

Realignment of Regulatory and Supervisory Functions

This recent decade has seen a significant transformation of the global and domestic financial landscape due to the forces of globalisation, advances in information and communication technology, financial innovation, financial liberalisation and the trend towards greater market orientation. Developments in the financial sector have led to enhanced access to financial services, improved service delivery and greater diversity in financial instruments. These have also been accompanied by the blurring of activities between the different types of players within the financial system. In an environment that is rapidly changing with new risks emerging, maintaining financial stability has become increasingly more complex and challenging. As the financial system evolves to facilitate the economic development and transformation process, with a growing trend towards greater deregulation and market orientation, regulators are faced with new challenges to ensure that the financial institutions and markets continue to function effectively. In this respect, the development of the financial infrastructure, building the capacity of financial institutions, enhancing financial capability of consumers as well as ensuring adherence to fair market practices have become areas of focus for financial regulators, in addition to maintaining financial stability.

In the context of this environment, the Bank has therefore continued to reassess its strategies and internal capabilities to ensure that it remains effective in achieving its objectives, in particular in promoting monetary and financial stability to support the economic growth process. Thus, to be strategically positioned to effectively respond to the changing financial landscape, Bank Negara Malaysia has embarked on a holistic review of its financial sector regulatory and supervisory functions to ensure a sound and efficient functioning financial system. The realignment of the regulatory and supervisory functions of the Bank therefore aims to facilitate a more integrated and holistic approach to financial sector regulation and supervision as well as enhance understanding of the dynamics of the inter-linkages between the various sectors. A further objective is to promote greater harmonisation of the regulatory and supervisory frameworks across the different sectors, taking into account the uniqueness and stage of development of the respective industries. The realignment also aims to ensure an effective and integrated approach to market conduct supervision and to enhance consumer capabilities as well as the assessment of trade-offs between competing objectives. The realignment of the regulation and supervision functions will also promote greater integration and cohesiveness in the management of the Bank's resources.

An extensive review of best practices in regulatory and supervisory approach was conducted taking into account the distinctiveness and phase of development as well as the future development of the Malaysian financial system. In this regard, the regulatory functions have been realigned along functional lines, hence diverging from sector specific demarcation of responsibilities. The supervisory functions have also been realigned to enable greater focus on the supervisory process and greater accountability in the assessment of microprudential risks. The realignment exercise however has not included the Development Finance and Enterprise Department. The existing functions and structure of the Development Finance and Enterprise Department will continue to focus on facilitating an enabling environment for the development of small and medium enterprises and to nurture the development financial institutions during the initial period of being supervised by the Bank.

The realignment process has thus resulted in the creation of new departments and has entailed considerable reorientation, rationalisation and streamlining of roles and functions of the existing



departments. In particular, the functional responsibilities of the Bank Regulation Department and Insurance Regulation Department have now been mapped into five new departments namely Financial Sector Development Department, Financial Surveillance Department, Prudential Financial Policy Department, Consumer and Market Conduct Department and a supporting administrative unit, the Regulation and Supervision Support Unit.

The strategic developmental functions of both the banking and insurance sectors are now merged into the **Financial Sector Development Department (FSD)**. The FSD is vested with the responsibility for the progressive development of the financial services sector including the promotion of sustainable and robust financial institutions and financial infrastructure enhancement aimed at fostering a competitive domestic financial industry that is able to meet the changing needs of the economy.

Of equal importance is to strengthen the ability and capacity of the Bank to effectively identify and measure potential risks and vulnerabilities of the system and to assess its implications on the functioning of the financial system and on financial stability. This responsibility is now with the **Financial Surveillance Department (FS)**, which is entrusted to undertake comprehensive and integrated macroprudential surveillance and assessments of emerging trends and vulnerabilities of the financial system. This will facilitate the formulation of policies and risk mitigation measures to strengthen the robustness and resilience of the financial system. With the setting up of the FS, collaborative mechanisms within the Bank have also been reoriented to facilitate better assessment of the risks emanating from domestic and international developments on the overall stability and functioning of the financial system. As part of its overall surveillance framework, the department also works closely with the supervisors to ensure that risk assessment has incorporated both macro and microprudential perspectives. In addition, the FS is also vested with the responsibility to enhance the potential of the credit bureau in the surveillance process through robust data warehousing and strengthened analytical capabilities. This includes a review of the credit bureau's data coverage and accuracy, to further improve its predictive value and effectiveness in the risk management and surveillance process.

With greater financial innovations, the emergence of new distribution channels and the introduction of new players with more innovative and complex financial products and services, the need for a more consistent regulatory approach across all sectors within the system has heightened. Harmonisation of policies across sectors and products is essential so as to level the playing field to avoid regulatory arbitrage, and to reduce unnecessary regulatory burden and cost of compliance. It is within this context that the prudential policy functions of both banking and insurance sectors have been consolidated into the **Prudential Financial Policy Department** to undertake the development of a sound and robust prudential framework for financial institutions that promotes harmonisation and alignment of regulatory treatment across sectors and across functionally similar products as well as facilitates a more integrated risk-based supervisory approach.

