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Development of the Financial Sector



Development of the Financial Sector

Amidst the challenging economic environment, the focus of the Bank in 2009 was to preserve the soundness and integrity of the financial sector, ensure continued access to financing, while forging ahead with longer term initiatives to enhance the capacity and growth potential of the financial sector. New liberalisation measures were introduced in early 2009 to enhance the role of the financial sector as a key enabler, driver and catalyst of economic growth as well as to strengthen Malaysia's economic linkages with other economies.

Preserving financial stability and ensuring continued access to financing

Given the spill-over effects from the global financial crisis, the Bank accorded priority towards easing the strains faced by the corporate and household sectors and putting in place measures to ensure financial stability is preserved at all times.

The Bank took pre-emptive actions to preserve financial stability and ensure continued access to financing

The reduction of the Overnight Policy Rate and the Statutory Reserve Requirement in the early part of 2009 to the lowest levels was part of a series of measures taken by the Bank to lessen the cost of borrowing for consumers to assist them in weathering the challenging business and economic environment. Financial institutions were encouraged to restructure or reschedule loans to assist borrowers, and grant relief on housing loan repayments for borrowers who were affected by retrenchment or reduction in working hours. The Bank also actively facilitated dialogues between the financial institutions and business communities to discuss issues relating to the viability of the industries and address concerns on financing from the financial sector. This was complemented by efforts taken by the Credit Counselling and Debt Management Agency (AKPK) which enhanced its outreach nationwide to provide assistance to individuals with credit problems.

In managing the impact of the economic slowdown on small and medium enterprises (SMEs), the Bank reviewed the eligibility criteria for the Small Debt Resolution Scheme (SDRS) to enable more SMEs with viable businesses to seek assistance to restructure or reschedule their loans. As at end-2009, 684 applications with loans amounting to RM471 million or 78% of total applications received were approved by the SDRS for rescheduling and restructuring. In addition, the Bank established a RM2 billion SME Assistance Guarantee Scheme (SME AGS) in February 2009 to ensure that viable SMEs continue to have adequate access to financing and at lower cost. This scheme utilised an 80% guarantee cover provided by the Credit Guarantee Corporation (CGC), with funding of the loans provided by all commercial and Islamic banks and selected development financial institutions (DFIs). As at end-2009, the RM2 billion SME AGS was fully utilised and assisted 9,415 SMEs in obtaining financing. The role of CGC to assist SMEs was further enhanced by the consolidation of ERF Sdn. Bhd.'s operations into CGC. ERF Sdn. Bhd. was established in 1989 as a one-stop centre to provide financing and advisory services to Bumiputera SMEs. With the consolidation, CGC is now better placed to provide a whole range of financial and advisory services to SMEs. As at end-2009, CGC has granted credit guarantees to support 402,867 SMEs which had outstanding financing of RM44.9 billion.

Complementing the efforts taken by the Bank to provide assistance to SMEs, the Government also established a Working Capital Guarantee Scheme totaling RM7 billion to provide working capital lines to SMEs. An Industry Restructuring Guarantee Scheme totaling RM3 billion was also introduced in 2009 to incentivise companies to restructure their operations towards higher value-added activities and application of green technology. These initiatives reflect the commitment to provide assistance to private companies to weather difficult times, while emphasising on the long-term objective to enhance the efficiency of the private sector. As at end-2009, the Working Capital Guarantee Scheme was fully utilised, assisting 5,329 borrowers. The Industry Restructuring Guarantee Scheme is still available until 31 December 2010 and as at 4 March 2010, 190 borrowers have benefited from this scheme.

Malaysia's Microfinance Framework

Micro enterprises are critical for balanced and sustainable economic growth

Micro enterprises constitute 78.7% of all businesses in Malaysia and employ over 1.2 million employees¹. More than four-fifths, 87.7%, of micro enterprises are in the services sector, with significant involvement in the retail, food and transportation sub-sectors. Even though these micro enterprises are small, they are agile and able to take advantage of niches that larger firms are not able to undertake effectively.

Financial empowerment through microfinance

In accessing financing from the formal financial system, the credit history of micro enterprises will be recorded by a recognised credit information system. This enables micro enterprises to build credit histories and credit ratings that opens new opportunities for these enterprises. With good credit ratings, micro enterprises can access further financing for business expansions at better financing rates. Micro entrepreneurs are better served by the formal financial system through the provision of 24-hour electronic banking and payment services which can enhance productivity and efficiency², and provision of advisory services such as financial management. Such advisory services are commonly provided by micro financing institutions (MFIs) as part of the complement of financing solutions. Significant resources are allocated by MFIs to help micro enterprises develop business capabilities through training workshops, networking events and business advisory services. This broad range of developmental services have contributed towards enhancing the viability and growth potential of micro entrepreneurs.

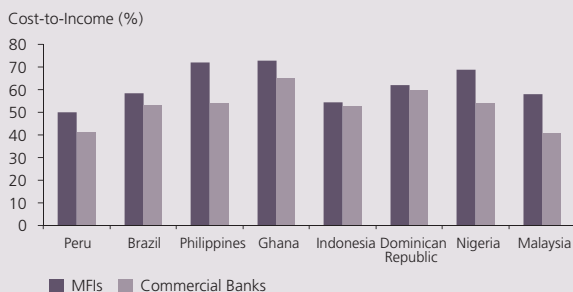
Inclusion in the formal financial system also helps to enhance the financial literacy of borrowers. This allows micro entrepreneurs to make more informed financial decisions, thus promoting the more effective utilisation of a broad range of financial products in a safe and responsible manner. Micro businesses will also have access to new services such as micro insurance schemes which provide businesses with additional tools to better manage various risks inherent in the business.

Microfinance is a challenging endeavour

Global experiences show that the cost-to-income ratio of MFIs is higher than those of commercial banks. This is due to the inherent nature of micro financing where the financing amounts are small

and customers are geographically dispersed, with many located in rural and underserved areas. Hence, MFIs are required to dedicate more resources to expand outreach to these customers. In order to serve customers well, MFIs need to put in place the procedures and processes that are necessary to accommodate the large volume of small applications and to monitor and facilitate release and repayments of micro financing accounts.

Chart 1
Cost-to-Income Ratio of MFIs and Commercial Banks of Selected Countries



Source: MIX Market Data, The Banker (July 2009), Annual Reports of Central Banks

Sustainable micro financing in Malaysia

Malaysia is recognised for its efforts to enhance access to financing. Among 183 countries, the World Bank has ranked Malaysia as number one in terms of "Getting Credit"³. As at end

¹ Department of Statistics Malaysia, (2007) "Census of Establishments and Enterprises 2005"
² World Bank, (2005) "Rural Finance Innovations"
³ World Bank, (2009) "Doing Business 2010"

2009, there were 449,703 micro finance borrowers in Malaysia with outstanding financing extended amounting to RM2.4 billion given through the formal financial system and government agencies.

Prior to 2006, the micro finance industry players comprised largely of government agencies serving the hardcore poor and the informal financing system. To enhance support for the growth of micro enterprises through improved access to the formal financial system, the National SME Development Council approved a sustainable micro finance framework named *Pembiayaan Mikro* in 2006. The framework identified three strategic initiatives: to define the parameters of an appropriate micro financing product, to raise awareness on micro financing, and to attract the participation of financial institutions in providing micro financing solutions.

With *Pembiayaan Mikro*, micro entrepreneurs now have access to financing which requires no collateral, and applies simple application procedures, minimal documentation and a quick approval and disbursement turnaround to meet the unique financing needs of micro enterprises. Under the *Pembiayaan Mikro* framework, the median approval time is four days and the median disbursement time is three days, significantly quicker than other business financing. To promote broader awareness of the availability and benefits of *Pembiayaan Mikro*, numerous initiatives were implemented including the creation and display of the *Pembiayaan Mikro* logos at premises that offer *Pembiayaan Mikro*, the direct distribution of flyers to more than 397,000 micro enterprises, feature articles in the newspapers and advertisements on television and radio.

Since its launch, the number of participating financial institutions in the *Pembiayaan Mikro* initiative has increased to nine, comprising six banking institutions and three development financial institutions. The active participation of these institutions have expanded access to micro financing through over 1,800 contact points nation wide. Recognising the diverse financial needs of micro enterprises, these financial institutions have adopted different business models and strategies that leverage on the institutional strengths and niches. A number of financial institutions have adopted a mass market model whereby the financial institution provides microfinance products through its existing branch network. Others, like Bank Rakyat, have adopted a cooperative model which provides microfinance to its members. Some have employed the distributor network model, which leverages on the distributive capabilities of strategic business partners. Another is the monoline model with a dedicated microfinance operation, formed with its own distinct branding and processes designed to uniquely appeal to micro enterprises.

