

Financial Institution Soundness and Resilience

THE BANKING SECTOR

The Capitalisation of the Banking Sector Remains Strong,¹ Bolstering Banks' Resilience against Potential Stress Arising from Adverse Financial and Macroeconomic Shocks

All banks continue to maintain capital ratios well in excess of the regulatory minimum (Chart 2.1), underpinned by continued profitability and sound asset quality. The overall risk profile of banks has also been broadly stable, with the ratio of risk-weighted assets to total assets² remaining largely unchanged in recent periods at around 58%.

Sustained profitability and sound asset quality strengthened the solvency position of the banking system

In the second half of 2019, banking system profitability was sustained above the estimated average cost of capital (Chart 2.2),³ further strengthening banks' solvency positions. Pre-tax profits recorded an annual growth of 15.4%, supported by strong growth in non-interest income (Chart 2.3). Profit-taking by banks in the government

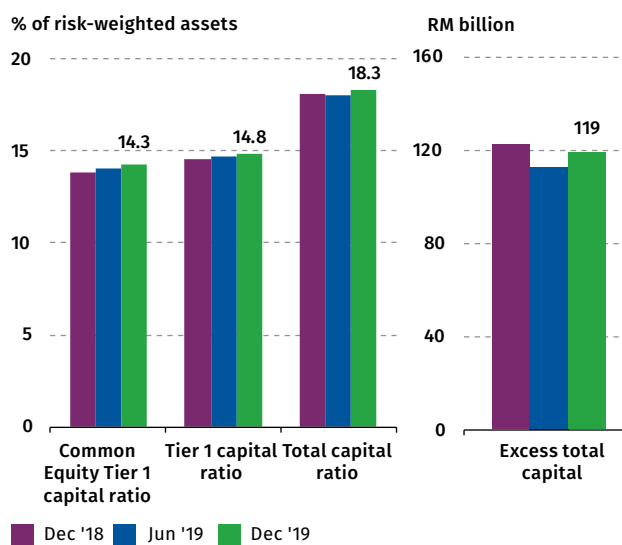
¹ Most of banks' capital (78%) are held in the form of Common Equity Tier 1 capital instruments such as ordinary shares and retained earnings, which are regarded as the most reliable and highest quality form of capital available to absorb losses.

² The ratio measures the relative riskiness of banks' assets. A higher ratio (or risk-weight density) generally indicates higher risk-taking by banks. Malaysian banking system risk-weight density has remained broadly stable in recent periods (December 2019: 57.6%; June 2019: 58.3%; December 2018: 58.2%).

³ The average cost of capital for Malaysian banks is estimated using the Capital Asset Pricing Model.

Chart 2.1: Banking System – Capitalisation

Banks maintained strong capitalisation



Note: Excess total capital refers to total capital above the regulatory minimum, which includes the capital conservation buffer requirement for 2018 (1.875%) and 2019 (2.5%) and bank-specific higher minimum requirements

Source: Bank Negara Malaysia

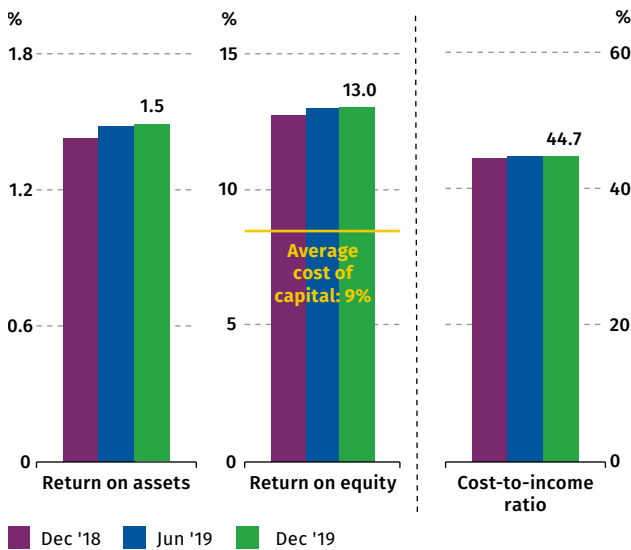
bond market amid declining yields in the second half of 2019 drove higher trading and investment income. The growth in fee and commission income has also been consistent with recent strides by banks to diversify revenue sources through the cross-selling of wealth management and insurance products.

In contrast, growth in net interest income from financing activities, which contributes the bulk (about two-thirds) of banks' gross income, moderated amid slower credit growth and further compression in banks' interest margins.⁴ Following the cuts in the Overnight Policy Rate (OPR) in May 2019 and the first quarter of 2020, slower adjustments to banks' funding costs (compared to the repricing of floating-rate loans)

⁴ For a broader discussion on trends affecting banks' interest margin, refer to the Financial Stability Review 1H 2019 Box Article 'Malaysian Banks' Profitability - Past Trends and Future Prospects'.

Chart 2.2: Banking System – Profitability

Banks sustained healthy profitability



Note: The average cost of capital for Malaysian banks refers to the average expected annual stock returns for all listed banks estimated using a Capital Asset Pricing Model

Source: Bank Negara Malaysia

will weigh on interest margins.⁵ However, with banks remaining generally prudent in their risk-taking, the drag on banks’ earnings is expected to be cushioned by higher non-interest income, continued loan growth and lower debt-servicing burdens of borrowers. The reduction in net interest income from the lower benchmark policy rate is therefore expected to be largely manageable for banks.

