

Abdul Rasheed Ghaffour: National Resolution Symposium 2024

Speech by Mr Abdul Rasheed Ghaffour, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the National Resolution Symposium 2024, Kuala Lumpur, 23 September 2024.

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Assalamualaikum w.b.t and a very good morning I bid to you.

It gives me great pleasure to be with you today and I would like to take this opportunity to first congratulate PIDM for curating this event.

Allow me to begin with a short story.

In the small village of Fudai in Japan, a man named Kotoku Wamura served as a mayor for over 40 years.

In the seventies (1970s), he initiated the construction of a 51-foot-high seawall to protect Fudai from tsunamis. This move encountered strong pushback. The city council balked at the height of the wall which was 20 feet taller than other seawalls constructed in neighbouring coastal towns. Some of the villagers laughed at him. Many dismissed it as an extravagant and unnecessary expense for such a small community and some even accused Wamura of overreacting. People couldn't see the need for such a high seawall.

Wamura died a few years after the seawall was completed. About 15 years later, in 2011, the Great East Japan Earthquake triggered a massive tsunami in the region. Many coastal towns were destroyed. However, thanks to Wamura's foresight and perseverance, Fudai escaped the devastation.

In the context of financial institutions today, recovery and resolution planning is our equivalent of Wamura's seawall. Just like the villagers who doubted the need for the barrier, there may be skeptics who question the cost and urgency of crisis preparedness. Some may believe it's an overreaction to hypothetical scenarios that may not materialise during their lifetime. But when the storm hits, those plans will be the very thing that stands between survival and collapse. Just as Wamura's seawall protected his village, robust recovery and resolution plans will help protect both the institution and the broader financial system.

Ladies and gentlemen,

Crisis readiness is critical for Malaysia as we navigate an increasingly complex and interconnected global financial landscape. We must be prepared to respond rapidly and effectively to emerging financial shocks that can ripple across borders. Being prepared involves cultivating a proactive and resilient mindset of continuously evaluating and improving our ability to anticipate, manage and mitigate the impact of crises.

Internally, within Bank Negara Malaysia, we are continuously enhancing our ability to respond effectively to crises. This involves understanding the financial landscape and

vulnerabilities within the system and taking corrective actions towards improving them. A key aspect of this includes ensuring that our prudential frameworks, such as risk-based capital requirements and proportionality in regulation, remain robust and adaptive to the changing environment.

Along the spectrum of crisis preparedness initiatives, recovery planning stands out as the primary line of defence for financial institutions to handle stress beyond their risk appetite. For this reason, Bank Negara Malaysia views financial institutions' recovery plans as a critical element in elevating crisis preparedness of the banking system. The submission of the first recovery plan from banks last year is an important step forward in the industry's commitment to being crisis ready.

But our journey is just beginning. The end game is not the plan, but rather, everything that goes into ensuring that the plan is credible and works when needed. In other words, careful planning rather than the plan itself is what ultimately provides confidence in the ability to respond to and recover from crises.

Industry must therefore continuously review and refine their recovery plans. Institutions should consider if these plans on paper can be operationalised in a timely manner and understand how they interact with the rest of the financial system to ensure risks are properly identified and mitigated.

In this regard, experience from past crises may provide useful insights. By analysing past crises, financial institutions can identify weaknesses in their recovery plans and refine their strategies accordingly. For example, the market reactions to decisions made by regulatory authorities during the 2023 banking turmoil in the US and Europe provide invaluable insights into the feasibility of various recovery options.

The recent crisis has also raised concerns on the effectiveness of loss absorbing capital including the treatment of credit hierarchy. Australia has recently proposed to phase out Additional Tier 1 capital instruments to be replaced with more stable and reliable capital. In Malaysia, these instruments account for less than 5% of total Tier 1 Capital. We will continue to respect the creditor hierarchy of claims and monitor further developments in this area. Another key lesson from the recent banking crisis is the critical importance of transparency and timely communication. Financial institutions must prioritise clear and consistent communication with stakeholders to maintain trust and stability especially during periods of uncertainty.

Now, as we strengthen our crisis preparedness, we must also have due regard for the unique challenges of Malaysia's dual financial system, arising from the coexistence of conventional finance and Islamic finance. The fast increasing and significant scale of Islamic banking and takaful in Malaysia requires recovery and resolution processes to consider Shariah requirements.

Mechanisms such as asset sales, liquidity provisions and restructuring efforts involving Islamic financial institutions will need to integrate Shariah considerations. For example, the unique features of Islamic financial products must be carefully considered during a resolution to ensure customers' rights are preserved, particularly for Shariah contracts that entail Islamic banks carrying on fiduciary roles while ownership of assets belong to customers. Adherence to Shariah principles in implementing recovery and resolution

actions ensures consistency with Islamic principles and values and mitigates legal and reputational risks, as well as promotes market confidence in the Islamic financial system.

Ladies and gentlemen,

Crisis preparedness is a shared accountability, requiring the collective efforts of all stakeholders involved in building a resilient financial system. This shared responsibility extends across regulatory bodies, government agencies, financial institutions and the broader financial industry.

