OVERVIEW

During 2006, the Bank’s governance and organisational development practices continued to be enhanced to ensure that the organisation evolves to meet the challenges posed by the dynamic external and domestic environment, as well as with the Bank continuing to progress towards the achievement of its desired outcomes. The Bank has continued to focus on the following priority areas:

- Continuously enhancing internal capacity and capability to achieve the Bank’s mission of promoting monetary and financial system stability and fostering a sound and progressive financial sector, that will support and sustain economic growth for the benefit of the nation;
- Developing a more performance driven and strategy-focused organisation; and
- Sustaining a working environment that supports knowledge workers and promotes a performance-differentiated work culture.

The increased pace of change in the global economic and financial landscape, as well as the more rapid development of the Malaysian financial system continue to re-define the scope of central banking. Whilst the monetary, regulatory and supervisory functions remain central to the core mandate of maintaining monetary and financial stability, the Bank has expanded its developmental role to help shape the economic and financial landscape. To that end, the Bank has focused on specific strategic results critical to sustaining financial stability and economic growth in the prevailing and prospective environment of rapid change and increased uncertainty.

In order to ensure the success of the Bank’s desired outcomes and strategic results, focused programs were initiated to enhance capacity and capability in the areas of governance, talent management, training and learning, knowledge management, as well as information and communications technology management.

Governance

The Bank’s Corporate Governance framework has three (3) important pillars, namely, independence based on its given roles; accountability based on the need for optimum effectiveness and efficiency in performing the given roles through the use of its available resources, as well as monitoring performance and managing the associated risks; and transparency in ensuring clarity of its actions as they impact the Bank’s multiple stakeholders.

Whilst the policy making function of the central bank is the mandate of the Management Committee chaired by the Governor and comprising three Deputy Governors and seven Assistant Governors, the responsibility for the general administration of the affairs and businesses of the Bank is vested in the Board of Directors. The Board of Directors comprises individuals of high integrity and eminence from industry and the public sector. The Board Audit Committee is chaired by an independent director. The Board had convened 12 monthly meetings during 2006. Four Board Audit Committee meetings were also held. Key issues pertaining to the corporate governance and organisational development of the Bank are deliberated at the Board meetings. The Board is also fully briefed on all policy matters pertaining to monetary and financial stability, as well as the management of the nation’s payment systems. The Board approves the Bank’s annual operating plan and budget.

The Management Committee, which is the highest executive body within the Bank, is chaired by the Governor, and meets once a week to deliberate on policy matters pertaining to the financial sector, the economy and the Bank’s operations. The Management Committee is supported by several policy committees, which are also chaired by the Governor. These committees include the Reserve Management Committee, Monetary Policy Committee, Financial Stability Policy Committee and Risk Management Committee. The policy committees provide a forum for cross-functional deliberation, and hence the implementation of consistent policies. The collective skills, broad experience and knowledge
of the Management Committee, combined with the legal framework under the Central Banking Act provides the Bank with the authority to remain autonomous in deliberating, setting and implementing its policy objectives.

In 2006, the Minister of Finance endorsed the establishment of an additional position for Deputy Governor, in line with the provisions of the Central Banking Act. Three new Assistant Governors were appointed in 2006, increasing the number to seven Assistant Governors. One specific enhancement is the placement of the regulatory and supervisory functions under separate Deputy Governors, as well as the re-structuring of the departments under the regulations and supervisory functions. The re-structuring aims for a more harmonised regulatory framework for the financial sector, improve functional specialisation within the Bank and provide more effective engagement with the financial sector and market. These changes in governance also amplify the Bank’s continuous efforts to improve management agility and enhance its integrity as a regulatory and policy-making institution.

