

Promoting Financial Stability

Bank Negara Malaysia (BNM) is mandated to promote financial stability conducive to the sustainable growth of the economy. We discharge this mandate by ensuring that the financial system is resilient and can withstand shocks throughout the economic cycle. We do this by promoting strong and well-managed financial institutions and ensuring orderly financial markets. This also includes fostering safe and reliable clearing and settlement systems.

Financial Stability Priorities in 2023

The global economy continued to face a series of challenges in 2023. High interest rates amid elevated inflation, the US banking turmoil, and geopolitical tensions weighed on global growth during the year. In addition, the global technology downcycle, shifts in consumer spending from goods to services, and ongoing trade restrictions dampened global trade activity. Despite challenging global conditions, the Malaysian economy continued to expand, growing by 3.7% in 2023 (2022: 8.7%).

Against this backdrop, the Malaysian financial sector continued to perform its intermediation function effectively. While a number of banking failures in advanced economies during the first quarter of the year raised concerns on the resilience of banks and financial markets in other jurisdictions, its spillover effects to our domestic financial sector were limited. Malaysian banks were unaffected. The resilience of the domestic financial sector continued to be underpinned by well-capitalised financial institutions and strong risk management practices. The various developmental reforms pursued under the existing and previous iterations of the financial sector blueprint have also enhanced the capacity and dynamism of the financial sector to keep pace with emerging developments and capitalise on new opportunities in support of Malaysia's economic development.

In 2023, we continued to focus our regulatory and supervisory initiatives on the following areas -

- First, upholding strong risk management practices, governance and internal controls of financial institutions as key pillars of a sound financial system.
- Second, making further progress in aligning the domestic regulatory framework with global standards.
- Third, strengthening the resilience of financial institutions against climate-related risks, fraud risk and cyber threats.
- Fourth, promoting fair outcomes for financial consumers through responsible practices.

Regulatory Priorities

In 2023, we issued 11 key prudential and conduct policies (refer to Diagram 1). These policies aim to preserve the resilience of financial institutions against risk events, strengthen financial institutions' safety and soundness through prudent practices, promote ethical and professional behaviour of financial institutions to achieve fair consumer outcomes, and foster the adoption of global regulatory standards appropriate to domestic conditions.

Strengthening governance, risk management and conduct

During the year, we finalised the policy on Responsibility Mapping. The policy establishes requirements for financial institutions to strengthen individual accountability at the senior level. This forms an integral part of broader efforts to ensure that financial institutions are managing their compliance and business risks effectively across the organisation. This policy emphasises the importance of the tone-from-the-top to drive good culture and decision-making in financial institutions. In Islamic finance, we pioneered the development of a policy for Islamic financial institutions on the application of *Hajah* and *Darurah* in navigating

situations of hardship¹ where exceptions from Shariah principles are permitted. The policy promotes more consistent application of governance standards that comply with Shariah principles. Specifically for the insurance sector, we updated the policy on management of insurance funds, focusing on measures that would ensure strong internal controls and governance surrounding the rectification of deficits and withdrawal of surpluses in insurance funds to preserve the sustainability of such funds.

Drawing lessons from the global banking failures in 2023, we have also finalised and issued principles on sound liquidity management for banks. The principles serve to codify BNM's expectations on sound practices to manage liquidity risks for all banks, including strengthened requirements on monitoring funding concentrations and contingency funding plans. Further details on the broader initiatives to strengthen resilience to liquidity shocks in the financial sector can be found in the feature article 'The Imperatives for Strengthened Regulation and Supervision of Liquidity Risk in Malaysia' in BNM's Financial Stability Review: Second Half 2023.

