

Banking Sector

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Banking Sector

PERFORMANCE OF THE BANKING SECTOR

The banking sector maintained a sound financial position during the year, underpinned by robust governance and risk management. Higher profits amidst sound asset quality contributed to further strengthening of the capital position. The stable funding conditions in 2017 enabled banks to remain supportive of the financial needs of businesses and households.

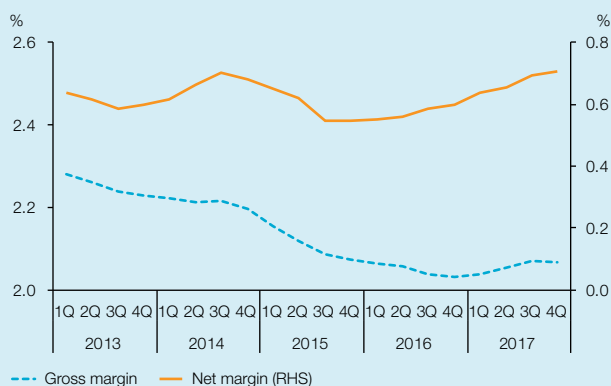
Strong capitalisation and stable funding conditions continued to support financing needs of the economy

The banking sector, including Islamic banks, posted pre-tax profits totalling RM36.2 billion in 2017 (2016: RM32.2 billion). Net interest/finance income increased by 7.8% (2016: 1.9%), reflecting mainly the slower growth of 1.2% in interest/finance expense (2016: 4.7%) as competition for deposits eased. A higher share of demand deposits (2017: 22.1%; 2016: 21.6% of total deposits) also contributed to lower funding costs of banks. Correspondingly, gross interest/finance margin widened marginally by four basis points to 2.11% of interest/finance-related assets (2016: 2.07%) (Chart 2.1). Overall earnings were further boosted by the higher fee-based income from financing-related activities (e.g. credit commitments) and active stock broking activities amidst a vibrant domestic equity market. Fee-based income recorded a double digit growth of 12.5% in 2017 after two years of negative growth (2016: -3.1%; 2015: -4.2%). Following the strong recovery, the share of fee-based income as a percentage of gross income increased to 15.2% (2016: 14.6%).

Increased automation and improved process efficiencies continue to support higher productivity in the banking sector. Pre-tax profits per employee

Chart 2.1: Banking System – Gross and Net Interest Margins

Gross and net interest margins improved slightly



Source: Bank Negara Malaysia

rose by 12.5% for the year to RM305,165 per employee. This was despite higher staff cost (2017: 7.1%; 2016: -6%) as banks sought to retain and hire high-skilled talent in a competitive labour market. Banks also spent a higher amount to upskill the workforce in response to changes in the operating environment and greater use of technology. This was reflected in the higher growth in training cost of 16.7% in 2017 (2016: 3.8%). Overall, the average returns on equity and assets rose to 13% and 1.5% respectively (2016: 12.5% and 1.3%).

Banks continue to maintain a strong level of capitalisation. Healthy earnings, coupled with generally conservative earnings retention policies, have enabled the banking sector to build strong buffers. As at end-2017, all banks reported capital ratios that were well above the minimum requirements specified (Table 2.1, Chart 2.2), including the 2.5% capital conservation buffer (CCB) that will only be fully phased-in beginning 2019. In addition, more than 80% of the sector's total capital is of high quality, in the form of equity, retained earnings and reserves. Tier 1 capital expanded by RM5.4 billion (2.5%), driven primarily

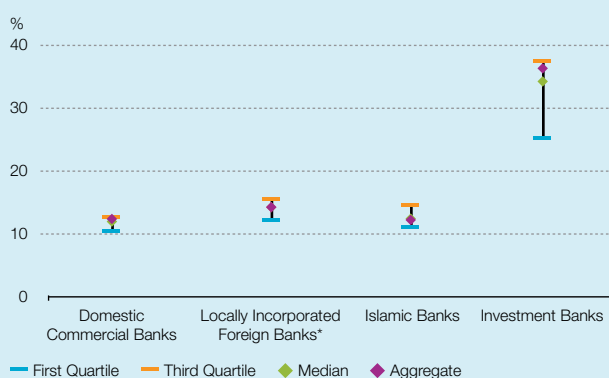
Table 2.1

Banking System: Year-end Capital Ratios

(% of risk-weighted assets)	Minimum	2015	2016	2017
CET1 Capital Ratio	4.5	13.3	13.1	13.3
Tier 1 Capital Ratio	6.0	14.2	14.0	14.3
Total Capital Ratio	8.0	16.6	16.5	17.1
Leverage Ratio (Observation period)	3.0	7.5	7.7	7.8

Source: Bank Negara Malaysia

Chart 2.2: Banking System – CET1 Capital Ratios

Banks maintain high quality capital

* With large operations in Malaysia

Note: Data as at end-2017
Source: Bank Negara Malaysia

by dividend reinvestments and capital injections. Capital buffers (including CCB) for the banking sector as a whole correspondingly strengthened further by 8.3% to RM134.8 billion (2016: 0.2%, RM124.5 billion).

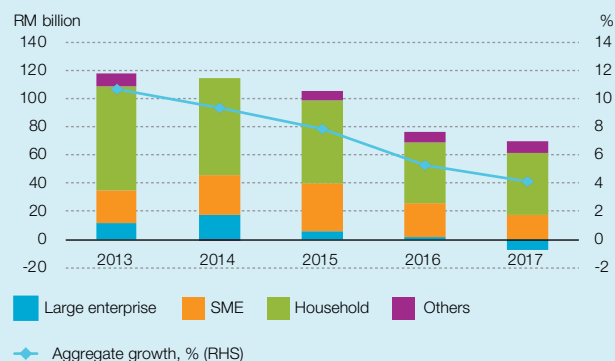
The balance sheet of the banking sector expanded by 4.3% for the year. In the first half of 2017, banks' holdings of Malaysian Government Securities surged by 29.4%, lending support to the local bond market during periods of outflows by non-residents (refer to 'Market Risk' in the Chapter on 'Risk Developments and Assessment of Financial Stability in 2017'). By year-end, banks' holdings of such papers declined slightly to RM168.6 billion (2016: RM147.8 billion). Reflecting the shift towards lower risk assets, banks' risk-weighted assets increased at a slower rate of 0.7% in 2017 (2016: 1.7%). The risk-weighted asset density ratio (risk-weighted assets as a share of total assets) correspondingly declined to 60.9% (2016: 63.1%). The leverage ratio (as reported by banks under the observation period) was nonetheless unchanged at

more than two times the prescribed minimum level of 3% which takes effect on 1 January 2018.

Total outstanding financing by banks grew at a moderate pace of 4.1% for the year (2016: 5.3%) (Chart 2.3). This reflected the slower growth of 1.8% in outstanding business sector financing which offset the steady expansion in financing extended to households at 5.1%. For large businesses, repayments outpaced disbursements as stronger business earnings encouraged large businesses to pare down borrowings for working capital. The moderation in growth of outstanding financing to businesses was observed in most sectors.

