

Promoting Financial Stability

One of the Bank's mandates is to promote financial stability in the interest of supporting sustainable economic growth. We do this by ensuring that the financial system remains resilient and can withstand shocks throughout economic cycles. This involves promoting strong and well-managed financial institutions. It also includes fostering safe and reliable clearing and settlement systems, and ensuring orderly financial markets. Ultimately, a sound and stable financial system facilitates the continuous delivery of effective services to financial consumers.

Financial Stability Priorities in 2022

As Malaysia fully transitioned to COVID-19 endemicity in 2022, economic activity recovered at a strong pace, with domestic growth expanding by 8.7%. However, this growth remained uneven across sectors, with certain economic segments continuing to struggle. At the same time, new challenges arose from global developments. These included elevated commodity prices, rising global inflation and strained supply chains. Aggressive tightening of monetary policy in developed economies further weakened most currencies against the US dollar, including the ringgit. Taken together, these events have resulted in increased cost pressures for firms

and households. In addition, Malaysians were affected by more frequent climate-related events such as flash floods, and continued to be targets for financial scams and frauds.

Against this challenging backdrop, our regulatory and supervisory priorities were focused on -

- First, managing a smooth exit from exceptional policy measures during the pandemic, while maintaining support for individuals and businesses recovering from the pandemic;
- Second, addressing emerging risks associated with climate change and cyber threats;
- Third, further strengthening risk management, disclosure and governance practices of financial institutions; and
- Fourth, promoting fair treatment of consumers.

Unwinding of COVID-19 relief measures

Banks, together with AKPK (Agensi Kaunseling dan Pengurusan Kredit), continued to implement the Financial Management and Resilience Programme (URUS) in 2022. URUS was put in place to ensure that help continues to be available to the most vulnerable borrowers at a more customised level when existing broad-based repayment assistance programmes came to an end. Over 7,000 individuals who were enrolled under URUS¹ received help to manage their debt and personal finances under a two-year programme. Beneficiaries will continue to have access to advisory, education and income support services from AKPK throughout the two years. The support measures introduced throughout the pandemic have helped prevent permanent scarring of affected borrowers. As at December 2022, the delinquency and impairment ratios among borrowers who exited the earlier broad-based repayment assistance programmes remained low at 1.4% and 1.8%, respectively, signalling improvements in their debt servicing ability.

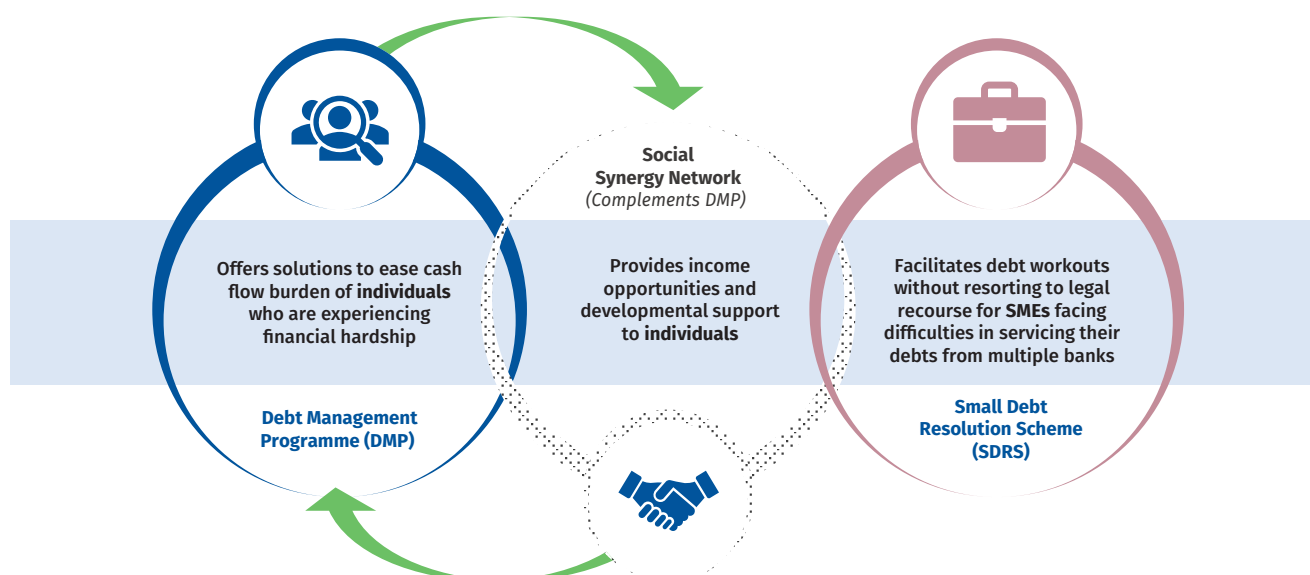
¹ The programme was open for applications from November 2021 to March 2022.

To ensure effectiveness of relief measures, we reviewed how banks were engaging affected borrowers and advising them on steps that they could take to review their instalment plans when their financial circumstances improved. This is important to reduce the cost of their overall debt. We found that banks were taking specific steps to reach out to their customers on reviewing their repayment plans. Customers were also provided with convenient access points and options to adjust their loan instalments, although this could be improved in some banks. Anecdotal evidence from some banks suggest that borrowers generally appear to be more inclined to maintain lower

repayments to preserve their financial buffers - possibly in response to higher costs of living.

While COVID-19 repayment assistance programmes have concluded, banks and AKPK continue to provide assistance to customers in need. Banks continue to offer customised restructuring and rescheduling (R&R) plans to borrowers that are still facing difficulties servicing their debt, alongside AKPK's ongoing programmes (see Diagram 1). SMEs may also obtain financing from various funds provided by the Bank. These funds are intended to help support SMEs' economic recovery and future growth. More details are found in the chapters "Promoting a Progressive

Diagram 1: AKPK's Programmes and Support Services for Distressed Individuals and SMEs



Source: Bank Negara Malaysia

and Inclusive Financial System" and "Promoting a Progressive and Inclusive Islamic Financial System".