Under *Pembiayaan Mikro*, outstanding micro financing of the nine participating financial institutions stood at RM616.5 million involving 57,403 customers as at end 2009. This represented an annual growth of 29.1% and 27.1% respectively. A survey conducted to gauge the performance of micro enterprises after receiving micro financing, showed an increased capacity of micro enterprises to serve new markets and customers. More specifically, the survey found that micro enterprises that received micro financing were able to invest and expand their business capabilities, thereby contributing to an average increase in revenue and employment of about 18.5% p.a. and 10% p.a.⁴ respectively.

Moving forward, the microfinance industry is expected to develop further with increased investments in technology and improvements to existing processes which will support an expanded outreach and further efficiency gains. As the micro financing industry grows, both financial institutions and non-bank financial institutions will continue to broaden the range of financial services being offered to include micro-insurance, remittances, Ar-Rahnu pawn-brokering and micro-investment schemes. This, in turn, will contribute towards greater financial inclusion.

⁴ Based on a random survey conducted by participating financial institutions, measuring the increase in revenue and employment 3 years after the micro enterprise receive micro financing

Investor sentiment in the Malaysian bond market was affected as the economic outlook remained weak. Corporations with investment grade ratings were unable to tap the bond market for financing as investors became highly risk averse towards bonds and commercial papers with slightly lower credit ratings. This created difficulties for corporations given that corporates source more than 50% of total financing requirements from the bond market. To preserve confidence in the bond market and ensure that viable corporations continue to have access to financing through the bond market, Danajamin Nasional Berhad (Danajamin) was established as the national financial guarantee insurer in 2009. Danajamin's objective is to provide credit enhancements to corporations with viable businesses and investment grade ratings to raise funds from the bond market at a reasonable cost. Danajamin is governed by strict corporate governance and strong prudential standards to ensure its commercial sustainability over the medium and longer term. As at end-February 2010, Danajamin has approved the applications of three companies from the oil and gas, construction and property, and plantation sectors. Danajamin expects to guarantee RM700 million of bonds to be issued by these companies targeted within the first half of 2010.

As a measure to facilitate debt restructuring of corporations, the Corporate Debt Restructuring Committee (CDRC) recommenced operations in July 2009 with an expanded mandate. CDRC was first established during the Asian financial crisis and had successfully resolved 57 cases. Given the increased dependence of the corporate sector on the bond market for funding, the CDRC framework was expanded to include the restructuring of private debt securities issued by the corporates in the overall restructuring scheme. Since its re-establishment in July 2009 to end-February 2010, the CDRC has received five applications involving debts totalling RM941 million. To enable more companies to seek assistance from CDRC, the eligibility criteria was revised in February 2010. Under the revised criteria, companies with aggregate indebtedness of RM30 million or more with at least two financial creditors became eligible for CDRC assistance. Additionally, companies may be eligible for CDRC assistance if receivers have been appointed but only over certain specified assets and the directors remain

in control over the company's operations. The CDRC will also assist listed companies that have been classified as PN17 or GN3 to undertake debt and financial restructuring.

Strengthening institutional capacity and enhancing operational efficiency and effectiveness

While the Malaysian financial sector as a whole is stronger, more efficient and more innovative, the unprecedented nature and scale of the global financial crisis has exerted challenges on the capacity of financial institutions to withstand extreme conditions. Many banking institutions took pre-emptive measures to strengthen capital positions through capital raising exercises and rationalisation of non-core businesses. In 2009, the banking sector as a whole raised approximately RM16.4 billion of capital, which boosted the risk-weighted capital ratio to 14.7% (2008: 12.6%) and the core capital ratio to 13.1% (2008: 10.6%). With stronger capital positions, banking institutions are on a more solid footing to seize opportunities that arise as the economy recovers and global markets stabilise.

In view of the enhanced capacity of the financial institutions, regional expansion was a key focus of selected banking groups that aspire to grow business beyond Malaysia and be regional players. In 2009, two domestic banking groups acquired strategic stakes in foreign financial institutions while two other banking groups ventured into two new countries through the opening of branches. Such ventures provide opportunities for domestic banking groups to penetrate new markets, broaden customer base and build regional franchise. As at end-2009, six domestic banking groups have presence in 19 countries worldwide. The profit contribution from overseas operations of the domestic banking groups accounted for 16.7% of total group profits.

The resilience of the insurance industry is testimony of the structured development of the insurance and takaful industries over the years, spurred by various capacity building initiatives taken by the Bank and the industry. There was significant growth in insurance fund assets and net premium income of both life and general sectors, which stood at RM150.4 billion and RM29.9 billion respectively, in 2009. Similarly, the takaful industry has achieved commendable progress with the takaful fund assets amounting to RM12.4 billion as at end-2009.

Recognising the need for boards of directors of financial institutions to continuously upgrade skills and competencies for the overall enhancement of institutional efficiency and performance, the Financial Institutions Directors' Education (FIDE) programme was established in 2008 to provide a structured programme of continuing education specifically tailored for directors of financial institutions. A total of 131 directors of banking institutions, insurers and takaful operators have completed the core programme. The FIDE programme which has been enhanced in response to evolutions in global management practices and input from participants, will contribute towards building a pool of qualified directors who are able to manage and drive the strategic direction of financial institutions in Malaysia.

Insurance penetration level in Malaysia remains moderate and hence, there are tremendous opportunities for growth for the insurance industry. To enhance the distribution channels of life insurance companies and promote greater insurance penetration, life insurance companies were allowed to freely branch and leverage on the widespread outreach of bank branches to distribute their products through bancassurance arrangements. Over the years, bancassurance has grown to be a key distribution channel for insurance companies, generating 38.2% of new premiums for the life insurance industry. With the flexibility to open new branches and have bancassurance tie-ups with multiple banking institutions, and as evidenced by the bancatakaful experience which was liberalised earlier, the potential for the insurance industry to enhance their revenue base and promote greater insurance penetration nationwide is significantly strengthened.

Enhancing Malaysia's inter-linkages with international economies

Malaysia's financial sector already has a sizeable presence of foreign players which accounts for approximately 20% of market share in the banking sector, and two-thirds market share in the insurance and takaful sector. This has contributed to Malaysia's inter-linkages with the international economies, facilitated the flow of trade and investment, creation of employment opportunities and the development of new financial products and services. To further strengthen the potential of the financial sector as an enabler, driver and catalyst of economic growth and to further enhance Malaysia's inter-linkages with the rest of the world, the Bank forged ahead with a comprehensive liberalisation plan to pursue

opportunities that would bring net benefits and contribute to the development of the Malaysian financial sector and the economy as a whole. The liberalisation plan also aims to reinforce Malaysia's position as an international Islamic financial centre. The liberalisation plan announced in 2009 was multi-pronged, focusing on enhancing the role of the conventional and Islamic finance sectors through three broad strategies:

- Issuance of new licences to qualified foreign players that can bring significant value propositions to the financial sector to strengthen its ability to be a key enabler, driver and catalyst of economic growth;
- Increased foreign equity limits in domestic financial institutions to provide greater flexibility to form stronger strategic partnerships that will encourage transfer of expertise and technology, and enhance international linkages and business opportunities; and
- Accord greater operational flexibility to existing locally-incorporated financial institutions for enhancement of the potential to play a more effective intermediation role and widen outreach of products and services to all economic segments, thus promoting financial inclusion.

Malaysia forged ahead with a liberalisation plan aimed at enhancing Malaysia's competitiveness and inter-linkages with international economies

These measures were sequenced in line with the objective of ensuring maximum benefits to Malaysia. Capacity and institutional building efforts will continue to be pursued, complemented by enhancements to the regulatory, supervisory and surveillance framework to ensure financial stability is preserved.

