



Malaysia

MALAYSIA

Malaysia comprises Peninsular Malaysia and the states of Sabah and Sarawak on the island of Borneo. It covers an area of approximately 330,000 square kilometers with an estimated population of 28.3 million in 2009. The capital city is Kuala Lumpur and the official language is Bahasa Malaysia. The currency unit is Ringgit Malaysia (RM).

BANK NEGARA MALAYSIA

Objective The Central Bank of Malaysia Act 2009 came into force on 25 November 2009. With the coming into force of this Act, the Central Bank of Malaysia Act 1958 is repealed and thus, ceases to apply.

The Central Bank of Malaysia Act 2009 enables the Bank to deal more effectively with emerging risks and challenges in discharging its role and responsibilities as the nation's central bank. The Act provides greater clarity on the Bank's mandate and vests the Bank with the necessary powers and instruments to achieve the mandate. The Act also provides for a more robust governance framework that provides high level of accountability and transparency. The Central Bank of Malaysia Act 2009 also provides for Bank Negara Malaysia's role to develop and promote Malaysia as an international Islamic financial centre.

THE PRINCIPAL OBJECTS OF THE CENTRAL BANK OF MALAYSIA (BANK NEGARA MALAYSIA) under the Central Bank of Malaysia Act 2009 are to promote monetary stability and financial stability conducive to the sustainable growth of the Malaysia economy. The primary functions of the Bank are:

- i. to formulate and conduct monetary policy in Malaysia;
- ii. to issue currency in Malaysia;
- iii. to regulate and supervise financial institutions which are subject to the laws enforced by Bank Negara Malaysia;
- iv. to provide oversight over money and foreign exchange markets;
- v. to exercise oversight over payment systems;
- vi. to promote a sound, progressive and inclusive financial system;
- vii. to hold and manage the foreign reserves of Malaysia;
- viii. to promote an exchange rate regime consistent with the fundamentals of the economy; and
- ix. to act as financial adviser, banker and financial agent of the Government.

Pursuant to these functions, Bank Negara Malaysia administers and enforces the following Acts:

- The **Banking and Financial Institutions Act 1989 (BAFIA)** provides for the licensing, and regulation and supervision of institutions conducting banking, finance company, merchant banking, discount house and money-broking businesses.

- The **Islamic Banking Act 1983** provides for the licensing, regulation and supervision of Islamic banks and International Islamic banks.
- The **Insurance Act 1996** provides for the licensing, regulation and supervision of insurance business (including reinsurance), insurance broking business, adjusting business and financial advisory business.
- The **Takaful Act 1984** provides for the registration and regulation of takaful business, international takaful business and for other purposes relating to or connected with takaful carried out by the takaful operator, international takaful operator, takaful agent, takaful adjuster and takaful broker.
- The **Money-Changing Act 1998** was enacted to provide for the licensing and regulation of money-changing business and other matters related thereto which previously came under the ambit of the Exchange Control Act 1953.
- The **Exchange Control Act 1953** governs dealings in gold and foreign currencies, payments, issuance of securities outside Malaysia, imports and exports and settlements. The Act also empowers the Controller of Foreign Exchange to grant permissions on the foregoing.
- The **Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLATFA)** contains provisions for the offence of money laundering, the measures to be taken for the prevention of money laundering and terrorism financing offences, and provides for the forfeiture of terrorist property and property derived from, or involved in money laundering and terrorism financing offences. The Minister of Finance has appointed Bank Negara Malaysia as the competent authority for the purposes of administering the AMLATFA. Bank Negara Malaysia has established the Financial Intelligence Unit to perform its functions and exercise its powers under the AMLATFA.
- The **Development Financial Institutions Act 2002 (DFIA)** provides for the regulation and supervision of development financial institutions (DFIs) prescribed under the DFIA. The DFIA, which came into force on 15 February 2002, aims to ensure effective and dynamic supervision of the DFIs.
- The **Payment Systems Act 2003 (PSA)**, which came into force on 1 November 2003, provides for the regulation and supervision of payment systems and payment instruments. The objective of the PSA is to ensure the reliable and efficient infrastructure and operation of national payment systems and to safeguard the public interest.

Policy-Making Body

Bank Negara Malaysia is governed by a Board of Directors. The current Board of Directors consists of the Governor of the Central Bank who is the Chairman, the Deputy Governors of the Central Bank, the Secretary-General to the Treasury and five other Directors.

Release of Policy Information

Information on monetary and financial policies is released, from time to time, in the form of press releases and Monetary Policy Statements (MPSs). The Monetary Policy Committee meets at least six times a year with additional meetings to be held if necessary. A MPS is issued on the same day as the corresponding MPC meeting.