Another critical aspect of governance is sound financial management of the Bank’s finances. The Bank conducts a bi-annual review of its operating plan and budget in order to ensure proper allocation of funds. The Bank’s greater involvement in developmental projects has created new requirements in terms of financial information. A two-year project was initiated in 2006 to develop an enhanced Financial Management System, to replace the current system that was originally introduced in the 1980s. Further, as a means to enhance internal controls as well as be more prudent in expenditure management, the Bank has implemented a revised Procurement Policy and Procedures in August 2006. The new procurement guidelines will not only enhance checks and balances in procuring goods and services, but will also improve competitive sourcing and pricing.

In promoting greater transparency of its policy actions, the Bank continues to publish regular communication of economic data analysis through monthly and quarterly bulletins as well as increasingly through the Bank’s website. The Bank’s Annual Report includes comprehensive explanations of all key policy decisions taken during the year, in addition to the relevant economic and financial performance data.

The Bank conducted a briefing to the Prime Minister and the Minister of Finance, where the assessment of the economy and the financial sector were presented. In the same forum, other strategic financial and economic issues as well as challenges confronting the country were also presented with important policy recommendations. Additionally, to maintain transparency of its policy direction, the Bank had intensified efforts to ensure that the general public and other key stakeholders were kept abreast with developments in the financial system through targeted press statements and briefings.

**Strategy and Performance Management**

The objective of strategy and organisational performance management is to ensure that the Bank has focus and clarity in what it wants to achieve, the right strategies in place to achieve these objectives, and the resources aligned in the most efficient and effective manner for this purpose. The goals are guided by the core functions of ensuring monetary, financial system and payment system stability. A Strategy Forum supports this process by providing a platform to deliberate the Bank’s effectiveness in delivering results, and how capacity and capability needs to be enhanced in order to improve organisational performance.

The internal strategy and performance management process plays a key role in:

- Enabling senior management to keep track of the wide range of organisational performance issues;
- Facilitating greater cross-functional dialogue on strategies;
- Ensuring that capacity and capability development efforts are aligned with the Bank’s strategic focus; and
- Promoting greater sharing of critical talent and information across functions and roles in the Bank.
Talent Management

The translation of the Bank's strategic intents into measurable results is supported by a framework that together manages talent demand, talent supply and staff performance. These efforts have allowed the Bank to promote greater organisational clarity on roles and performance expectations across various levels within the Bank.

As a performance-oriented organisation, the Bank places emphasis on the need to differentiate its Compensation Aggregates (Annual Base Salary, Short Term Incentives and Benefits) based on merit of performance. The Bank implemented a new broad banded job grading and salary structure in line with the revised roles of staff. The revised scheme was affected from 1 May 2006, and included a performance-based salary adjustment to staff, as well as performance differentiated reward. The Bank also introduced specialist ladders for critical central banking functionalities, namely actuarial, risk management, econometrics and monetary policy, shariah and portfolio strategists. The objective of the specialist ladders is to ensure the Bank remained competitive in attracting, developing and retaining certain types of talents in these critical areas. The need for additional specialist or technical laddering will be reviewed from time to time.

The on-going review of talent requirements is complemented by a revised Behavioural Competency model for Senior Executives and above, meant to foster new types of skills and work practices in the Bank. The inculcation of appropriate behavioural, functional and technical competencies will provide greater clarity for staff in their respective functions, as well as provide a ‘development compass’ in steering an individual’s progression within the Bank.

An increasingly important dimension of the Bank’s talent management is the Bank’s Scholarship Programme, which is one of the strategies for building a long-term talent pipeline to meet the Bank’s requirements. The Bank has increased the number of scholarships offered by 85 percent (from 91 scholarships in 2005 to 168 scholarships in 2006) in order to better meet future talent needs. The Bank’s scholarship focus areas are essentially in the core central banking disciplines and any newly identified emerging areas of competencies. The efforts to develop a more robust long-term talent pipeline is reinforced by a succession management system that takes into account the need for leadership and technical talent, vis-à-vis the anticipated attrition. The succession management is complemented with the Bank’s rigorous leadership development programme. The Bank was recognised for these efforts with the Exemplary Practice Award under the leadership development category at the world-renowned Annual Corporate Xchange University Award For Excellence and Innovation in Corporate Learning, Orlando, Florida. The Bank is the first central bank to receive such an award.

