Banking Measures Introduced in 2004

In 2004, further initiatives were undertaken to strengthen the safety and soundness of the financial system and promote competition and efficiency in the banking industry. In addition, measures were implemented to ensure continuous access to financing as well as to enhance consumer protection and confidence in the banking sector.

Measures to Enhance Safety and Soundness

Incorporation of Market Risk into the Risk-Weighted Capital Ratio

The market risk capital adequacy framework was issued for implementation in September 2004. The commercial banks, merchant banks, finance companies and discount houses, collectively known as the licensed institutions, are now required to incorporate their market risk positions into the risk-weighted capital ratio (RWCR) and comply with the minimum RWCR by the second quarter of 2005. Even with the incorporation of market risk, the minimum RWCR requirement remains at 8%.

Under this framework, only interest rate risk and equity risk in the trading book are included, while for foreign exchange risk, both trading and banking book positions are incorporated. Nevertheless, licensed institutions are expected to have in place adequate measures to manage their interest rate and equity risk exposure in the banking book. In line with Bank Negara Malaysia's efforts to enhance corporate governance in licensed institutions, the Board is charged with the responsibility of approving policies and strategies on market risk management and ensuring that adequate measures are in place to monitor and control such risks.

Capital Treatment on Holdings of Other Licensed Institutions' Instruments

The capital framework issued in 1989 required holdings of other licensed institutions' capital instruments to be deducted from the capital base. In tandem with the development of the domestic capital market and international regulatory practices, Bank Negara Malaysia revised the capital treatment to facilitate trading and market making activities of capital instruments issued by licensed institutions. The revised capital treatment, issued in July 2004, specified that the holdings of other licensed institutions' capital instruments would be exempted from capital deduction if it does not exceed 10% of the licensed institution's capital base. However, the capital treatment for the holdings of capital instruments issued by related companies or companies within the same banking group remains unchanged.

Regulatory Treatment for Residential Mortgage-backed Securities

The regulatory treatment, issued on 17 September 2004, accorded a 20% risk weight for the first tranche of residential mortgage-backed securities issued by Cagamas MBS Berhad, a wholly-owned subsidiary of Cagamas Berhad, under the RWCR framework. In addition, holdings of subordinated residential mortgage-backed securities are required to be deducted from capital base. Holdings of residential mortgage-backed securities issued by Cagamas MBS Berhad together with other credit facilities granted to Cagamas MBS Berhad are subjected to the single customer credit limit of licensed institutions.

Regulatory Treatment for Ringgit-denominated Bonds Issued by Multilateral Institutions

Issued in October 2004, ringgit-denominated bonds issued by Multilateral Development Banks and Multilateral Financial Institutions were accorded a 0% risk weight under the RWCR framework and classified as liquefiable assets under the New Liquidity Framework.

Implementation of Basel II

In April 2004, Bank Negara Malaysia announced the implementation approach and timeline of the new Basel Capital Accord (Basel II). Basel II would be implemented in two phases. In particular, as a minimum, banking institutions will be required to implement the Standardised Approach for credit risk and basic indicator approach for operational risk under Basel II in 2008. However, banking institutions which meet the requirements set by Bank Negara Malaysia will be allowed to adopt the Internal Ratings Based approach in January 2010 without having to comply with the Standardised Approach for credit risk in 2008. The decision whether to migrate directly to the Internal Ratings Based approach in 2010 rests entirely with the Board of Directors based on the banking institution's gap and impact analysis as well as cost-benefit considerations. In September 2004, the minimum requirements on governance structure, gap analysis and development of implementation plans with regard to Basel II were issued to the banking institutions.

Guidelines on Minimum Security Standards for Cheques

As part of Bank Negara Malaysia's continuing efforts to combat rising cheque frauds and to maintain consumers' confidence in using cheques, various measures were undertaken to deter counterfeiting and fraudulent alterations of cheques as well as to facilitate easier detection of such activities. Bank Negara Malaysia issued, in July 2004, the Guidelines on Minimum Security Standards for Cheques which specify the minimum requirements with regard to the role of banking institutions in payment and collection of cheques drawn by or paid in by customers. In addition, the Guidelines set the minimum standards for security features on cheques, cheque fraud detection facilities and security management in cheque printing. Banking institutions are also expected to educate consumers on the risks involved in the use of cheques and the safeguards to be adopted to help prevent cheque fraud.

Guidelines on Management of IT Environment (GPIS 1)

To strengthen and enhance the level of information technology (IT) management in banking institutions, Bank Negara Malaysia issued GPIS 1 in May 2004. The Guidelines place the responsibility on the Board and senior management in implementing good IT governance and risk management practices. The Guidelines set the minimum requirements on system security, system development and operations in an IT environment to ensure appropriate controls are in place to safeguard the institution's systems, data and information. To ensure timely resumption of critical IT operations in the event of a disaster, banking institutions are required to establish an appropriate business resumption and contingency plan. The implementation of the requirements and best practices would enable the institutions to minimise the risks associated with service interruptions, unauthorised access to customers' information, fraud and loss of customers' confidence.