Regulatory Priorities

The Bank issued several key policies in 2022. These policies aim to strengthen financial institutions' resilience and preparedness against risk events, foster adoption of global regulatory standards appropriate to domestic conditions and strengthen financial institutions' internal governance, controls, disclosures and business conduct.

Safeguarding against climate-related risks

Financial sector resilience against climate risk events is crucial to us. We are taking active steps

to integrate climate risk considerations into our regulatory and supervisory frameworks. This is to ensure that financial institutions effectively monitor and manage climate-related risks. Our efforts on this front are summarised in Diagram 2. Further details on broader climate initiatives can also be found in the chapter "Towards a Greener Financial System".

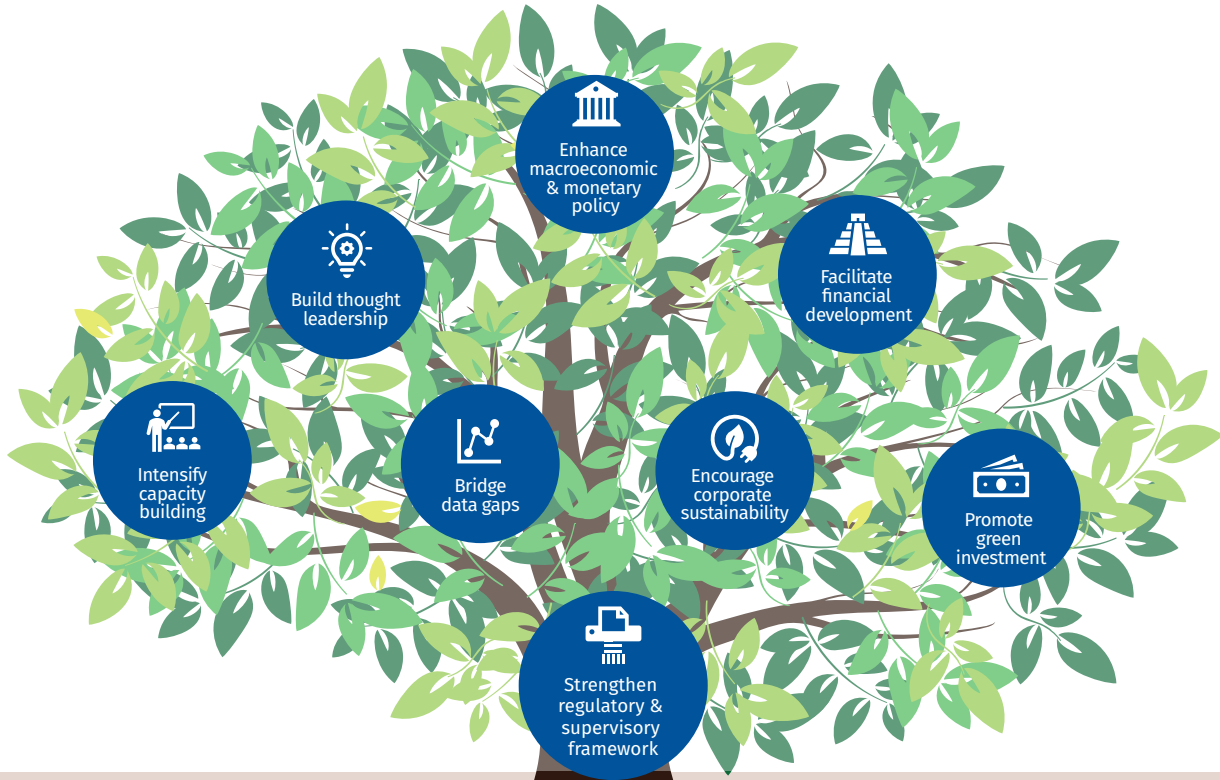
Fostering implementation of global regulatory standards

We remain committed in aligning our domestic regulatory framework with international standards, where appropriate, to enhance the resilience of our financial system. This includes the adoption of key elements² from the Basel III reform package.

² Particularly the minimum capital requirements, leverage ratio and liquidity standards.

Diagram 2: Overview of Climate-Related Initiatives, including Key Regulatory and Supervisory Initiatives

Ensuring resilience against climate-related risks and a just and orderly transition to a low carbon economy



In 2022, we undertook three initiatives in regulation and supervision to enhance climate resilience of the financial sector

1 Climate Risk Management and Scenario Analysis Policy Document

Outlines the principles and specific requirements on the management of climate-related risks by financial institutions

2 2024 Climate Risk Stress Testing (CRST) Exercise Discussion Paper

Explores proposed parameters on the applicability and format of CRST exercise, and technical elements such as scenario selection, portfolio scope and granularity

3 Climate Change and Principle-based Taxonomy

Improves availability and collection of economic activity data based on the extent they meet climate objectives and promote transition to a low-carbon economy

These initiatives allow financial institutions to...