In tandem with the broad liberalisation efforts, the Bank continues to be supportive of regional integration initiatives, promoting strategic partnerships and enhancing collaboration and cooperation efforts with regional economies. A new licence was issued to the largest commercial bank in the People's Republic of

China to establish operations in Malaysia, forging stronger partnerships and relations between both countries. This licence was issued as part of a very limited number of banking licences that Malaysia may consider issuing from time to time under bilateral arrangements. Additionally, the Bank and the People's Bank of China established a 3-year bilateral swap arrangement designed to promote bilateral trade and investment between the two countries. The Bank also entered into a memorandum of understanding (MoU) with the China Banking Regulatory Commission to strengthen cooperation between the two regulatory authorities on banking supervision and in the promotion of regional financial integration. On areas of financial supervision, the Bank is also involved in active negotiations to pursue MoUs with other countries. Such partnerships contribute towards enhancing Malaysia's collaboration and economic and financial inter-linkages within the region.

Enhancing infrastructure for financial market development

Initiatives on financial market development during the year focused on creating a facilitative regulatory environment, enhancing the infrastructure and introducing new products to support the development of deep and vibrant financial markets in Malaysia.

The Bursa Suq Al-Sila is the world's first Shariah-compliant commodity trading platform

The Bursa Suq Al-Sila (formerly known as Commodity *Murabahah* House) was launched in August 2009 as the world's first Shariah-compliant commodity trading platform to facilitate the sale and buy-back of commodities in commodity *murabahah* transactions. The web-based centralised exchange which uses crude palm oil (CPO) as its underlying commodity, serves as a fully Shariah-compliant alternative to other commodities offered through the London Metal Exchange and domestic commodity brokers and is the first internet-based platform in the world. The platform is expected to further enhance the trading of commodities for liquidity purposes between Islamic financial institutions in Malaysia and facilitate cross-border liquidity transactions through a more cost-efficient platform. To promote

the development of commodity *murabahah*, selected foreign exchange administration rules were liberalised to facilitate payments between participants. Although Malaysia already has a well-functioning and efficient Islamic interbank market, this platform provides another viable alternative for liquidity management and further enhances global inter-linkages in the international Islamic financial system.

The Principal Dealer framework, first introduced in 1989 as part of the initiatives to develop the primary and secondary public debt securities markets, was reviewed in 2009 and changes were made to the entry requirements, obligations, incentives and assessment of Principal Dealers. In recognition of the increasing importance of Islamic finance and the prominent role played by Islamic banks in money market activities, the revision also paved the way for the introduction of the Islamic Principal Dealer (i-PD) System, thereby allowing Islamic banks to act as Principal Dealers for Islamic debt securities issued by the Government and the Bank. The primary aim of the new Principal Dealer framework is to ensure that banking institutions continued to be incentivised to participate in primary auctions and secondary market trading in order to promote a liquid and deep market.

Growing significance of Islamic finance and Malaysia as an international Islamic financial centre

Despite the challenging economic environment, the continued expansion of Islamic finance has demonstrated its viability and resilience. As at December 2009, the total assets of the Islamic banking sector, including DFIs increased to RM303.3 billion, accounting for 19.6% of the total assets in the banking system. Meanwhile, the takaful industry recorded an increase in market share from 7.7% to 7.9% of the overall insurance sector from 2008 to 2009. During the year, a new retakaful licence was awarded, while two banking institutions and three retakaful institutions were granted approvals to commence International Currency Business Unit operations.

In 2009, the Bank continued its efforts to promote a clear understanding and consistent interpretation of Shariah contracts in Islamic finance. The initiative to develop a comprehensive codification of Shariah contracts known as Shariah Parameters achieved a major milestone,

with the first Shariah Parameter on *murabahah* contract issued in 2009. The Shariah Parameter on *murabahah* would serve as a main source of reference for the Islamic financial institutions in developing *murabahah* products and services. As at December 2009, 49.4% of Islamic contracts were structured in the form of *murabahah*, including *Murabahah Purchase Orderer* and *Al-Bai Bithamin Ajil*. The Bank is currently working on and aiming to finalise the Shariah Parameters for the remaining contracts on *ijarah*, *mudharabah*, *musharakah*, *istisna'* and *wadiah* by end-2010. Similar efforts were also made at the regional level with the proposed establishment of *Majma' Kewangan Islam Nusantara* or MAKIN, an association of Shariah scholars to promote mutual recognition on Shariah standards and principles for the ASEAN region.

The Association of Islamic Banking Institutions Malaysia also introduced four standardised agreements based on *wakalah* and *murabahah* for interbank and corporate placements. These agreements comprising standard principles governing such transactions help to eliminate uncertainties and facilitate bilateral negotiations between players. Several Islamic financial institutions from Brunei, Indonesia and the United Kingdom have agreed to adopt the documents for their transactions.

Development of human capital in Islamic finance remains a key priority in positioning Malaysia as a key hub for Islamic finance. The International Centre for Education in Islamic Finance (INCEIF) established by the Bank in March 2006 to enhance the supply of high calibre professionals to support the development of Islamic finance has produced its first batch of Chartered Islamic Finance Professional (CIFP) graduates comprising 32 students in 2009. With a current enrolment of 1,423 students from 64 countries undertaking various programmes ranging from the CIFP, Masters in Islamic Finance and PhD in Islamic Finance, INCEIF has made commendable progress in positioning itself as a key international centre of educational excellence in Islamic finance. As part of the initiatives to support the talent supply in Islamic finance, the Bank, under the Fund for Shariah Scholars in Islamic Finance awarded scholarships amounting to RM3.5 million to 68 students to undertake the CIFP programme on a full-time basis at INCEIF commencing June 2009.

The Bank also focused on strengthening strategic bilateral and multilateral cooperation to promote global partnerships and cross-border business ventures in Islamic finance. In 2009, two MoUs were signed between the Bank and the United Kingdom Trade and Investment (UKTI), as well as with the Hong Kong Monetary Authority (HKMA). The primary objectives of both MoUs are to promote mutual cooperation in the area of Islamic finance, particularly in the development of talent and expertise as well as fostering and strengthening business linkages and infrastructure support. Following the MoU between the Bank and UKTI, a Malaysia-United Kingdom (UK) Islamic Finance Forum was held in July 2009 aimed towards enhancing business interaction in Islamic finance and encouraging two-way investments between the UK and Malaysia. Two private sector-led MoUs building upon the strengthened relationship between Malaysia and the UK was further executed in the year to develop talent and expertise in Islamic finance, between INCEIF and Reading University, and between the Islamic Banking and Finance Centre UK (IBFC), Cardiff University Business School and the Islamic Banking and Finance Institute Malaysia Sdn. Bhd. (IBFIM). These MoUs provide a framework of collaboration in exchanging resources and developing new training programmes in Malaysia and the UK. Towards operationalising the MoU between the Bank and HKMA, the first working level meeting between the Bank and HKMA held in December 2009 focused on capacity building and human capital development in Islamic finance.

The Islamic capital market achieved significant milestones in 2009 with a landmark issuance and listing of USD-denominated sukuk

To further advance Malaysia as an international Islamic financial centre, Malaysia International Islamic Financial Centre (MIIFC) promotion activities focused on increasing foreign participation in the Malaysian Islamic financial system including from established financial centres in Europe, Asia and the Middle East. A new long-term brand *Shaping Islamic Finance Together* was introduced to position Malaysia as the intellectual epicentre for Islamic financial

activities. *Shaping Islamic Finance Together* is Malaysia's brand proposition to global talents, leading players, investors and issuers to shape the future of Islamic finance together through the MIFC initiative, leveraging on and benefiting from Malaysia's experience of more than 30 years in Islamic finance.

Despite the downturn in the global economy and heightened risk environment, the Islamic capital market achieved significant milestones in 2009 with the landmark issuance of the USD1.5 billion Emas Dollar Sukuk and USD3 billion Emas Dollar Bond by PETRONAS. The Emas Dollar Sukuk was listed concurrently on Bursa Malaysia, Labuan International Finance Exchange and the Luxembourg Stock Exchange. Due to overwhelming response and the growing confidence of investors in sukuk issuances, the papers were oversubscribed by 6.28 times. The listing of the GE Capital Sukuk amounting to USD500 million on Bursa Malaysia also elevated the status of Bursa Malaysia as the world's top exchange in terms of value of sukuk programme listings in 2009. These developments in the sukuk market reinforced Malaysia's position as the centre for sukuk origination and an international Islamic finance centre.

Promoting fair treatment of consumers and strengthening consumer activism

Consumers of financial services have an important role in exerting market discipline on financial institutions, contributing towards the development of an efficient and competitive financial sector. Hence, a key pillar of the Bank's developmental initiatives is to promote fair and equitable market practices by financial institutions and raise the level of financial capability of consumers through consumer education and awareness programmes.