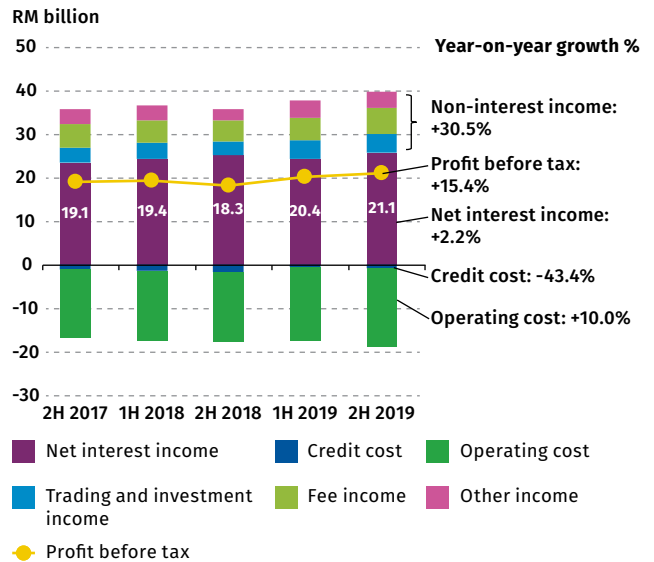
Interest rate risks in both the trading book and the banking book also remained low despite higher holdings of corporate bonds and negotiable instruments of deposit by several domestic banking groups. This reflects the active risk management and hedging strategies of banks, which have continued to contain exposures to levels well within prudent loss limits set individually by banks.

Banks continue to keep a firm lid on operational costs with sustained efforts to streamline and automate business processes as well as optimise their physical branch presence. On aggregate, the operating cost-to-income ratio remains stable at 44.7%.

⁵ This is also partly due to the increased stability of banks’ funding profile in recent years. Banks now have a greater share of sticky and longer-tenure fixed deposits, following the implementation of the Bank’s Liquidity Coverage Ratio and impending Net Stable Funding Ratio requirements.

Chart 2.3: Banking System – Income, Cost and Profit before Tax

Growth in banks' profits was driven by non-interest income



Note: Year-on-year growth computed based on figures for 2H 2019 and 2H 2018

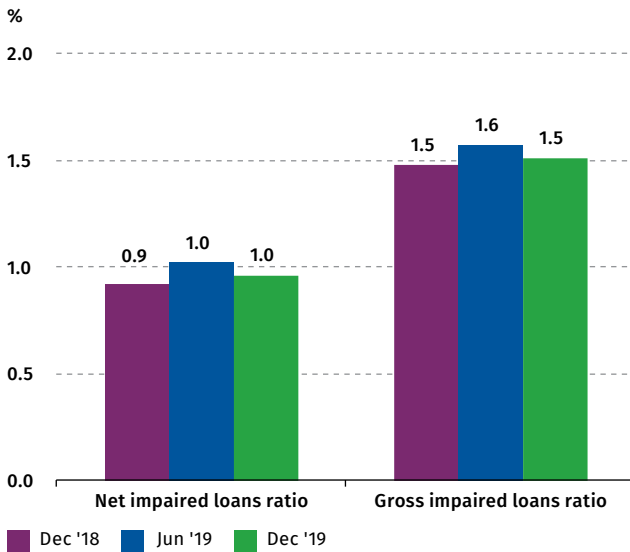
Source: Bank Negara Malaysia

Potential credit and market losses within financial buffers of banks

Impairments remain low across most credit portfolios and have been stable as a share of total banking system loans at 1.5% (Chart 2.4). As earlier noted, there has been some deterioration in loan performance in specific segments of the household and business sectors, but potential losses remain within the financial buffers of banks (for further details, refer to the credit risk section). In the wake of the COVID-19 pandemic, banks are expecting an increase in the share of restructured and rescheduled loans, particularly by borrowers in the business segments that have been most affected by the pandemic. This is likely to increase provisions over the short-term. Banks are well-positioned to absorb the potential impact on profitability, given the prudent provisioning buffers built up over the years. Total provisions including regulatory reserves held by banks against credit losses stood at RM33.9 billion or 126.4% of impaired loans as at end-2019 (Chart 2.5). Active monitoring and recovery efforts also saw several banks record impairment reversals on selected large credit accounts in December, thus sustaining overall asset quality.

Chart 2.4: Banking System – Asset Quality

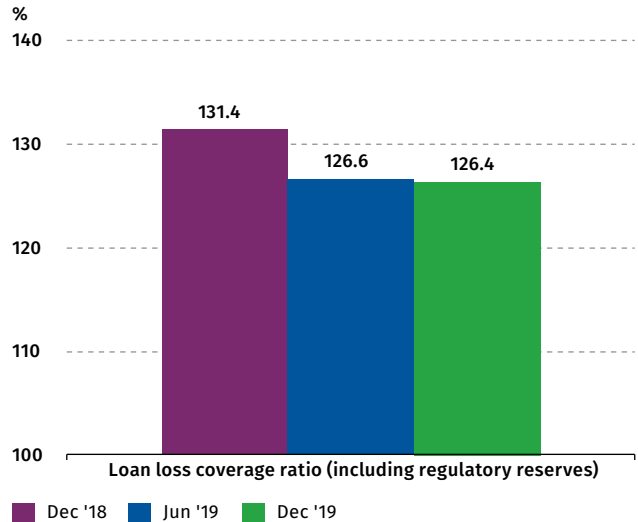
Impairment ratios remain low



Source: Bank Negara Malaysia

Chart 2.5: Banking System – Provisions

Banks continued to maintain strong buffers against potential credit losses



Source: Bank Negara Malaysia

Risks from DBGs’ overseas operations remained low despite the subdued regional economic environment

Weaker regional economic conditions affected the performance of domestic banking groups’ (DBGs) overseas operations⁶ in the second half of 2019 (Chart 2.6).

DBGs’ operations in Singapore, which account for almost half of total overseas assets (Chart 2.7), continued to face headwinds amid the challenging operating environment. The impairment ratio remained elevated at 3.8% (June 2019: 3.5%) due to higher new impairments relative to recoveries during the period. In Indonesia, DBGs recorded higher loan loss provisions amid the more moderate domestic growth performance with the impairment ratio rising to 4.1% (June 2019: 3.6%). Notwithstanding this, banking operations in Indonesia remained profitable as reflected by the weighted average return on equity of 9.8% (June 2019: 10.4%).

⁶ Refers to DBGs’ overseas offices (branches and subsidiaries) operating outside of Malaysia and Labuan International Business and Financial Centre (LIBFC). Cumulatively, DBGs have presence in 14 overseas jurisdictions, with major operations in Singapore, Indonesia, Thailand and Hong Kong SAR.

