

CONTAGION RISK

Contagion Risk Posed by Non-bank Financial Institutions Remained Low

Assets of non-bank financial institutions⁴⁵ (NBFIs) in Malaysia expanded by 2.9% in the second half of 2019 to account for 40.6% of financial system assets (Chart 1.28). Holdings of common assets and equity interests in financial institutions continue to be the key channel for the transmission of risks from NBFIs to the financial system (Chart 1.29).

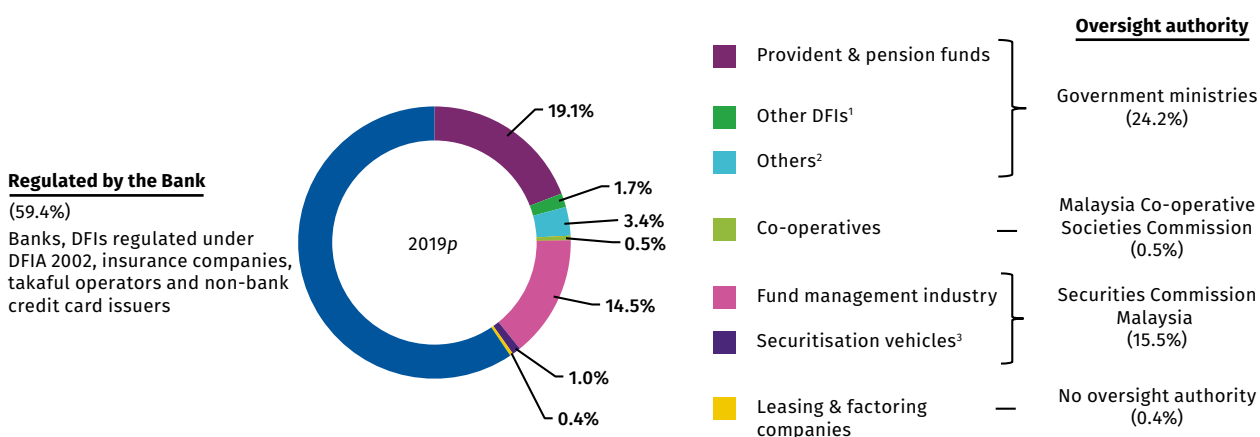
The retirement funds and fund management industry, comprising entities including *Kumpulan Wang Simpanan Pekerja* (KWSP), *Kumpulan Wang Persaraan* (KWAP) and *Amanah Saham Nasional Berhad* (ASNB), account for approximately 82.8% of NBFIs' total assets. Investments by these entities recorded a marginal decline (-1.1%) during the second half of 2019, against the backdrop of a weaker domestic equity market. Their combined

investment holdings remained significant, accounting for 30.0% and 42.3% of total equity market capitalisation and total outstanding debt issuances, respectively. Any large-scale disposal of these assets could impact market sentiment and cause sharp price adjustments, which may subsequently affect the balance sheets of other financial institutions holding similar assets. This can arise if these entities come under financial stress or display herd behaviours in response to adverse market developments. Such risks remain low given the strong financial buffers of the larger entities and their sizeable share of strategic investments that are less reactive to temporary valuation changes. The medium- to long-term investment horizon of retirement funds is also expected to continue to support orderly domestic market conditions during periods of non-resident outflows.

The share of savings by households with retirement funds and the fund management industry increased slightly in 2019 to 51.6% (1H 2019: 50.3%) of household financial assets. About a third of these savings are discretionary savings that are more sensitive to returns and could precipitate "runs" on the funds. Despite the weaker equity market

Chart 1.28: Financial System – Composition of Assets

NBFIs accounted for 40.6% of total financial system assets



p Preliminary

¹ Development Financial Institutions (DFIs) that are not regulated by the Bank under the Development Financial Institutions Act 2002 (DFIA 2002)

² Refers to pawn brokers, money lenders, non-bank providers of credit and hire purchase financing, non-bank provider of education financing, non-bank provider of housing credit, government-owned trustee company and social security organisation