- ✓ Integrate climate-related risks into their governance, business strategies, risk management framework, scenario analysis and disclosures
- ✓ Improve and complement overall risk management framework

- ✓ Facilitate assessment on their resilience to physical and transition risks arising from various climate scenarios
- ✓ Facilitate reviews and engagements with supervisors

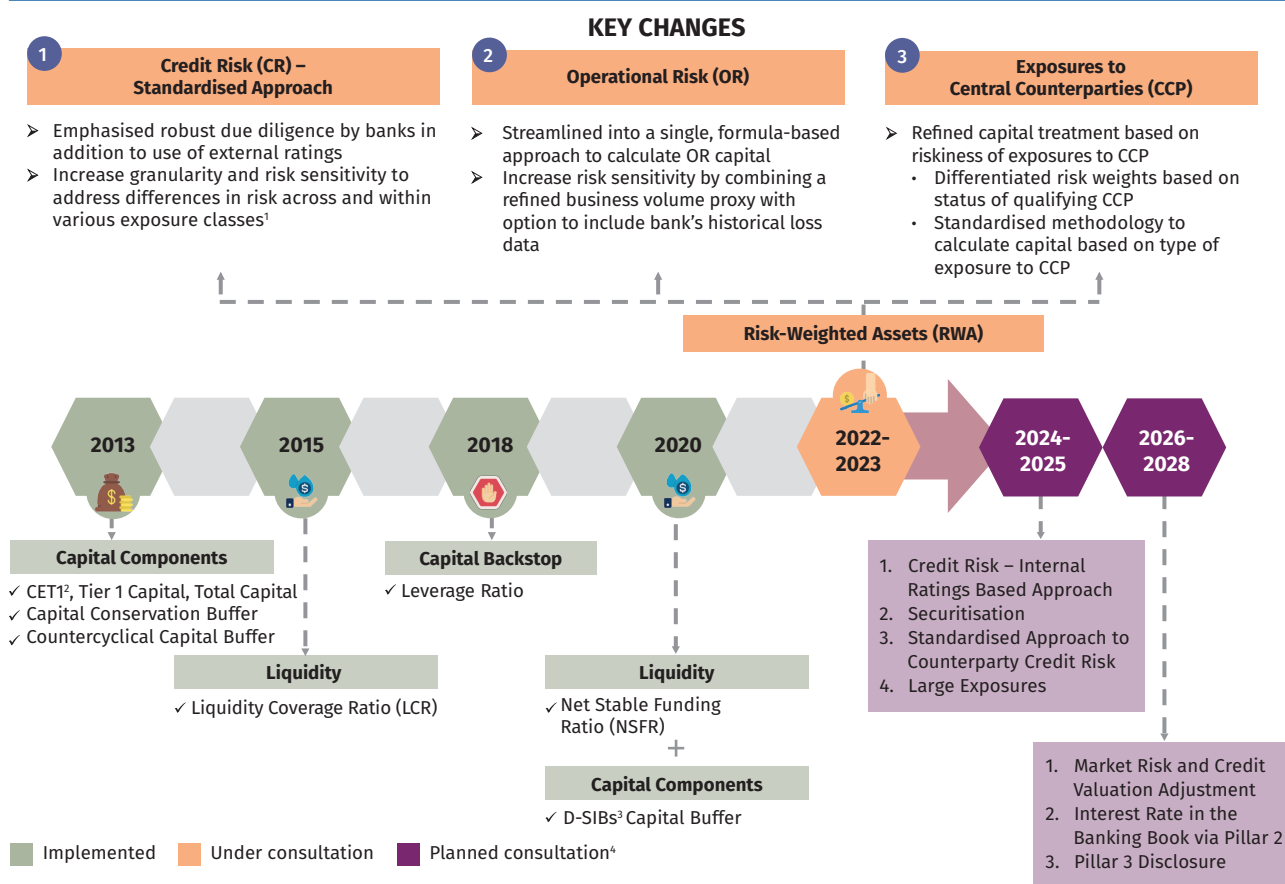
- ✓ Promote consistent classification of exposures to climate-related risks across the industry
- ✓ Enhance capabilities to assess economic activities and their associated impacts on climate and the broader environment

Source: Bank Negara Malaysia

In 2022, we worked on revisions to standards for risk-weighted assets of banks (see Diagram 3). Three Exposure Drafts were issued (on Credit Risk, Operational Risk and Exposures to Central Counterparties, respectively). These revisions aim to improve the robustness and risk sensitivity of

risk-weighted assets. In addition, they will improve the comparability of capital ratios among banks domestically and internationally. Banks applying internal models will also be required to adopt a new capital floor requirement based on the revised standardised approach.

Diagram 3: Malaysia's Progress in Adopting Basel III Reform Package



¹ Covered bonds, project finance, object finance, commodities finance, retail and real estate
² Common Equity Tier 1 capital
³ Domestic systemically important banks
⁴ Consultation timelines will take into consideration future developments

Source: Bank Negara Malaysia

Strengthening internal governance, controls, disclosures and conduct

Efforts to strengthen the pillars of a sound prudential framework continued amid an evolving operating landscape and rapid pace of digitalisation in the economy (see Diagram 4). We focused on strengthening disclosures and transparency as well as ensuring effective and timely management of technology and cyber risks. We also strengthened the standards on proper advice and selling practices to promote consistent standards across insurance intermediaries³. This aims to mitigate the risk of mis-selling and safeguard consumer interests with the emergence of more diversified channels of distribution for insurance and takaful products.

The Bank is committed to being open, transparent and inclusive in our policy making process. Inputs obtained from engagements with the industry and the public through various channels are useful in

informing our final policies, including the approach to implementation, to achieve the intended policy outcomes.

