

# External Relations

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# External Relations

## OVERVIEW

Against the backdrop of an uncertain global economic and financial environment in 2002, discussions at the international fora focused on enhancing surveillance, strengthening domestic financial systems and improving the international financial architecture (IFA) for crisis prevention and resolution. Co-operation in measures to curb money laundering activities made further progress during the year, including efforts to combat the financing of terrorism. At the regional level, significant progress was achieved in taking forward the Chiang Mai Initiative (CMI) through the signing of additional Bilateral Swap Arrangements (BSA) and strengthening the modalities for regional surveillance. In addition, continued progress was made

of Malaysia's Anti-Money Laundering Programme and, in its report, commended Malaysia for the significant progress in establishing an appropriate anti-money laundering programme. The APG report represented an important recognition of Malaysia's efforts and the progress achieved. During the year, Malaysia also participated in international discussions on measures to combat the financing of terrorism activities.

In the area of **IFA reforms**, some progress was made in developing mechanisms to facilitate more orderly sovereign debt restructuring for crisis resolution. The International Monetary Fund (IMF) adopted a two-track approach to address outstanding implementation issues through the introduction of collective action clauses as

**International discussions focused on developing a sovereign debt restructuring mechanism. At the regional level, financial co-operation and regional surveillance strengthened further. A significant milestone in co-operation was the establishment of the Islamic Financial Services Board (IFSB) in Kuala Lumpur.**

in enhancing co-operation in capacity-building and technical areas among regional economies.

In 2002, the external relations of Bank Negara Malaysia was guided by two major considerations. Participation in international, regional and bilateral meetings was aimed at strengthening international and regional co-operation and highlighting issues and concerns considered important from a national and regional perspective. The objective was to ensure that the interests of emerging market economies, such as Malaysia, were given due consideration.

A significant milestone in co-operation in the **development of Islamic finance** was the establishment of the Islamic Financial Services Board (IFSB) in Kuala Lumpur in November 2002. As the standard-setting body for the regulation and supervision of Islamic financial institutions, the IFSB would assume an important role in advancing the development of Islamic banking as an integral component of the international financial system.

Efforts to combat **money laundering activities** in the global financial system intensified in 2002. Malaysia shared its experience in putting in place a comprehensive legislative and institutional framework to combat money laundering. The Asia-Pacific Group (APG) on Money Laundering conducted an evaluation

well as a sovereign debt restructuring mechanism. Further refinements were also introduced in the IMF, with the adoption of new guidelines to strengthen country ownership and streamline IMF conditionality for adjustment programmes. However, reforms of a more fundamental nature remained limited. The push by emerging and developing economies for greater representation in the decision making process in the IMF was blocked by the lack of consensus on the 12th General Review of Quotas. Reform efforts were also limited in the area of promoting stability and efficiency in the global financial markets.

Regional financial co-operation made significant progress in 2002, particularly in the context of the Association of South-East Asian Nations (ASEAN)<sup>1</sup> and ASEAN Plus Three<sup>2</sup>. The **regional surveillance** process, conducted under the ambit of the CMI, facilitated a greater understanding of current issues of concern, including the risks of a global downturn, price deflation, management of capital flows, capital account liberalisation, and exchange rate stability. Measures to further enhance regional surveillance in ASEAN Plus Three moved forward, including a review of the modalities to enhance the effectiveness of the

<sup>1</sup> Refers to the Association of South-East Asian Nations, comprising Brunei Darussalam, Cambodia, Indonesia, Laos PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

<sup>2</sup> Comprises ASEAN plus Japan, Korea and P.R. China.

surveillance process. A further development in the ASEAN surveillance process was the inauguration of the ASEAN Central Bank Governors' Meeting held in Yogyakarta in July 2002. These efforts complemented the surveillance efforts carried out in other international and regional fora, including the IMF, Bank for International Settlements (BIS), South-East Asian Central Banks (SEACEN)<sup>3</sup>, Asia-Pacific Economic Co-operation (APEC)<sup>4</sup> and the Asia-Europe Meeting (ASEM)<sup>5</sup>.

**Capacity-building and training** initiatives remained an important area of regional co-operation. In this regard, the SEACEN Research and Training Centre continued to be the premier institution in conducting research and training programmes on monetary and financial policies, central banking operations and bank supervision. Capacity building efforts also strengthened further in other fora, including the ASEM, South-East Asia, New Zealand and Australia (SEANZA)<sup>6</sup> group, and Executives' Meeting of East Asia-Pacific Central Banks

### Regional financial co-operation strengthened in 2002, with the inauguration of the ASEAN Central Bank Governors' Meeting. A further development was the progress made under the Chiang Mai Initiative (CMI).

(EMEAP)<sup>7</sup>. The initiatives were aimed at enhancing skills development in the central banks for effective discharge of their responsibilities and to cope with the new challenges posed by changes in the economic and financial environment.