Information on monetary and financial policies and statistics are available on the Bank's website: <http://www.bnm.gov.my> and in the Bank's publications, which can also be downloaded from the Bank's website.

MONETARY POLICY IMPLEMENTATION

Monetary Policy Objectives

The objective of monetary policy is to maintain price stability while giving due regard to the developments in the economy. The Central Bank of Malaysia Act 2009 Section 23, 25 and 26 stipulate that the Monetary Policy Committee (MPC) is responsible in formulating monetary policy and matters related to the conduct of monetary policy operations, and that the Bank shall implement the decisions of the MPC.

Monetary Policy in 2009

Bank Negara Malaysia's monetary policy decisions are based on the assessment of the balance of risks to economic growth and inflation over the medium-term.

As one of the most open economies in the region, Malaysia is adversely impacted by the deteriorating external environment. The Overnight Policy Rate (OPR) was reduced by 25 basis points in November 2008, followed by further reductions of 75 and 50 basis points in January and February 2009 respectively. The Statutory Reserve Requirement (SRR) was also reduced from 3.5 percent to 2 percent on 1 February 2009, and to 1 percent on 1 March 2009. The reductions in the OPR and SRR were pre-emptive measures aimed at providing a more supportive monetary environment for the domestic economy.

The weak global demand has dampened global food and energy prices and exerted downward pressure on domestic inflation. Since peaking in Q3 2008, inflation has moderated and turned negative in June 2009. The negative inflation was temporary and due largely to base effects. Inflation turned positive in January 2010, with an increase of 1.3% in the CPI.

The Malaysian economy has exhibited stronger signs of improvement in the third quarter and evidence suggests that domestic economic activity is gaining strength. Domestic demand, particularly private consumption and public sector spending, has been the main impetus of growth. Going forward, the pace of economic recovery is expected to gain momentum, as business and consumer sentiments improve further in an environment of continued fiscal support, accommodative monetary policy and continued access to financing. In addition, the gradual improvement in the global economy will continue to contribute positively to the recovery of the domestic economy.

Policy Signals	The Overnight Policy Rate is the indicator of the Bank's monetary policy stance.
Policy Indicators	Bank Negara Malaysia monitors a broad range of real, monetary and financial indicators to gauge the current and prospective state of inflationary pressure and strength of economic activity. Bank Negara Malaysia also monitors the stock and flow of liquidity in the financial system, and evaluates the impact of past monetary policy decisions.
Monetary Instruments	The framework for monetary operations and liquidity management in the Malaysian dual banking system; conventional and Islamic has evolved over the years, and the range of available monetary policy instruments has widened especially with respect to Bank Negara Malaysia's debt securities and Islamic money market instruments.

In 2009, conditions in the domestic money market remained stable as reflected in the stable average overnight interbank rates. Monetary operations were focused on managing surplus liquidity in an environment of global financial market uncertainties. The domestic money market was relatively insulated from the spillover effects of the global financial crisis, mainly due to lower cross-border credit exposures and smaller derivatives and foreign currency denominated business by Malaysian banks. Strategies formulated in 2008 in response to the global financial crisis were extended into 2009 where the maturities of monetary instruments remained short to create a buffer for any volatility in the portfolio flows.

As an additional measure to increase the Bank's flexibility in managing liquidity shocks, the Bank also widened its list of eligible securities for financial institutions to access its standing facility during stressed market conditions. The expanded list of eligible securities included those issued or guaranteed by EMEAP central banks, securities issued by quasi-sovereign agencies, Malaysian banking institutions as well as the domestic corporate sector with a minimum credit ratings set as pre-requisite for the eligibility.

Total borrowing through various monetary instruments was RM223 billion as at end December 2009 of which conventional borrowings accounted for 77% of total borrowings and Islamic borrowings with 23%. In terms of composition of monetary instruments, uncollateralised borrowings remained the principal instrument, accounting for 60% while Wadiah Acceptance (guaranteed custody) constituted 17% of the total borrowings. Bank Negara Monetary Notes (BNMNs) and Sukuk BNM Ijarah accounted for 13% while repo operation, which is of lower cost and collateralised, made up 8% of the total borrowings. In July 2009, the Bank introduced Bank Negara Monetary Notes – Murabahah (BNMN-Murabahah) which is based on a widely accepted syariah concept with crude palm oil as the underlying asset. The introduction of this instrument adds to the diversity of monetary instruments in managing liquidity in the Islamic banking system.

