

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.