Financing extended by banks to small and medium enterprises (SMEs) expanded by 6% in 2017 (2016: 9.5%). Slower growth in financing to SMEs in the construction and real estate sectors, reflecting softer conditions in the property market, contributed to slower overall financing growth for the year. Banks remain supportive of the financing needs of SMEs. During the year, about 104,000 SME applications were approved by banks, resulting in a sustained approval rate of around 77% (2016: 77.3%). The share of SME financing increased to about 53% of total business financing by banks as at end-2017 (2016: 51%). In June 2017, the Bank consolidated four special financing schemes for SMEs (namely the Fund for Small and Medium Industries 2, New Entrepreneurs Fund 2, Fund for Food, and Micro Enterprise Fund) into an omnibus fund called BNM's Fund for SMEs, with total allocation of RM10.1 billion. This was intended to better optimise utilisation of the funds available in response to changing demand from SMEs. Since inception, around RM30 billion financing has been granted to more than 75,000 SMEs for working capital and business expansion. The Bank has also enhanced the features of BNM's Fund for SMEs to

Chart 2.3: Banking System – Growth in Outstanding Financing

Bank financing grew at a moderate pace

Source: Bank Negara Malaysia

Disaster Relief Facility for SMEs

- On 7 November 2017, the Bank activated the Disaster Relief Facility totalling RM500 million to alleviate the financial burden and assist in the resumption of business activities of SMEs affected by floods in Malaysia. Eligible businesses could obtain financing of up to RM500,000 at 2.25% per annum, from 8 November 2017 to 31 May 2018.
- As at end-February 2018, more than 180 applications from SMEs amounting to approximately RM58 million have been approved. Financial institutions have also proactively assisted 353 affected SMEs with debt obligations totaling RM154 million, through repayment moratorium and restructuring and rescheduling of credit facilities.

further assist SMEs with no track record or collateral. Furthermore, access points to the fund were expanded through more participating financing institutions.

Banking sector financing to the household sector sustained an annual growth rate of 5.1% in 2017 (2016: 5.3%). Financing was driven mainly by the purchase of residential properties which grew by 9% (2016: 9.4%), while growth of financing extended for consumption credit (purchase of transport vehicles, personal financing, credit card and purchase of consumer durables) was flat. Eligible borrowers continued to have access to home financing as reflected in the approval rates which have remained above 70% for the past few years.

The asset quality of banking sector loans remained intact throughout the year. Continued improvements in banks' risk management practices have kept delinquencies and impairment at low levels. In 2017, delinquencies, as measured by loans-in-arrears of between one and three months, declined slightly to 2.1% (2016: 2.2%) of total bank loans. The amount of impaired loans (net of individual impairment provisions) similarly decreased by RM104.3 million to account for 1.1% of total loans net of individual impairment provisions as at end-2017 (2016: 1.2%). Banks' provisioning levels remained adequate with a loan loss coverage ratio (including regulatory reserve) of 114.8% (2016: 112.1%).

Measures taken to strengthen financing affordability have helped to maintain the low level of impairment and delinquency ratios for the household sector, which stood at 1% and 1.4% of total household loans respectively (2016: 1.1% and 1.4%, respectively). For the business sector, a deterioration in credit quality was observed during the year in the oil and gas-related exposures. Overall, impairment for the business sector portfolio remained low at 2.5% of total business loans (2016: 2.5%). The improvements in banks'

risk management practices, with more favourable economic and labour market conditions, continued to support overall loan performance with banks' net interest/finance margin (gross interest/finance margin net of impairment provisions and operating costs) improving to 71 basis points (2016: 60 basis points) (Chart 2.1).

DEVELOPMENT OF THE BANKING SECTOR

Initiatives implemented under the Financial Sector Masterplan (2001 – 2010) and the Financial Sector Blueprint (2011 – 2020) have placed the banking sector on a stronger footing to support the needs of the economy. The banking sector is more resilient today, supported by strong institutions. Greater competition has also contributed to improved banking system efficiency.

As Malaysia transitions into a high value-added, high-income economy, the banking sector will continue to assume an enhanced role in supporting this transformation. In line with this, the ongoing and future initiatives will focus on: (i) extending the outreach of financial services in order to create more meaningful access to a wider segment of the population; (ii) developing innovative financing solutions for SMEs; and (iii) leveraging on technology to drive innovation and further efficiency.




Enhancing financial inclusion

Building on the momentum of financial inclusion initiatives over the years, further progress has been achieved in promoting inclusive access to affordable banking services for all segments of the Malaysian population during the year (Diagram 2.1).

The Bank further intensified efforts to increase bank account ownership and utilisation of formal banking services by the public. This focused on: (i) expanding agent banking reach and services

Diagram 2.1

Selected Financial Inclusion Indicators

	10,454	financial access points, serving 99% of the Malaysian population
	96.2%	sub-districts with a population of 2,000 or more have access to basic banking services
	7,193	financial access points provided by authorised banking agents
	31,044	savings accounts opened via authorised banking agents
	136.7 million	financial transactions at authorised banking agents, amounting to RM11.4 billion

Note: Data as at end-2017
Source: Bank Negara Malaysia

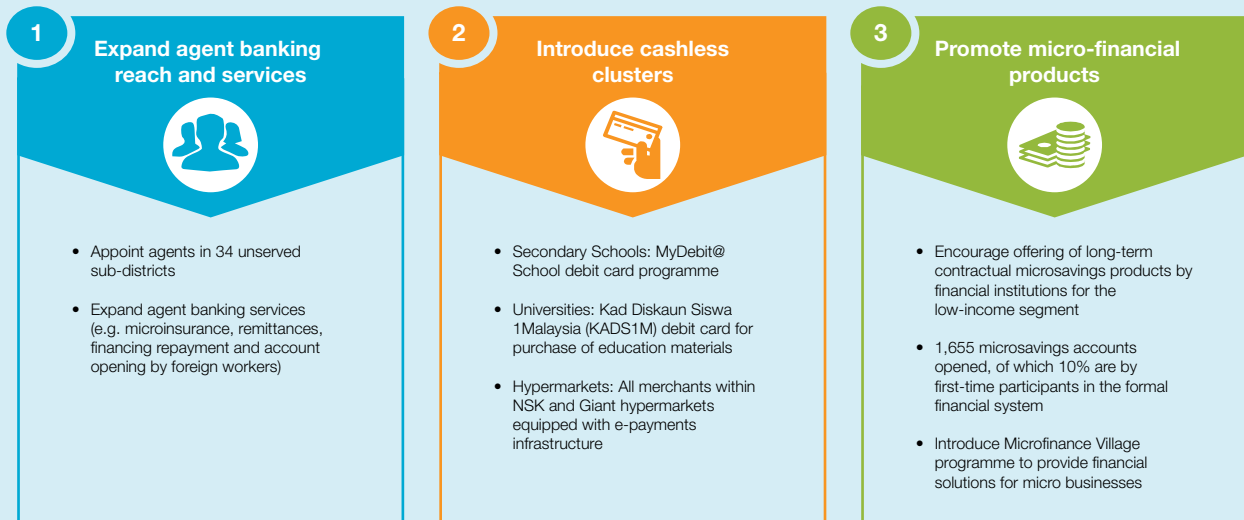
in unserved areas; (ii) introducing cashless clusters to encourage e-payments as a way to bring the unbanked community into the formal financial system; and (iii) promoting micro-financial products (Diagram 2.2).

Focus on increasing bank account ownership and utilisation of formal banking services to further enhance financial inclusion

During the year, the Bank also explored the use of geo-spatial technology and satellite imaging to enhance the identification and monitoring of financial access points in Malaysia. In December 2017, the Bank signed a Memorandum of Understanding

Diagram 2.2

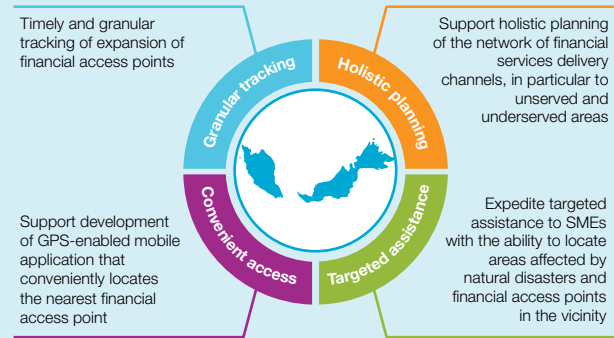
Increasing Bank Account Ownership and Banking Services Utilisation



Source: Bank Negara Malaysia

Diagram 2.3

Benefits from the Application of Geo-spatial Analytics



Source: Bank Negara Malaysia

(MoU) with Remote Sensing Agency Malaysia, an agency under the Ministry of Science, Technology and Innovation to formalise cooperation in this area. Using remote sensing and Geographical Information System technology, a centralised database and online portal will be established to enable the automated mapping of and access to information on all financial access points in the country via satellite imaging. Moving forward, the ability of geo-spatial analytics to overlay information such as administrative boundaries, demographics, infrastructure and topography is expected to further enable financial institutions to improve delivery of financial services. In addition, a GPS-enabled mobile application will allow the public to locate the nearest financial access points conveniently (Diagram 2.3).