With the development of a more diversified, more complex and sophisticated financial system, significant attention has been given to enhance the financial literacy and market conduct framework in Malaysia. This has essentially aimed at enabling consumers to make well-informed decisions on financial matters with confidence. Regulators and supervisors also have a greater role to play in the provision of safety nets aimed at ensuring the fair treatment of consumers. As such, adequate information on and access to financial products and services that is supported by strong regulatory oversight and an effective redress process, will contribute towards establishing

an appropriate balance of power between consumers and their service providers. The establishment of the **Consumer and Market Conduct Department (CMC)** is aimed at adding further focus to the Bank's efforts in enhancing the financial capability of consumers as well as strengthening the appropriate market conduct practices and fair consumer treatment by the financial service providers and intermediaries. In line with the mandates of the department to safeguard the interest of customers and promote adherence to fair market practices, the supervision of financial intermediaries is now placed with CMC. The department is also responsible for market conduct regulation and supervision of the wholesale markets that are under the purview of the Bank.

The vision to create a vibrant, innovative and competitive international Islamic financial services industry in Malaysia has prompted special efforts and focus on strengthening Malaysia's position as an international Islamic financial centre, MIFC. In this respect, the **Islamic Banking and Takaful Department** has also been streamlined to ensure this focus and to create an enabling environment through improvements in the regulatory regime to effectively support the unique characteristics of an Islamic financial system. The department is also vested with the responsibility of reinforcing the development of the relevant prudential policies aimed at promoting the robustness and soundness of the Islamic finance industry.

The Payment Systems Department was also rationalised and renamed **Payment Systems Policy Department** with the focus on the development of policies and strategies to promote the safety, security and efficiency of the payment systems and payment instruments in the country as well as to drive migration to e-payments initiatives. The rationalisation is also intended to achieve greater check and balance between payment system policy and operations in line with international best practices.

The responsibility to ensure the soundness and robustness of the financial institutions lies with the supervision departments. In this regard, the supervisory functions of the Bank have been realigned with the primary objectives of developing, enhancing and implementing an effective surveillance framework to ensure the safety and soundness of the financial institutions and to promote sound business and operational practices. In this respect, the function of administering the relevant banking, insurance, takaful and payment systems Acts has now been transferred to the respective supervision departments thus better aligning the principal accountabilities for the health of the financial institutions with the authority for decision making. The supervision sector helps foster the stability and strength of the financial system by monitoring the safety and soundness of the banks, insurance companies, takaful operators and other institutions under the purview of the Bank as well as actively promoting the adoption of international best practices in corporate governance and risk management. Consistent with these objectives, the supervision sector now includes the Financial Conglomerates Supervision, Banking Supervision, Insurance and Takaful Supervision and, IT and DFI Supervision Departments.

The **Financial Conglomerates Supervision Department (FCS)** is entrusted with the supervision of individual financial conglomerates while the **Banking Supervision Department** undertakes supervision of stand-alone commercial banks, stand-alone investment banks and all Islamic banks including Islamic banking subsidiaries of domestic banks. The responsibility to ensure the soundness and robustness of the insurance companies and takaful operators (including the reinsurance companies and retakaful operators) is vested with the **Insurance and Takaful Supervision Department**. The Information Systems Supervision Unit has now been renamed **IT and DFI Supervision Department** to reflect its enhanced role in supervising development

finance institutions, payment system operators and issuers of payment instruments in addition to its responsibility for information systems supervision of all institutions under the purview of the Bank.

While the sector specific supervisory approach is retained, a matrix reporting framework has been adopted for the supervision of the financial institutions that are part of financial conglomerates so that an integrated approach to supervision and assessment of the risk profile can be undertaken on a group basis across the banking and insurance sectors. The new structure of the supervision sector also provides the necessary foundation for effective consolidated supervision to take place as the Bank adopts a more universal framework in its supervisory approach that is applicable across financial industries and moves towards principle-based and differentiated supervision.

The increased complexity in banking activities, emergence of new risk factors and continuous change in financial landscape have accentuated the need for the role of financial risk expertise that can undertake risk assessment both at the individual institution level as well as on a system-wide basis. For this reason, dedicated risk units on credit, market, operational and insurance risks have been established in the supervision departments to serve both the regulation and supervision sectors. These units provide technical input through monitoring and examination of developments and trends of risks in the financial system to support policy development, supervisory functions and macroprudential surveillance on risk management practices.

As part of the overall efforts to align the Bank's resources and enable departments to be more strategically focused, a dedicated administrative support unit, the **Regulation and Supervision Support Unit** has been established to provide centralised administration services, knowledge management support and coordinate the learning/development initiatives, for the efficient functioning of the regulation and supervision departments.

The new organisational structure of the regulation and supervision sectors came into effect on 27 November 2006. The changes to the organisational structure have been accompanied with the streamlining of internal processes to reflect the new workflow and reporting structure. Relevant collaborative mechanisms between all the departments in the Bank have also been enhanced to ensure seamless and effective coordination as well as mitigate potential risks arising from these changes. The realignment exercise has allowed for a more holistic, integrated and focused approach to financial regulation and supervision thus strengthening the ability of the Bank to effectively achieve its objectives and desired outcomes.

Table 1: Organisational Structure

