Muhammad bin Ibrahim: The lessons of managing risks during the global financial crisis – the Malaysian banks' experience

Opening remarks by Mr Muhammad bin Ibrahim, Deputy Governor of the Central Bank of Malaysia, at the Asian Institute of Finance (AIF) and Institut Bank-Bank Malaysia (IBBM) Risk Roundtable Forum 2010, Kuala Lumpur, 12 October 2010.

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My opening remarks will consist of three parts. Part I, I will make comments on global financial reform and regulatory priorities. Part II, I will share some regulatory initiative embarked upon by BNM. Part III, I will conclude by giving you an assessment of the banking industry during the recent financial crisis and why it had remained resilient.

Global financial reform and regulatory priorities

The global financial reform initiative to strengthen the financial sector is consistent with our priorities to enhance prudential regulation and supervisory framework in Malaysia. Efforts to further improve risk management and corporate governance, strengthening the role of supervisors in the oversight of financial institutions and improve market discipline are not new to Malaysia. We have been doing this well before the global financial crisis and these initiatives will continue into the future. For example stress testing on banking institutions was introduced many years ago.

In carrying out our regulatory responsibility, we will continue to ensure an effective balance between maintaining prescriptive rules and allowing some degree of flexibility under a more principle-based approach to regulation. Our principled based approach to regulation will be supported by effective supervisory oversight. Therefore, we do not foresee a significant shift in our current approach to regulation following the proposed global financial reforms. In fact, this reinforces our thinking that the approach we are taking is appropriate for our system.

Bank Negara Malaysia has been engaging the banking industry to better understand the impact that the proposed reforms have on Malaysia's economy and financial system. This will allow us to develop implementation strategies for Malaysia after taking into account specific characteristics of the domestic financial system, including compensating tools and arrangements within the financial system that mitigate risks to financial stability. An important point to consider is that, the implementation process does not result in any unintended consequences. This is where engagement with the banking industry is of utmost importance. We used inputs from the industry and share the inputs at regional and international-level regulatory fora, thus providing an emerging market perspective to the recommended proposals.

Malaysian financial reform, regulatory framework and conduct of supervisors

Some key regulatory initiatives by Bank Negara Malaysia to further enhance its prudential regulatory framework and conduct of supervision moving forward.

- ***First***, to strengthen financial sector legislation through the modernisation and consolidation of existing regulatory/oversight laws under Bank Negara Malaysia's purview. The enhanced legislation ensures that Bank Negara Malaysia is entrusted with the necessary mandate and power to maintain financial stability and to conduct effective supervision of financial institutions.

- ***Second***, complement existing micro-prudential rules with macro-prudential instruments to address system-wide risks with the aim of ensuring greater resilience of individual institutions, and the financial system as a whole.
- ***Third***, enhance comprehensive cross-border crisis management and financial stability surveillance arrangements. This can be done via channels such as the EMEAP Monetary and Financial Stability Financial Committee, which was established in 2007 to enhance regional collaboration and cooperation in the area of macro-monitoring and crisis management. Efforts are also directed to strengthen financial safety nets within the region (e.g. cross-border collateral arrangements, currency swap arrangements). We are quite confident these arrangements will further strengthen the resilience of regional financial systems and economies. These measures will become increasingly important in the light of our effort to increase the integration of financial systems within the region.
- ***Fourth***, establish a holistic framework for consolidated supervision. All the activities of financial conglomerates are within appropriate risk levels and not overly complex, and the large groups are not a source and channels for amplifying contagion effects. Supervisory cooperation initiatives at the regional level will also be directed at enhancing existing or introducing additional platforms (e.g. creation of supervisory colleges) for discussing issues related to the supervision and resolution of cross-border financial institutions.
- ***Fifth***, promote fair and transparent market conduct practices by financial institutions through heightened market conduct surveillance and transparency requirements, while also raising the level of financial capability of consumers through education and awareness programmes.

How Malaysia survived the global financial crisis

Let me conclude by outlining why we had not been adversely affected by the recent financial crisis.

Banking system maintained strong financial and capital buffers at end 2008 during the peak of the crisis as evidenced by:

- Strong capital position with RWCR of 12.6% and core capital ratio of 10.6%.
- Ample liquidity with total interbank placements of more than RM150 billion with BNM that can be unwound to release RM liquidity to the system at any time.
- Low exposures to foreign currency (FX) denominated assets.
- Banks' leverage position remains manageable and lower than foreign institutions abroad.
  - Balance sheet leverage (i.e. total assets / common equity) for the Malaysian banking system of about 15 times (vs. global average of about 20 to 30 times).

Banks had strengthened institutional set-up and capacity post Asian Financial Crisis through:

- More robust risk management standards and practices.
- Stronger corporate governance structure.
- Smooth implementation of the Standardised Approach of Basel II's Capital Adequacy Framework.
- Balanced and diversified business portfolios.

Enhanced financial infrastructure post Asian Financial Crisis through:

- Enhanced depth and size of bond and Sukuk market (about 107 % of GDP).
- Strengthened financial safety nets (e.g. establishment of Malaysian Deposit Insurance Scheme)/Danajamin/CDRC/SDRS.
- Strengthened regulatory and supervisory approach (e.g. gradual move towards principles based regulations, adopting of risk based supervision).
- Legislative reforms (e.g. introduction of the Central Banking Act to articulate the financial stability mandate; amendments to the Companies Act to codify directors' duties).
- Enhanced role by the training institute too develop talent and leaders of tomorrow (ICLIF,INCEIF, AIF).