Digitalising financial services

The banking sector continued to harness the use of electronic platforms in 2017 to increase efficiency and value-add of financial services offered to consumers. During the year, digital platforms and e-touch points were leveraged to enhance efficiency and convenience in the provision of financial offerings to SMEs. In collaboration with the Bank and financial industry, the Credit Guarantee Corporation Malaysia Berhad developed imSME, Malaysia's first SME financing referral platform. The platform provides SMEs with a one-stop online access point to financing and structured assistance. Launched in February 2018, the platform matches SMEs' financing needs with suitable financing products from various institutions and funds in a seamless and efficient manner. Applications that are unmatched or rejected will be referred to the imSME Financial Advisory Team, which provides structured assistance to SMEs to improve their future financing eligibility and connect them to alternative financing providers (Diagram 2.4). This should significantly ease the process of obtaining financing for SMEs. To date, 15 institutions (banks and development financial institutions) have participated in the imSME platform to offer financial products and services.

Another key initiative to enhance public access to financial information was the launch of eCCRIS on 19 January 2018. eCCRIS is an online platform for

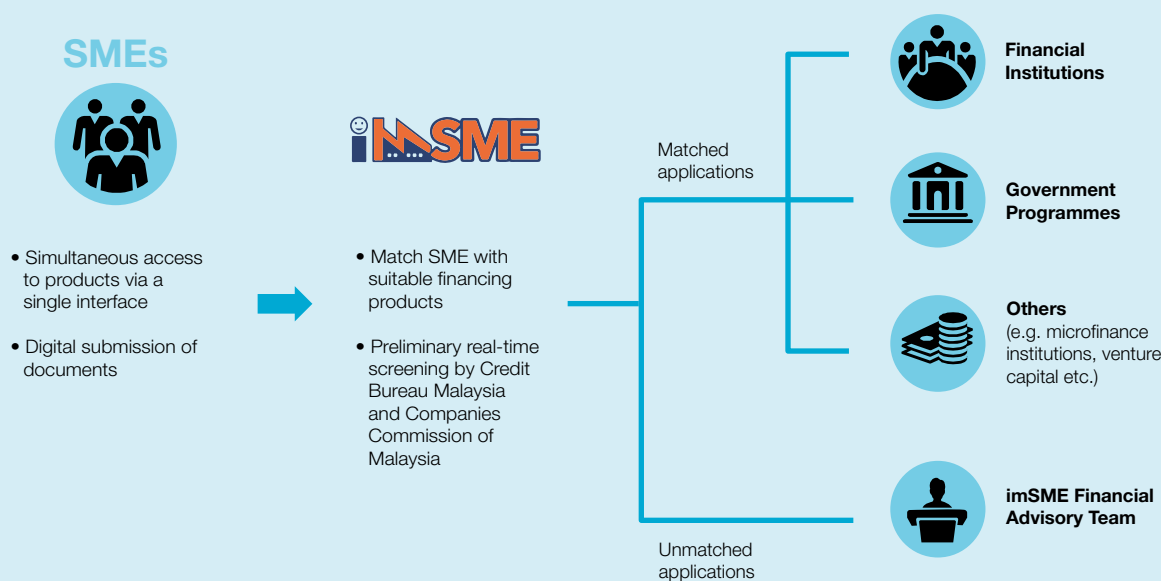
individuals and businesses to access their own credit history. Prior to its launch, borrowers could only obtain personal Central Credit Reference Information System (CCRIS) reports from the branches of the Bank and Agensi Kaunseling dan Pengurusan Kredit. With this initiative, borrowers can now avail themselves to quick and easy access to credit information via the eCCRIS website at their own convenience. This further complements efforts to inculcate a sound credit culture by empowering borrowers to actively monitor and take charge of their own credit standing. eCCRIS also supports direct requests by borrowers to update information in CCRIS in a secure environment. More than 42,000 individuals and businesses have registered for an eCCRIS account as at 7 March 2018.

Professionalising the banking sector

The industry continues to demonstrate a strong commitment towards strengthening the professional standards of its workforce. By end-2017, a total of 199 key senior management officers and directors have enrolled in the Chartered Banker programme introduced by the Asian Institute of Chartered Bankers (AICB). The internationally recognised programme combines theory and practice to equip practitioners with the highest standards of professionalism. As at end-2017, over 5,100 new employees in the financial sector have completed the compulsory ethics module.

Diagram 2.4

imSME, the Online SME Financing Platform



Source: Bank Negara Malaysia

Efforts were also directed during the year towards elevating technical competencies in the banking sector. Beginning January 2018, key personnel in critical job functions are required to obtain specialised qualifications from programmes offered by AICB. These are in the areas of credit, compliance, risk management, audit and Anti-Money Laundering/Counter Financing of Terrorism. This will further strengthen the reputation of the banking profession, underpinned by the consistent demonstration of high levels of professionalism and competence in banking conduct and operations (refer to the box article on 'Financial Sector: Employment Conditions and Preparing the Workforce for the Future').

Enhancing the role of development financial institutions (DFIs)

Since their establishment, DFIs have continued to promote key sectors of strategic importance to the economy and act as key levers in advancing the socio-economic objectives of the country. Funds have been channelled towards priority sectors, particularly agriculture, SMEs, maritime, infrastructure, export-oriented, and capital-intensive and high-technology industries. DFIs also provide advisory services and technical assistance to nurture the sustainable development of identified strategic sectors.

Between 2008 and 2017, total outstanding financing by DFIs recorded an average annual growth rate of 9%. The financing needs of the priority sectors have been met through various financing schemes and programmes. For instance, DFI-based financing schemes have been introduced since 2015 to promote affordable home ownership. During the year, the schemes were expanded to cater not only for the youth and agriculture communities, but also for the bottom 40% household income group (B40). As at end-2017, total financing of the schemes reached RM1.5 billion, benefitting nearly 7,000 families. For the agriculture sector, a microfinancing programme was launched in November 2017 to finance agro-based micro-entrepreneurs from the B40 group. As at end-2017, total financing amounting to RM5.1 million was channelled to more than 1,000 agro-based microfinance accounts.

Given the role of DFIs in developing and promoting socio-economic mandates, it is imperative that the performance measurement framework for DFIs look beyond traditional financial performance indicators such as volume of financing and loan growth. Greater focus should instead be placed on broader measures to critically evaluate DFIs' performance. A more holistic

performance measurement system is therefore critical to quantify DFIs' developmental impact on the economy, community and environment. This in turn will strengthen their accountability in achieving their mandate and focus their resources on areas that deliver the greatest development impact for a given social cost.

To this end, the Bank worked with the industry during the year to implement comprehensive and robust performance measurement frameworks across DFIs. The frameworks aim to better capture developmental, in addition to financial, indicators to measure the socio-economic contributions of DFIs to the economy and society. These include:

- the extent of positive (or negative) spillovers generated from a DFI's funding and business activities to the community such as number of jobs created, improvements in standards of living of the low income group, and better governance and financial management of targeted businesses;
- effectiveness of DFIs in expanding private sector investments (through loans, equity or guarantees) into new growth areas; and
- contribution of DFIs to the development and implementation of relevant Government policies to catalyse the growth of targeted sectors of the economy.