We also took steps to enhance the market conduct requirements for financial institutions to reinforce their responsibilities to safeguard consumer interests, especially when dealing with vulnerable consumers. Further details on the requirements for vulnerable consumers can be found in the feature article on 'Personalising Financial Services: Promoting Fair Treatment of Vulnerable Consumers'. Amid more offerings of Buy Now Pay Later (BNPL) schemes, we also expanded the coverage of regulatory requirements applicable to Personal Financing to cover BNPL. This applies to financial institutions under BNM's purview where they are required to conduct reasonable affordability assessments to mitigate excessive borrowings by households. They are also required to comply with requirements relating to late payment charges. We also continued to raise standards of professionalism within the insurance and takaful intermediary sector through strengthened qualification criteria, alongside stronger expectations on corrective actions to be taken on those found to engage in improper practices.

¹ Hardship is a situation of unfavourable circumstances, severe adversity or intolerable levels of distress, arising from internal or external factors that require a person to resort to a different solution(s) which may permit an exception in applying existing Shariah principles or Shariah rulings, as set out in the Paragraph 8.1 of policy on *Hajah and Darurah*.

Advancing the adoption of global regulatory standards

BNM continues to drive progress on Malaysia's adoption of the strengthened capital and liquidity regulations in the Basel III reform package². This aims to ensure the continued strong resilience of the banking sector to cushion unexpected shocks by building buffers during good times (see Diagram 3 on 'Malaysia's progress in adopting Basel III reform' in BNM's Annual Report in 2022).

The focus during the year was to finalise the policy³ on capital requirements relating to operational risk and exposure to central counterparties⁴. We are also finalising the Basel III capital requirements for credit risk and will issue the finalised policy in 2024. Similarly, for insurers and takaful operators, we completed a comprehensive review of the risk-based capital framework (RBCT) to ensure its continued effectiveness to address existing, new and emerging risks. We plan to consult the industry on the new RBCT in 2024.

