

Assessment of Malaysia's Observance with the Principles for Financial Market Infrastructures

Financial market infrastructures refer to the payment and settlement systems through which all financial market transactions are settled. In April 2012, the Bank for International Settlements (BIS) Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions (IOSCO) issued the Principles for Financial Market Infrastructures (PFMI). The PFMI replaced the previous standards issued by the BIS and IOSCO, namely the Core Principles for Systemically Important Payment Systems, the Recommendations for Securities Settlement Systems and the Recommendations for Central Counterparties. This single standard harmonises and enhances the existing international standards for payment systems that are systemically important, central securities depositories, securities settlement systems and central counterparties to ensure effective risk management, leveraging on the lessons learnt during the recent global financial crisis. As part of the Financial Sector Assessment Program conducted by the International Monetary Fund (IMF) and the World Bank in 2012, Malaysia was among the first countries to be assessed for compliance with the new PFMI.

This box article presents a summary of the IMF's assessment and key observations of Malaysia's compliance with the PFMIs. The IMF's detailed assessment will be published separately on its website.

Malaysia was assessed to have 'observed' all 19 Principles that are applicable to Real-time Electronic Transfer of Funds and Securities System (RENTAS) and its operator, Malaysian Electronic Clearing Corporation Sdn. Bhd. (MyClear) (Table 1). In addition, there are five recommendations outlined for authorities responsible for the oversight of financial market infrastructures. Of these, the Bank and Securities Commission Malaysia (as the responsible authority for the financial market infrastructures operated by Bursa Malaysia Berhad) were collectively assessed to have 'observed' or 'broadly observed' all five responsibilities.

The key findings from the IMF's assessment are:

- **Activities of RENTAS are supported by a robust legal basis that provides certainty to the enforceability of the rights and obligations of the RENTAS operator with clear and predictable consequences.** The Central Bank of Malaysia Act 2009 provides the mandate for the Bank to own and operate payment and settlement systems while the Payment Systems Act 2003 (PSA) accords the Bank with oversight powers and recognises the Bank as the authority responsible for promoting the reliable, efficient and smooth operation of the national payment and settlement systems. Meanwhile, the Contracts Act 1950 governs the participation agreement that binds the participants to the operating rules and procedures of RENTAS. As RENTAS is a designated payment system under the PSA, MyClear is required to comply with the conditions stipulated in the Supervisory Expectations and Requirements on Designated Payment Systems issued by the Bank, which includes the requirement for MyClear to ensure the reliability, efficiency, and smooth operation of the system.
- **Existing credit and liquidity risk management practices, including policies and procedures to handle participant defaults, provide a high degree of confidence that RENTAS is able to continue operating and meet settlement obligations.** Rules and procedures in managing the failure or insolvency of participants are clearly defined in the Participation and Operation Rules for Payments and Securities Services. This facilitates timely action by both MyClear and the participants to minimise potential losses and mitigate contagion risks. The design of RENTAS only permits settlement of transactions if the necessary funds or securities are available in the respective accounts. The Liquidity Optimiser Settlement Facility and the intraday credit facility provided by the Bank promote efficient liquidity management by the participants.

Table 1

Level of Observance of the Principles for Financial Market Infrastructures and Responsibilities of the Central Bank, Market Regulators, and Other Relevant Authorities for Financial Market Infrastructures

Principles for Financial Market Infrastructures	Level of Observance
1. Legal basis	O
2. Governance	O
3. Framework for the comprehensive management of risks	O
4. Credit risk	O
5. Collateral	O
6. Margin	NA
7. Liquidity risk	O
8. Settlement finality	O
9. Money settlements	O
10. Physical deliveries	NA
11. Central securities depositories	O
12. Exchange-of-value settlement systems	O
13. Participant-default rules and procedures	O
14. Segregation and portability	NA
15. General business risk	O
16. Custody and investment risks	O
17. Operational risk	O
18. Access and participation requirements	O
19. Tiered participation arrangements	NA
20. FMI links	O
21. Efficiency and effectiveness	O
22. Communication procedures and standards	O
23. Disclosure rules, key procedures, and market data	O
24. Disclosure of market data by trade repositories	NA
Responsibilities of the Central Bank, Market Regulators, and Other Relevant Authorities for Financial Market Infrastructures (FMIs)	Level of Observance
A. Regulation, supervision, and oversight of FMIs	O
B. Regulatory, supervisory, and oversight powers and resources	O
C. Disclosure of policies with respect to FMIs	BO
D. Application of the principles for FMIs	O
E. Cooperation with other authorities	BO