During the year, the Bank enhanced its surveillance over market practices of licensed financial institutions. Thematic examinations focusing on the imposition of fees and charges, credit card promotions, selling of investment-linked and structured products were conducted. On-site visits and calls were undertaken to assess the sales and marketing practices of financial institutions, including the competency of frontline officers in promoting financial products, and to assess the effectiveness of banking institutions in facilitating access to the SME AGS. These activities provided

important insights for the Bank to proactively address concerns on the marketing practices of financial institutions. Overall, the intensified market conduct supervision has resulted in improvements in the banking and insurance industries' operational procedures such as procedures in identifying and resolving cases of replacement of policies. Additionally, following the Bank's reviews on advertisements and promotional materials of financial institutions to ensure fair and transparent terms and conditions, 22 incidents of insufficient disclosures in advertisements and promotional materials have been identified and banking institutions were required to rectify these shortcomings or withdraw the advertisements.

On the area of fees and charges, the focus of the Bank's efforts is mainly to ensure that the fees and charges imposed by financial institutions are reasonable and fair to consumers. With improved financial literacy of consumers, there will be greater market discipline exerted on financial institutions to ensure that the fees and charges are commensurate with the product quality and cost of providing such service to consumers.

Towards enhancing consumer awareness and capacity to make informed financial decisions, the comparative tables on fees and charges were expanded to cover electronic funds transfers. Information booklets on how to lodge complaints were issued, as part of the series of information kits issued to provide step-by-step guidance on how to select a suitable financial product that best meets consumers' needs, the rights and responsibilities of consumers as well as the redress mechanisms available to them. The Bank also continued to expand its outreach efforts to a wider segment of the population, including a pilot programme on financial education for deaf children, and consumer education programmes organised during *Minggu Kesedaran Kewangan 2009* in collaboration with the Financial Mediation Bureau, AKPK and the Malaysian Deposit Insurance Corporation (PIDM). Approximately 30,000 consumers attended the programmes organised during the *Minggu Kesedaran Kewangan 2009* which signifies the increased interest by consumers in financial matters. The Bank also published selected *bankinginfo* material in Braille, and AKPK launched the *Celik Wang* book (the Bahasa Malaysia version of Money Sense) that provides guidance to consumers on how to manage money wisely.

Financial Products Transparency and Disclosure

The financial environment is marked by a more competitive financial services sector, increasing access to financial services, broader range of financial products and services, and more complex financial transactions. The proliferation of financial products and services ranging from basic banking services and risk protection products to more sophisticated and complex financial products, including for retirement and asset accumulation, has necessitated enhancements to market conduct practices, including on financial products transparency and disclosure to foster continued public confidence in the financial system.

Mitigating risk to consumers while promoting competition

As consumers grow more affluent and seek financial products and services to enhance and protect their financial well-being, it is important for consumers to have better access to pertinent information to facilitate more informed decision making consistent with consumers' needs, risk tolerance and financial circumstances. With limited financial skills and lack of access to relevant information to fully appreciate the complexities of some financial products, it is difficult for consumers to grasp the true costs and potential risks that are associated with these products. This would increase the risk of consumers selecting unsuitable products which are inconsistent with their needs and risk appetite. Furthermore, aggressive sales practices by intermediaries and staff of financial service providers may also lead to unsuitable purchase of such products which later results in disputes, and eventually undermine the integrity of financial service providers. Apart from providing relevant information to consumers to facilitate decision making, it is the responsibility of financial service providers to conduct customer suitability assessments to ensure that financial products sold are appropriate to the requirements of customers.

Adequate and effective product disclosure and transparency would therefore, facilitate consumers to be more active in safeguarding their own interests while exerting market discipline on the financial service providers. Over the medium-term, continuous activism by consumers will drive the market towards greater efficiency and innovation that satisfies consumer demands leading to healthy competition, thus pushing the financial service providers to offer better and cost-effective products and services to consumers. It is envisaged that the availability of more varied products offered at competitive prices will enable a wider segment of the population to participate, thus contributing towards greater financial inclusion to benefit the economy as a whole.

Enhanced disclosure standards

Recognising the importance of adequate and effective disclosure to consumers in particular, and financial service providers generally, the Bank has recently issued the Guidelines on Product Transparency and Disclosure (Guidelines). These Guidelines serve to raise the disclosure standards for retail financial products and aim to support informed decision making by consumers through meaningful and timely disclosures.

It is recognised that transparency and disclosure as a consumer protection tool will only serve its purpose if consumers are able to understand the information provided to assess product suitability and conduct comparative shopping. It is therefore, important that for information to be meaningful, there has to be a right balance between providing adequate and relevant information to consumers with ensuring the information provided is clear and easy to understand. Given that excessive information could be counter-productive, confusing to the consumer and may inhibit sound decision making, the disclosure must therefore, be focused on key and relevant information central to factors which will facilitate the consumer's decision making. Apart from the types of information to be disclosed, the manner of presentation of such information also has a role in facilitating consumer understanding. A well-designed presentation, which anticipates the

consumer's thought process, will enable the consumer to navigate through the information and understand the significance of the information when utilising it in decision making.

Based on these considerations, the Guidelines provide both general and product-specific disclosure principles to be observed by financial service providers. To ensure disclosures are meaningful and facilitate decision making, the Guidelines require financial service providers to disclose important and relevant information, including key terms and conditions in a timely, clear and concise manner. Apart from these general disclosure principles, the Guidelines also specify product-specific disclosure requirements ranging from banking and Islamic banking products, insurance and takaful products, to payment instruments as well as remittance services.

In recognising that meaningful information disclosure also include the timely manner such information is disclosed, the Guidelines specify the relevant information to be disclosed at each of the three stages of entering into a financial contract, namely, the pre-contractual stage, at the point of entering into a contract stage and during the term of the contract stage. The staging of information disclosure ensures that manageable portions of information are given to avoid overloading the customers. Another key requirement of the Guidelines is the provision of a product disclosure sheet to prospective customers by financial service providers. To facilitate comparative shopping, the format and the type of information to be disclosed in the template for product disclosure has been standardised across the industry. Amongst the information to be disclosed in the product disclosure sheet are key features of the product, key terms and conditions, fees and charges, significant risks associated with the product and important notices or warning statements on the financial product.

The Guidelines also emphasise the use of plain and intelligible language in the contracts, agreements and policy documents so that information can be communicated in an easy and comprehensible manner for customers to better understand their contractual rights and responsibilities. For the more complex financial products and services, financial service providers must ensure that products are adequately explained in a manner which promotes product understanding by using appropriate examples, if necessary.

Customers seeking legal recourse

The expectations of consumers are also changing rapidly in tandem with the increased awareness levels, growing wealth and greater affluence. As a result, consumers are now demanding better product choices, greater transparency and disclosure, and more consumer-centric practices from financial service providers. With greater awareness of rights and responsibilities, consumers are increasingly more confident in asserting their rights to resolve disputes through the legal process as evidenced by the recent court case relating to the customer's liability limit for an unauthorised credit card transaction. This signals the need for financial service providers to appropriately identify, assess and mitigate risks associated with the way the financial products are designed and marketed to customers. It would include ensuring greater disclosure of products and services to avoid being exposed to reputational and legal risks.

Expectations on financial service providers

The increasing sense of empowerment amongst consumers have increased the expectations on financial service providers to embed good business conduct practices, including the disclosure standards into their business culture, supported by board and senior management oversight. Business models of financial service providers need to be underpinned by robust treat-customers-fairly framework and proactive response to the changing customer needs. Products must be designed with due regard to the needs and interests of the target market and reasonable care must be exercised over the distribution of the products and services, to mitigate the risk of misselling and reputational risk. Financial service providers should only introduce products to the market after the

appropriate systems, monitoring and controls to support the product are in place, including proper training of the marketing staff.

The recent court judgements on the *Al-Bai Bithaman Ajil* cases also amplify the importance of proper legal documentation of the Islamic financial transactions to ensure the requirements of the underlying Shariah concepts applicable in the contracts are transparent to customers. Additionally, financial service providers must put in place proper internal controls to ensure strict adherence to the processes required under Shariah to mitigate the risks of being challenged in the court of law.

The responsibilities placed on financial service providers to achieve the expected disclosure standards will be rigorously enforced by the Bank through supervisory oversight. Financial service providers that fail to meet the disclosure standards will be subject to appropriate supervisory action by the Bank which include being subject to more rigorous requirements before offering new products to consumers and even product recall.