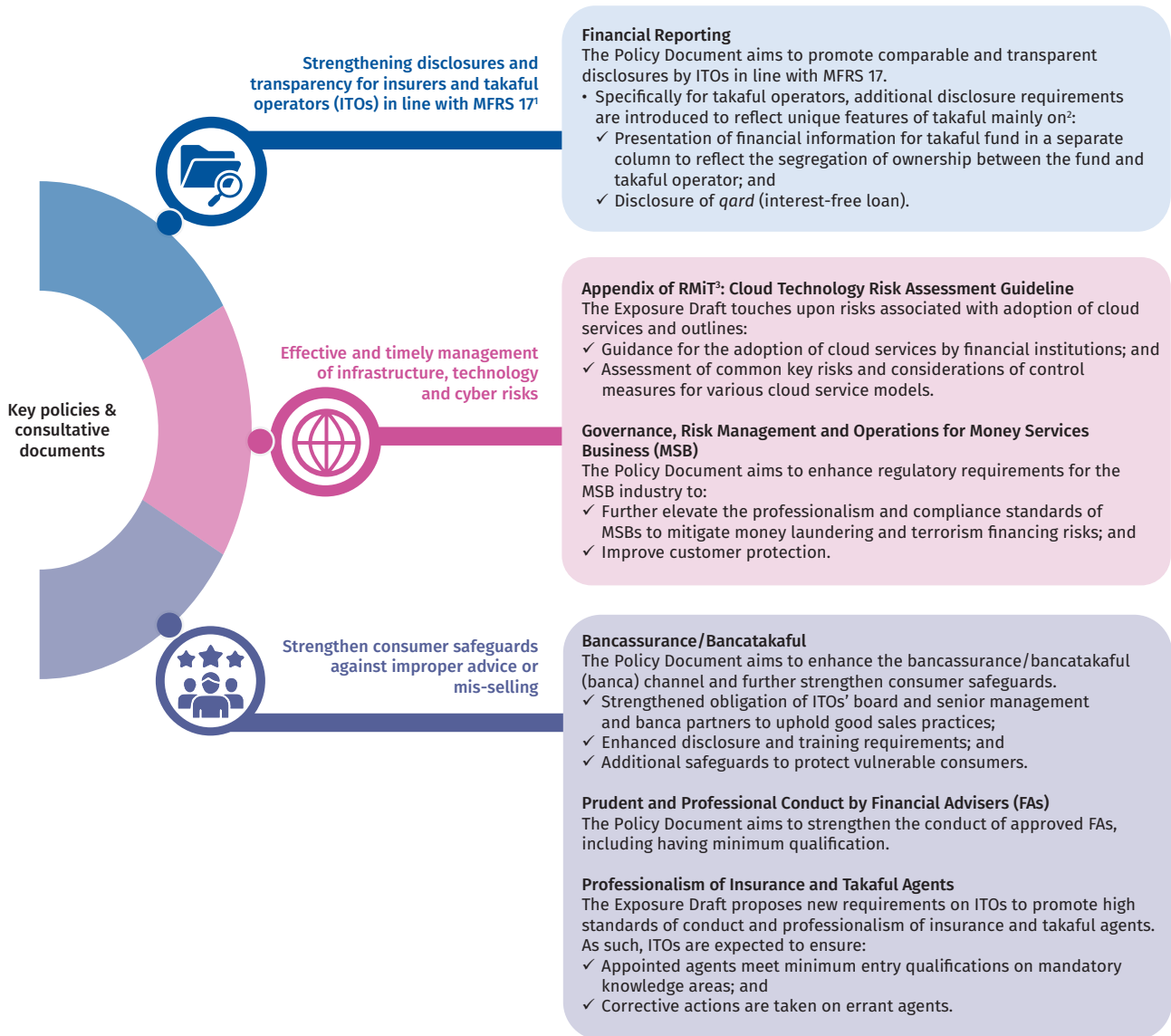
Supervisory Priorities and Approach

We adopt a risk-based and forward-looking approach when supervising financial institutions that are licensed and approved by the Bank. In the past year, we gradually resumed on-site reviews to assess financial institutions' risk profiles, including the impact from adjustments made to internal controls, systems and processes in the wake of the pandemic.

Throughout the year, we continued to monitor and assess emerging risks faced by financial institutions. We focused our supervisory reviews on assessing

³ This includes financial advisers (FAs), bancassurance/bancatakaful (banca) sales staff and insurance/takaful agents.

Diagram 4: Summary of Key Policies and Consultative Documents Issued in 2022



¹ Malaysian Financial Reporting Standards (MFRS) 17 is a new accounting standard for insurance contracts

² Aligned with recommendations by the Malaysian Accounting Standards Board (MASB) and the Shariah Advisory Council of Bank Negara Malaysia (SAC)

³ Policy Document on Risk Management in Technology (RMIT)