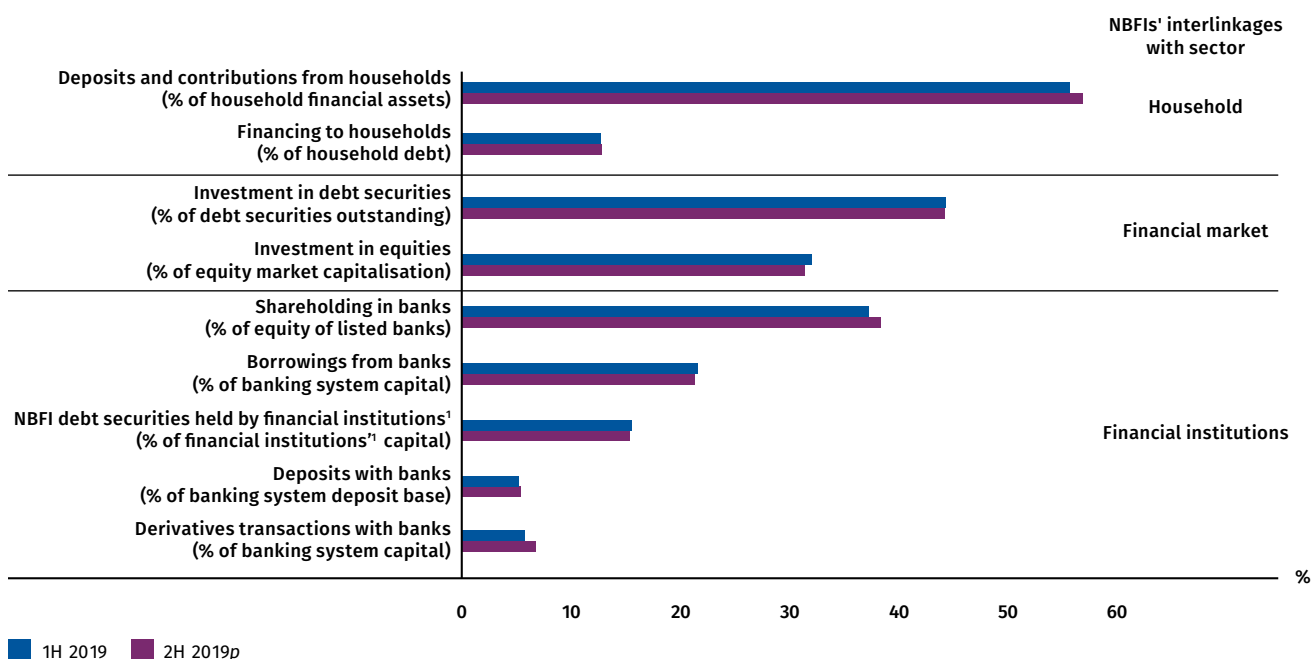
³ Refers to outstanding asset-backed securities and asset size of national mortgage corporation

Source: Bank Negara Malaysia, Malaysia Co-operative Societies Commission, Securities Commission Malaysia and published financial statements

⁴⁵ Refers to entities undertaking activities including the provision or facilitation of credit creation and investments through management of public funds, collective investment schemes and retirement funds, that are not under the purview of the Bank.

Chart 1.29: Non-bank Financial Institutions – Interlinkages with the Financial System

Key channel for the transmission of risks from NBFIs to the financial system remained through holdings of common assets and equity interests in financial institutions



p Preliminary

¹ Refers to banks, insurance companies, takaful operators and DFIs under DFIA 2002

Source: Bank Negara Malaysia, Malaysia Co-operative Societies Commission, Securities Commission Malaysia and published financial statements

performance and lower dividends announced by some funds during the year, the funds are expected to remain resilient against withdrawal risks. This continues to be supported by adequate liquidity buffers in the form of deposits and government debt securities held by the funds to meet potential withdrawals. Prudential requirements on investments and leverage that apply to fund management companies that are regulated by the Securities Commission further mitigate the risks of “runs” on fund management companies that could have broader spillovers to the financial system.

Financial stability risks arising from the activities of non-bank credit intermediaries are assessed to be low

About 12.3% of the NBFIs’ assets in Malaysia are represented by activities of specialised and small credit intermediaries such as credit co-operatives, moneylenders as well as non-bank providers of housing loans, hire purchase, and student loans. Financing extended by these NBFIs grew by 2.9%

in the second half of 2019. Financial stability risks arising from these NBFIs are assessed to be minimal as aggregate financing still remained small (12.2%) in comparison to the banking system. More than 40% of NBFIs’ financing to households feature automatic salary deduction facilities, which help to contain credit risks. Some NBFIs, including credit co-operatives, must also comply with responsible financing guidelines applicable to banks that require NBFIs to conduct affordability assessments before granting loans. Among the larger non-bank credit intermediaries, financing activities are largely funded by long-term loans and debt issuances, thus mitigating funding rollover risks. As at end-2019, the average remaining maturity for NBFI-issued debt securities increased further to 7.4 years from 6.7 years (2018) due to the longer average tenure of new debt issuances.

In recent years, incidents of default and failure among non-bank credit intermediaries in Asian economies have raised some concerns over broader risks to their respective domestic financial systems. In Malaysia, the small share of credit intermediation activities by NBFIs and strong

financial buffers of significant NBFIs substantially reduce such risks. Additionally, most NBFIs in Malaysia are subjected to formal regulatory oversight as statutory bodies or institutions licensed and prudentially supervised by the Securities Commission and Malaysia Co-operative Societies Commission. Over the longer term, the continued growth and concentration of statutory retirement funds could present heightened risks

to the domestic financial system in the unlikely event of stress in the institutions that manage these funds. Measures by the NBFIs to diversify their investment portfolio through holdings of foreign and alternative assets,⁴⁶ commensurate with their risk management capabilities, as well as measures to encourage the growth of private retirement schemes, will contribute towards mitigating these risks.

⁴⁶ Among others, this includes property, infrastructure and private equity investments.