The staff strength of 2,488 as at December 2006 has demonstrated an increase of six percent from December 2005 (staff strength of 2,345), with five percent attrition due to retirement and resignation. With a ratio of Executive to Non-Executive of 72:28, the Bank continues to emphasise the increase in professional talent, and a greater proportion of ‘executive’ level staff.

Knowledge Management

The emphasis accorded to Knowledge Management (KM) continues to deliver significant benefits to the Bank where embedded KM practices and greater engagement of external stakeholders have been enabled by the use of technology and systematic process improvements. Increasingly, KM practices are being institutionalised into the work culture of the Bank for improved productivity, enhanced learning for staff and closer collaboration with stakeholders.

Knowledge visibility, accessibility and reuse remained key KM value propositions for the Bank in improving performance. Towards this end, the Knowledge Hub, launched in February 2006, provided for the systematic identification, capture, sharing and storage of Strategic Knowledge Assets (SKA) across the Bank. By providing staff better access to the Bank's knowledge assets, the Knowledge Hub enables faster response times, reduces redundancies and provides more opportunities for new ideas to surface. Over time,
the Knowledge Hub is envisaged to shift the Bank to a more collaborative culture and with its unified view, will enhance the value of the Bank’s intellectual capital. The steady growth in content captured and re-used is seen as a positive measure of improving knowledge visibility in the Bank.

The Bank’s efforts in promoting a Knowledge Based Organisation have enhanced horizontal collaboration through greater participation in cross-functional work teams, communities of practice and peer-assist groups. Various tools, such as after-action-reviews and storytelling were increasingly integrated into work processes to capture and share knowledge. In further enhancing horizontal collaboration, a Knowledge Fair was organised in November 2006. Various initiatives were showcased, through talks, multimedia presentations, games and interactive activities which provided a conducive learning environment for Bank staff.

In recognition of the synergies between KM and Learning, the Knowledge Management Centre and the Human Resource Development Centre (HRDC) were merged in August 2006. This is to enable more integrated KM and learning processes, and thus improve the services provided to staff of the Bank. Further, the work undertaken to enhance talent management also promoted the development of new competencies, and hence new types of knowledge assets.

The year 2006 also marked the beginning of a journey to develop the Bank’s Enterprise Portal (EP). The EP enables real-time access to knowledge, anytime, anywhere as well as collaborative platforms to help staff stay connected to one another, as well as supporting more efficient collaboration with industry. To support the increasingly collaborative environment both internally and externally, a content management framework was also developed to govern the quality of content in terms of accuracy, timeliness and integrity, as well as efficiency of content flows in the Bank.

New work in progress includes intellectual capital measurement as a means to extract greater value from knowledge management tools and practices.

Training and Learning Management
The learning and development strategy focused on quality learning solutions, as well as the inculcation of self-directed learning through the development of personal learning roadmaps. This placed greater emphasis on the staff being responsible for their own self-development. The complementary development of the departmental learning roadmap had heightened the department’s accountability to knowledge and skill acquisitions, and has facilitated the process of aligning the learning agenda with the Bank’s objectives.

In addition, supervisors were also encouraged to be equipped with coaching skills to grow leaders in their units. In terms of enhancing technical skills, several modules on central banking knowledge were customised for on-line learning using the Bank’s e-learning platform. Bank-wide functional learning solutions were also designed to meet the needs of line departments. 28 functional courses were organised in 2006 of which 18 were new. The new learning solutions covered areas on Risk Management, Forensic Accounting and Computing, International Accounting Standards and Islamic Finance.

In 2006, the Bank organised two sessions of the LDP (Leadership Development Programme) in collaboration with the Center for Creative Leadership (CCL) for selected managers with the potential to assume greater responsibilities. This programme included a 360-degree assessment on one’s self-awareness of leadership effectiveness, strategic discourses with senior management of the Bank on leadership issues and challenges, and dialogues with proven industries leaders and highly recognised academics in the areas of leadership.