Supervisory Priorities and Approach

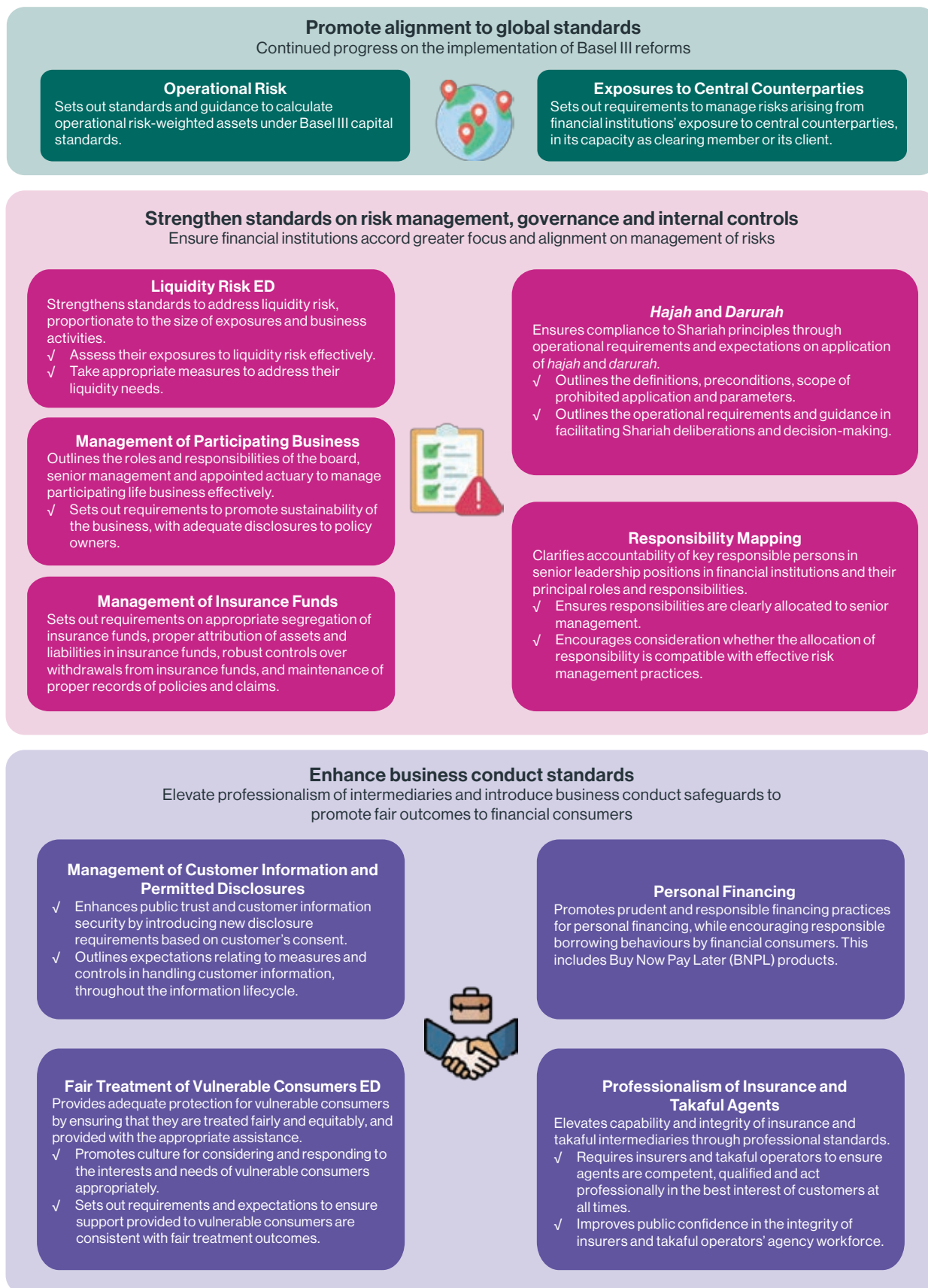
BNM's approach to supervision is risk-based and forward-looking. We conduct on-site reviews and off-site information analysis to assess the risk profiles of financial institutions, and their ability to manage and respond to risk events from a continuously evolving operating environment. In 2023, we resumed the frequency of our on-site reviews which had been interrupted during the pandemic years. In addition, we continued to conduct more targeted reviews to complement our ongoing supervision. These reviews included assessing (i) the preparedness of banks to respond to and withstand crises through robust recovery and resolution planning; (ii) the robustness of AML/CFT-related policies and controls in financial institutions; and (iii) financial institutions' compliance with Shariah governance requirements.

² Basel III is an internationally agreed set of measures developed by the Basel Committee on Banking Supervision (BCBS) in response to the financial crisis of 2007-09. The measures serve to increase the level and quality of regulatory capital, ensure that significant risks are properly captured, improve bank liquidity and prevent excessive leverage.

³ The policy sets out standards and guidance for computation of risk-weighted assets which improves risk sensitivity as a measure to determine how much capital should be set aside.

⁴ Central counterparties (CCPs) are financial institutions that provide clearing and settlement services for trades in foreign exchange, securities, options and derivative contracts.

Diagram 1: Key Policy Issuances and Updates in 2023



Source: Bank Negara Malaysia

We also conducted reviews on the readiness of newly licensed digital banks to commence their operations. These evaluations covered digital banks' governance structures, and risk management policies and controls with a particular focus on their ability to meet the higher expectations in managing technology and operational risks. We also reviewed how the digital banks would execute the strategies committed under their business plans to close market gaps in the unserved and underserved segments. Importance was also placed on ensuring that countermeasures against fraud were in place to protect the interest of the digital banks' customers.

Another key supervisory focus was on financial institutions' progress in implementing the requirements in the Climate Change and Principle-based Taxonomy (CCPT). The CCPT is a framework that guides financial institutions to identify and categorise economic activities that contribute to climate resilience. In 2023, BNM together with industry representatives in the CCPT Implementation Group⁵ continued to work towards improving the consistent application of the CCPT classification system. Efforts were taken to develop more granular criteria and information that can be used by financial institutions to conduct climate-related due diligence assessments on customers. The aim is to support the effective assessment and management of climate-related risks and encourage financial flows towards environmentally sustainable economic activities.