New performance measurement frameworks being implemented to better capture the developmental impact of DFIs

REGULATORY AND SUPERVISORY FRAMEWORK

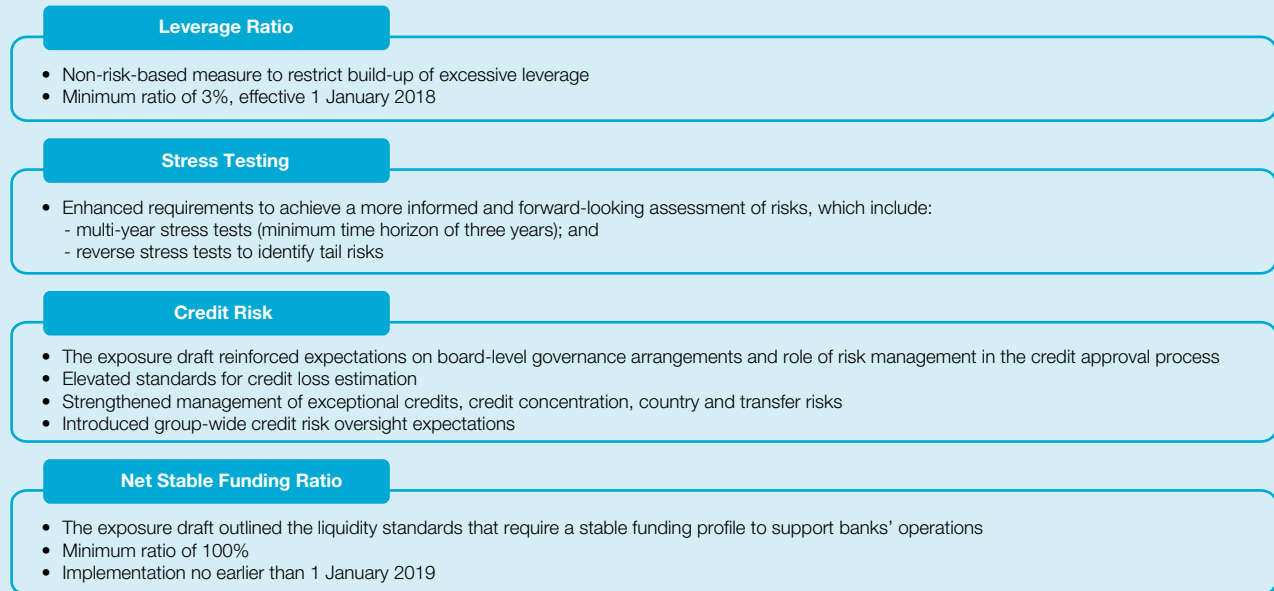
Regulatory and supervisory activities in 2017 continued to be directed towards strengthening the resilience of the banking sector, while remaining supportive of the financial needs of the economy. Efforts were wide-ranging, focusing on further raising the governance standards and risk management practices within banks, and the domestic implementation of Basel III standards (Diagram 2.5).

Implementing Basel III standards

The implementation of Basel III standards remains a regulatory priority for the Bank (Diagram 2.6). The standards aim to strengthen the resilience of banks by raising the level and quality of regulatory capital, restraining leverage and improving liquidity

Diagram 2.5

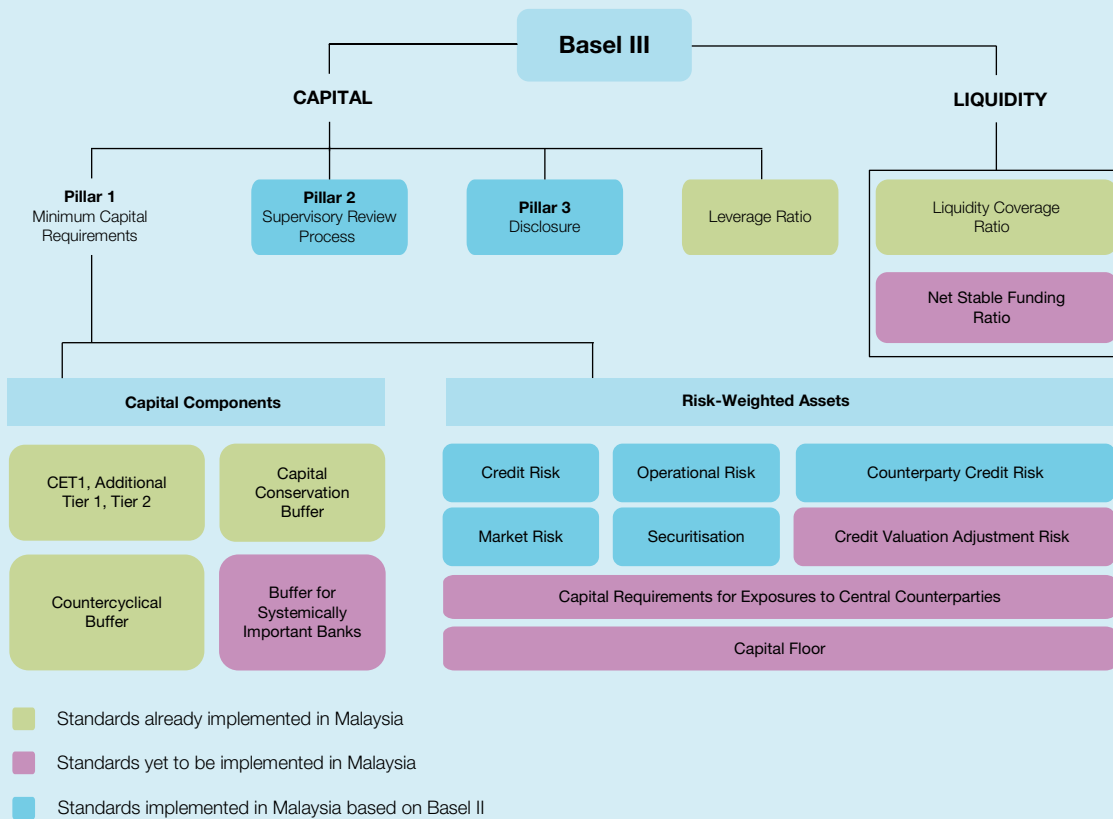
Summary of Key Prudential Standards Issued in 2017



Source: Bank Negara Malaysia

Diagram 2.6

Implementation of Basel III Standards in Malaysia



Source: Bank Negara Malaysia

Measurement of Leverage Ratio (LR)

$$\text{LR} = \frac{\text{Tier 1 Capital}}{\text{Total LR Exposures}} \geq 3\%$$

where Total LR Exposures is the sum of on- and off-balance sheet exposures, derivative exposures and securities financing transaction exposures

management. Implementation is informed by careful assessments of the operational effects and impact of the standards on domestic intermediation and market development, in order to identify and manage potential unintended consequences.

In December 2017, the Bank issued the final Leverage Ratio (LR) standards for banks. The LR reinforces the risk-based capital requirement with a simple, non-risk-based backstop measure. The minimum ratio of 3% became effective on 1 January 2018, in line with the globally agreed timeline. As expected, banks transitioned smoothly, with all banks comfortably meeting the 3% minimum requirement. As at end-2017, the banking system leverage ratio stood at 7.8%, with 94% of banks reporting an LR of at least 6% (2016: 7.7%; 94% of banks). Given the strong capital position, the implementation of LR is not expected to constrain intermediation activities nor require banks to raise additional capital.

In September 2017, the Bank published the exposure draft on Net Stable Funding Ratio (NSFR) for a two month consultation. The NSFR requires banks to maintain sufficient stable funding in relation to their asset profile and off-balance sheet obligations over a one year horizon. The Bank proposed for the NSFR to be implemented no earlier than 1 January 2019, taking into account operational enhancements required to prepare for its implementation and the overall sequencing of Basel III standards that are being gradually introduced for the banking sector.