Conclusion

Effective transparency and disclosure standards that inspire good market conduct practices and consumer confidence is essential in promoting a resilient, efficient and sustainable financial services sector. Equally important is the need to raise the level of financial capability of Malaysian consumers to be empowered to take greater responsibility in personal financial management, which would establish a strong foundation for the effective exercise of consumer preferences and activism.

As consumers become more financially savvy and financial institutions offer more sophisticated products and services, it is important that sufficient disclosures of the risks and benefits of such products and services are made. To address the risk of mis-selling of financial products, the Bank developed a more consistent and comprehensive disclosure framework for retail financial products, emphasising on key product features, risks and benefits, and major terms and conditions of the contract. This disclosure framework sets out the general and product-specific disclosure requirements, aimed towards improving the basic parameters governing product disclosure.

Existing channels were also enhanced for consumers to seek advisory services and raise issues and complaints on financial matters. Financial service providers were required to comply with several mandatory requirements and to adopt best practices for effective handling of complaints under the new guidelines on complaints handling. Since its establishment in July 2008, the Integrated Contact Centre (ICC) at the Bank had experienced a significant increase of about 90% in the number of customers seeking its services. Of the 253,801 customers seeking its services, 244,882 were related to financial enquiries and advisory whilst 8,919 were complex cases on banking and insurance which required facilitation, assistance and resolution. ICC resolved 84% or 7,493 of these complex cases in 2009. The Bank also received a total of 531 cases from SMEs specifically relating to access to financing in 2009. Following the Bank's facilitation and monitoring, 92% or 490 cases were effectively resolved. This has supported SMEs to continue to obtain access to financing, even in the more challenging environment. The upward trend in the number of individuals and businesses seeking information and assistance is attributed to, among others, increased promotion and expanded channel of redress at the Bank. In 2009, the Bank expanded its walk-in public service centres BNMLINK (Bank Negara Malaysia Laman Informasi Nasihat dan Khidmat) at branches in Kota Kinabalu, Kuching and Kuala Terengganu to promote financial advisory to the members of the public and businesses, bringing the total of BNMLINK centres nationwide to six. To complement this, the Bank also introduced short message service (SMS) in 2009 as an additional channel for members of the public to contact the Bank to make enquiries, submit

complaints, obtain mailing address and contact details of the Bank, and seek information on how to obtain credit reports. Since its inception in November 2009, the Bank has received and addressed 489 SMS from customers.

AKPK also opened two new branches in Alor Setar and Kota Bharu during the year, thereby bringing the total number of branches nationwide to 11. As at end-2009, AKPK had provided credit counselling services to 110,452 customers, of which 29,399 customers with debts amounting to RM2.88 billion had received assistance under its Debt Management Programme.

Continued development of human capital

In line with the Bank's priority to strengthen human capital development in the financial sector, the Bank continued with efforts to enhance the role and effectiveness of institutional platforms established for this objective. The Asian Institute of Finance (AIF) (formerly known as the Financial Services Education Centre) was fully operationalised in 2009, providing a platform for coordinated initiatives on human capital development in the financial sector. One of AIF's priorities is to elevate the capacity of the financial services industry training institutes, namely Institut Bank-Bank Malaysia, IBFIM, Malaysian Insurance Institute and the Securities Industry Development Corporation to meet the current development needs of the industry and to respond proactively to the rapidly changing financial landscape which will place greater demands on skill sets of financial professionals. Towards this end, the banking, insurance and Islamic financial services industries have agreed to commit significant financial resources to support efforts by the training institutions and this is complemented by a matching contribution from the Bank. AIF has also established a risk management centre and a research and publication centre which will offer cross-cutting programmes in risk management for the financial sector, and conduct applied financial research to enhance the quality of programmes provided by AIF and the training institutes, respectively.

Since the inception of the Financial Sector Talent Enrichment Programme (FSTEP) in 2007 to train and prepare high calibre graduates for employment in the financial services industry, a total of 785 participants have enrolled in the

programme, with 604 participants successfully completing the programme, and 79 participants currently undergoing on-the-job training in various financial institutions. Almost all FSTEP graduates have been offered employment opportunities in the financial sector, indicating the success of the programme. To further enhance FSTEP, the “pre-selected scheme” approach was adopted in 2009 which enabled financial institutions to be proactively involved in the selection of FSTEP participants and expedite the recruitment process by financial institutions, thereafter. A Quality Assurance Committee was also established to enhance the overall quality of FSTEP’s programme. The Quality Assurance Committee is in the midst of reviewing the syllabus and programme delivery to meet the current needs of the financial services industry.

Preserving the integrity of the financial system

In 2009, the anti-money laundering and counter financing of terrorism (AML/CFT) framework was further enhanced through three major initiatives of expanding the scope of offences that can be investigated under the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLATFA), improving level of compliance among the reporting institutions, as well as strengthening joint efforts and collaboration with domestic law enforcement agencies and international counterparts. New predicate offences were included during the year that expanded the scope of offences that can be investigated under the AMLATFA to cover trafficking in person, illegal money changing, illegal foreign currency trading, and additional offences relating to corruption, extortion, criminal breach of trusts and forgery. The inclusion of these new predicate offences that brings the total predicate offences to 245, also enables reporting institutions to report suspicious transactions related to a wider scope of criminal activities. The enhancement to the legal framework was complemented by ongoing AML/CFT awareness among segments of reporting institutions as well as providing a number of targeted feedback sessions and conducting on-site examinations on selected reporting institutions. To effectively investigate syndicated crimes in breach of a number of provisions in different legislations, several joint operations with law enforcement agencies were conducted, particularly those involving illegal money lending, illegal money changing or illegal money remittances, illegal deposit taking, illegal investment scheme and drugs trafficking activity. This approach has enabled pooling of investigation resources

among law enforcement agencies and reduction of overall investigation time.

Given the increasing trend of cross-border crimes, the efforts to expand our international network by forging closer collaboration with financial intelligence analysts at the international level has been intensified. The Bank has signed MoUs with its counterparts in eight countries in Asia and Europe on the exchange of financial intelligence, bringing the total number of MoUs signed to date by the Bank to 28.

Malaysia has continued to show strong commitment to comply with international standards on transparency and exchange of information to curb illegal activities. Malaysia supports this effort to comply with these standards by signing international trade agreements with treaty partners and amending domestic laws. Malaysia is in the “White List” issued by the Organisation for Economic Cooperation and Development. This achievement bodes well for sustaining the overall confidence, competitiveness and attractiveness of Malaysia.

Outlook

While the recovery of the global economy is progressing, the external environment is expected to remain uncertain in the coming year. The reforms put in place over the years and stabilisation measures implemented in 2009 however have enabled the financial sector to remain resilient and supportive of the needs of the economy. To realise the vision of the nation to become a high-income economy and achieve developed economy status by 2020, the financial sector has an important role towards supporting this transition. For this purpose, a new blueprint for the financial sector is being drawn up, with the objective of enhancing the role of the financial sector as an enabler, driver and catalyst of economic growth, with enhanced capacity to contribute effectively to the economic transformation process.

The blueprint is aimed at developing a strong and stable financial sector that best serves Malaysia, one that is competitive, dynamic and inclusive, and that provides comprehensive and quality services to all segments of society. This best positions Malaysia’s financial sector to adapt to and leverage on the relevant forces of

change, including the changing demography, characteristics and financial requirement of Malaysian households and businesses, regulatory landscape, greater economic and financial integration, and latest advancements in information and communication technology.

A new blueprint for the financial sector is being drawn up to realise the nation's vision to become a developed economy by 2020

Another key milestone in the coming year is the review currently undertaken on the existing legislations governing financial institutions and intermediaries. While the new Central Bank of Malaysia Act 2009 reinforces the Bank's mandates on preserving monetary and financial stability, the proposed enhanced legislation will provide further clarity to the Bank's powers, supporting a differentiated regulatory and supervisory regime that best achieves the mandates given to the Bank, including promoting a sound, progressive and inclusive financial sector. The review will also reinforce the emphasis placed on effective board oversight and strong governance structures and processes as greater flexibility is accorded to players that are well-managed. An important consideration in the review is to promote a market-based environment for players to thrive and innovate while maintaining sufficient safeguards with adequate legislative powers for the Bank to ensure that financial stability is preserved at all times.