Promoting fair outcomes for financial consumers

The focus of BNM's supervisory activities on market conduct in 2023 was directed at five key conduct risks (Diagram 2).

In promoting fair outcomes to consumers, we continued to take action against unjustified fees imposed by banks. The banks were ordered to cease the unjustified fees and provide restitution to affected customers where relevant. We also introduced requirements for banks to standardise certain generic terms and conditions in their housing loan/financing agreements. Standardisation in how these terms and conditions are expressed in agreements aims to help consumers better understand their legal rights and obligations under the agreements.

⁵ CCPT Implementation Group serves as a collaborative platform for financial industry players to share knowledge, experiences and common issues to CCPT implementation. It was established under the purview of JC3 represented by members of domestic and foreign financial institutions, including banks, insurers, takaful operators as well as asset management companies.

Diagram 2: Key Conduct Risks in 2023



Source: Bank Negara Malaysia

In relation to the targeted repayment assistance (TRA) introduced during the COVID-19 pandemic, we reviewed how banks were meeting expectations to proactively re-engage their customers to revise the terms of their loan agreements when their financial conditions improved. In the insurance and takaful sector, we assessed motor policies and product disclosure sheets to ensure the terms around the choice of repairers that policyholders can send their vehicles to is made clearer to policyholders. We also reviewed practices by insurance intermediaries to ensure appropriate handling of premium monies received from customers. For financial institutions that failed to meet the expected standards of fair conduct, we took firm actions against them. Further details on the actions taken can be found in the section 'Supervisory and Enforcement Actions'.

BNM continued to maintain a strong focus on the effectiveness of financial institutions' controls to safeguard their customer's information. Measures being taken by financial institutions to further strengthen their cyber resilience and controls around the management of third-party service providers will contribute towards ensuring the protection of confidential information. Further details on cyber resilience can be found in the section on 'Cyber resilience and combating financial fraud' and the chapter on 'Operational Risk' in BNM's Financial Stability Review: Second Half 2023. We will continue to monitor progress made by financial institutions on this front as part of our ongoing supervisory activities.

Cyber resilience and combating financial fraud

As technological advancements continue to take place at an unprecedented pace, BNM expects financial institutions to continuously manage the attendant risks that may threaten financial stability, consumer outcomes and confidence in the financial sector. Preserving operational and cyber resilience remains a key priority for us and financial institutions.

To step up the resilience against fraud, we announced the requirement for financial institutions to implement five key fraud countermeasures and a kill-switch capability in September 2022 (Diagram 3). Most banks have fully implemented the six countermeasures.

We continued to work closely with financial institutions to ramp up other safeguards to combat financial fraud. We intensified efforts to educate customers on scam tactics and how to protect themselves against fraud attempts. We issued FAQs to further assist in the operationalisation of the fraud countermeasures. Financial institutions were also required to conduct independent validation reviews to assess the robustness of their controls on fraud detection and management, and effectiveness of their fraud countermeasures. Additionally, some banks