Source: Bank Negara Malaysia

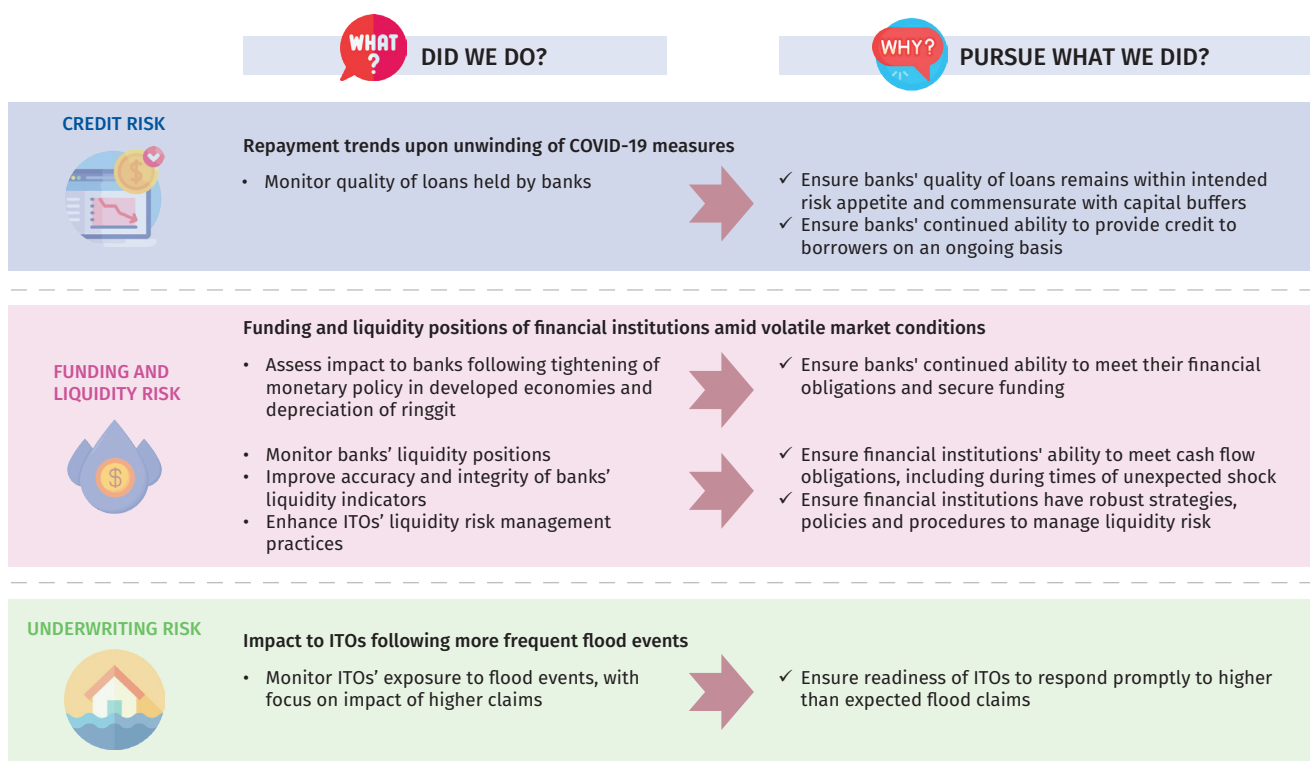
how financial institutions are managing risks from the unwinding of COVID-19 related measures, headwinds from the external environment and domestic large-scale catastrophes. A summary of the key areas we pursued is in Diagram 5.

A key focus of the insurance and takaful industry during the year was preparations for the adoption of the new accounting standard (MFRS 17), which takes effect from 1 January 2023. This entailed

investments to integrate their business, finance and IT systems, and reconfigure processes, where required. The impact of MFRS 17 on ITOs' shareholders' equity is more significant for family or life ITOs and varies across ITOs. This is mainly driven by the specific business portfolio and the choice of assumptions used to derive insurance/takaful liabilities under the new accounting approach. Overall, all ITOs' shareholders' equity remains positive⁴. Given the significant changes arising from

⁴ i.e., ITOs' assets exceed liabilities.

Diagram 5: Focus Areas of Supervisory Monitoring in 2022



Source: Bank Negara Malaysia

the standard to the reporting and presentation of the financial results of ITOs, ITOs will continue to engage key stakeholders to explain the impact of MFRS 17 on their financial performance so that the information disclosed is well understood.

Promoting fairer outcomes for financial consumers

We also enhanced oversight of financial institutions' business conduct to ensure consumers are treated fairly. This takes into consideration the evolution of business models over the years, driven by increasing digitalisation. In 2022, the Bank focused its market conduct supervisory activities and priorities in five areas as summarised in Diagram 6 to address key and emerging conduct risks.

The Bank's thematic, on-site and off-site reviews covered banks' and ITOs' key product offerings. For banks, the reviews focused on the quality of suitability and affordability assessments conducted when onboarding borrowers, and repricing practices to ensure fair treatment of customers. For ITOs, we reviewed key motor product offerings to ensure fair contractual terms applied to customers. We also focused on reviewing the redemption process of Perlindungan Tenang vouchers. More

details on this can be found in the chapter on "Promoting a Progressive and Inclusive Financial System". Where appropriate, the Bank took firm and proportionate actions against financial institutions that did not meet expected standards. These include issuing directives to remove unfair contractual terms, improve clarity of policy terms on benefits and exclusions, refund unfair charges to consumers and strengthen due diligence of distribution partners. Further details on the actions taken can be found in the section on "Supervisory and Enforcement Actions".

Cyber resilience and combating financial scams

Ensuring cyber resilience and combating financial scams is one of our key priorities. Recent data breaches globally have impacted customers' finances and confidence in the payment system. In 2022, the Bank conducted the first industry-wide cyber drill exercise, BNM RE4CT. With over 270 participants from 35 financial institutions, BNM RE4CT was a good testbed to ascertain financial institutions' resilience and responses against cyber threats. The industry exhibited satisfactory levels of readiness and resilience in responding to cyber threats. We found that financial institutions were well-versed with

Diagram 6: Key Business Conduct Areas to Ensure Fair Treatment of Financial Consumers



Source: Bank Negara Malaysia

their internal incident response and business continuity plans. However, there is room for financial institutions to further improve communication with the public and media. This is to ensure prompt dissemination of accurate information during a cyber crisis. In addition to BNM RE4CT, we also continued to collaborate with the financial industry to pursue initiatives to strengthen their preparedness against cyber-attacks (see Diagram 7).

With financial fraud and scams on the rise, the Bank focused its supervisory efforts to strengthen technology risk management of financial institutions. This is aimed at mitigating cases of financial fraud and scams. During the year, we issued supervisory letters to financial institutions covering new detailed requirements and expectations on managing online frauds⁵. This is in addition to the five key measures for immediate implementation across all banks (see Diagram 8). We also continued to collaborate

⁵ Some examples include monitoring and blacklisting devices or phone numbers that have been used for illegal transactions, and ensuring that internet banking services and mobile applications are only run on secured versions of web browsers and supported versions of operating systems, respectively.

with the financial industry, Polis Diraja Malaysia (PDRM), Malaysian Communications and Multimedia Commission (MCMC) and National Anti-Financial Crime Centre (NFCC) to combat financial fraud and scams, and create greater public awareness on relevant issues and security measures.