Disaster Recovery Capabilities of Banking Institutions

In July 2004, Bank Negara Malaysia initiated a survey covering 25 institutions to assess the state of readiness of banking institutions' disaster recovery capabilities and to gather information on recovery strategies. The findings of the survey were shared with the industry to further improve their IT disaster resumption arrangements. Bank Negara Malaysia will continue to review the business resumption contingency plans of banking institutions during its on-site IT audit and monitor the testing of disaster recovery plans through reports submitted by banking institutions.

Measures to Enhance Competition and Efficiency in the Banking Industry

New Interest Rate Framework

To enhance the effectiveness of the monetary policy transmission process and the efficiency of financial market operations, Bank Negara Malaysia introduced a new interest rate framework in April 2004. The framework also aims to facilitate more efficient pricing of financial products. Effective 26 April 2004, the ceiling on Base Lending Rate (BLR) and the maximum lending spread of 2.5 percentage points above the BLR or cost of funds were removed. Banking institutions were given the flexibility to determine the BLR based on their own cost structure and lending strategies. This flexibility is expected to facilitate greater product innovation and customisation within the banking industry to meet the differentiated needs of the growing economy.

Revised Regulatory Treatment for New Cagamas Debt Securities

As a measure to further improve the efficient functioning of the domestic bond market, Bank Negara Malaysia revised the regulatory treatment for new Cagamas debt securities issued after 4 September 2004. The risk weight for holdings of new Cagamas debt securities was increased from 10% to 20% under the RWCR framework. In addition, holdings of new Cagamas debt securities together with other credit facilities granted to Cagamas Berhad are subjected to the single customer credit limit of licensed institutions.

Single Customer Credit Limit – Discount Houses

With effect from 1 October 2004, the Single Customer Credit Limit (SCCL) requirement was extended to the discount houses to ensure excessive exposure in holdings of Private Debt Securities (PDS) to a single issuer is avoided. The SCCL imposed on a single issuer is set at 35% of the approved capital funds of the respective discount houses for all new investments in PDS.

Deduction of Ringgit Debt Securities from Eligible Liabilities

In October 2004, commercial banks and merchant banks were allowed to deduct their holdings of the following ringgit-denominated debt securities in the trading book from eligible liabilities in the computation of Statutory Reserve Requirement (SRR):

- Specified RENTAS securities issued through the Principal Dealers network;
- All corporate debt securities including Cagamas securities; and
- Ringgit-denominated securities issued by Multilateral Development Banks and Multilateral Financial Institutions.

The deduction would reduce the holding cost of these papers for the commercial banks and merchant banks. This aims at promoting secondary trading of such securities in the bond market and levelling the playing field for commercial banks and merchant banks with that of the other players in the bond market.

Innovative Tier-1 Capital Instruments

Effective December 2004, licensed institutions are allowed to issue innovative Tier-1 capital instruments for inclusion in Tier-1 capital under the RWCR framework. The issuance of such instruments is, however, subject to the prior approval of Bank Negara Malaysia and the fulfilment of minimum requirements specified in the Guidelines.

Measures to Enhance Consumer Protection

Financial innovation and innovative developments in technology have increased the range and complexity of products and services offered by a myriad of service providers. This in turn, has provided consumers with a wider range of options to manage their personal finances. To ensure that consumers are equipped to make financial decisions that meet their needs and are given a fair deal by financial institutions, Bank Negara Malaysia has put in place a long-term and structured consumer education and protection framework.

Basic Banking Services Framework

To ensure that consumers have access to basic banking services and that these services are provided at minimal costs, Bank Negara Malaysia implemented a basic banking services framework with effect from February 2005. Under this framework, all banking institutions are required to offer at least one basic savings account (BSA) and one basic current account (BCA) to all Malaysians, including permanent residents. The framework provides an account holder with at least 14 free transactions per month, including eight ATM cash withdrawals. In addition, BSA and BCA account holders can perform at least two Interbank GIRO transactions per month at not more than RM0.50 per transaction, while those who subscribe to internet banking services are entitled to unlimited online account enquiries, fund transfers within the same banking institution and payment of bills, at no charge. The basic savings account earns interest irrespective of the account balance.

Imposition of Fees and Charges on Banking Products and Services

In an effort to ensure that consumers and small and medium enterprises (SMEs) have access to financial products and services, apart from the BSA and BCA, at reasonable costs, Bank Negara Malaysia issued Guidelines to govern the imposition of fees and charges by banking institutions in December 2004. Banking institutions are required to obtain the prior approval of Bank Negara Malaysia for any upward revision of existing fees and charges or for any new fees and charges to be imposed on products and services offered to individuals and SMEs. In this regard, banking institutions are required to justify the imposition of or increase in fees and charges as well as the conditions under which the fees may be imposed.

To promote greater market transparency, the Guidelines also require banking institutions to publish all fees and charges imposed on products and services offered to individuals and SMEs at all branches and on their websites. Banking institutions are also required to notify their customers at least 21 days before making any change to the terms and conditions of products and services including fees and charges.