Following industry feedback received during the consultation period, the Bank is currently assessing specific areas of NSFR, including where: (i) further domestic customisation may be appropriate (e.g. treatment of off-balance sheet obligations); and (ii) further clarification may be warranted (e.g. illustrations on interdependent asset-liability pairs). Ongoing impact assessments and engagements over the coming months will continue to inform the Bank's

final implementation approach. The Bank intends to finalise the standards in the first half of 2018.

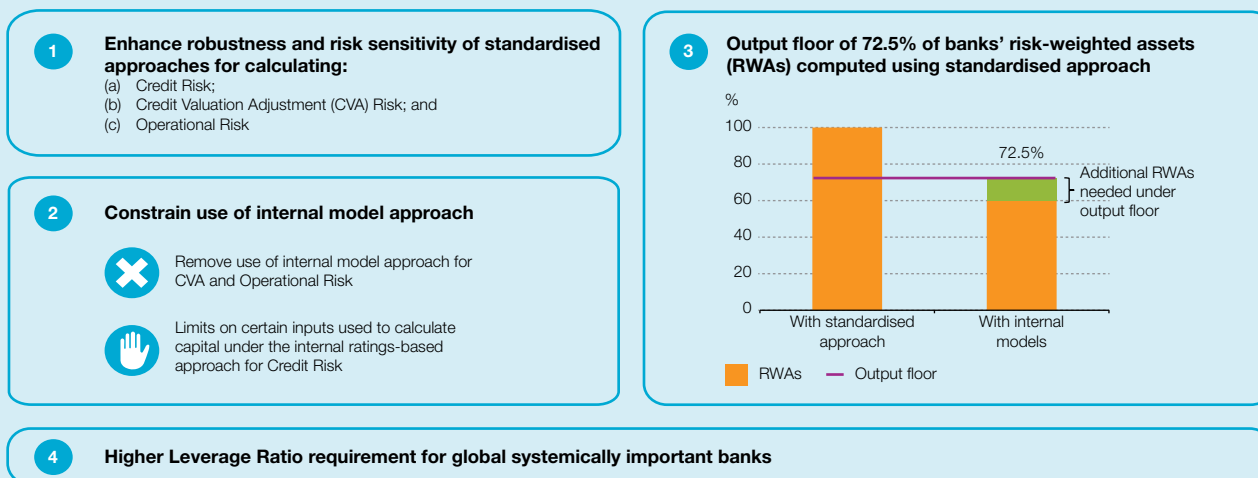
Banks with NSFR levels currently below 100% would need to adjust their balance sheets. Based on engagements with the industry, such adjustments are more likely to involve the liability side of the balance sheet. While this may exert some upward pressure on funding cost, the later implementation date provides additional time for banks to undertake the necessary steps to rebalance their funding profiles. Accordingly, the Bank expects any impact on borrowing cost to be more manageable. As at end-2017, the average NSFR for the banking industry (based on observation period reporting) stood at 107.6%, with 76% of banks reporting NSFR levels at or above 100% (2016: 103.2%; 55% of banks).

Domestic implementation of the remaining components of Basel III will consider relevant modifications to reflect domestic conditions and risks

On the global regulatory front, the Group of Central Bank Governors and Heads of Supervision, which is the oversight body for the Basel Committee on Banking Supervision (BCBS), endorsed the outstanding Basel III post-crisis regulatory reforms in December 2017 (Diagram 2.7). The endorsement includes a delayed implementation timeline to 1 January 2022 (previously set at 2019) for the revised minimum capital requirements for market risk. The deferment thus aligns with the implementation date of the revised capital standards for credit risk and operational risk, and allows more time for necessary systems and infrastructure enhancements. At present, there remains a number of components of the Basel III reforms that have yet to be implemented in Malaysia. Together with the recently endorsed elements of the Basel III reforms package, the Bank expects to develop and communicate proposals for domestic implementation over the next few months, taking into account relevant modifications to reflect domestic conditions and risks.

Diagram 2.7

Elements of Outstanding Basel III Regulatory Reforms



Source: Basel Committee on Banking Supervision

Enhancing credit risk management and provisioning practices

The Bank finalised the revised standards on Credit Risk in January 2018 to replace the 2001 guidelines. The revised standards advance various aspects of credit risk management practices of financial institutions which are necessary to reflect developments that have occurred over the years (Diagram 2.5). These include diversity of product offerings, growing cross-border operations of financial institutions and further deepening of the domestic capital market as an alternative source of financing particularly for large businesses. Requirements under the enhanced standards will take effect from 1 July 2018 for banks, while a longer transition period has been granted for insurers and takaful operators that will be implementing the standards for the first time.

The revised standards, which require the use of more advanced credit loss estimation approaches by financial institutions, also support the implementation of the Malaysian Financial Reporting

Standards 9: Financial Instruments (MFRS 9) which became effective on 1 January 2018. The forward-looking approach of the new impairment rules under MFRS 9 requires financial institutions to estimate expected credit losses throughout the lifetime of credit facilities, having regard to wider macroeconomic developments. This contrasts with MFRS 139, where impairment provisions are recognised only when there is objective evidence of impairment (Diagram 2.8).

While higher provisions are expected under MFRS 9, the estimated magnitude of impact on banks' earnings and capital is within the Bank's expectations. The impact would be largely mitigated by the regulatory reserve requirement which banks are allowed to use to offset the increase in provisions. As a result, despite the higher provisions, banks continue to maintain capital levels well above the regulatory minimum.

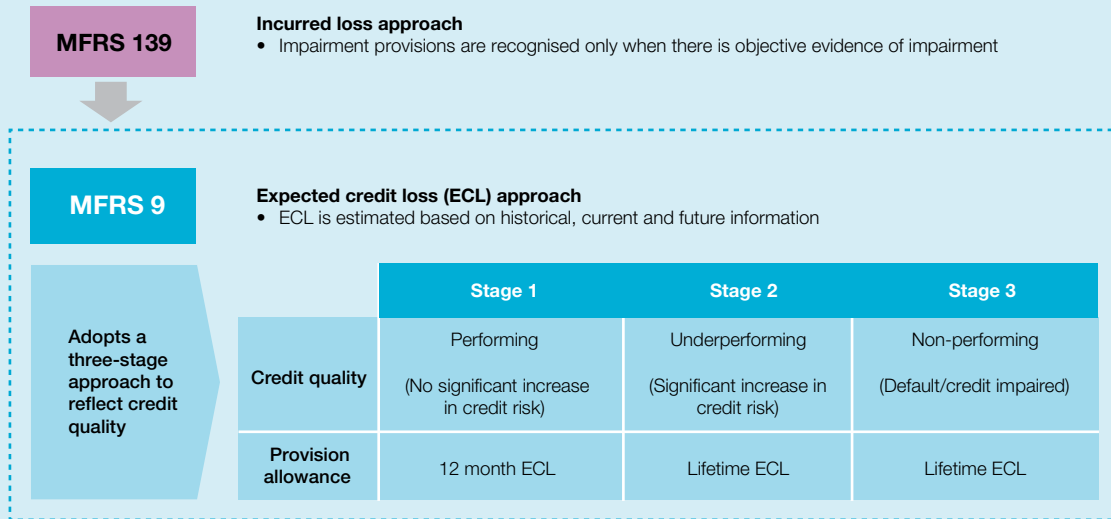
Having regard to the inherent subjectivity of MFRS 9 and data limitations that may be encountered in the initial operationalisation period, the Bank decided to

Key Revisions to Final Standards on Credit Risk following Industry Feedback

- Expanded scope of acceptable credit risk mitigation measures to ensure more accurate estimation of credit risk
- Flexibility on the governance arrangements to manage problem credit, commensurate with its severity
- Greater clarity on the independent credit review function to ensure continued effectiveness of post-approval review activities

Diagram 2.8

MFRS 9 Provisioning Requirements



Source: Bank Negara Malaysia

Recalibrated Computation of Regulatory Reserve Requirement

$$\text{Stage 1 and 2 provisions plus regulatory reserves} \geq 1\% \text{ of total credit exposures*}, \text{ net of Stage 3 provisions}$$

* excluding exposures to Government of Malaysia, Bank Negara Malaysia, banks and prescribed DFIs

maintain the regulatory reserve requirement for at least two more years beginning 1 January 2018. Banks are also expected to further refine and recalibrate the MFRS 9 models to ensure that changes in credit quality and risk profile are captured in a timely manner and that sufficient provisions are made to buffer against a deterioration in asset quality.