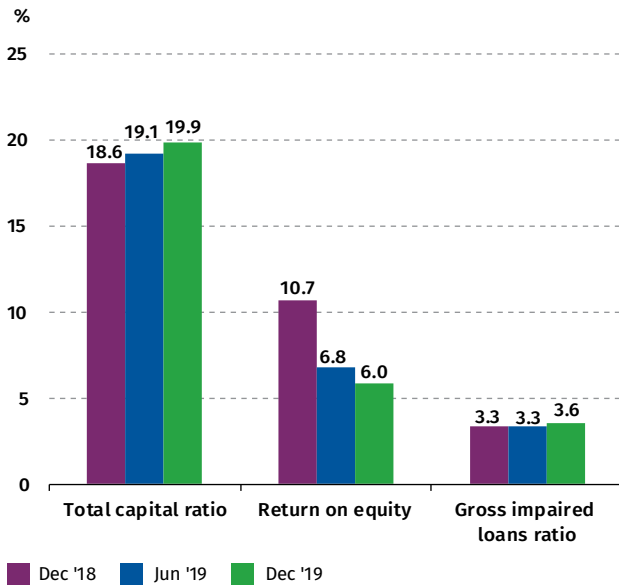
Meanwhile, the impact from heightened social unrest and political uncertainties in Hong Kong SAR has been limited as overseas operations in Hong Kong SAR remained small (7.5% share of total overseas assets) relative to other markets. Several DBGs have scaled back treasury and interbank activities, further reducing exposures in Hong Kong SAR (annual asset growth in 2019: -6.8%). DBGs recorded better earnings performance in Thailand (December 2019: 8.6%; June 2019: 7.3%), supported by relatively firm economic conditions, which contributed to higher interest income and improved asset quality.

The economic impact of the COVID-19 pandemic in the region will continue to weigh on the performance of DBGs’ overseas operations. In the first half of 2020, significant measures being taken by authorities to support affected businesses are however, expected to mitigate credit losses to banks. Based on banks’ internal stress tests, the potential impact of a further deterioration in the performance of DBGs’ overseas operations is expected to be manageable as their operations in Malaysia remain the largest contributor (84.5%) to overall profitability.

For 2020, banks are expecting weaker credit growth compared to 2019. This remains significantly dependent on the duration of the COVID-19 pandemic. While the impact of COVID-19

Chart 2.6: Banking System – Key Financial Indicators of Overseas Operations

Overseas operations remained profitable despite weaker economic conditions

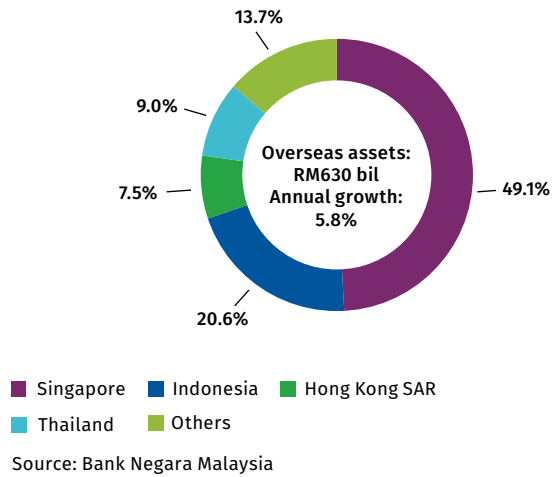


Note: The average key financial indicators are weighted by the asset size of selected overseas operations
 Source: Bank Negara Malaysia

on the economy is likely to be significant in the short-term, banks are entering this period from a position of strength, with significant capital and liquidity buffers. The prudent management of credit risks and diversified income sources will provide support to profitability. In addition, banks’ digitalisation strategies are expected to drive further operational efficiencies, lending additional support to long-term profitability and overall viability.

Chart 2.7: Banking System – Asset Composition of Overseas Operations

Overseas operations continue to be largely concentrated in Singapore and Indonesia



In response to the COVID-19 pandemic, the Bank also announced a series of regulatory measures in support of banks’ efforts to assist affected households and businesses. Banks have been allowed to draw down on capital and liquidity buffers, to support lending activities. These buffers, which have been built up over the years, along with liquidity management by the Bank, have placed banks in a strong position to support the economy during these challenging times. The sustained profitability of banks, underpinned by sound underwriting and risk management practices, will also help banks gradually restore their buffers once the flexibilities are lifted.

THE INSURANCE AND TAKAFUL SECTOR

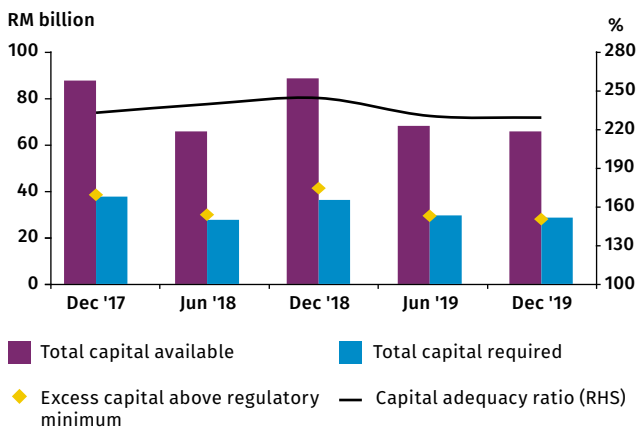
The Insurance and Takaful Sector Remains Well-capitalised

The insurance and takaful sector maintained strong capital buffers throughout the second half of 2019, well above the prescribed regulatory level of 130% (Chart 2.8). Capital buffers held against insurance and takaful risk, the largest component of total capital required, have remained largely stable in line with the relatively benign claims environment. However, the low interest rate environment in recent years has increased the capital buffers that insurers and takaful operators (ITOs) are required to hold against market risk exposures. While this could pose some challenges, particularly for the performance of life insurance and family takaful funds if interest rates fall further, it is not expected to have a material impact on insurers' profitability or solvency (refer to the Information Box on 'Assessing the Impact of Declining Interest Rates on Life Insurers' Solvency Positions').