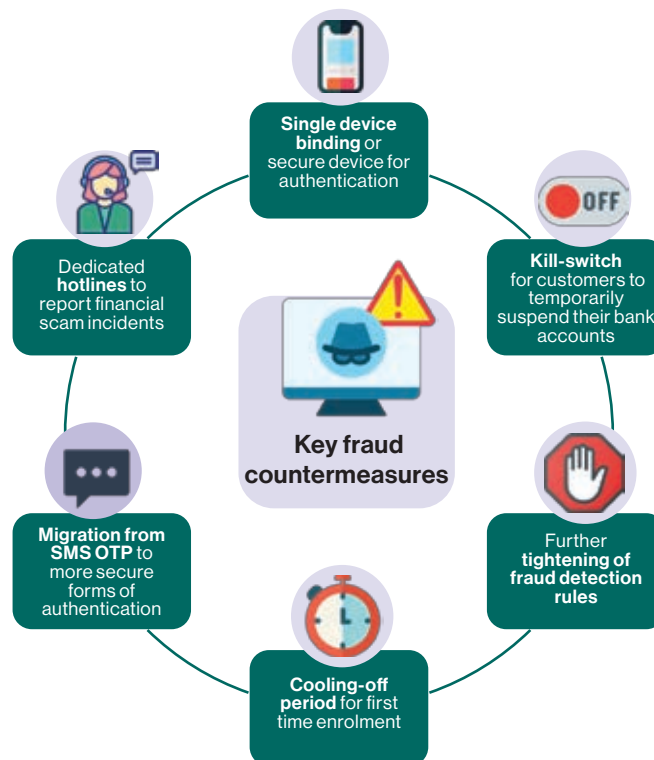
were required to appoint a senior independent director to oversee the bank’s management of fraud and data breach incidents, coordination with the National Scam Report Centre (NSRC), as well as the communication strategy of the bank with its customers, affected victims and the public. These efforts have contributed to a marked reduction in cases of unauthorised online banking fraud as reported to the NSRC. Further details on NSRC can be found in the chapter on ‘Maintaining Financial Integrity’.

Engagement with other regulators and supervisors

BNM continued to cooperate closely with our international counterparts on the oversight of financial institutions that have cross-border operations. We participated in 17 supervisory colleges in 2023 organised by home regulators of locally-incorporated foreign banks, insurers and takaful operators (including one reinsurer). The supervisory colleges provided a platform for supervisors and regulators to share and exchange views on industry and market developments, emerging risk areas and supervisory priorities.

We also continued to actively participate in international forums and committees. We are an observer and member of the Basel Committee on Banking Supervision (BCBS)

Diagram 3: Key Fraud Countermeasures



Source: Bank Negara Malaysia

and Basel Consultative Group respectively, supporting the committee's broader outreach and engagements on international prudential standards. We also participated in the review of the Basel Core Principles⁶ which has been finalised recently. We continued to contribute to the development of global insurance standards through our representation in the International Association of Insurance Supervisors (IAIS) Executive Committee, Policy Development Committee and various sub-committees including the Supervisory Forum. These engagements have also informed our own regulatory requirements, supervisory frameworks and practices to ensure they remain effective, responsive and aligned with international best practices. At the regional level, our participation in the central bank platforms such as the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) and the Association of Southeast Asian Nations (ASEAN) helped in strengthening our cooperation with other central banks on monetary and financial stability issues and to advance our strategic priority areas through constructive policy dialogues. Further information on our role in the international and regional communities can be found in the chapter on 'International Engagements'.

We continued to actively engage in cyber information sharing initiatives at regional platforms such as the ASEAN Cybersecurity Risk Information Sharing Program (CRISP), as well as collaboration with other key regulators and international organisations. Additionally, we further strengthened bilateral strategic collaboration with relevant regulatory authorities within the ASEAN region, to facilitate the sharing of cyber threat intelligence (CTI).