The Bank’s financial commitment towards staff development for 2006 stood at 7.8% of total staff salary, (7.6% in 2005). On the average, each staff received eight training days in 2006 during the year with average cost of RM6,200 per employee compared to RM5,400 in 2005.
Technical Assistance and Collaboration Programmes with External Agencies
As part of the Bank’s continued efforts to enhance regional and international cooperation, three learning programmes were organised under the Bank’s International Learning programme flagship. This included the Basic Central Banking Course, Banking Supervision Foundation Course, and Insurance Regulation and Supervision Course. In total, 28 international participations from 15 countries benefited from these courses. All the foreign participants were sponsored under the Malaysian Technical Co-operation Programme (MTCP).

The Bank signed a technical co-operation arrangement with the Da Afghanistan Bank (DAB) in 2006 in the area of development and capacity building. Through the technical co-operation program, officers from DAB participated in the Bank Negara Malaysia’s International Learning Programme and SEACEN’s courses on banking supervision and leadership development.

The Bank also hosted the first “AITRI-Toronto Centre Leadership Programme” (AITRI – ASEAN Insurance Training and Research Institute) for the ASEAN insurance regulators and supervisors. The programme was aimed at providing specific focus in building and enhancing capacity for insurance regulators and supervisors with the skills and competencies to make difficult decisions quickly, implement change in their organisations effectively and deal with stakeholders in their jurisdiction using the Toronto Centre’s ADAPT methodology and the OUI (Outward-Upward-Inward) model. The programme was facilitated by five programme leaders, four from the Toronto Centre and one from the Bank’s Human Resource Development Centre. A total of 17 participants attended the programme which included five participants from Singapore, Cambodia and Thailand.

ICT Management
Information and Communications Technology (ICT) continues to be a key enabler in achieving the Bank’s desired outcomes and the platform for collaborative workforce and leveraging on new knowledge and processes. In 2006, the Bank had put in place systems to monitor and deter illegal financial activities. Reporting Institutions can now perform their obligations under the Anti-Money Laundering Act 2001 (AMLA) by submitting Suspicious Transaction Reports or Cash Threshold Report through a secure online environment. The Bank had also extended the existing system capability to enable the insurance companies to submit their fraud cases online.

In order to facilitate information collection and sharing, the Bank had enhanced its enterprise architecture to cater for new developments in the financial landscape. This included amongst others the information on Small and Medium Enterprises (SMEs) now being submitted online, as well as the system to speed up the approval of new Islamic banking products requests by the financial institutions. This will help to promote greater innovation of products and services in a timely manner.

In 2007, the Bank will leverage on the Enterprise Portal (EP) platform to deploy Bank-to-Financial-Institutions (B2FI) collaborative channel between the Bank and the financial institutions under its supervision. The Bank is also continuing to enable greater horizontal collaboration within the organisation by enhancing internal processes and information accessibility via the Bank-to-Employee (B2E) facet of the EP platform. Upon deployment in 2007, the B2E will enable information to be delivered to individuals, groups and communities based on interests, job profiles and roles. Over time, the Bank envisaged further productivity enhancement through the leverage of these common capabilities by existing IT systems and likewise the exposure of their information and services on the EP platform.

ICT risk management plays a critical role in protecting information assets of the Bank. Throughout the year, the Bank has been able to enforce effective infrastructure security management. Security processes have been standardised, enforced and operationalised using the best of breed tools leading to improved security management, risk management and response-recovery. With these vital steps and measures implemented, the Bank’s information and ICT infrastructure are safeguarded from external threats despite
numerous attempts in cyber-attack and virus/worm propagation.