Profits in the life insurance and family takaful sector were supported by investment gains from holdings of debt instruments

Chart 2.8: Insurance and Takaful Sector – Capital Adequacy Ratio

Aggregate capital adequacy ratio remained well above the regulatory minimum of 130%



Source: Bank Negara Malaysia

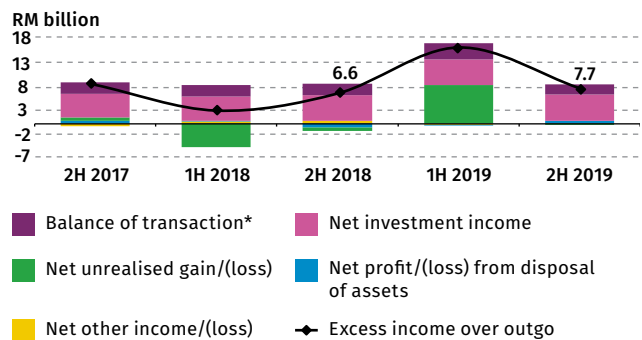
On aggregate, the insurance and takaful sector recorded higher profits⁷ in the second half of 2019 compared to the same period in 2018. This was mainly attributed to better performance in the life insurance and family takaful sector (Chart 2.9) arising from gains on investments in debt instruments as interest rates declined. Overall returns on investments correspondingly trended higher (2H 2019: 2.6%; 2H 2018: 1.9%), offsetting the weaker performance of insurers' equity investments.

Life insurers and family takaful operators' income continued to be underpinned by growth in net premiums from both existing and new business. New premiums sustained the strong growth recorded in the first half of 2019, driven by higher sales of ordinary takaful policies, and non-participating endowment and term-life products (Chart 2.10). The strong growth of ordinary family takaful business largely reflected sustained sales of mortgage and credit-related takaful products during the period.

Investment-linked business sustained its growth at 7% for the full year of 2019. Despite adjustments to new regulatory requirements⁸ to improve policyholder outcomes which came into effect in July 2019, new

Chart 2.9: Life Insurance and Family Takaful Sector – Composition of Income and Outgo

Higher excess income over outgo driven by net unrealised gains



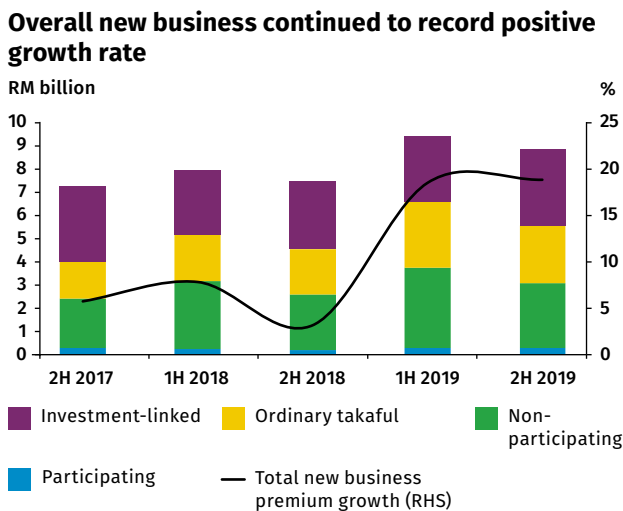
* Excess of net premium after deducting benefit payouts, agency remuneration and management expenses

Source: Bank Negara Malaysia

⁷ For life insurance and family takaful business, profits refer to excess income (net premiums) over outgo (benefit payouts, agency remuneration and management expenses) of the life insurance and family takaful funds.

⁸ ITOs have to comply with requirements on the Minimum Allocation Rate, which specifies the minimum proportion of premiums/contributions for investment-linked policies/certificates to be allocated to the unit funds, and the Sustainability Test, which requires investment-linked premiums/contributions to be set at sustainable levels to ensure coverage is able to last for the entire expected term. These requirements will be implemented in phases from July 2019 to July 2020.

Chart 2.10: Life Insurance and Family Takaful Sector – New Business Premium Growth and Product Composition



Source: Bank Negara Malaysia

business performed better (+11%) in the second half of 2019 relative to the same period last year. It remains too early to assess the impact of the requirements on longer-term profitability. However, ITOs have taken various measures to manage the impact, including refining their product designs, increasing reinsurance/retakaful support or rebalancing business portfolios. This is expected to mitigate any longer-term effects on profitability although the extent of adjustments by ITOs will only become clearer in the coming year.

Business performance also benefitted from improvements in persistency following the implementation of the Balanced Scorecard (BSC) initiative, which better aligns sales incentives with the quality of advice provided to individuals who buy insurance or takaful products. In 2019, more than 800 additional agents recorded persistency rates⁹ above 90% in the first year. Continued improvements in sales practices driven by the BSC are expected to lend support to premium growth while reducing mis-selling risks.

In the general insurance and takaful sector, profitability declined in the second half of 2019 mainly due to higher motor claims paid (+6%) (Chart 2.11). Going forward, several factors are expected to continue to drive higher claims in the motor segment. Amendments to the Civil Law Act 1956 and the Compendium of Personal Injury

⁹ Refers to a new product sold/marketed (other than a single premium or contribution product) which remains in force at the end of the following policy or certificate year.

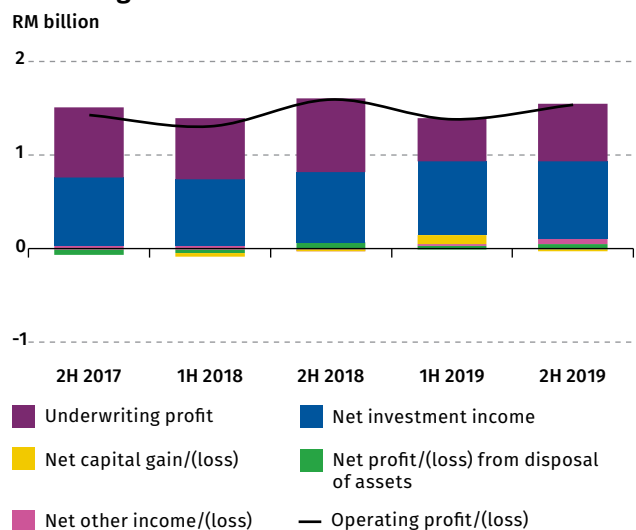
Awards which came into effect in September 2019 and October 2018, respectively, have increased the scope and amount of compensation payable for loss of life, loss of earnings, loss of dependency and personal injury. This is expected to add up to 3.3% to average claims costs for third party bodily injury and passenger liability claims.

