



GOVERNOR'S STATEMENT

The financial stability of the Malaysian financial system continued to be sustained in 2010. This has allowed the financial sector to provide important support to the economy, despite the challenging conditions arising from global developments that occurred during the course of the year. The financial sector was supported by strong fundamentals including enhanced financial buffers, high asset quality and sound risk management. The soundness of the financial sector has not only contributed towards the efficient functioning of the financial intermediation process, but it has ensured the orderly response to shocks to the financial system. Conditions in the financial markets and the payment and settlement systems also remained orderly and efficient, facilitating the increase in external trade and domestic economic activities.

With the coming into force of the Central Bank of Malaysia Act 2009 (CBA), Bank Negara Malaysia has in 2010 further strengthened the governance and accountability arrangements in the management of financial stability. Within the Bank, the Financial Stability Policy Committee which has been in place since 2004, has the responsibility for the deliberation of risks to financial stability and the formulation of policy responses to manage such risks. Recognising the relationship between financial stability and monetary stability, a joint meeting of the Financial Stability Policy Committee and the Monetary Policy Committee was established this year to provide a forum for the effective deliberation and consideration of macroprudential measures to safeguard financial and macroeconomic stability. Pursuant to the CBA, the Financial Stability Executive Committee has also been operationalised with the mandate to approve proposals by the Bank to take actions to avert a risk to financial stability where it concerns entities not regulated by the Bank or for the resolution of systemically important financial institutions.

Supervisory activities in 2010 remained focused on bolstering the capacity of financial institutions to anticipate and respond to emerging risks, and ensuring that identified risks both to individual institutions and the system as a whole are well managed. The focus was directed in particular at promoting effective governance, and more robust stress testing and capital management processes by the financial institutions to ensure their continued resilience under a range of economic and financial scenarios. This was complemented by the continuing review of prudential standards to take into account both global and domestic developments. The Bank has also strengthened its surveillance of the growing activities of non-bank entities to ensure that any potential risks to financial stability will be managed at an early stage.

While household indebtedness has increased in the recent years, it has continued to be supported by strong financial buffers at the aggregate level. Income growth, the high savings rate and favourable employment conditions have contributed to supporting the debt servicing capacity of households. To ensure that this does not become a source of financial instability, a comprehensive series of policies were introduced during the course of the year. These include prudential policies applied in the residential property sector, new credit card measures and strengthened requirements for banks to adopt prudent and responsible lending practices. This was reinforced by more intensive supervisory oversight of financial institutions with respect to the management of household lending portfolios. More targeted financial education programmes as well as advisory and support arrangements have also served to promote responsible borrowing by households. These pre-emptive and more holistic measures also aim to contribute towards further strengthening the resilience of the household sector.

The overall performance of the insurance industry has been positive even though conditions have remained challenging under a low interest rate environment, rising claims costs and more volatile financial markets. The industry as a whole is more resilient to these challenges given its sound capital position and the efforts directed at promoting further improvements in capital and risk management. Moving forward, as Malaysia transitions into a high value-added and high income economy, the market potential for the insurance and takaful industry will be significant. A key priority therefore lies in enhancing the capacity of the industry to support the new and larger demand for insurance and takaful solutions. As part of this evolution, the further consolidation and rationalisation of the general insurance sector will continue to be encouraged, while broader structural issues in the motor insurance segment will be addressed with the implementation of a new motor cover framework.

In Islamic finance, the foundations for financial stability have also been further strengthened with the implementation of prudential standards issued by the Islamic Financial Services Board in both the Islamic banking and takaful sectors. On the international front, the requisite building blocks as recommended by the Islamic Finance and Global Financial Stability Report have set out the key priorities in the agenda to promote the stability of the global Islamic financial system. Among the important global institutional arrangements in support of these priorities is the establishment of the Islamic Financial Stability Forum to deliberate the risks to financial stability and the International Islamic Liquidity Management Corporation which commenced operations early this year to facilitate liquidity management across borders.

The more diversified and matured financial system that has evolved over this recent decade has provided a stronger foundation for financial stability with strong domestic banking institutions operating at its core. Moving forward, the focus is to build on these foundations to support its continued resilience to withstand potential shocks or disruptions in the financial system and the broader economy. The further development of the financial system also aims to position the financial

sector to effectively support Malaysia's economic transformation into a high value-added, high income economy, while further promoting financial inclusion and regional financial integration. The new financial sector blueprint to be released by the Bank later this year will outline strategies to achieve these objectives.

The functioning of the financial system during the year has continued to be well supported by the payment and settlement systems infrastructure. With the increased sophistication in the financial system and the growth in cross-border trade and financial flows, these infrastructure have continued to be modernised. An important focus, amongst others, is the regional effort to establish a common platform for Asian post-trade processing infrastructure. This will integrate the Malaysian real time gross settlement system, RENTAS, with the international clearing and settlement systems such as Euroclear as well as global securities depositories such as the International Central Securities Depository. On the domestic front, the migration to e-payments has gained further traction, supported by greater collaboration between the Government, Securities Commission, Bursa Malaysia and the financial services industry players.

The expansion of the Malaysian financial sector over the recent decade has seen our financial institutions venture beyond our borders, in particular to the Asian region. It has also seen the entry of new foreign players establishing their presence in both the conventional and Islamic finance sectors in the Malaysian financial system. The entry of these new foreign players will not only add to the capacity of the domestic financial sector to support the development of new growth industries, but will also further enhance Malaysia's international linkages. Greater supervisory cooperation and coordination domestically and across borders have consequently become more important to support the effective supervisory oversight of financial institutions and overall management of financial stability. Towards this agenda, the Bank has and will continue to pursue new and enhanced collaborative arrangements with other national and foreign regulatory authorities to further reinforce cooperation in cross-border banking supervision, capacity building and other initiatives to achieve greater regional financial integration.



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