Supervisory and Enforcement Actions

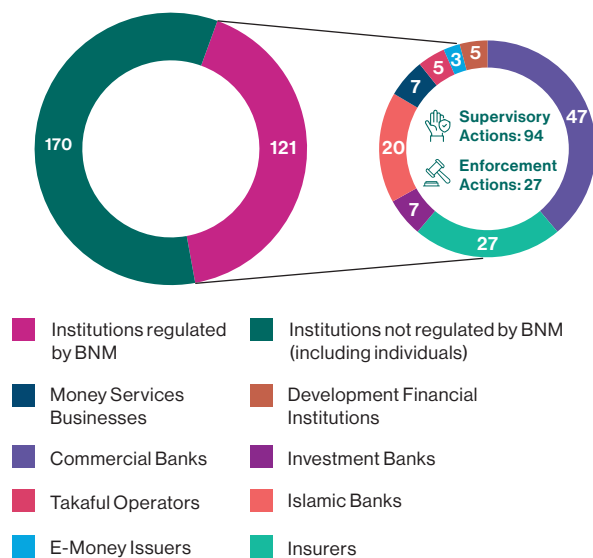
BNM employs a range of supervisory and enforcement actions to promote compliance, good governance and sound risk management practices among financial institutions. The types of actions taken against financial institutions are based on the severity of breaches. Supervisory actions such as reprimands and directives are preventive and corrective in nature. We take these actions to ensure financial institutions rectify gaps and establish strong compliance frameworks and processes. Enforcement actions such as administrative penalties and compounds are more likely to be pursued in cases of material regulatory breaches. These include breaches

involving elements of criminal misconduct, recurring and unresolved risk management and control deficiencies, and consumer conduct breaches that have adverse consequences on public interest.

In 2023, our enforcement approach continued to support positive changes in the risk and compliance culture of financial institutions. A total of 291 supervisory and enforcement actions were taken on financial institutions (see Chart 1). Details of enforcement actions by BNM are published on our website to deter future misconduct.

BNM continued to take strong enforcement actions against illegal deposit-taking and remittance activities that can pose significant financial risks to the public and facilitate criminal activity. We issued nine cease and desist orders against illegal money services business (MSB) operators and opened three Investigation Papers. We also forfeited assets from illegal activities, amounting to RM11 million. For breaches of the Money Services Business Act 2011 and Anti-Money Laundering Act 2001, we secured convictions against 11 illegal MSB operators with a total fine of RM570,000. In addition, we also secured convictions with a fine of RM15,000 on an individual for breaches of customers' information under the Financial Services Act 2013.

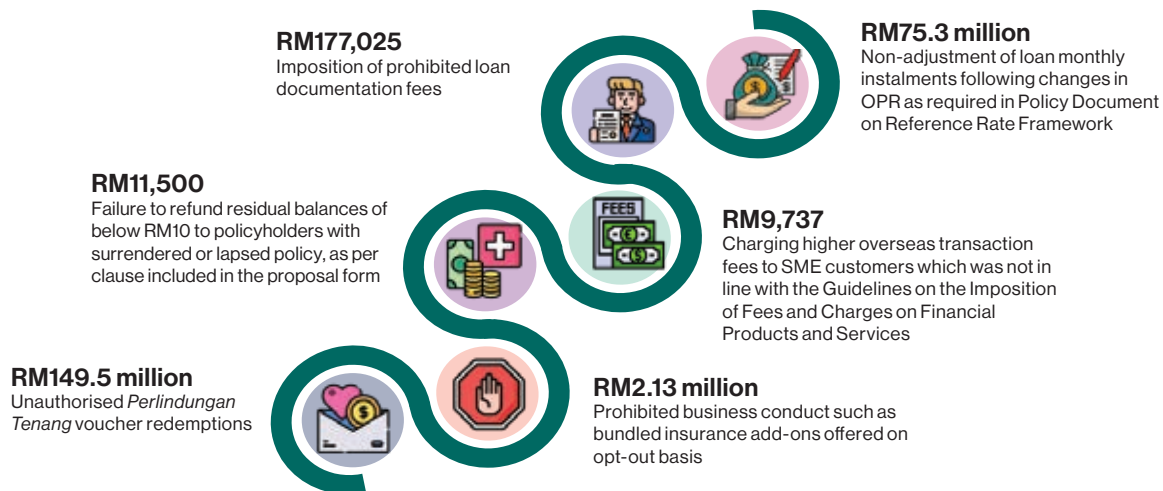
Chart 1: Number of Actions Taken by Type of Institutions in 2023



Source: Bank Negara Malaysia

⁶ The Basel Core Principles are a comprehensive standard for establishing a sound foundation for the regulation, supervision, governance and risk management of the banking sector.