Additionally, the Bank continuously updates the Financial Consumer Alert List. This list allows consumers to cross-check the legitimacy of entities or schemes representing themselves as regulated financial institutions or activities. The Bank takes all forms of financial fraud and scams seriously as they undermine public confidence and can impact livelihoods. As such, we will continue to enhance our supervisory efforts and response in this area.

Engagements with other regulators and supervisors

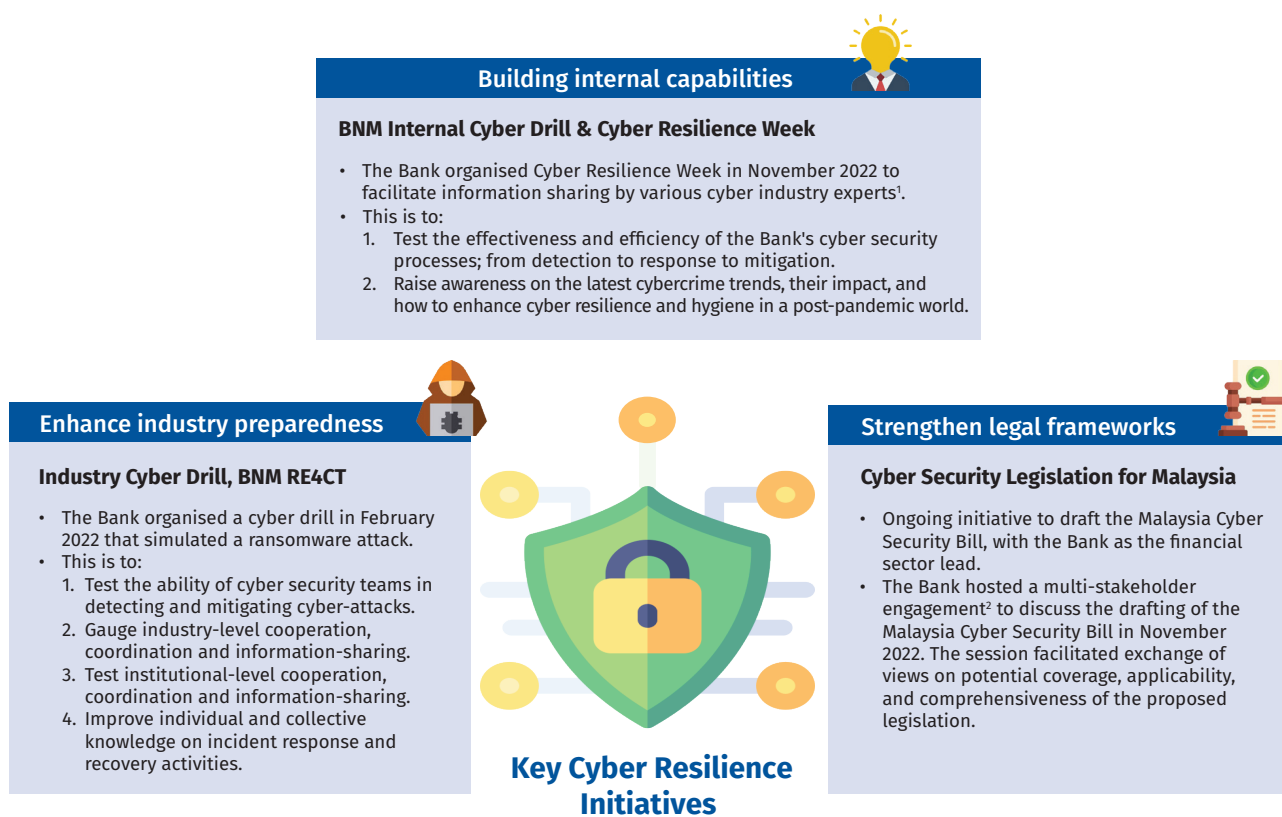
In the Bank’s continued cooperation with our international counterparts, we participated in three supervisory colleges organised by the home regulators of locally incorporated foreign banks. These engagements are important to support effective supervision and oversight of financial institutions in Malaysia. It also serves as

an important platform to cultivate trust and timely information sharing on emerging risks and key supervisory issues.

We also continued to actively participate in international forums and committees⁶. These platforms provide useful insights for our policy development and supervisory functions, particularly in key areas such as climate change and emerging technology. This year, we participated in a cross-border crisis simulation exercise

organised by the Financial Stability Institute (FSI). The exercise provided an opportunity for the Bank to evaluate our cross-border crisis management framework which led to several enhancements identified to further strengthen the effectiveness of existing cross-border arrangements. We will use these insights to continue engaging with financial institutions, the Ministry of Finance and Perbadanan Insurans Deposit Malaysia (PIDM) to build sound crisis management as well as recovery and resolution planning capabilities.