During the year, Bank Negara Malaysia also participated as a key member of Malaysia's negotiation team to the World Trade Organisation (WTO). Malaysia remained committed to further liberalisation of its financial services sector as set out under the Financial Sector Masterplan. On bilateral co-operation, the Central Bank continued to promote Bilateral Payments Arrangement agreements as a mechanism to enhance trade with non-traditional markets as well as to advance its Malaysian Technical Co-operation Programme.

## INTERNATIONAL FINANCIAL CO-OPERATION

### Islamic Financial Services Board

An important milestone in international financial co-operation was the establishment of the **Islamic Financial Services Board (IFSB)** in Kuala Lumpur in November 2002. The creation of the Islamic Development Bank in 1975 and the Accounting and Auditing Organisation for Islamic Financial Institutions in 1990, and the establishment of the IFSB in 2002 provide the foundations for the promotion of a sound and stable Islamic financial system and its integration as

a viable component of the international financial system. The IFSB would serve as an association of central banks, monetary authorities and other institutions responsible for the supervision and regulation of Islamic financial services. Its functions include the development and dissemination of globally-accepted standards and codes, setting and dissemination of standards and core principles, as well as the adaptation of existing international standards for the supervision and regulation of the Islamic financial industry, consistent with Shari'ah principles. Adoption of such standards and codes by member countries would be voluntary. The IFSB would also co-operate with other standard-setting bodies to promote monetary and financial stability. Through the provision of technical assistance, research and training, the IFSB aims to promote sound practices in Islamic financial services. The nine founding members of the IFSB comprised the Bahrain Monetary Agency, Bank Indonesia, Bank Markazi Jomhouri Islami Iran, Central Bank of Kuwait,

Bank Negara Malaysia, State Bank of Pakistan, Saudi Arabian Monetary Agency, Bank of Sudan and Islamic Development Bank. Malaysia was accorded the honour to host the IFSB in Kuala Lumpur. The IFSB started operations in early 2003 from its office in the Central Bank. The planning for a new permanent office building is in progress and completion is expected in 2005.

The Secretary-General of the IFSB has been appointed and will assume office in early 2003 for a duration of three years. The IFSB is managed by the IFSB Council which reports to the IFSB members at the General Assembly. The Council is supported by a Secretariat, headed by the Secretary-General and a Technical Committee.

<sup>3</sup> Refers to the South-East Asian Central Banks, comprising central banks from Chinese Taipei, Indonesia, Korea, Malaysia, Mongolia, Myanmar, Nepal, Philippines, Singapore, Sri Lanka and Thailand.

<sup>4</sup> Refers to the Asia-Pacific Economic Co-operation group, comprising Australia, Brunei Darussalam, Canada, Chile, Chinese Taipei, Hong Kong China, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, P.R. China, Peru, Philippines, Russian Federation, Singapore, Thailand, United States and Vietnam.

<sup>5</sup> Refers to the Asia-Europe Meeting members, comprising Austria, Belgium, Brunei Darussalam, Denmark, Finland, France, Germany, Greece, Indonesia, Ireland, Italy, Japan, Korea, Luxembourg, Malaysia, Netherlands, P.R. China, Philippines, Portugal, Singapore, Spain, Sweden, Thailand, United Kingdom, Vietnam and European Commission.

<sup>6</sup> Acronym for South-East Asia, New Zealand and Australia, comprising central banks from Australia, Bangladesh, Hong Kong China, India, Indonesia, Iran, Japan, Korea, Macau China, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Papua New Guinea, P.R. China, Philippines, Singapore, Sri Lanka and Thailand.

<sup>7</sup> Refers to the Executives' Meeting of East Asia-Pacific Central Banks, comprising central banks from Australia, Hong Kong China, Indonesia, Japan, Korea, Malaysia, New Zealand, P.R. China, Philippines, Singapore and Thailand.

### Regional and Multilateral Surveillance

In an environment of increased uncertainty in the global economy, **regional surveillance** assumed greater significance in 2002. The surveillance represents an important complement to surveillance conducted under the Article IV consultation mechanism of the IMF. Given global uncertainties, surveillance is required at both the regional and international levels. At the regional level, among the ASEAN and ASEAN Plus Three, there is consensus for regional surveillance to develop beyond the present practice of highlighting issues of concern. Regional surveillance is conducted at both the ASEAN and ASEAN Plus Three and at the EMEAP and SEACEN regional meetings. These meetings focus on macroeconomic and structural policies undertaken in individual economies. The fora also provide an avenue for the exchange of views on areas of concern at both the national and regional levels. In addition, to facilitate

remedial policies to deal with any deflationary tendencies in the domestic economy. The development of vulnerability and resilience indicators was given priority for strengthening surveillance. There was also closer monitoring and exchange of information on capital flows which was considered important for effective macro-prudential surveillance at the national, regional and international levels. The development of forward-looking indicators on future trends in capital flows was also used as early warnings of emerging risks and vulnerabilities.