Heightened vigilance on operational risk

A trending issue for banks has been the growing exposure to operational risk. In February 2017, the Bank initiated an inaugural industry-wide survey on Emerging Operational Risk to study the risk landscape of the Malaysian banking sector. Chief risk officers of banks shared various perspectives on risks that were of paramount concern to their organisations. Details on the survey results were shared with the industry via the MYHORIZON report in January 2018. The report also provides a consolidated view of actual loss events reported during the year and discusses the

range of actions and steps financial institutions can consider to mitigate similar losses going forward. This information aims to offer useful insights on emerging risk developments as input for banks to improve their operational risk management frameworks. While an increasing number of banks have strengthened their operational risk functions to improve the management and oversight of operational risk, developing talent with the necessary skill set and experience to support enhancements to systems and controls continues to be a key priority for banks.

**Banking Sector:
 Top 5 Operational Risks in Malaysia**

1. Cyber threat
2. Non-adherence to regulatory requirements
3. Fraudulent applications for banking products
4. Human errors in task execution
5. Inaccurate or incomplete reporting

Promoting fair and responsible business conduct

The Bank continues to focus its efforts to further promote fair, responsible and professional business conduct by banks and payment instrument issuers. Over the years, banks have made significant strides in strengthening governance arrangements and internal controls. Equally important is for banks to also continue to enhance the quality of services and products offered to consumers and safeguard confidentiality of customer information.

During the year, the Bank conducted thematic reviews on: (i) quality of disclosures by banks on financial products offered; (ii) practices in the imposition of fees and charges on customers; and (iii) effectiveness of internal controls for safeguarding customer information. Based on findings from the thematic reviews, the Bank has taken supervisory and enforcement actions against 35 banks and payment instrument issuers. These included cease and desist orders on excessive or prohibited fees and charges issued against three institutions. The Bank also issued directions to 33 institutions to improve product disclosures and to strengthen processes for safeguarding customer information and resolving customer complaints.

Managing organisational culture and misconduct risk

The momentum in shaping sound core values within financial institutions gained further traction in 2017. Building on the Corporate Governance standards issued in 2016, the Bank's supervisory framework was enhanced to incorporate a specific focus on organisational culture when assessing overall safety and soundness of financial institutions. Many of the issues plaguing financial institutions can be addressed by creating a more robust and ethical operating environment and organisational culture. Findings from the Bank's MYHORIZON report lent further support to the importance of organisational culture where 65% of reported losses were found to be associated with internal fraud, regulatory non-compliance and operational lapses.

The Bank will accord greater focus on culture in its supervisory activities

In assessing the key drivers of organisational culture (Diagram 2.9), the Bank takes into account both financial and non-financial aspects. The focus of

Diagram 2.9

Key Drivers of Organisational Culture of Financial Institutions



Source: Bank Negara Malaysia

supervisory assessments considers the financial institutions' business model and structure, and the impact of control functions and internal interactions (between the board and senior management, and between senior management and staff) on behaviour (Diagram 2.10).

From observations of the non-financial aspects of organisational culture (such as recruitment, capacity building, compensation and performance management, and whistleblowing), banks appear to be increasing efforts to ensure that risk appetite and policies reflect the core values and capacity of the institution to take on and manage risks. Banks also continue to improve the implementation of risk-aligned remuneration frameworks, for example through introducing deferred or multi-year remuneration payments. Going forward, the Bank will continue to place importance on the culture of financial institutions as part of its ongoing supervisory activities. Financial institutions are therefore expected to direct efforts to foster sound culture and conduct within the organisation. These should include: (i) improving performance management practices via more balanced key

performance indicators; (ii) maintaining effective channels of communication for whistleblowing; and (iii) strengthening pre-employment screening processes.

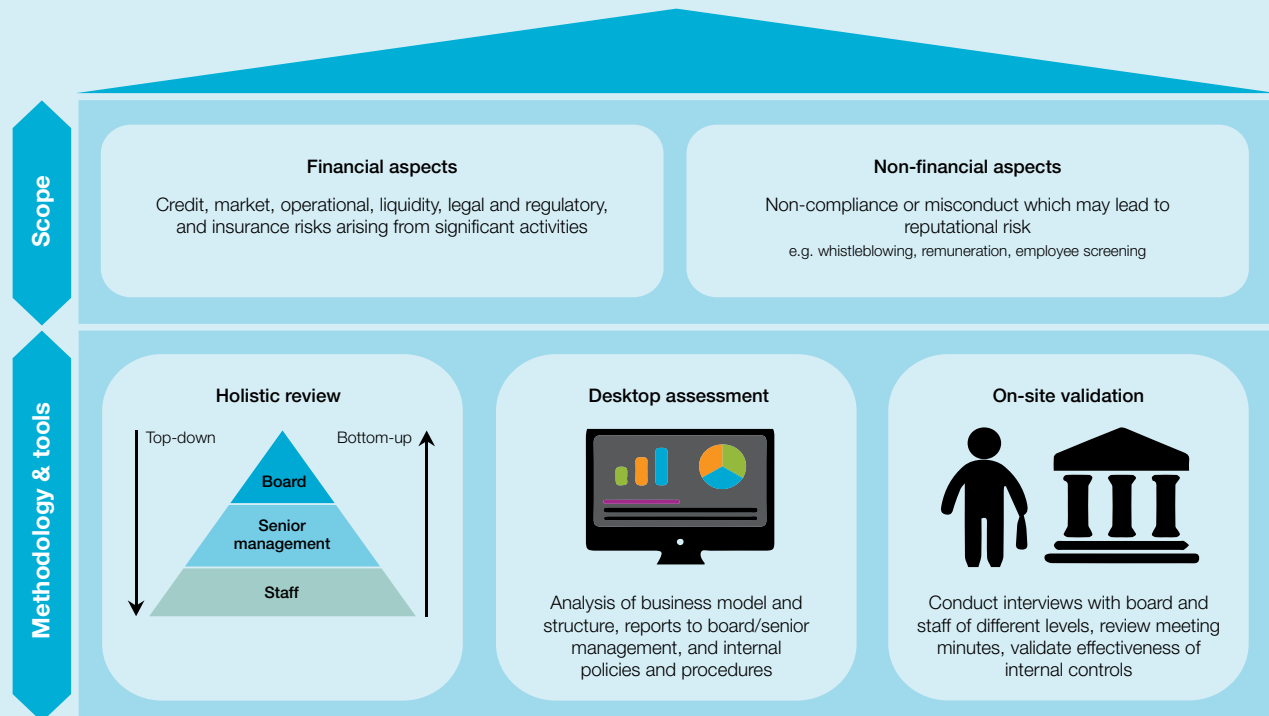
REGIONAL AND INTERNATIONAL COOPERATION

Close cooperation with home and host supervisors remained a key priority in supporting the Bank's supervisory activities during the year. In April 2017, the Bank signed an MoU on Banking Supervision and Financial Development Cooperation with the Bank of Thailand. The collaboration supports the effective supervision of banks with operations in both Thailand and Malaysia amid deepening trade and investment linkages, and greater cross-border banking activities particularly in the Asian region. It also facilitates closer cooperation to ensure sustainable development and financial sector resilience, including in the areas of market conduct supervision, consumer protection, financial inclusion and literacy, and combating financial crime.