**RISK MANAGEMENT IN BANK NEGARA MALAYSIA**

Embedding risk management practices in all operations, policy and strategic initiatives are integral to promoting a sound risk management culture. In order to provide assurance of the safety and soundness of the Bank’s operations, the Risk Management Unit (RMU) continued to implement the 3-pronged risk assessment approach comprising the three steps of self-assessment by line departments, an independent assessment of line departments by RMU and a bank wide organisational risk assessment by RMU and Risk Management Committee (RMC) to instill sound enterprise risk management practices.

**Risk Management Governance Structure**

The risk management governance structure is an essential part of the efforts to ensure that risk management practices are effective, by providing sufficient check and balance as well as having clear accountability of risk. The Bank has accordingly put in place an institutional framework comprising establishment of management committees, design of roles and functions and work processes, with in-built internal controls, bearing these principles in mind.

At the apex of the Bank’s risk management governance structure is the Risk Management Committee (RMC), which is the forum at the leadership level for focused and regular deliberation on risk issues. It also provides the risk management oversight and determines standards and requirements to ensure that appropriate strategic and operational risk control measures are implemented by all departments including all projects. The RMC is chaired by the Governor and meets four times a year to deliberate risk issues affecting the Bank, as well as individual departments. The RMU is responsible for providing the assessments on risk management and how the issues are being addressed as well as risk management policies, methodologies and adoption of risk management best practices.

**Risk Management Practices**

In 2006, the Committee continued assessing departments’ risks, controls and emerging risk issues in their operations and business plans so as to maintain constant vigilance on the Bank’s overall risk profiles.

The commitment shown by departments in carrying out the self-assessment review of the department’s risk profiles marked the increased awareness and ownership of line departments in managing risks of core business processes, policy-making and strategic initiatives. This continued progress has been vital in creating a risk culture that involves employees at all levels and in providing a fertile ground for advocating enterprise risk management practices. The clear segregation in risk ownership is to inculcate proactive traits in managing risks while ensuring that the risk management process is continuous and self-sustaining. In addition, the Risk Management Unit provides technical support and performs a coordination and oversight role by assisting departments in their reporting to Management.

In 2006, RMU performed independent assessments of selected line departments and reported to RMC directly. As risks can no longer be managed in isolation, the RMU also assessed thematic or organisational risks such as capacity development and data management, which cut across functional lines to address interdependencies that may impinge on the achievement of the strategic goals and objectives of the Bank. These thematic risks are identified by RMU and assessed by consulting relevant departments as well as reviewing processes undertaken in carrying out the Bank’s critical functions and responsibilities.

The combination of all three assessments mentioned is expected to provide a holistic view of risk profile and potential risks in the Bank. This approach will contribute towards greater risk awareness, organisational alignment and strengthen inter-linkages throughout the Bank. The RMU is also responsible for reviewing risk management policies by benchmarking against global best practices and providing technical support to line departments.
In 2006, the Bank also became a member of the International Operational Risk Working Group (IORWG), which was established to act as a centre of competence on Operational Risk Management (ORM) for central banks. The objectives of the Group are to share best practices, to innovate new framework and methodologies for the central bank community as well as to generate the value of managing operational risk.

**Strategic and Policy Risk**
Strategic risk is associated with the risk inherent in the formulation and execution of the Bank business plans and strategies. If not managed effectively, it can impede the achievement of the strategic aims and objectives of the Bank. As a result, significant emphasis has been placed in ensuring that all line departments identify the strategic risks in their core processes and bank-wide projects. The Management Committee and the various Steering Committees chaired by senior management play a vital role in ensuring that all existing and emerging risk issues in the business plans are being addressed. To complement this, the contents of the annual declaration, the self-assessment tool, and the independent assessments by RMU are also designed to capture and address strategic level risks to enable management to proactively manage and contain the Bank’s overall risk.