Profitability of the general insurance and takaful sector declined due to weaker underwriting performance, particularly in the motor segment

In addition, repair costs for newer vehicle models have continued to trend higher. The increased pricing flexibility accorded to ITOs under the phased liberalisation of Motor Tariffs has partly relieved higher claims cost pressures on overall underwriting performance. However, premium adjustments have largely remained modest, falling within a 10% band around tariff rates for most policies, reflecting both regulatory guidance and competitive pressures in the industry. Ongoing consultations with the Government and industry on the next phase of liberalisation are focusing on providing stronger incentives for road safety

Chart 2.11: General Insurance and Takaful Sector – Composition of Operating Profits

Slight deterioration in operating profits attributed to lower underwriting profit, particularly in the motor segment



Source: Bank Negara Malaysia

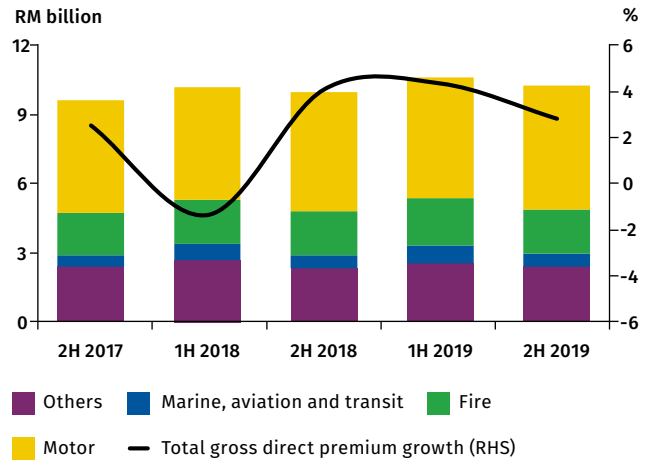
and increasing transparency in the assessment of claims as well as repair costs in order to keep premiums affordable. This remains critical to preserve access to motor insurance without undermining the solvency of ITOs.

The overall performance of general ITOs continues to be largely supported by premium growth in the motor and fire segments which collectively account for more than 70% of total premiums (Chart 2.12). In 2019, premium growth in these segments moderated slightly in line with lower motor vehicle sales and more competitive pricing of new fire products.¹⁰ The gradual liberalisation of the fire tariffs could pose continued pressure on profits although ITOs are expected to maintain positive underwriting margins given the historically favourable claims experience.

The COVID-19 pandemic and the consequent impact on economic activity and financial markets will adversely affect premium and contribution growth in 2020. In response to the pandemic, the Bank has also supported a number of measures by ITOs to preserve continuous coverage for policyholders and takaful participants who are experiencing financial constraints as a result of the pandemic. These include additional flexibility for policyholders and takaful participants to reinstate or make alterations to their policies in order to preserve coverage, the waiver of certain fees and charges, and the option of deferring payments of premiums and contributions without affecting their coverage.

Chart 2.12: General Insurance and Takaful Sector – Gross Direct Premium Growth and Product Composition

Gross direct premium grew at a slower pace



Source: Bank Negara Malaysia

Based on internal assessments, the impact of the slower premium and contribution growth and relief measures can be absorbed by the ITOs without affecting claims paying ability. The Bank has also taken steps to reflect planned enhancements to the capital framework for ITOs which aim to improve the risk capture and overall consistency of the framework. These enhancements are expected to cushion any impact of the relief measures on solvency, and reduce risks of pro-cyclical behaviour by ITOs in response to significant volatility experienced in the financial markets. The measures taken are expected to enable ITOs to continue supporting households and businesses in managing their risks through these exceptional circumstances.

¹⁰ Under the phase 1 of the tariff liberalisation, general ITOs are able to introduce new products and add-on covers priced at market-determined rates.

Assessing the Impact of Declining Interest Rates on Life Insurers' Solvency Positions