Financial Mediation Bureau

It is important that, in the event of disputes involving products or services offered by financial institutions, consumers have recourse to an inexpensive and effective avenue to seek redress. In this regard, Bank Negara Malaysia spearheaded efforts to enhance the dispute resolution mechanism for consumers to resolve conflicts through an impartial and equitable process.

On 20 January 2005, the Financial Mediation Bureau (FMB) was launched, as a result of the merger between the Banking Mediation Bureau and the Insurance Mediation Bureau and, as such, is an integrated agency for the resolution of disputes against financial institutions under the supervision of Bank Negara Malaysia. The FMB's scope was expanded to cover disputes against Islamic banks, takaful operators, development financial institutions as well as selected payment system operators and non-bank issuers of credit and charge cards to ensure that customers of these financial service providers have access to the dispute resolution mechanism. The scope of the FMB was also expanded with regard to product coverage, type and nature of complaints as well as limits of awards. The FMB provides consumers with a fast and efficient avenue to seek legal redress as an alternative to resolutions through the court process. In addition, consumers benefit from the convenience of a single bureau and consistent processes and procedures applied across the different financial service providers.

Deposit Insurance

In furthering efforts to strengthen the consumer protection framework and enhance the financial safety net of the banking system, Bank Negara Malaysia issued, in November 2004, a concept paper to the banking industry on the introduction of a Deposit Insurance System in Malaysia. The key objective of the deposit insurance system is to provide a reasonable level of protection to depositors on their deposits held with banking institutions. The concept paper detailed some of the features being considered for a deposit insurance system.

Comparative Tables

To facilitate meaningful comparison and minimise the cost of information search amongst consumers, Bank Negara Malaysia has published comparative information on key rates, namely base lending rates, fixed deposit rates and negotiable instrument of deposit rates via BankingInfo website. Moving forward, comparative tables on commonly offered deposit and credit products will be developed.

Concept Paper on Product Transparency and Disclosure

As part of Bank Negara Malaysia's continuous efforts to promote greater market transparency, a concept paper on product transparency and disclosure by the banking institutions was issued in March 2004. Frequently, the risks and costs of financial products and services are not adequately disclosed in the promotional material and that important terms and conditions may not be given due prominence. To ensure that consumers understand the nature and extent of the risks involved, the concept paper requires that the information be worded and presented in a clear, concise and effective manner. Specific information that must be disclosed includes risk factors, yield, pricing, fees and charges, terms and timeliness of information being disseminated to consumers using standard definitions and terminology. The disclosure requirement also applies to advertisements to ensure that the marketing and promotional material are not misleading.

Complaint Handling

Effective complaint handling is vital to ensure that customer complaints are promptly investigated and resolved in a satisfactory manner. Complaints that are carefully recorded and properly analysed to identify the problems and root causes would enable banking institutions to address the shortcomings in their operations. Starting from June 2004, banking institutions are required to submit a half-yearly report on the number and nature of complaints received. Bank Negara Malaysia will continue to play a role in handling customer complaints against banking institutions to ensure that complaints are dealt with promptly and efficiently to ensure customers are treated fairly by banking institutions.

Revised Guidelines on Financial Reporting for Licensed Institutions (BNM/GP8)

Following the issuance of two concept papers to the banking industry, the revised guidelines on financial reporting for licensed institutions were issued for implementation in October 2004. The primary objective of the revised Guidelines is to ensure compliance with international accounting standards and consistent disclosure of all material and exceptional items among financial institutions to facilitate evaluation, assessment and comparison of the financial position and performance of the institutions.

The revised Guidelines set out the minimum disclosure requirements and licensed institutions are encouraged to disclose additional information in their financial statements. The major changes to the Guidelines are as follows:

- Licensed institutions are required to prepare interim financial reports on a quarterly basis;
- Interim financial reports prepared on a quarterly and half-yearly basis are not required to be published in the newspapers. Instead, licensed institutions shall make available the interim financial reports in their websites;
- Licensed institutions are required to segregate their securities portfolio into 'held for trading', 'held-to-maturity' and 'available-for-sale' categories;
- Licensed institutions are given two options to account for their derivative transactions; and
- Interest accrued and recognised as income prior to the date the loans are classified as non-performing shall be reversed out of income. Subsequently, interest earned on non-performing loans shall be recognised as income on a cash basis.

The first set of financial statements prepared under the revised BNM/GP8 would be for the financial year ending 31 December 2005.

Measure to Improve Access to Financing

Upliftment of Restrictions on the Provision of Bridging Finance for Property Development

The restrictions on the provision of bridging finance facilities for property development, introduced in 1999 to address the property market overhang, were uplifted in September 2004. To ensure that the upliftment does not lead to oversupply in the property market, banking institutions are required to consider the impact of the project that it proposes to finance on the property market in the surrounding vicinity. This is in addition to the standard viability assessment on the project itself. Banking institutions are also required to provide its board of directors, whose concurrence is required to approve bridging finance facilities, with adequate information to assess such impact.