In 2017, the Bank participated in supervisory college meetings of six foreign financial institutions with operations in Malaysia, and hosted one for a domestic banking group.

Diagram 2.10

Supervisory Assessments on Organisational Culture of Financial Institutions



Source: Bank Negara Malaysia

These meetings continue to be a key platform for exchanging key supervisory concerns and coordinating supervisory activities involving cross-border financial groups. Bilateral engagements were also held with the Financial Services Authority of Indonesia in July 2017 and Hong Kong Monetary Authority in October 2017. These engagements covered assessments of economic

and financial conditions in the home and host countries, sharing of developments on supervisory frameworks, and concerns and actions taken to address emerging risks. Such engagements continue to play an important role in supporting the Bank's ability to identify and respond to identified risks affecting Malaysian banks in a timely manner, working together with its counterparts.

AKPK – Advancing Prudent Financial Behaviour

By Sahara Hashim and Ili Syazana

Introduction

Agensi Kaunseling dan Pengurusan Kredit (AKPK) is an agency established by the Bank in 2006 to provide advisory services and assistance to individual borrowers in managing their finances. It contributes to a sound and robust financial system by creating a financially savvy society through the provision of three core services namely: (i) one-to-one financial counselling and advice on money management skills; (ii) a personalised debt management programme; and (iii) financial education. More than three million individuals have benefitted from the programmes and initiatives conducted by AKPK since its inception.

This article discusses the progress made by AKPK in carrying out its mandate to promote prudent financial behaviour, describes the profile of indebted borrowers and sets out AKPK's priorities moving forward.

Towards Financial Prudence

Financial counselling and advice

Since its inception, AKPK has provided financial counselling and advice to 683,169 individuals. This reflects AKPK's goal to equip individuals with the essential ability to manage money wisely, so that they spend within their means and achieve financial goals. AKPK provides free, one-to-one financial counselling and practical advice on money management to help individuals control their spending and debt. This is provided through its 11 branches, and 18 counselling offices nationwide via the branch network of commercial and Islamic banks. In addition, AKPK leverages on its strategic partners, including Government agencies and non-government organisations, in offering counselling at the work place.

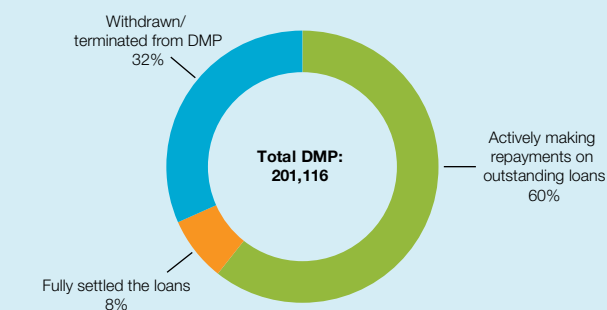
Debt Management Programme

Out of the total number of individuals who had sought financial counselling and advice from AKPK, 29% of them were enrolled into the Debt Management Programme (DMP), a personalised programme to provide eligible borrowers with solutions for their financial situation. These individuals represent a total debt value of RM21.7 billion. To date, 15,439 borrowers representing 8% of DMP participants have fully settled their debts and graduated from the programme. About 60% of DMP participants remain active in servicing their debt while the remaining 32% had either withdrawn from the DMP or had their participation terminated (Chart 1). Common reasons for withdrawal or termination include improved financial circumstances that enable borrowers to fully settle or manage the debt on their own, the death of a participant, or the inability to make debt repayments on a consistent basis.

Proactive interventions by AKPK play an important role in supporting DMP participants in meeting and sustaining their repayment obligations. These include issuing early payment reminders, offering a 'Second Chance' programme to prospective defaulters and active monitoring of payments from all new DMP participants during the first three months after being enrolled into DMP under the 'Early Care' initiative to shape good repayment habits. These interventions have contributed towards reducing the numbers of borrowers that are terminated from DMP, from 35% in 2016 to 25% in 2017. In addition, the annual debt collected by AKPK under the DMP have increased significantly to RM877 million in 2017 (2007: RM21.7 million). Of the amount collected thus far, over 80% was paid promptly by borrowers.

Chart 1: Status of DMP Participants as at end-2017

Majority of DMP participants are actively making repayments



Source: Agensi Kaunseling dan Pengurusan Kredit

The DMP has also had an important impact in reducing bankruptcies. It is estimated that about 20% of the borrowers who had enrolled into DMP were at the early stage of bankruptcy proceedings or foreclosure of their properties. Once borrowers are enrolled into the DMP, participating financial institutions (PFIs) will provide moratorium on the bankruptcy or foreclosure proceedings to enable all parties to agree on repayment plans. This also helps to reduce the number of bankruptcy cases that need to be handled by the court.

The PFIs have also benefitted from the DMP. The PFIs are able to recover the defaulted loans from the borrowers without resorting to court processes which are time consuming and costly. Since the inception of AKPK, the PFIs have recovered about RM4.5 billion of defaulted loans that would otherwise need to be written off. The PFIs also benefitted from the savings of fees payable to debt collection agencies, generally between 15% to 25% of the amount recovered, compared to a nominal fee of 3% paid to AKPK.

All of the above can be attributed to three key roles of AKPK in administering the DMP: (i) building support and agreement among PFIs on debt restructuring terms that can be reasonably met by distressed borrowers; (ii) counselling on financial management and lifestyle changes which are critical to help borrowers regain control of their debt; and (iii) active monitoring and follow up on borrowers that are more likely to fall behind on payments. To further assist DMP participants who have fully settled their debts, AKPK is in the process of rolling out a post-programme initiative to provide continuous guidance and support to these customers. It aims to systematically track behavioural changes and ensure that positive financial behaviour is sustained.

Financial literacy—a more inclusive financial education and outreach

AKPK's financial education modules are designed to address the different needs and circumstances that arise at different life stages - from young adults in tertiary education; entering the workforce and starting a family; to senior citizens in their retirement. Financial education programmes also aim to address the specific challenges that are faced by more vulnerable groups in the bottom 40% (B40) and middle 40% (M40) income groups. Key topics covered include the importance of saving and how to save, setting financial goals, selecting financial products that match needs and goals, budgeting, basic borrowing and debt management.

Financial education publications by AKPK are available in four main languages and are continuously updated to incorporate new financial management tools and behavioural observations. AKPK's financial education initiatives have also been advanced further at the university level where a Personal Financial Management course was introduced as an elective or an extra-curriculum programme to teach young adults good personal financial management before they enter the workforce. A total of 34 higher learning institutions have infused AKPK's Personal Financial Management module in their respective curriculum (Diagram 1).

Diagram 1

AKPK's Financial Education Modules and Publications

2015

Financial education modules for four key life stages

- To empower consumers with knowledge, skills and tools to build, manage, and protect their personal wealth
- Designed based on specific life events (i.e. tertiary education, entering workforce, starting and raising a family, and retirement) to ensure an impactful financial education that reaches its targeted consumers

2012

Self-Help Guide on Debt Relief Plan

- Aimed at guiding and empowering consumers who wish to manage their debts on their own

2011

POWER! Managing Your Debts Effectively

- Targeted primarily at young individuals and new borrowers, aims to empower individuals to manage their finances effectively
- Provides practical financial knowledge, skills and tools to help in making sound and responsible borrowing decisions

2008

Money \$ense

- A tool to promote financial literacy across various target groups
- Developed based on real-life experiences of customers who have sought AKPK's credit counselling and enrolled into AKPK's DMP
- Further developed into a Personal Financial Management module and taught to trainees of Program Latihan Khidmat Negara until 2014

Old Master Q Money Management Comic

- To convey financial education in a simple, fun and easy to understand manner

Source: Agensi Kaunseling dan Pengurusan Kredit

Ensuring that all Malaysians have access to its services has always been one of AKPK's priorities. Acknowledging that its financial education initiatives need to be responsive to individuals from all walks of life, and provide flexibility for individuals to receive information at times and in ways that they prefer, AKPK introduced an online microsite platform (ask.akpk.org.my). The online learning portal is filled with financial education advice and tips, budget planning tools and financial calculators to help consumers manage their finances. AKPK has also sought new ways to reach out to financial consumers through digital platforms such as Facebook, Instagram and YouTube, which have attracted more than 10 million viewers.