Diagram 7: Key Cyber Resiliences Initiatives

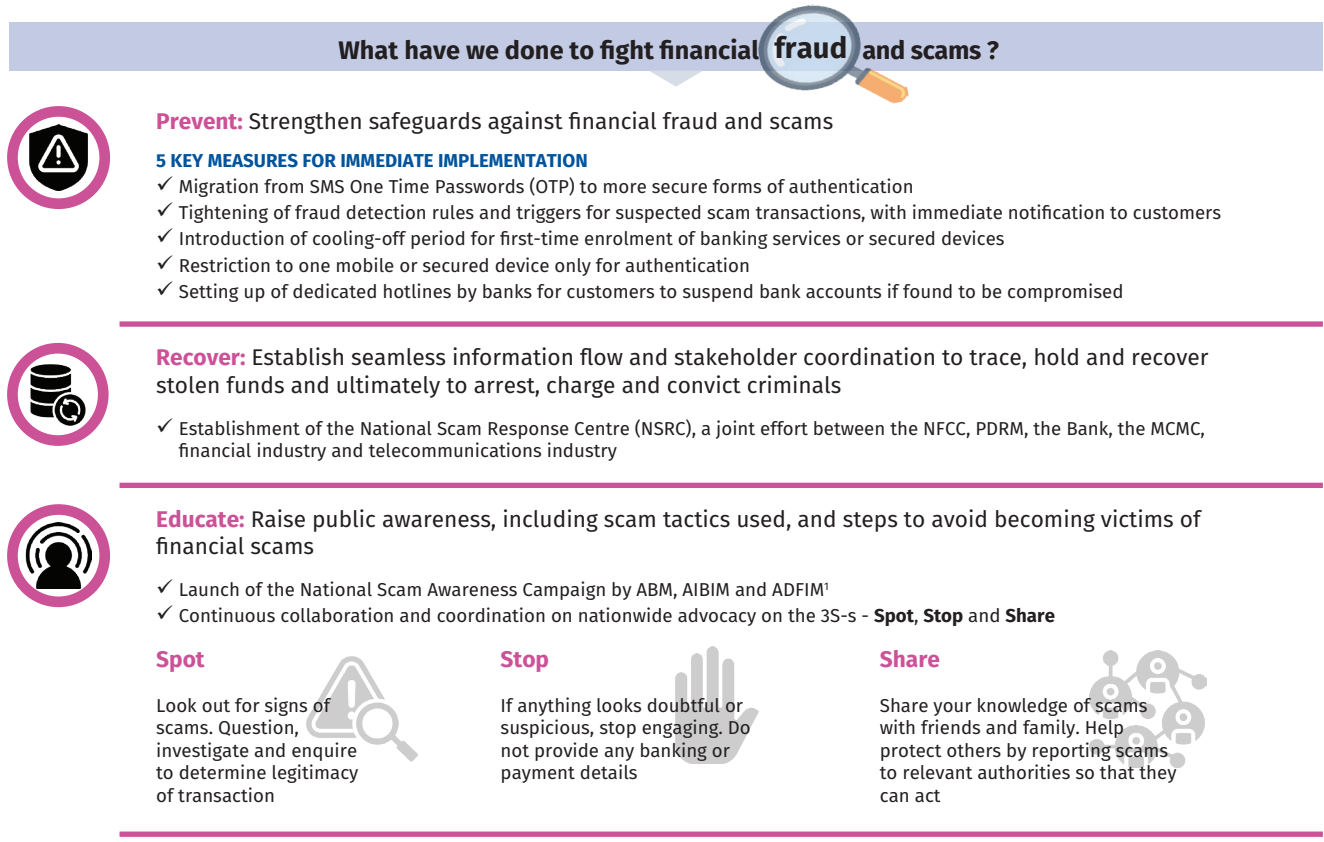


¹ PDRM, National Scam Response Centre (NSRC), MCMC and cyber security-related companies such as Trend Micro, CyberSecurity Malaysia and Vigilnet.my
² Participation from financial institutions, payment system operators, Payments Network Malaysia Sdn Bhd (PayNet), PIDM, National Cyber Security Agency Malaysia (NACSA) and International Islamic University Malaysia (IIUM)

Source: Bank Negara Malaysia

⁶ These include the: (i) Basel Committee on Banking Supervision (BCBS); (ii) Cybersecurity Resilience and Information Sharing Platform (CRISP); (iii) International Association of Insurance Supervisors (IAIS); (iv) Executives' Meeting of East Asia-Pacific Central Banks (EMEAP); (v) Islamic Financial Services Board (IFSB); (vi) Network for Greening the Financial System (NGFS); and (vii) ASEAN Taxonomy Board.

Diagram 8: Whole-Of-Nation Approach in Combating Financial Fraud and Scams



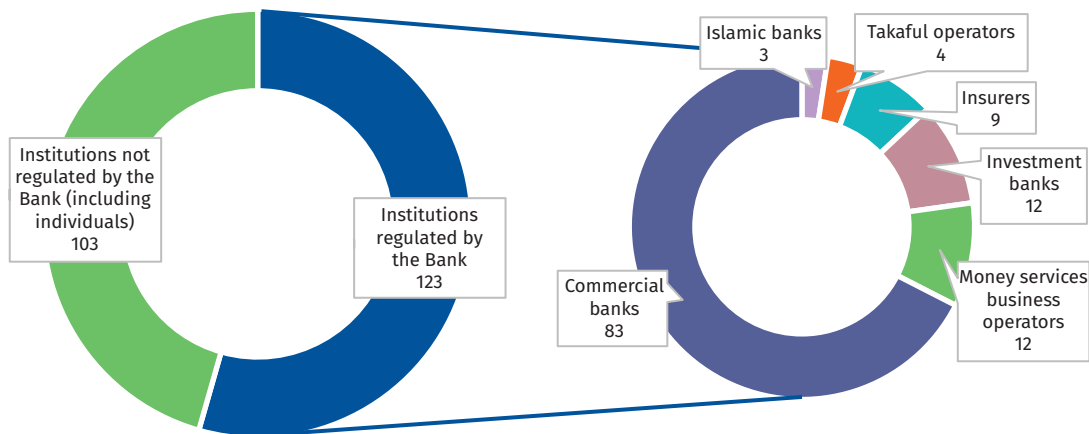
financial institutions (see Chart 1). Majority of the actions taken were against low-severity breaches.