Policy risk is managed through a structured framework and process for policy making and implementation. Major components of the framework are the internal committees and working groups for cross-functional consultations and deliberations. The high-level committees include the Management Committee, Monetary Policy Committee, and the Financial Stability Committee; all chaired by the Governor. Policy working groups, chaired by Assistant Governors with membership comprising directors of relevant departments, form the working level forum for policy formulations. These working groups ensure that all information and expertise are tapped in the design and formulation of policies. In certain cases, the consultation process includes external stakeholders. This structure serves to ensure that the Bank’s policy-making mechanism is effective in promoting monetary and financial stability.

**Financial Risk**
In managing the Bank’s financial risks arising from its treasury operations, an independent Treasury Risk Management Section (TRMS) of the Investment Operations and Financial Market Department has been entrusted to specifically assess and enforce the Bank’s treasury risk management policy with direct reporting to the Deputy Governor. In 2006, treasury risk management in the Bank continued to develop into a more specialised field employing the latest advancement in risk technology and risk methodology to effectively manage market, credit and operational risks associated with the Bank’s investment operations. In the area of market risk, the Bank has embarked on a new investment framework with greater emphasis on managing market risk through risk budgeting, and enhanced focus on risk-adjusted return for its investment performance assessment. With the advent of more complex investment instruments, the Bank had also invested in new technology and systems to enhance market risk monitoring and assessment capability. In the area of credit risk, the Bank maintained its stringent credit policy to ensure credit exposures undertaken through the Bank’s investment strategy remained within acceptable level, while the Bank continued to strengthen its treasury operational risk framework with on-line monitoring and early warning indicators.

**Operational Risk**
Department Heads continue to have direct responsibility in managing operational risk by ensuring that risk management practices are integral to daily operations and that all risks are appropriately addressed. In complementing the risk management process, the Risk Management Unit continued to play a proactive role and work in a collaborative manner with line departments to ensure that key risks are appropriately addressed.

Critical measures to address operational risk include budgetary controls, procurement framework and internal audit function. Budgetary controls are to promote planning and ensuring effective and efficient use of financial resources whereas the procurement
framework sets the governance and best practices in acquisition or implementation of projects. The internal audit function is responsible for providing assurance to the Board on control and compliance, risk management and governing processes in the Bank.

**Business Continuity Management**

Within the Business Continuity framework, there are two high level components, the Crisis Management Committee and the Crisis Management Team. The Crisis Management Committee, which comprises Management Committee members, symbolises high level endorsement of the Business Continuity programme in the Bank. The Crisis Management Team has membership comprising directors from all identified critical departments and support teams.

As in previous years, periodic assessments of the Bank’s capabilities to respond to crisis were done. This was achieved via the live-run exercises as well as the twice yearly Crisis Management Team meeting which discusses emerging business continuity issues.

During the year, a particular risk that was given much attention by the risk community was the potential outbreak of the Avian Influenza (AI). This external risk which triggered concern in early 2006 has the ability to interrupt business operations with significant and prolonged staff absenteeism as well as physical infrastructure disruptions. In response to this risk, the Bank drew up a Preparedness Plan for Pandemic Influenza to synchronise responses across the Bank. The Preparedness Plan had identified implications on both the financial and economics sectors as well as outlined measures to be taken in managing the economy, the financial sector and the insurance industry, and the payment and settlement system.

The RMU had also conducted Business Impact Analyses, which are used for analysing the potential impact of crisis to line departments and drive the priorities, strategies and solutions for managing business continuity and recovery for departments specifically and for the Bank as a whole. It also forms the underlying basis for reviewing existing crisis arrangements and for identifying new recovery strategies.

In addition, RMU participated in the Bank’s annual Knowledge Management Fair to continue building up the awareness and understanding of Business Continuity Management (BCM). Although business continuity plans are already in place, opportunity for invocation is rare and almost non-existent for staff not involved with critical functions, hence there is a need to promote appreciation of its significance. Through various programmes such as talks, quizzes, puzzles and games, staff thinking towards business continuity arrangement is internalised by promoting the interest and sharing of knowledge concerning business continuity arrangements.