Recognising this, we have made interagency collaboration a cornerstone of our approach to crisis preparedness. The Financial Stability Executive Committee (FSEC) was established to support Bank Negara Malaysia's statutory mandate of preserving financial stability through its powers to decide on potential policy measures to be implemented to avert or reduce risks. Members of the FSEC comprise representatives from Bank Negara Malaysia, the Ministry of Finance and Securities Commission Malaysia. The diverse membership helps ensure that decisions made balances between protecting the rakyat's welfare, safeguarding financial stability and preserving economic growth.

We also participate in regular crisis simulation exercises to further test various aspects of our crisis response capabilities. To date, Bank Negara Malaysia has participated in and carried out no less than five simulations in the last three years, either on a standalone basis or in collaboration with the industry or other agencies. These simulation exercises allow key entities to rehearse coordinated responses and identify potential gaps in the approach. We have found these simulations to be immensely helpful in identifying and closing gaps in our crisis response measures.

In a similar vein, it is critical for financial institutions to conduct regular testing of their recovery plans through crisis simulation exercises. These simulations will help institutions gauge how well their recovery plans function in real-world-like situations. They will reinforce familiarity with the roles and responsibilities of individuals and teams during a crisis, allowing for more rapid reaction times.

Financial institutions must also pay attention to recovery from operational incidents. While such incidents may not always breach thresholds for the activation of formal recovery plans, execution of Business Continuity Plans (BCPs) and communication strategies are critical areas that require careful attention. BCPs are designed to ensure that critical business functions can continue during and after a disruption, which includes having backup systems and predefined procedures for maintaining operations. Poor execution in these areas can significantly delay recovery and escalate operational issues into even larger crises. For example, a minor IT outage could lead to significant financial transactions being delayed, which in turn could affect market confidence.

In addition to internal efforts, industry-led initiatives can also play a significant role in hastening progress in recovery and resolution planning. By facilitating the exchange of knowledge and best practices, the financial industry can benefit from a collaborative learning environment. In this regard, the industry could leverage on existing platforms such as The Association of Banks in Malaysia (ABM) and the Asian Institute of Chartered Bankers (AICB) to facilitate coordination of these initiatives. Financial

institutions are encouraged to take advantage of valuable opportunities to share insights, lessons learned, and practical experiences in recovery and resolution planning, driving the entire industry forward.

Ladies and gentlemen,

Collaboration with home and host authorities in cross-border initiatives is central to strengthening Malaysia's crisis preparedness. Our interconnected global financial system requires coordinated efforts in managing the various risks that threaten it. Malaysia has been proactive in fostering these international relationships to better equip ourselves to tackle crises that may extend beyond national borders.

For example, Malaysia actively participates in cross-border initiatives, such as regional workshops and crisis simulations, to identify gaps in cross-border resolution and improve our ability to manage failures. We also organise supervisory colleges and resolution-focused groups for our regional banking groups. These platforms continue to be an important way to build mutual trust and a shared understanding of cross-border risks. Through these initiatives, Malaysia not only enhances its domestic crisis preparedness but also plays a key role in cultivating a more resilient regional financial ecosystem.

An important consideration that is often overlooked in a recovery plan is the complexity of cross border interactions, particularly for institutions that operate in multiple jurisdictions. On top of legal and regulatory differences, different countries may have varying procedures and frameworks, making it challenging to coordinate actions and align strategies. Financial institutions must therefore ensure their recovery and resolution plans fully account for their overseas operations and intra-group dependencies.

Given the global nature of many institutions, risks in one part of the group can quickly affect other areas across borders. To mitigate this, it is essential for financial institutions to clearly define the arrangements between subsidiaries during times of stress. Proactively identifying and addressing these dependencies is key to strengthening crisis management.

Effective communication strategies are equally important when managing crises that involve overseas operations. Institutions must carefully plan how information is relayed within the group and to shareholders. It is crucial to maintain public confidence, ensuring that communication is clear, consistent, and avoids creating unnecessary panic. Better coordinated cross-border communication can significantly reduce the potential for confusion or misinformation during a crisis. On the regulators' end, authorities have been leveraging on the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) platform which has established the Crisis Management and Resolution Framework in 2013 to further improve crisis communication and coordination among member countries.

Ladies and gentlemen,

Malaysia's approach to recovery and resolution planning will continue to be both proactive and adaptive, and an important priority in our ongoing efforts to promote a resilient banking sector.

There is much work left to be done. For instance, on the regulatory front, Bank Negara Malaysia is cognisant of the importance of liquidity funding during stressful operating environments. We are exploring ways to enhance our liquidity assistance framework, by broadening the range of acceptable collateral during stressed periods and improving the time taken to value such collateral. Another example is resolution planning for non-member institutions of PIDM such as investment banks.

It is perhaps timely for us to reflect on the applicability of the resolution framework for non-member institutions. This would ensure that all institutions, regardless of membership status are adequately prepared to manage potential crises. We will continue to work with industry and other relevant stakeholders on such initiatives.

In closing, I would like to extend our sincerest gratitude to PIDM for their tireless efforts in the area of crisis preparedness. Their contributions have been instrumental in bolstering our recovery and resolution capabilities, helping us build a stronger and more resilient financial system.

Together, with continued collaboration and dedication, we will ensure that Malaysia remains well-prepared to navigate any challenges that lie ahead.

With that, I wish all of you an insightful and productive session ahead.

Thank you.