The pension reform initiative is currently being undertaken by the Government. This initiative aims to enhance the pension system in Malaysia, protecting against the risk of poverty in old age and smoothing consumption from working life into retirement. There are opportunities for the financial sector to have an important role in the provision of retirement products and to facilitate the development of a robust pension system as a key financial safety net for Malaysians.

In the insurance sector, progressive deregulation of rates and commissions will be pursued to promote greater competition and innovation. A new scheme for basic motor insurance coverage for third party

bodily injury and death is being formulated, acting as a catalyst to the ongoing reforms in the general insurance and takaful sector. The reforms which will have implications on the business strategies of insurers and their approaches to risk management, will be complemented with a holistic review of motor insurance practices and the supporting infrastructure to enhance underwriting practices and significantly improve claims management. Industry groups have been formed to study these issues and recommend appropriate transition towards a more efficient and effective operating environment, while improving practices across the entire value chain of the motor insurance sector. Efforts are also being taken to put in place a more effective insurance compensation system to enhance the existing financial protection for the policyholders of insurance companies and takaful operators. This system will contribute to financial stability through the promotion of sound risk management practices by insurers.

The pension reform and holistic review of the general insurance sector, particularly motor insurance business is currently underway

On the consumer front, ongoing efforts towards improving financial literacy will be reinforced with initiatives to strengthen avenues for consumer redress. The establishment of a financial ombudsman and improved product transparency, particularly in the area of pricing, commissions, fees and charges will be implemented.

As regional integration intensifies driven by larger trade and investment flows, Malaysia's financial sector is well positioned to benefit from opportunities that emerge from these developments. Malaysia's competitive advantage in Islamic finance will strengthen as Malaysia evolves into an international hub for Islamic finance. Moving forward, the potential of the financial sector to be a key enabler, driver and catalyst of economic growth will be reinforced, with commensurate enhancements to the regulatory and supervisory framework to support the orderly growth and development of the financial sector.

Safeguarding Financial Stability under the Central Bank of Malaysia Act 2009

The Central Bank of Malaysia Act 2009 (Act) provides greater clarity on the Bank's financial stability mandate and the corresponding primary functions. The financial stability provisions in the Act represent the cumulative experiences of the Bank in addressing many of the issues and challenges in preserving systemic stability taking into account current and anticipated future developments in the domestic and global environment.

Clearly defined financial stability mandate

The Act explicitly recognises the financial stability mandate of the Bank. In carrying out its financial stability mandate, the Bank is entrusted with the responsibility to regulate and supervise financial institutions under its purview, provide oversight over the money and foreign exchange markets, exercise oversight over the payment systems and promote a sound, progressive and inclusive financial system. As the elements contributing to or affecting systemic stability are very diverse, establishing a comprehensive definition of financial stability remains a challenging task. The financial stability mandate in the Act is defined in terms of the risks to financial stability, that is, risks that (i) disrupt, or are likely to disrupt, the financial intermediation process including the orderly functioning of the money and foreign exchange markets, or (ii) affect, or are likely to affect, public confidence in the financial system or the stability of the financial system. This approach accords the Bank with the flexibility to respond to unforeseen circumstances that may not be captured by a restrictive definition of financial stability. These parameters also provide definitive triggers for the Bank to exercise its powers under the Act consistently under different circumstances to ensure that such actions are only taken in the interest of preserving financial stability.

Strengthened scope of surveillance to facilitate pre-emptive risk mitigation policies

In order to avert or reduce risks to financial stability, it is vital for the Bank to be empowered to act pre-emptively and decisively, particularly in situations where a potentially destabilising build-up of systemic risks is foreseeable, but not necessarily originating from institutions or sectors that are directly under the Bank's regulatory purview. Non-regulated entities are increasingly more interconnected with financial institutions that are critical to the intermediation process and may have a more significant role in the financial system going forward. Access to relevant information in a timely manner therefore becomes highly critical. As such, the Act accords the Bank with the ability to collate, assess and monitor critical information through comprehensive provisions hence enabling the conduct of more effective and holistic surveillance, covering both regulated and non-regulated institutions and markets in the financial system. Should such a situation arise, the Bank will be able to take the necessary intervention and resolution measures to mitigate risks that stem from regulated and non-regulated entities based on a set of well-defined parameters.

Enhanced intervention and resolution powers to prevent, manage and resolve systemic crises

As the domestic financial system becomes more integrated with the regional and global financial markets, the Bank's ability to respond swiftly to manage and resolve crisis in an orderly manner is critical to prevent disruptions to the intermediation process and the broader economy. Past crises have demonstrated that effective and extensive powers in maintaining financial stability is an important determinant in ensuring orderly resolution of crisis or distressed institutions that could cause large negative externalities to systemic stability. Experience from previous crises has also shown that the speed and efficacy of crisis resolution measures would preserve financial intermediation function, reduce system-wide losses, protect public interest and promote confidence in the financial system. With a clear objective of minimising the ultimate costs to the financial system and economy, the Act institutionalises clear triggers and a more flexible set of crisis intervention and resolution policy instruments to deal with distressed institutions or markets,

expeditiously and effectively. Rapid expansion of cross-sector and cross-border linkages implies greater scope for financial contagion and underscores the importance of coordinated policy response amongst different agencies. In this regard, the Act provides for coordination and cooperation arrangements with other supervisory authorities at both the national and international levels.

Power to avert or reduce systemic risks that emanate from non-viable institutions

The Act further strengthens the Bank's ability to take pre-emptive actions to mitigate risks to financial stability that originate from failure of a specific institution. In this regard, the Bank is empowered under the Act to issue an order in writing to relevant persons to take appropriate corrective measures that are necessary to preserve systemic stability. Where privately-initiated resolution strategies are ineffective in minimising system-wide distress or the overall costs to the financial system, the Bank is empowered to undertake capital support measures to strengthen the loss-absorbing capacity of the financial system, either via the direct purchase of shares or capital instruments or by providing the necessary financial support to another financial institution or a body corporate established by the Bank for such purpose. If a financial institution, which has ceased to be viable or is likely to be non-viable, has adverse systemic implications, the Bank is empowered to direct a transfer to and vesting of a part or the whole of the failing institution's business or shares in another financial institution or a body corporate established by the Bank. This provision is designed specifically to facilitate the establishment of a bridge institution or facilitate private sector resolutions. This would minimise the use of public funds, preserve the franchise value of non-viable institutions and more importantly, to conserve crucial financial services that are non-substitutable and which have a key role in supporting the intermediation process. These financial stability powers, exercisable only upon firm assessment of credible threats to systemic stability, may also be exercised over entities that are not regulated by the Bank and that are likely to have systemic risks to the financial system.

Power to stem institutional or market liquidity shocks from threatening solvency and overall stability

The strong interrelationship between funding liquidity, asset market liquidity, institutional solvency and their role in influencing financial conditions underscores the need for more extensive liquidity interventions by central banks. The Act enables the Bank to use a broad range of instruments to provide liquidity assistance in order to contain liquidity shocks to financial institutions more effectively and prevent material disruptions to the functioning of the financial system and its stability. Taking cognisance of continued expansion of cross-border operations and centralised liquidity management by financial institutions, the Act also empowers the Bank to provide liquidity assistance to subsidiaries or branches of a financial institution outside Malaysia via arrangements with other central banks, in particular when external liquidity and funding shocks may destabilise the domestic financial system. This enhanced flexibility for the Bank to provide liquidity assistance has been designed taking into consideration the present and future developments in asset and funding markets as well as the corresponding financial risks to the Bank.

Strengthened processes, governance and accountability

The enhanced oversight function and powers to address financial stability concerns are complemented by strengthened framework for governance, transparency and accountability. Under the circumstances where any of the financial stability powers are invoked on institutions that are beyond the regulatory reach of the Bank or where it involves public funds or impinges on personal rights, the Act provides that such decisions are taken by the Financial Stability Executive Committee (FSEC). In essence, the FSEC shall decide on proposals relating to the (i) issuance of orders to entities which are not regulated by the Bank to undertake measures to avert or reduce risks to financial stability, (ii) extension of liquidity assistance to entities that are not regulated by the Bank or to overseas subsidiaries or branches of Malaysian financial institutions, (iii) provision of capital support, and (iv) issuance of an order for compulsory transfers. The FSEC comprises the

Governor, one Deputy Governor and three to five other members to be appointed by the Minister on the recommendation of the Board of Directors. The composition of FSEC is designed to reinforce the element of independent external oversight and enhance the efficacy of decision making mechanism. The clear majority of non-executives in the composition is intended to ensure the robustness of discussion and the independence of decision making in extending financial support or imposing certain financial stability measures. The Act requires that the members must be persons of probity, competence and sound judgment. The Act also provides that the relevant supervisory authority shall be represented by its head or representative as a member at any meeting of the FSEC when considering proposed actions in relation to an institution under the supervision or oversight of the supervisory authority. In addition to this, the Secretary General to the Treasury will be invited to all meetings of the FSEC involving financial institutions which are not regulated by the Bank.