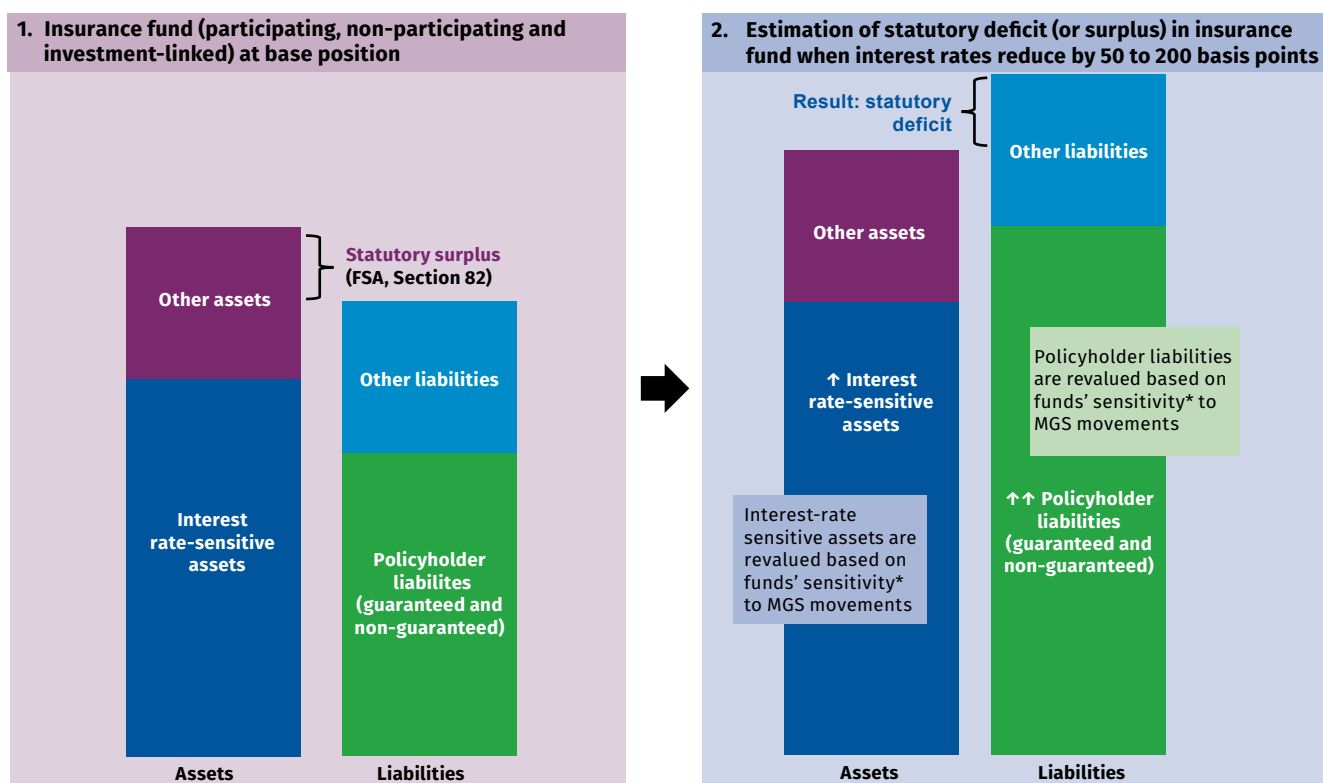
Background

Life insurance companies generally operate with a negative duration gap given the lack of long-term financial assets available to match the duration of their liabilities arising from products with much longer policy terms of more than 15 years. As a result, declining interest rates can have a bigger impact due to upward adjustments in the value of liabilities¹¹ that exceed assets. This in turn will reduce a life insurer's solvency position. Given the prolonged low interest rate environment, a sensitivity analysis was carried out to assess Malaysian life insurers' solvency positions under declining interest rate scenarios.

Methodology

The sensitivity analysis assessed the change in value of life insurers' assets and liabilities for each fund (i.e. participating, non-participating and investment-linked funds) following parallel declines in interest rates ranging from 50 basis points (bps) to 200 bps. The assessment is undertaken separately for each fund in line with requirements¹² for insurers to maintain minimum solvency positions at the fund level. In assessing the impact on funds' solvency positions, the assessment excludes additional buffers within shareholders' funds and fungible surpluses from other funds that can typically be applied to offset any deficit that might arise. Results at the fund level are then used to estimate the impact to the capital adequacy ratio (CAR) at the company level. For this analysis, the value of non interest rate-sensitive assets is assumed to remain constant. This assumption is considered conservative as assets such as equities and properties typically appreciate in value when interest rates decline (Diagram 2.1).

Diagram 2.1: Illustration on Sensitivity Analysis Approach



* Sensitivity refers to the expected changes in valuation of assets and liabilities of a particular fund as interest rates move downwards by 100 basis points

Source: Bank Negara Malaysia

¹¹ Insurance liabilities are derived by computing the net present value of future benefit payouts and expenses. The risk free rate or the internal rate of return are typically used as the discount factor.

¹² Based on the Financial Services Act 2013 (FSA), all licensed insurers are required to maintain assets in an insurance fund of a value equivalent to or higher than the liabilities of that fund.

Results and findings

Based on the sensitivity analysis, the Malaysian life insurance sector is expected to remain resilient with the aggregate industry CAR sustained above the prescribed regulatory level of 130% even under a scenario of 200 bps parallel decline in interest rates. The results reflect the favorable claims experience and relatively strong pricing power that life insurers have. Out of 42 funds offered by all 14 life insurers, only four insurance funds of three life insurers were insolvent under the different scenarios. In aggregate, these funds account for 1.5% of the total value of all life insurance funds (Table 2.1). In each case, the insurance companies have adequate capital buffers to support the insolvent funds.

Table 2.1

Impact of Interest Rate Reduction on Insurance Funds' Solvency

Interest Rate Reduction (bps)	Number of Funds Becoming Insolvent			Size of Insolvent Funds (% of Total Life Insurance Industry Fund)
	Participating	Non-participating	Investment-linked	
-50	-	-	-	-
-100	-	-	-	-
-150	-	2	1	0.8
-200	-	3	1	1.5

Source: Bank Negara Malaysia

The impact of interest rate shocks on individual funds, largely depends on the type of fund (Table 2.2), which influences the expected cash flows and discount rates applied. The impact on non-participating funds was the most pronounced relative to other funds given that their liabilities are all guaranteed and hence, are valued using risk-free discount rates i.e. MGS yields.

Participating funds on the other hand, were less sensitive to interest rate movements relative to non-participating funds. This reflects the nature of a participating policy, which comprises both guaranteed and non-guaranteed benefits. Non-guaranteed benefits represent the share of the insurer's business profits attributable to the policyholders, which may vary over time depending on the fund's business and investment performance. They are valued using a fund-based yield (FBY), which is more closely aligned to the risk profile and outlook of the participating fund, as the discount rate. The resulting valuation changes from a movement in the FBY therefore tends to be less sensitive to changes in interest rates compared to non-participating funds.

Investment-linked funds are also less sensitive to lower interest rates compared to non-participating funds. This reflects the feature of an investment-linked policy where any increase in the cost of insurance is borne by the policyholder's unit investment fund. If the policyholder's unit investment fund becomes depleted, the policy will lapse and the corresponding insurance liability of the insurer will cease. This reduces the expected amount of future net outflows and liabilities for the insurer.