FINANCIAL STABILITY

Authorities Responsible for Financial Stability and Supervision of the Financial Sector and Institutional Coverage of the Financial Supervisory Authorities

Bank Negara Malaysia is the key authority responsible for the financial stability and supervision of the financial sector. Other authorities that contribute to financial stability are the Securities Commission of Malaysia and the Malaysia Deposit Insurance Corporation (PIDM). The Securities Commission of Malaysia is responsible for the promotion of a fair, efficient, secure and transparent capital market and is ultimately responsible for investors' protection. It also ensures proper conduct of market institutions. PIDM contributes towards financial stability through the administration of the deposit insurance system for the banking sector as well as the promotion of sound risk management practices by the financial industry. The institutional coverage of these supervisory institutions, among others, are as follows:

Bank Negara Malaysia

- Commercial banks, investment banks, money-brokers, Islamic banks, development financial institutions, insurance and reinsurance companies, insurance broking companies, adjusting business, financial advisers, takaful and retakaful operators, payment systems operators and money-changers.

Securities Commission of Malaysia

- Stockbroking companies, exchanges, clearing houses, central depositories, universal brokers, investment banks (for market conduct) and asset fund management companies.

Malaysia Deposit Insurance Corporation

- Commercial banks and Islamic banks.
- Following the implementation of the Government Deposit Guarantee on 16 October 2008, the institutional coverage was also extended to international Islamic banks and development financial institutions until 31 December 2010.

Strategy for Supervision and Monitoring of Financial Stability

Supervisory Approach of Bank Negara Malaysia

Maintaining financial system stability through the promotion of resilient and progressive financial industry remains to be the key agenda of Bank Negara Malaysia. With the continuous evolution of the financial landscape as well as greater volatility in the financial markets, Bank Negara Malaysia's focus is centered on ensuring that the supervisory framework and approach are responsive to the dynamic and challenging economic conditions while maintaining the stability and resilience of financial institutions. On this premise, efforts were taken to strengthen supervisory processes, practices and infrastructure for effective and prompt identification of emerging risks and vulnerabilities.

Against this backdrop, the Risk Based Supervisory Framework (RBSF) has been enhanced to be more dynamic and forward looking in detecting early signs of weaknesses which may have potential impact on the solvency of financial institutions and consequently have destabilizing effects on the financial system and the real economy as a whole. Essentially, the enhanced framework is underpinned by more

comprehensive and holistic risk assessments of individual financial institutions both at the entity and group level. More importantly, the framework applies to all types of financial institutions thereby, ensuring similar risks are addressed in a consistent manner across the financial sector. This in turn enables seamless consolidated supervision of financial conglomerates. The framework also facilitates the appropriate concentration of supervisory attention on institutions that are of higher risk. The supervisory approach under the RBSF focuses on risks inherent in significant activities, the quality of oversight and risk management control functions, earnings sustainability and capital adequacy in absorbing the residual risk, in line with the implementation of Basel II and risk based capital standards.

RBSF places reliance on the oversight functions within financial institutions namely the board and senior management, internal audit, compliance and risk management functions. The work of external auditors and actuaries are also relied to a certain extent to complement Bank Negara Malaysia's supervisory efforts by leveraging on their expertise and proficiency, for example, in the area of reserves, accounting and financial reporting. In this regard, regular discussions are conducted to enhance awareness and clarity of Bank Negara Malaysia's expectations on their roles and degree of reliance placed on their work for supervisory purposes.

For effective implementation of RBSF, a Quality Assurance Framework (QAF) had been instituted to ensure consistency in terms of risk assessment, timely and effective intervention and feedback across the Bank Negara Malaysia's supervisory departments. The intervention measures arising from the supervisory assessment are supported by Supervisory Intervention Guide which has been developed to ensure consistency in the intervention measures with defined formal and informal supervisory actions. In ensuring the RBSF continues to remain relevant and robust, a dedicated Supervisory Practices Unit was established to ensure continuous enhancement and consistency in the implementation of the framework.

Other initiatives undertaken for effective supervisory approach include greater integration between the macro-surveillance and supervision functions. This was achieved with improved two-way flow of information exchange which equipped supervisors with latest development of emerging risks within the broader financial system. In addition, rigorous scenario analyses were conducted to assess the ability of each financial institution to withstand shocks arising from various simulated scenarios of volatile markets, unstable financial systems and economic downturns.

Taking cognisance from the growing significance of active participation of financial institutions in international markets and cross-border operations and exposures, coupled with the increased regionalization of Malaysian domestic financial institutions, initiatives were also taken to strengthen cross-border cooperation among regulators for effective information sharing.