In relation to an order to take measures necessary to avert or reduce risk to financial stability, the Act requires the Bank to give the affected person an opportunity to make representations. Similarly, the Act also provides for the fair determination of transacted price arising from an order for compulsory transfers. The transacted price will be ascertained by an independent valuer to be appointed by the Bank, and mutually agreed by both the transferor and transferee. If there is an appeal on the transacted price, the Bank shall constitute an Assessor Committee comprising three members drawn from a panel that is appointed by the Minister to consider the appeal.

In summary, the Act captures the core elements of macroprudential stability, encompassing ex ante surveillance powers to allow for timely identification of material risks to financial stability, pre-emptive powers to avert and mitigate systemic risks as well as the ex post powers to reduce the impact and cost of instability to the financial system. The Bank is provided with adequate legal backing to effectively discharge its role and responsibilities in addressing current and future challenges in safeguarding financial stability for the overall development of the financial system so as to support sustainable economic development.

Repositioning the Insurance and Takaful Industry to Support the Changing Socio-economic Landscape

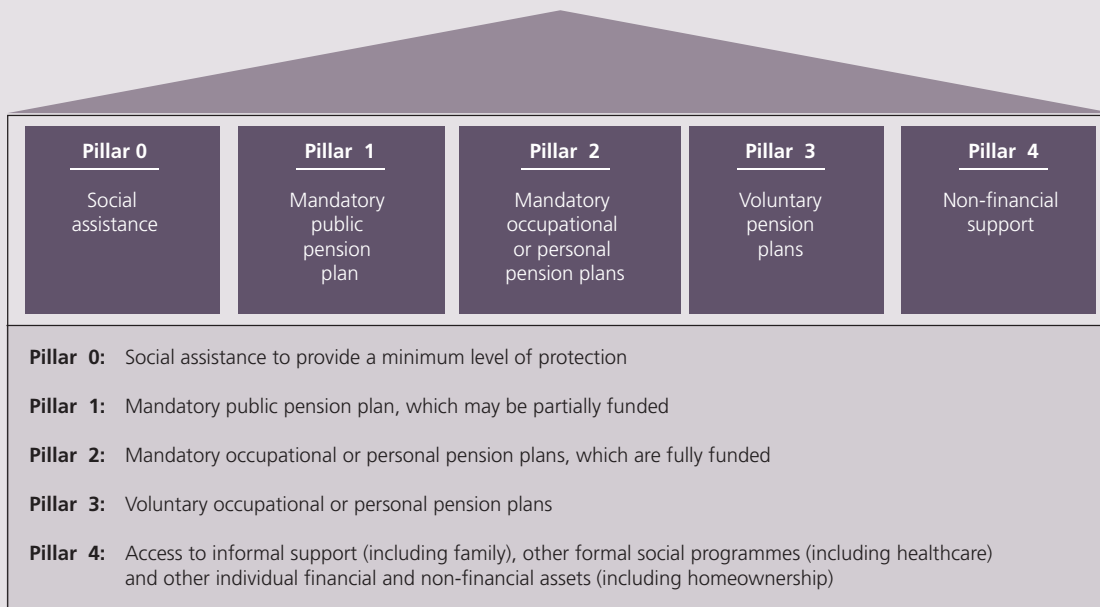
The insurance and takaful industry have made significant strides to become an important component of the financial system and a vital pillar to support the economic and social development of Malaysia. The evolution of the socio-economic landscape in Malaysia over the years has been instrumental in shaping the scope of business of insurers and takaful operators to provide traditional financial protection products to include a broad range of financial planning options such as wealth creation. Two significant areas are in the development of retirement financing and healthcare financing.

Enhanced focus on retirement financing

There has been significant global recognition of the importance of pension systems in the economic stability of countries and the security of an ageing population. Cognisant of the core objectives of pension systems, which are old-age poverty alleviation and smoothing consumption from work life into retirement, the World Bank has adopted a multi-pillar approach towards pension system design to address the needs of target population segments.

The World Bank multi-pillar pension framework provides a structured approach in efforts to evaluate the comprehensiveness and effectiveness of Malaysia’s pension system design. A multi-pillar pension system would better address the differing needs of target population segments by diversifying the types and sources of retirement income across the pillars. By promoting the sharing of risks and responsibilities between the individual, the Government and the private sector in the provision of pension benefits, the pension system of any given country would be more sustainable in the pursuit of a more equitable form of pension structure that suits country-specific needs.

Chart 1
World Bank Multi-Pillar Pension Framework¹



¹ Adapted from Holzmann, Hinz and Dorfman (2008) "Pension Systems and Reform Conceptual Framework" World Bank

Malaysia's pension system is primarily underpinned by Pillar 2 which is the occupational retirement income schemes operated by the Employees Provident Fund, Public Service Department of Malaysia and Armed Forces Fund Board. These schemes are complemented by various welfare assistance programmes, including those operated by the Social Welfare Department of Malaysia, which serve to alleviate poverty. However, there is still much capacity and scope for the enhancement of Malaysia's pension system, in particular in the promotion of pension products provided by the private sector.

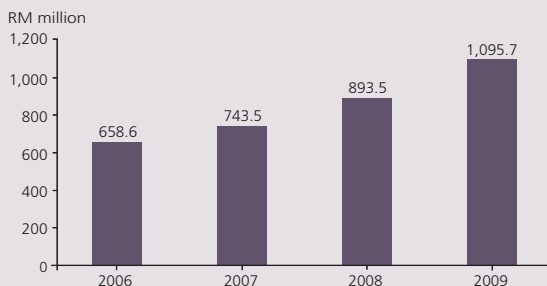
While Malaysia has a relatively comprehensive mandatory occupational pension scheme for employees of the public and private sectors, the present system which has been in existence for more than five decades might not be sustainable in the longer term to effectively support the ageing demographic structure of the Malaysian population. In 1980, the number of Malaysians aged 55 and more comprised 8% of the total population and this is expected to increase to 16% by 2020. With the improved quality of life, the life expectancy of Malaysians has increased from only 56 years in the 1950s to 76 years for females and 71 years for males currently. This is estimated to increase to 79 years and 75 years respectively in 2020. The longevity risk has posed great challenge to the adequacy of savings for retirement, further compounded by premature exhaustion of retirement savings in the early period of retirement, particularly in view of the prevailing practice of lump sum withdrawal at age 55.

Towards enhancing the Malaysian pension system, the Government has embarked on a pension reform initiative, guided by the World Bank's multi-pillar approach. For comprehensiveness, the reform necessitates an integration of the various pension pillars to bridge gaps in the provision of financial safety nets. The insurance and takaful industry in particular, would play a significant role in strengthening the development of a vibrant voluntary private pensions market of Pillar 3 to complement the social pension infrastructure made available by the Government. The offering of pension products such as annuity plans by insurers and takaful operators will enable retirees to benefit from a regular income stream, beyond retirement for a sustainable standard of living. It is key, therefore, to create greater awareness among Malaysians on the importance of retirement planning and making available product lines which accommodate the needs of the ageing population.

Growing significance of medical and health protection

With the changing socio-economic landscape, Medical and Health Insurance (MHI) and Medical and Health Takaful (MHT) are expected to continue to grow strongly. Total MHI gross direct premiums and MHT gross direct contributions increased 22.6% from RM0.9 billion in 2008 to RM1.1 billion in 2009 (Chart 2).

Chart 2
Total Gross Direct Premiums/Contributions of
Medical & Health Insurance and Takaful



Source: Bank Negara Malaysia

This growth is in line with the trend of increasing private expenditure in healthcare (average 17% per annum over the period 2003 to 2008) that reached a total of RM18.9 billion in 2008. The trend is expected to continue as rising cost of healthcare becomes an impetus to seek cost-effective ways to provide for healthcare needs and protection from catastrophic healthcare spending. Furthermore, as Malaysia progresses towards a high-income economy, household expenditure on healthcare is expected to increase especially with a growing middle-class population. A highly-skilled workforce will also demand better

healthcare benefits leading to higher healthcare spending by employers. Insurers and takaful operators are expected to respond to such developments by providing more cost-effective options to consumers. One recent innovation is the introduction of no-claims bonus for MHI plans where consumers with a good claims record will receive cash payments.