Table 2.2

Average Sensitivity of Insurance Funds to 100 bps Decline in Interest Rates

	Participating	Non-participating	Investment-linked
Assets (%)	+8.0	+8.6	+5.9
Liabilities (%)	+12.4	+15.8	+7.4

Source: Bank Negara Malaysia

MULTI-YEAR SOLVENCY STRESS TEST FOR BANKS AND INSURERS

Stress Test Affirmed Resilience of Financial Institutions

The Bank's multi-year solvency stress test exercise examines the potential impact of prolonged financial and macroeconomic strains on the resilience of individual banks and insurers, and the overall financial system. Similar to previous exercises, the latest stress test contains three scenarios, one baseline and two distinct adverse scenarios, over a four-year horizon (2020-2023). The scenarios were designed to be sufficiently severe, with low likelihood to occur (for details, refer to the Information Box on 'Solvency Stress Test Scenarios, Key Assumptions and Shock Parameters'). While unfolding developments surrounding COVID-19 have been unprecedented, the economic impact of these developments over the stress test horizon is likely to be captured by the range of shocks applied under the adverse scenarios. For added conservatism, the stress test exercise does not incorporate any additional policy intervention by the Government,¹³ the Bank or other authorities, nor management actions by the financial institutions themselves that could be taken to preserve the resilience of financial institutions under stress. In all likelihood, should the stress scenarios materialise, financial institutions and authorities will take mitigating actions that would improve the outcome of the exercise.

Results from the latest exercise affirm that the banking and insurance sector is able to withstand extreme stress, with existing capital levels and earnings buffers sufficient to absorb potential losses and support lending activity. The capital buffers of banks and insurers in excess of the

regulatory minima stood at RM121 billion and RM23.6 billion respectively,¹⁴ more than double the buffers during the Global Financial Crisis in 2008. Given the continually evolving nature of the COVID-19 response both domestically and globally, the Bank will be updating the stress tests at individual bank level to ensure that they reflect relevant tail-end and major known risks as more clarity emerges on the duration and severity of the pandemic.

Financial system remains resilient under simulated adverse macroeconomic and financial conditions

At the end of the four-year stress horizon, the banking system's capital ratios remained above regulatory minima (Chart 2.13). Nearly 90% of losses are credit-driven, as loan impairments increase significantly under severe macroeconomic conditions (Chart 2.14). Similar to past exercises, banks incur limited losses from other risk drivers (Chart 2.15).

Similarly, the insurance sector is able to maintain capital adequacy ratios (CAR) above the regulatory minima (Chart 2.16). For life insurers, market risk shocks are the largest loss driver, reflecting their significant holdings of financial assets that are susceptible to market valuation changes. For general insurers, shocks related to higher motor claims contribute significantly to a reduction in capital through weaker operating profitability (Diagram 2.2).

¹³ Including servicing guarantees extended for debt held by financial institutions.

¹⁴ As at February 2020 for banks and as at end-2019 for insurers.

