

Regulatory Framework for Foreign Financial Institutions and Investment Banks in Malaysia

Developments in the global financial markets over the recent year have placed great scrutiny on the effectiveness of regulatory and supervisory oversight regimes around the world. These recent events have emphasised the crucial need for sound regulatory and supervisory frameworks which keep pace with the rapidly evolving financial landscape.

This article outlines the key features of the regulatory and supervisory regime that is applied on foreign banking institutions and insurance companies, and on the investment banks operating in Malaysia. The oversight of foreign banks and insurers is aimed at reinforcing the soundness and resilience of their domestic operations, whilst the regulatory framework on investment banks intends to ensure prudent business operations. This supports the objective of maintaining the overall stability of the financial sector.

The Regulatory Approach for Foreign Financial Institutions in Malaysia

Malaysia's financial system hosts a diversity of foreign financial institutions, with many of them having an entrenched presence – being pioneers during the formative years of the Malaysian financial system in the 19th century. At present, foreign financial institutions control 26% of banking and insurance sector assets. The presence of these financial institutions, each with distinct business strengths and niches, infuses the Malaysian financial community with improved technical expertise, best practices and technology and enables consumers to benefit from world-class products and services.

However, the recent crisis has drawn attention to the far-reaching implications that internationally active financial institutions have on the financial stability of individual economies which host their presence. Given their widespread businesses and the complexity of their operations and governance processes, concerns arise on their transmission of external shocks into host markets. While many globally-renowned financial institutions operate in the Malaysian financial system, the regulatory framework in Malaysia provides adequate safeguards to minimise cross-border contagion effects.

An important feature of Bank Negara Malaysia's regulatory framework on the Malaysian operations of foreign banking institutions and insurance companies is the requirement for local incorporation. Coupled with the existing comprehensive financial safety net in place, the operations of foreign banking institutions and insurance companies in Malaysia and their customers' interests are safeguarded as illustrated below:

Key Features of the Regulatory and Supervisory Framework for Foreign Financial Institutions in Malaysia

Local incorporation creates a legal separation between the domestic entity and its foreign parent company

Greater degree of protection to Malaysian consumers

- Assets and capital of the domestic entity are 'ring-fenced' to ensure that obligations in Malaysia, especially to bank depositors and insurance policyholders, are firstly fulfilled.
- Repatriation of dividends, payment of management fees and extension of loans and advances to the foreign parent company are subject to compliance with prudential requirements.

Permanent capital commitment to support Malaysian operations

- Imposition of minimum capital requirements on the domestic entity secures dedicated capital funds in Malaysia to safeguard the sustainability and continuity of their Malaysian operations.

Constitution of a separate board of directors in Malaysia whose fiduciary duties are specific to the Malaysian operations

- The board is responsible for the stewardship of the domestic entity, including evaluating the suitability of global strategies in the context of the domestic market and being accountable for the adoption of such strategies.
- The participation of Malaysians on the board is expected to imbue local knowledge and ensure business strategies are aligned with the local environment.

Protection under the financial safety net

Regulatory and supervisory oversight by Bank Negara Malaysia

- Same degree of oversight by Bank Negara Malaysia is exercised on foreign financial institutions, as in the case of domestic players.
- Adequate powers to take prompt and pre-emptive measures to address any emerging risks and vulnerabilities of the financial institution.

The interests of bank depositors and insurance policyholders are safeguarded

- Deposits in the locally-incorporated foreign banks are protected under the Malaysia Deposit Insurance Corporation on the same basis as domestic banking institutions.
- Mechanisms are in place for the protection of insurance policyholders through the insurance guarantee scheme fund.

Eligible for Bank Negara Malaysia's liquidity assistance

- Locally-incorporated foreign banks can access these facilities subject to the same criteria as domestic banks.

The Regulatory Approach for Investment Banks in Malaysia

Investment banks in Malaysia operate within a regulatory regime where similar rigour is applied in the prudential regulatory and supervisory approach as for commercial banks. The characteristics of the Malaysian regulatory and supervisory framework for investment banks include:

Key Features of the Regulatory and Supervisory Framework for Investment Banks in Malaysia

Dual regulation and supervision by Bank Negara Malaysia and the Securities Commission

Clear accountabilities minimise regulatory gaps and overlaps

- Arrangements formalised under a Memorandum of Understanding between the two agencies ensure that responsibilities are unambiguous and well-defined.
- Bank Negara Malaysia is responsible for the prudential regulation of investment banks to ensure their safety and soundness and the overall stability of the financial system.
- The Securities Commission is responsible for the investment banks' business and market conduct in order to promote market integrity and investor protection in the capital market.
- Cohesive arrangements facilitate prompt and decisive action by the two agencies.

Similar regulatory and supervisory regime to commercial banks

Prudential regulation of investment banks

- Investment banks are subject to prudential requirements, which are similarly applied to commercial banks, including Basel II, limits on exposures to single counterparties, connected lending restrictions and corporate governance standards.

Supervisory and surveillance framework

- Comprehensive and holistic risk assessments are conducted on the investment banks' businesses and overall health, including the conduct of on-site examinations.
- Enables early detection and pre-emptive action to be taken to address emerging risks and vulnerabilities in individual investment banks.
- Banking groups that have both commercial banks and investment banks are supervised on a consolidated basis to enable comprehensive assessments of their safety and soundness. Bank Negara Malaysia is also organised internally to support such oversight, with a dedicated department supervising financial conglomerates.

Access to wider sources of funding and liquidity

Able to accept deposits

- Investment banks in Malaysia can accept deposits of RM500,000 and above and are players in the interbank market.
- This provides them with more stable and diversified sources of funding.

Eligible for Bank Negara Malaysia's liquidity assistance

- Investment banks can access these facilities, providing a safety net for their temporary liquidity needs.

The regulatory and supervisory framework for financial institutions in Malaysia will be continuously strengthened to ensure that financial stability is preserved at all times.