As income levels and public awareness of healthcare increases, there will be increasing demand for higher levels of cover and a more comprehensive suite of benefits. For example, some insurers have increased or removed lifetime limits on claims, while others are considering including traditional medicine to the benefits covered. Certain lines of critical illness products now allow consumers to make multiple claims, although for different illnesses each time, in response to an environment where better medical technology increases the likelihood of recovery from critical illnesses. With increased life expectancy, there is also a push towards longer term MHI and MHT, with some products now covering policyholders up to age 100.

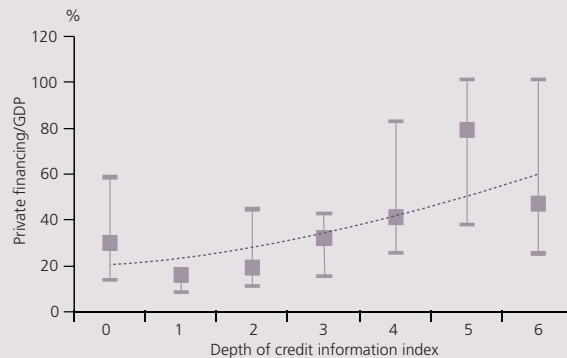
It is clear that as the MHI and MHT segment matures and as Malaysia moves towards a high-income economy, the range of products and services will grow to meet the diverse needs of the Malaysian population.

In facing the challenges of an ever-changing socio-economic landscape, the Bank will continue to review and refine the regulatory and supervisory approach for the insurance and takaful industry to ensure that the players remain resilient, responsive and progressive in serving the needs of Malaysians.

Regulatory Framework for Credit Reporting Agencies in Malaysia

Credit information sharing is an important element in the financial system and has important consequences on the functioning of the credit market, financial stability and economic development of a nation. The sharing of credit information reduces asymmetries of information and search costs, thereby enhancing access to financing to a broader spectrum of the population, through the formal system.

Chart 1
Private Financing/GDP versus Depth of Credit Information



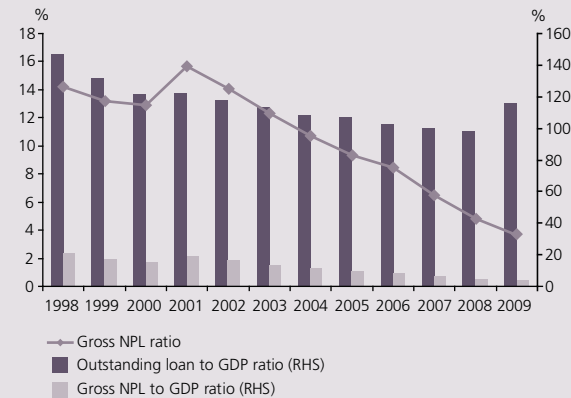
Source: Internal computation based on The World Bank dataset 2007

Such sharing of information also lowers the cost of financing for borrowers with good credit background and history. Advancements in risk and decision-making analysis, and the availability of a wide range of credit information on a real-time, anytime basis have significantly shortened loan processing time. In some instances, it has even facilitated instantaneous decision on application for credit. From a social perspective, the sharing of credit information contributes towards inculcating financial discipline and avoiding incidences of imprudent and excessive borrowings among borrowers. Borrowers demonstrating strong financial characters are able to leverage on such “reputational collateral” to obtain borrowings at favourable terms and rates.

For financial and credit institutions, credit information helps to strengthen the entire chain of credit evaluation and administration of credit risk management. This in turn contributes towards institutional safety and soundness, and stability of the overall system.

In Malaysia, the credit information services industry has been in existence for more than 10 years. At present, such services are being provided by both private and public entities. Consolidated credit information sharing has proven to be beneficial to both borrowers and lenders. Access to shared credit information has contributed towards reducing the duration in the processing of housing loans by banks, from an average of 3.3 days in 2004 to 2.4 days in 2009. The availability of such information has also supported the development and adoption of advanced credit and portfolio risk management tools such as credit scoring and portfolio analysis by financial institutions. These tools not only facilitate more effective credit decisions, but also more robust administration and management of credit risks. Collectively, these have paved the way for continued improvement in the quality of loan portfolio of financial institutions over the past decade, supported by prudent underwriting and credit risk management practices by financial institutions.

Chart 2
Ratios of Outstanding Loans and Gross NPLs to GDP and Gross NPL Ratio, 1998 - 2009



Source: Bank Negara Malaysia

Given the extensive usage of credit information and its implications for financial stability and potential impact on the general public, it is important for the appropriate safeguards and legislative framework to be in place for credit information to be shared in a responsible manner among the participants and players in the credit reporting industry. The absence of a regulatory framework governing the activities of private credit reporting agencies (CRAs) in Malaysia and inadequate legislative requirements have surfaced several fundamental gaps and weaknesses in the credit reporting industry. These became more evident in the recent years and constrained access to financing of certain borrower segments through the formal channel. Among the concerns that were raised and debated extensively by the public were inaccurate and outdated credit information, incomplete information leading to mistaken identities, excessively long retention period of adverse credit records, absence of consumer rights and redress mechanism – all converging towards the lack of accountability, integrity and standards for consumer care on the part of the private CRAs.

These developments have led to the tabling of the Credit Reporting Agencies Bill 2009 (CRA Bill), which is to be debated in the Parliament in 2010. The CRA Bill is an important legislation that can contribute towards the healthy development of a regulated and structured credit information sharing industry, that would pave the way for better credit culture, improved risk management and overall credit processing time within the country. The CRA Bill was finalised after consultations with the relevant government agencies to strike a balance between consumers’ rights to privacy and protection, and lenders’ rights to information for improvements in credit evaluation and risk management purposes. Among the salient features of the CRA Bill are as follows:

- **Coverage:** In providing protection to both individuals and non-individuals, the CRA Bill will cover credit information relating to both natural persons and other entities, such as corporations, partnerships, cooperatives and other organisations;
- **Regulation of CRAs:** A Registrar of Credit Reporting Agencies (Registrar) will be appointed by the Minister of Finance to regulate and supervise CRAs. CRAs are required to obtain a certificate of registration from the Registrar to undertake credit reporting businesses. The Registrar is also responsible for resolving complaints and disputes between consumers and CRAs;
- **Preserving privacy:** CRAs are required to notify consumers that information on them is being collected. CRAs are also required to obtain the consent of the consumers on disclosures to third parties;
- **Consumer rights:** Consumers are accorded the rights to access own information that is held by CRAs, and shall not be charged for correcting any information that is found to be inaccurate, incomplete or misleading;

- **Accuracy and security of information:** CRAs are required to take reasonable steps to ensure that information held are accurate, complete, not misleading and up-to-date. CRAs are also obligated to put in place the necessary safeguards (e.g. systems, procedures and processes) to ensure the security and safety of the information; and
- **Enforcement mechanism:** Violation of the CRA Bill shall invite penalties ranging between RM50,000 to RM1 million or a six-month to three-year imprisonment or both, depending on the severity of the offence.

The changing structure and dynamics of the financial system, growing consumer activism and deeper financial inclusion will expand the outreach of credit facilities and financial services. These developments will shape the environment surrounding the credit reporting industry that demands for improved transparency for consumers while not neglecting the value added services that are required to support the development of enhanced risk assessment methodologies and adoption of more sophisticated credit decisioning models. The Central Bank of Malaysia Act 2009 and the CRA Bill contain key elements that provide for a balanced platform for the efficient sharing of credit information among lenders and the effective protection of consumer data and privacy rights. Credit information in the Centralised Credit Reference Information System (CCRIS), where necessary, may be made accessible to qualified CRAs within a regulated environment to further enhance the risk management capabilities of lenders, thus promoting stability of the financial system. CRAs can complement the information contained in CCRIS with information from other non-bank sources such as utility companies and trade suppliers and develop specialised risk management models. This will provide more extensive content, coverage and quality of products and services. Collectively, the CRAs can have an important role in contributing to prudent credit expansion in the country, and a well-structured regulatory framework for such agencies will support this development.