- **Observed (O)** – Any identified gaps and shortcomings are not issues of concern and are minor, manageable, and of a nature that can be taken up in the normal course of activities.
- **Broadly observed (BO)** – The assessment has identified one or more issues of concern that are to be addressed and followed up in a defined timeline.
- **Partly observed (PO)** – The assessment has identified one or more issues of concern that could become serious if not addressed promptly. High priority should be accorded to addressing these issues.
- **Not observed (NO)** – The assessment has identified one or more serious issues of concern that warrant immediate action. Highest priority should be accorded to addressing these issues.
- **Not applicable (NA)** – Does not apply because of the particular legal, institutional, structural or other characteristics of the financial market infrastructure.

- Clear and comprehensive rules and procedures are in place to provide settlement finality and mitigate settlement risk.** The PSA provides for all funds and securities settled in a designated payment system to be final and irrevocable, while operational procedures issued by MyClear clearly define the actual point at which settlement is considered final. All ringgit transactions in RENTAS are settled in the books of the Bank, while foreign currency transactions are settled in the books of commercial banks. These foreign currency settlements are conducted via a Payment versus Payment (PvP) arrangement that is jointly supervised with a foreign regulatory authority or through an appointed banking institution that is regulated and supervised by the Bank.
- Appropriate rules, procedures and controls are in place to ensure the integrity of securities transactions and minimise principal risk of exchange-of-value settlement systems.** As the central securities depository for public and private debt securities, MyClear ensures that the rights of securities issuers and holders are adequately protected. These include prevention of unauthorised creation or deletion of securities and daily reconciliation of securities issued. RENTAS adopts PvP and Delivery versus Payment (DvP) processes for exchange-of-value settlements where both securities and foreign currency settlements are conducted by simultaneously debiting and crediting the respective accounts, provided sufficient balances are available to effect the transaction. The occurrence of finality is synchronised for both legs of the transaction thus eliminating principal risk.
- Effective controls are in place for general business and operational risk management.** As the operator of RENTAS, MyClear is required to put in place controls to effectively monitor and manage its financial performance and liquidity position to address any business risk. The system infrastructure was upgraded in 2011 to support the future expansion of RENTAS services. Since its implementation in 1999, RENTAS has consistently achieved at least 99.9% of system availability. Stress testing on the processing capacity of RENTAS is undertaken periodically to ensure that there would not be any degradation in performance as a result of increased transaction volumes. Business continuity planning for RENTAS is comprehensive with three levels of backup facilities, as well as rigorous and regular contingency plan testing.
- The operation of RENTAS is guided by policies which ensure fair and open access, efficiency and effectiveness in meeting the requirements of the participants and markets it serves, as well as transparency to inform sound decision making and foster confidence.** In practising fair and open access, criteria for access to RENTAS and orderly exit procedures are clearly stipulated in the Rules and Operational Procedures, which are published on MyClear's website. RENTAS is designed and operated based on best practices and international standards. The services provided by RENTAS are continuously improved to reflect international developments and to meet the evolving needs of the participants, the financial market and the economy. This includes the recent introduction of renminbi settlement services and the link up with the International Central Securities Depository (ICSD), Euroclear. Moving forward, RENTAS will be enhanced to adopt the Society for Worldwide Interbank Financial Telecommunication (SWIFT) messaging standard to enhance operational efficiency for its participants and the system as a whole. This initiative is expected to be completed in 2014. Formal meetings with relevant stakeholders are held prior to effecting changes to system rules. Current information on the design and operations of RENTAS is accessible on MyClear's website.

Key Recommendations

The compliance assessment made several recommendations to further enhance the risk management practices of MyClear. This would ensure that RENTAS continues to achieve a high level of observance of the PFMI as the financial market develops. The recommendations also included

suggestions for further improving disclosures of policies and cooperation with authorities in promoting the safety and efficiency of financial market infrastructures.

Going forward, the regulatory framework governing RENTAS operations is to be strengthened under the FSA, to provide explicit protection for the collateral placed by participants for intraday credit facilities and repurchase arrangements. MyClear has indicated its commitment to further enhance the robustness of its risk management systems, including ensuring the portability of customers' securities following a merger or acquisition, and addressing risks associated with Euroclear as more transactions build up in the future. To further strengthen its default management procedures, periodic tests with the involvement of its participants are being planned by MyClear. The disclosure framework will also be enhanced to promote better understanding and management of risks by participants. In addition, efforts will continue to be taken to further strengthen existing cooperation and exchange of information arrangements between the Bank and other supervisors and authorities, including the Securities Commission.