Diagram 4: Refund and Reinstatement Arising from Non-compliances to Business Conduct Requirements in 2023



Source: Bank Negara Malaysia

BNM has also taken preventive measures to disrupt and dismantle schemes or entities that are potentially involved in illegal activities. These include listing in Financial Consumer Alert, case disclosures to other relevant law enforcement agencies, referrals of cases to domestic and international counterparts, blocking of website and social media accounts, as well as public awareness campaigns.

As part of supervisory actions taken by BNM in relation to consumer conduct breaches, we secured restitution amounting to more than RM227 million for 2.4 million financial consumers (summarised in Diagram 4). We took punitive actions against insurance and takaful brokers, and financial advisers that failed to meet acceptable standards of professionalism. These actions included imposing shorter renewal periods for their approved business, issuing stop business orders and rejecting applications for renewal of approval. We also issued specific directives, requiring corrective measures to be taken by these intermediaries to raise standards in the quality of advice and fair dealings.

Going Forward

The financial landscape continues to evolve, driven by greater digitalisation of financial services, climate change and demographic shifts. Against this backdrop, BNM is

committed to ensure the financial system is resilient and well-positioned to support economic activity.

- We will continue to maintain a strong focus on financial institutions' governance, Shariah and risk management practices, while further strengthening our domestic regulatory framework in line with international standards.
- We will intensify efforts to protect the integrity of the financial system and prevent its abuse, including through strong enforcement actions and collaborations with other enforcement agencies to combat fraud risks and financial scams.
- We will work to preserve strong incentives for financial institutions to ensure fair treatment of consumers through timely and proportionate conduct policy and supervisory interventions.
- We will continue to advance efforts to enhance the industry's capacity and preparedness to manage climate-related risks, and to support an orderly transition towards a greener and more sustainable economy. This will include better integration of climate risk considerations into our regulatory and supervisory frameworks.
- We will strive to promote a regulatory environment that is responsive to technological innovation, including developments in AI, while ensuring the related financial, strategic and operational risks are well-understood and managed.

Personalising Financial Services: Promoting Fair Treatment of Vulnerable Consumers

A progressive and inclusive financial system is characterised by the presence of financial institutions that are responsive to the needs of financial consumers. Bank Negara Malaysia's (BNM) mandate includes regulating the business conduct of financial institutions to engender trust and confidence in the financial system. BNM promotes fair treatment of consumers, including vulnerable consumers by strengthening business conduct standards on financial institutions to better respond to their needs.

Any person may experience or go through vulnerable circumstances at some point in their lives due to unavoidable or unpredictable life events. Vulnerable consumers may face greater constraints in their ability to act in their own best interests and hence, face higher risks in their capability to respond to such events. BNM expects financial institutions to exercise greater care when they are dealing with vulnerable consumers and to respond to their specific needs appropriately. The introduction of additional requirements for financial institutions to ensure their products, services and delivery channels can better meet the needs of vulnerable consumers aims to reduce the likelihood of unfair treatment or exclusion from essential financial services.

Types of Consumer Vulnerabilities

The circumstances that can contribute to vulnerability covers a wide spectrum that can arise from factors such as health issues, medical conditions, level of income and savings, life events, level of education and financial capability as well as age. A combination of these factors, such as having a low level of financial literacy and low financial resilience can also amplify vulnerabilities for some consumers, making them less able to cope with their financial circumstances. This is also true when significant life events affect a consumer at the same time. For example, experiencing a serious illness or injury after an accident or job retrenchment. Consumers experiencing such vulnerabilities often face constraints in making informed financial decisions and may not be able to fully benefit from financial development and innovations such as the use of digital financial services.

Diagram 1: Consumers in Vulnerable Circumstances

Challenges in access



- Faces challenges in accessing financial services or requires assistance to engage with financial services.
- Example: individuals with disabilities or senior citizens who need assistance to use digital financial services.