Macro Surveillance Framework

The macro surveillance framework is complementary to and integrated with the micro surveillance oversight functions of the Bank. The framework also interacts with macroprudential regulation and incorporates assessment of system-wide risk areas to provide a more comprehensive assessment and management of the financial system and stability. This is performed through:

- a holistic risk assessment approach that enables the early identification of potential risks and emerging vulnerabilities as well as financial excesses that could threaten financial stability; and
- risk mitigation/reduction approach that aims at enhancing the resilience and tolerance of the system towards shocks and disturbances, or at minimising the potential impact on overall stability.

The threats to financial system stability could emanate in a direct and indirect manner arising from:

- the interlinkages within the financial system, and macro implications of microprudential actions, systemically important financial institutions and non-regulated (by the Bank) entities with systemic significance; between the financial system and the real sector; and increased integration with the external sectors either via the trade or investment channels, or due to growing capital mobility as well as from payment and settlement channels. The Bank's macro surveillance framework aims to be able to identify susceptible trends of risks across sectors and financial entities, both at present and over time. The framework also provides for a mechanism among regulators both within and across jurisdictions in the area of surveillance and resolution in order to contain potential systemic risks beyond the national boundaries, particularly given the intensified regionalisation by the Malaysian financial institutions.

The macro surveillance activities encompass the following:

- Monitoring and assessing the potential implications of developments and emerging trends in the domestic economy, external sector, corporate and household sectors on the financial system; and
- Monitoring and assessing the potential implications of developments in sector-specific issues on the overall system wide stability i.e. the banking system, financial markets, insurance and takaful sectors and payment systems and interlinkages among the various sectors.

The key potential risks to the financial stability once identified, assessed and ranked in order of importance, are used as inputs to achieve coherent policy formulation and coordinated pre-emptive actions among key stakeholders.

In this regard, the macro surveillance approach is designed to be pre-emptive and forward-looking in nature in order to provide adequate lead time for policy actions where necessary. The macro surveillance process involves analysis and assessment of both quantitative and qualitative information using static and trend analyses, scenario and sensitivity analyses as well as forward-looking analytical tools such as stress testing and early warning systems.

**Plan and
Progress for the
Implementation of
Basel**

- In view of the many sources from which systemic risk can emanate, enhanced procedures and arrangements have been put in place to leverage on existing surveillance arrangements by domestic and cross-border authorities and agencies in the assessment of regional financial vulnerabilities and global conditions, such as with the:
 - Securities Commission of Malaysia, Malaysia Deposit Insurance Corporation and other national authorities;
 - international financial institutions and regulatory bodies (e.g. the International Monetary Fund, World Bank, Financial Stability Board, Bank for International Settlements); and
 - central bank groupings and agencies (e.g. the Monetary and Financial Stability Committee under EMEAP and SEACEN).
- Regional and international supervisory cooperation is also being further enhanced to enable effective identification of risks emanating from cross border institutions as well as the timely and equitable resolution measures.

The Risk-Weighted Capital Adequacy Framework (RWCAF) became effective from January 2008 with the implementation of the Standardised Approach for credit risk and the Basic Indicator Approach, the Standardised Approach and the Alternative Standardised Approach for operational risks. In 2009, the Bank finalised the Standardised Approach for securitisation components of the RWCAF. In addition, the Internal-Ratings Based (IRB) approach for credit risk was finalised and will apply to 11 banking institutions that had been given the approval to migrate directly to the IRB approach (from Basel I) in 2010.

The final Pillar 2 and Pillar 3 frameworks will be issued in early 2010.

**CURRENT MONETARY
OFFICIALS
(as of December
2009)**

Governor Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz

Deputy Governors Dato' Ooi Sang Kuang
Dato' Zamani bin Abdul Ghani
Dato' Mohd Razif bin Abd. Kadir

**Board of
Directors** Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz
Dato' Ooi Sang Kuang
Dato' Zamani bin Abdul Ghani
Dato' Mohd Razif bin Abd. Kadir
Tan Sri Dato' Sri Dr. Wan Abdul Aziz bin Wan Abdullah
Datuk Oh Siew Nam
Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor
Dato' N. Sadasivan
Tan Sri Dato' Sri Mohd. Hassan Marican
Tan Sri Dr. Sulaiman Mahbob

Assistant Governors Dato' Mohd Nor bin Mashor
Dato' Muhammad bin Ibrahim
Ms. Nor Shamsiah binti Mohd Yunus
Mr. Gopala Krishnan Sundaram
Mr. Bakaruddin Ishak
Dr. Sukhdave Singh
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**Secretary to the
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