Indebtedness— who and why?

Poor financial planning consistently ranks as the top reason why DMP participants default on their debt (Diagram 2). Without proper financial planning, individuals are at risk of spending beyond their means and supporting such spending through the build-up of substantial debt (Case 1).

Case 1

Mazyun and Mazlan, a young married couple, worked as an interior designer and bank executive respectively. Despite just starting out in their careers in urban Kuala Lumpur, and with little savings set aside, they racked up a substantial amount of housing, personal and credit card debt to finance a lavish lifestyle. Over just four years, they had accumulated a total debt of RM1.2 million on a combined salary of RM20,000 per month.

The unexpected termination of Mazlan's employment contract plunged the couple into serious financial hardship, with Mazyun unable to sustain repayments on the couple's multiple loans on a single income source.

More than 73% of DMP participants are from the lower monthly income bracket of below RM4,000. Many of these DMP participants become indebted due to insufficient savings which leave them unable to cope with large unforeseen expenditures, such as medical emergencies. Matters are compounded when they are forced to rely on more expensive forms of debt such as credit cards and personal financing, to deal with financial challenges. Consequently, they are more likely to fall into greater debt (Case 2).

Case 2

Azmi works as a factory supervisor with a monthly income of RM3,000. He is married with three school going children. He was servicing his loans as scheduled, and spent what was left of his savings on local holidays with his family.

His financial difficulties started when his wife fell ill. With no savings or insurance to fall back on, he took up personal loans and used credit cards to pay for his wife's medical treatment. Struggling to meet his debt repayments and family expenses, he eventually defaulted on his debt obligations. His children withdrew from school when Azmi could not afford to pay for their school books.

In general, individuals who have a tendency to spend beyond their means are likely to accumulate higher debts, which if not managed appropriately would lead to financial distress. In this instance, AKPK provides counselling services to highly indebted individuals, particularly on the need to make lifestyle changes. The majority of DMP participants who successfully completed the programme have been observed to change their behaviour. This includes getting into the habit of saving, developing household budgets and spending modestly.

Case 3

Ali works as a Finance Manager with an insurance company. He has two children with a net household monthly income of approximately RM5,500. He lived a lavish lifestyle with no financial planning for his future. His total credit card debts and personal financing debt amounted to RM100,600 with monthly repayments totalling RM4,125. He could not pay his debts solely based on his monthly salary.

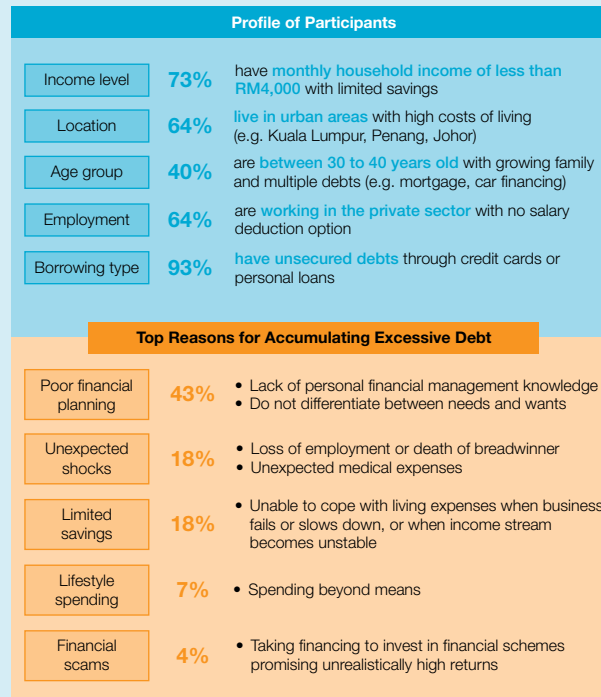
Ali enrolled into the DMP in 2009. Throughout the programme, Ali adjusted his household expenditure by cutting down on expensive food and clothings. The change in lifestyle enabled Ali to pay off his debts. He was also able to set aside some money for his family's medical insurance and children's education. Ali successfully completed DMP in June 2012, one year ahead of the DMP schedule.

Greater access to financial services and a highly competitive market can further add to challenges faced by individuals. In particular, behaviours of financial institutions that actively promote financial products that may not be suitable for certain consumers, have made it even more important for individuals to have the knowledge to make sound financial decisions. This has also become more important to guard against a proliferation of investment scams.

AKPK's strategies and approaches aim to deliver interventions that focus on individuals who are likely to be more vulnerable to financial hardship. To this end, AKPK has increased its presence in major cities. In 2017, 32% of the total financial education programmes were conducted in Kuala Lumpur and Putrajaya, and 84% of financial education and counselling activities have specifically targeted individuals who are starting and raising families.

Diagram 2

Profile of AKPK's DMP Participants



Source: Agensi Kaunseling dan Pengurusan Kredit

Priorities Going Forward

National strategy on financial literacy

A national strategy on financial literacy is being formulated by the Financial Education Network (FE Network)¹ to elevate financial literacy among Malaysians. As an FE Network member, AKPK will coordinate with its partners within the network to align and increase the reach and impact of financial education programmes targeted at young and working adults. New approaches for measuring the effectiveness of these programmes will also be pursued.

Holistic approach to financial rehabilitation – going beyond bank credit

Since 2014, AKPK's services have been expanded to include individuals with borrowings not only from financial institutions regulated by the Bank but also several large non-bank financial institutions such as Malaysia Building Society Berhad, credit cooperatives and Perbadanan Tabung Pendidikan Tinggi Nasional. This has enabled AKPK to provide more comprehensive solutions to borrowers, and enlarge the number of individuals who can access its services. Moving forward, efforts are underway to extend coverage of the DMP to include customers of other non-bank credit institutions. This is also in line with the recent appointment of AKPK by the Government as a nominee for the Voluntary Arrangement scheme (a pre-bankruptcy rescue mechanism) under the Insolvency Act 1967 [Bankruptcy (Amendment) Act 2017]. As the appointed nominee, AKPK would manage a process to provide financial consumers with the opportunity to restructure and/or reschedule their debt before they are declared bankrupt.

¹ FE Network members comprise of the Bank, Securities Commission Malaysia, Ministry of Education, Ministry of Higher Education, Employees Provident Fund, Perbadanan Insurans Deposit Malaysia, AKPK and Permodalan Nasional Berhad. The FE Network serves as an inter-agency platform to increase the impact of financial education initiatives and identify new opportunities for improving financial literacy among the Malaysian public through greater alignment, closer collaboration and a strong focus on impact assessments.

Conclusion

As individuals gain greater access to financing, it becomes increasingly important that they practice prudent and responsible financial behaviour. AKPK plays an important role in this mission, not just to assist borrowers in trouble but to advocate greater financial literacy among all Malaysians. AKPK is committed to building on its deep knowledge of financial consumer attitudes and behaviour, and its strategic position as a trusted adviser within the financial ecosystem, to help more individuals make effective use of financial services to improve their welfare while contributing to broader financial stability.