Low financial resilience



- Have limited capacity to withstand financial shocks.
- Example: individuals who are highly indebted or have little or no savings.

Adverse life events



- Experiencing or have experienced temporary or long-term financial hardship due to adverse life events such as job loss, natural disaster, the death or total permanent disability of the main breadwinner.

Limited financial skills



- Have limited understanding on financial matters, poor language skills or limited digital skills.
- Example: individuals who have low financial skills, who are illiterate, or who are not conversant in Bahasa Malaysia or English.

Source: Bank Negara Malaysia

Anticipated Outcomes of the New Measures for Consumers

With the introduction of new measures on fair treatment of vulnerable consumers in the existing Policy Document on Fair Treatment of Financial Consumers, financial institutions are required to consider the specific circumstances of vulnerable consumers and how to address the issues they may face. The board of directors and senior management of financial institutions are expected to ensure reasonable standards of fair dealing that are informed by a better understanding and consideration of the needs of vulnerable consumers. This in turn must be supported by appropriate policies and processes to deliver improved customer experiences for such consumers. The measures also serve to ensure that consumers are provided with relevant information on actions they can take to receive the assistance and support appropriate to their needs should they encounter a sudden change in their financial circumstances.

The examples below illustrate how vulnerable consumers may be assisted by staff who are equipped with appropriate training to recognise, assess and respond to signs of vulnerability. This would reduce the likelihood of vulnerable consumers making poor financial decisions that may have detrimental implications on their financial well-being.



Mr. Tan is a retiree with no regular income. He went to the bank to close his fixed deposit account. Based on the recommendation of a friend, he wanted to place his entire savings in a high-risk investment product which promised higher returns compared to fixed deposits. The staff explained the risks involved in the language and manner he can understand. The staff alerted him on the possibility that he might make losses on his investment and advised him to reconsider if it was safer to keep his money in low risk investments such as fixed deposit or a money market fund.



Loga is a deaf consumer but holds a steady job with a good income. He cannot read and understand English and Bahasa Malaysia well. He went to the branch to sign his housing loan agreement. When prompted by the branch staff to read the agreement before signing, he did not respond. The staff who has been trained to identify consumer vulnerability sensed that he has hearing disabilities. The staff took the time to explain the key terms to him using simple written notes and visual aids. Loga was able to understand his rights and obligations prior to signing up for his housing loan.

It is important for all consumers to have easy access to information on whom they can contact if they need assistance or advice from financial institutions in managing their financial obligations in the event that they encounter a sudden change in their circumstances. As vulnerable consumers may have different communication needs, financial institutions are expected to provide a range of communication channels. This would enable vulnerable consumers to better convey their needs through a channel they find most convenient and are comfortable with as illustrated in the example below. Financial institutions are also required to regularly test the effectiveness of channels used to communicate important information to vulnerable consumers. Financial institutions' customer service processes should hold their staff to standards that emphasise treating vulnerable consumers with sensitivity and respect, with appropriate flexibility provided for staff to deliver tailored responses where necessary to alleviate genuine financial hardship. This would enable such consumers to better cope with challenging life events and avoid further financial distress.



Sheila was recently diagnosed with cancer and required hospitalisation. She wanted to make a claim on her critical illness insurance policy. She needed to contact her insurer by phone given her situation. When she called, the customer service officer enquired about her diagnosis, was able to understand her needs and helped to email the relevant forms that she needed to complete to make a claim. Sheila's claim was promptly processed. The staff also informed her of other digital channels which Sheila could use should she need to contact the insurer again.

The new measures will come into effect in 2025 after a period of transition for financial institutions to comprehensively review and enhance their current policies and processes. While BNM strives to lift overall standards of fair dealing that financial institutions are expected to meet, BNM remains focused on intensifying financial education initiatives to help consumers to make better financial choices as the strongest form of protection against consumer harm.