
ROA	-0.3%	1.5%
ROE	-4.5%	18.7%

	2001-06	Jan-Sep 2007
Growth in finance & insurance services	6.9%	11%
Share of GDP	9.2% (2000)	10.2% (2006)





**Thank You**



# Useful links

- Bank Negara Malaysia (<http://www.bnm.gov.my>)
  - Source of useful hyperlinks: <http://www.bnm.gov.my/index.php?ch=17&pg=54&ac=57>
- Malaysian Deposit Insurance Corporation
  - <http://www.pidm.gov.my>
- Bankinginfo and Insuranceinfo
  - <http://www.bankinginfo.com.my>
  - <http://www.insuranceinfo.com.my>
- Credit Counselling and Debt Management Agency
  - <http://www.akpk.org.my>
- Centres for education and development
  - <http://www.iclif.org>
  - <http://www.inceif.org>
- Other regulators
  - <http://www.sc.com.my>
  - <http://www.lofsa.gov.my>