We also continued our efforts to combat financial crimes such as illegal deposit-taking and remittance. During the year, we issued seven cease and desist orders against illegal money services business (MSB) operators and opened five investigation papers. This resulted in the Bank imposing a total compound of RM50 million against these entities for illegal deposit-taking and the laundering of proceeds from illegal activities. Additionally, the Bank also secured court convictions against four companies and one individual for illegal MSB, illegal deposit-taking,

contravention of banking secrecy requirements and money laundering. These convictions resulted in fines totalling RM141.4 million and jail terms for the offenders.

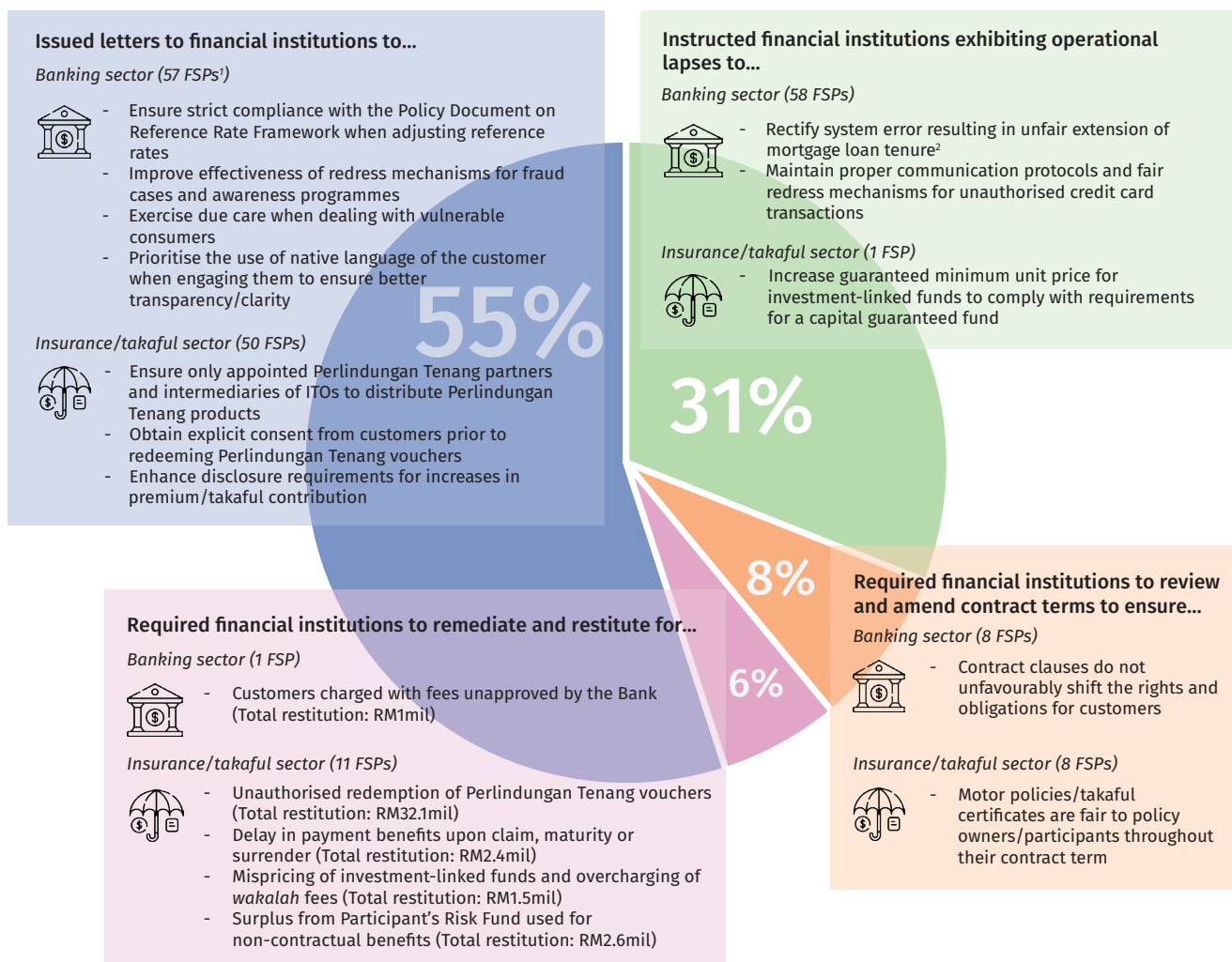
On the market conduct front, we took active steps to safeguard consumers' interests. Prompt actions were taken to cease unfair industry practices and to ensure fair redress by errant financial institutions to affected consumers. Arising from these, the Bank secured restitutions amounting to over RM39.6 million for half a million financial consumers. Other supervisory actions taken are as summarised in Diagram 9.

Chart 1: Number of Actions Taken by Type of Institutions in 2022



Source: Bank Negara Malaysia

Diagram 9: Summary of Supervisory Actions Taken to Uphold Fair Consumer Outcomes



¹ i.e., Financial Service Provider

² Only 1 FSP was found to have system errors and instructed to rectify the issue

Source: Bank Negara Malaysia

Going Forward

The financial landscape is expected to continue to undergo rapid changes in the coming years. This will be driven by forces of change such as digitisation of financial services, climate change and demographic changes in Malaysia. These changes will inevitably bring new regulatory challenges. As such, the Bank will continue to ensure that our regulatory and supervisory frameworks -

- (i) Respond to emerging issues in a timely manner;
- (ii) Promote a financial system that is resilient to future shocks;

- (iii) Set high standards of professionalism and fair conduct for financial service providers. This includes safeguarding consumers' interest against unfair or unethical practices, particularly in the case of vulnerable segments; and
- (iv) Preserve the integrity and safety of the financial system. This includes introducing new process improvements to ensure timely and effective enforcement actions and continued collaborations with other law enforcement agencies to combat illegal activities.