Chart 2.13: Banking System – Post-shock Total Capital Ratio

Post-shock capital ratios remain above regulatory minima

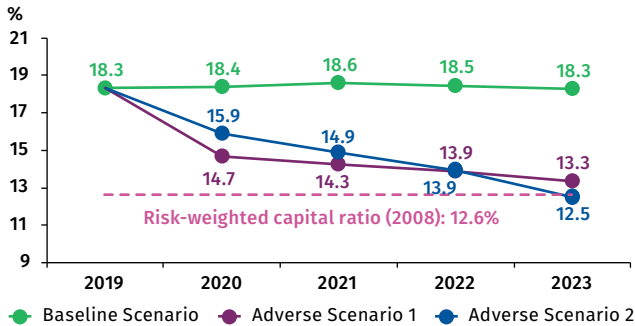


Chart 2.14: Banking System – Post-shock Gross Impaired Loans Ratio

Loan impairments expected to rise sharply under adverse conditions

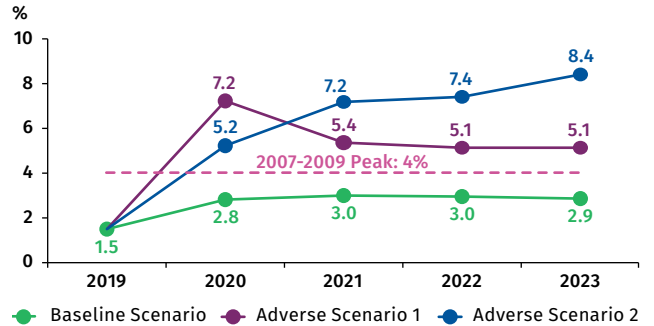


Chart 2.15: Banking System – Loss Drivers in Adverse Scenario 2

Nearly 90% of losses are credit-driven

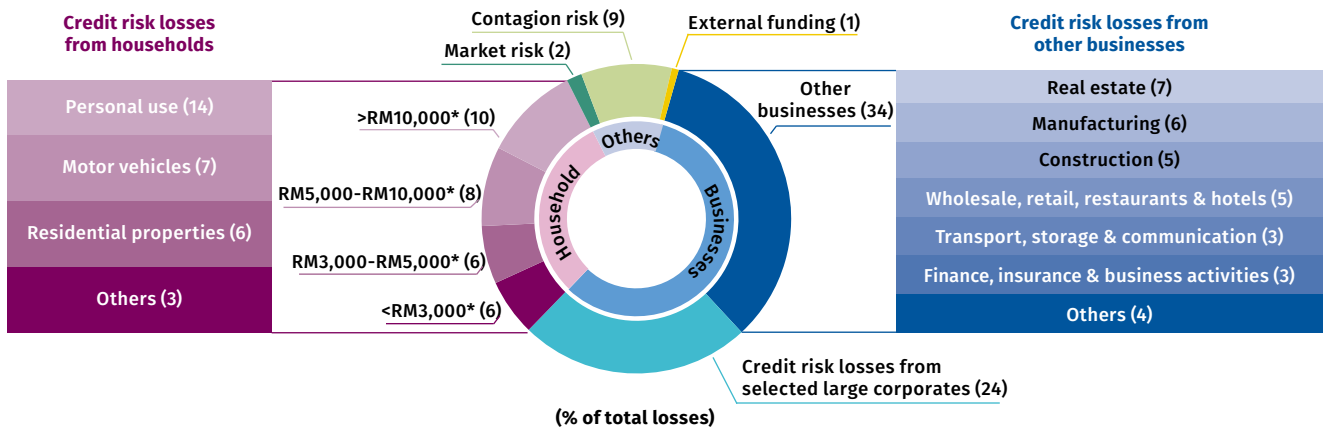


Chart 2.16: Insurance Sector – Post-shock Capital Adequacy Ratio

Post-shock CAR remain above regulatory minimum of 130%

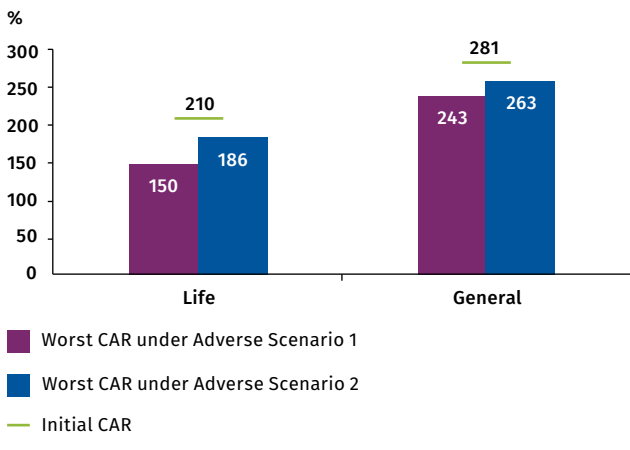
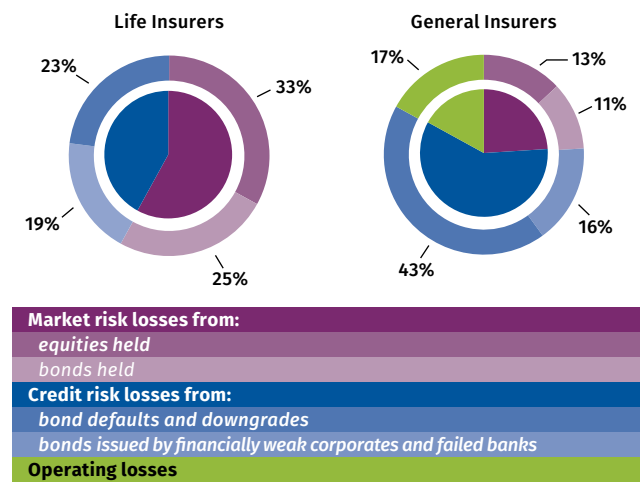


Diagram 2.2: Insurance Sector – Loss Drivers in Adverse Scenario 1



* Households monthly income groups
Source: Bank Negara Malaysia

Solvency Stress Test Scenarios, Key Assumptions and Shock Parameters

The first adverse scenario (AS1) simulates a V-shaped GDP growth path, in which Malaysia is assumed to experience a sharp recession with a magnitude equivalent to 2.5 standard deviations from the baseline growth in the first year of stress. This simulates a recession more severe than that experienced during the 2008 Global Financial Crisis. Under this scenario, shocks to global growth spill into the domestic economy, leading to lower income for households and firms, weaker business and consumer sentiments and severe stress in financial markets. This is followed by a strong rebound in the following years, amid positive counter-cyclical policy responses and improving sentiments.

In the second adverse scenario (AS2), an L-shaped growth path is simulated with a cumulative decline of 6 standard deviations spread across over four years. This scenario assumes an environment of prolonged sluggish growth, which will adversely impact income, wealth and sentiments over an extended period, as policy responses are either minimal or significantly underwhelming. Again, there is a deliberate focus on conservatism in this stress scenario, as the Government is likely to roll out sizeable measures to address the weakness in the economy.

Table 2.3

Solvency Stress Test Scenarios, Key Assumptions and Shock Parameters

Key Assumptions	AS1 – V-shaped Recession	AS2 – L-shaped, Protracted Recession
Balance sheet and income projections <ul style="list-style-type: none"> o Weaker annual loan growth o Annual decline in banks' income growth, differentiated across segments o Annual decline in insurers' premium income 	<ul style="list-style-type: none"> o Drops to as low as +0.5% o Up to 48% o Up to 46% 	<ul style="list-style-type: none"> o Drops to as low as -2.1% o Up to 21% o Up to 33%
Credit risk shocks <ul style="list-style-type: none"> o Probability of default (PD) <ul style="list-style-type: none"> • Business loans • Household loans o Loss given default (LGD) <ul style="list-style-type: none"> • Business loans • Household loans o Default of selected non-financial corporates with large borrowings from the financial system 	<ul style="list-style-type: none"> • 5% to 10% • 1% to 14% • 45% to 54% • 18% to 90% o Corporations that have weak financial standings (below prudent thresholds) under simulated shocks 	<ul style="list-style-type: none"> • 6% to 12% • 1% to 13% • 46% to 58% • 17% to 89%
Market risk shocks <ul style="list-style-type: none"> o Annual increase in MGS yields o Annual increase in corporate bond yields o Annual decline in FBM KLCI o Annual depreciation against major currencies 	<ul style="list-style-type: none"> o Up to 86 bps o Up to 103 bps o Up to 34% o 10% to 19% 	<ul style="list-style-type: none"> o Up to 71 bps o Up to 79 bps o Up to 17% o 4% to 8%
External funding risk shock <ul style="list-style-type: none"> o Reversal of claims by non-resident banks 	<ul style="list-style-type: none"> o Up to 30% of borrowings and deposits 	<ul style="list-style-type: none"> o Up to 15% of borrowings and deposits
General insurance risk shock <ul style="list-style-type: none"> o Increase in claims ratio 	<ul style="list-style-type: none"> o Up to 30% 	<ul style="list-style-type: none"> o Up to 16%
Contagion risk shocks <ul style="list-style-type: none"> o Interbank o Banks to insurers 	<ul style="list-style-type: none"> o Deterioration in counterparty bank's solvency o Deterioration in value of bonds issued by banks that failed the stress test under the adverse scenarios 	

Source: Bank Negara Malaysia