On the issue of **exchange rate management**, there is an international consensus that no single exchange rate regime is appropriate for all countries under all circumstances. In contrast to the “two-corner solutions” of fixed or flexible exchange

### Multilateral surveillance called for greater coordination among major countries to promote stability and growth.

early detection of emerging risks and challenges, the exchange of views on policy initiatives serves as a peer review exercise for regional economies to continuously review policies to strengthen resilience to adverse external shocks. The focus is also on greater co-operation and co-ordination among the region's economies to promote domestic sources of growth. As regional growth in trade contributed to enhancing economic resilience in 2002, further strengthening of structural reforms and new initiatives to enhance regional sources of growth would add to greater resilience in the face of global uncertainties.

An important area of the **multilateral surveillance** discussions in 2002 was policy co-ordination among the major industrial countries. The International Monetary and Financial Committee of the IMF called upon the major industrial countries to adopt policies that promoted global stability and growth. Member countries were urged to refrain from policies that could have adverse implications for other economies. It was acknowledged that the macroeconomic and financial fundamentals in Asia, including Malaysia, had strengthened and thus increased the ability to cope with the challenges resulting from a less favourable external environment.

### Selected Surveillance Issues

Noting that deflationary forces had begun to emerge in the global environment, regional economies remained vigilant to implement pre-emptive

rate regimes, it is generally agreed that sustainability of any exchange rate would be determined by sound fundamentals and strong macroeconomic and structural policies. During the year, it was highlighted that the stability of the major currencies and that of the major currencies of the region were important for maintaining stability in regional financial markets.

International discussions on **highly leveraged institutions** noted that while hedge fund activity had expanded in recent years, the size and leverage of the average hedge fund had declined, while transparency and regulatory oversight had increased. Nevertheless, continued surveillance of hedge fund activity was important in order to preserve financial stability.

The issue of appropriate **sequencing of capital account liberalisation** attracted much attention in the international and regional fora in 2002. Bank Negara Malaysia participated in a seminar jointly organised by the BIS and the State Administration of Foreign Exchange of the People's Republic of China in Beijing in September 2002. Malaysia's experience on the management of equity flows since the Asian crisis was presented at the seminar, emphasising in particular that capital controls served as an aid to reform but not as a substitute for sound policies. The controls implemented were targeted to achieve specific objectives. The flexible and pragmatic

implementation of the measures was important for its success. The Malaysian experience was also presented at the ASEAN Plus Three High-Level Seminar on Management of Short-term Capital Flows and Capital Account Liberalisation in Beijing in October 2002, highlighting the changing pattern of capital flows to Malaysia, the principles governing Malaysia's exchange control regime and strategies for crisis prevention.

The work of capital flows monitoring among SEACEN economies also progressed further in 2002 with

### The focus of IFA reforms was on crisis prevention and resolution. Progress remained limited on global governance issues.

regular exchange of information via standardised data templates. This process was augmented in 2002 with the introduction of regular assessments of such information. In November, the sharing of data was extended to discussions on capital flows developments in the region and emerging risks via teleconferencing.

In the course of 2002, the attention of the international fora also focused on measures to strengthen the **stability and resilience of domestic financial systems**. This was in recognition of the key role of strong and robust financial systems in crisis prevention and in facilitating sustainable growth. It was noted that reform measures in Asia, in the aftermath of the 1997 crisis, had yielded positive results and placed the Asian financial systems on a stronger footing to cope with an uncertain global environment in 2003.

#### Financial sector restructuring and reform

remained an important topic in the multilateral and regional surveillance process. This issue was given prominence at the EMEAP Governors' Meeting which Bank Negara Malaysia hosted in Kuala Lumpur in July 2002. Among the issues discussed at a number of the regional fora were the compliance with the 12 Key Standards and Codes for Strengthening Domestic Financial Systems advocated by the Financial Stability Forum, and the concerns associated with the implementation of the Basel II Capital Accord for economies in the region. These issues were discussed at the dialogue between the EMEAP Working Group on Banking Supervision and the senior officials from the Basel Committee on Banking Supervision (BCBS) in Kuala Lumpur in August 2002. An important outcome of the

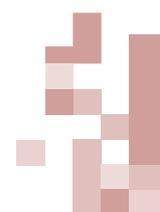
discussions was the general agreement by the BCBS to ensure that there would be flexibility in the implementation of Basel II and to review specific issues relating to collateral recognition, treatment of lending to small and medium enterprises and operational risks.

In addition to discussions on multilateral surveillance and strengthening domestic financial systems, the **reform of the International Financial Architecture (IFA)** was another important item on the agenda of international meetings in 2002.

Some progress was made in terms of initiatives to promote crisis prevention and private sector involvement in crisis resolution. However, progress remained limited in the area of fundamental reforms, particularly in global governance and accountability issues.

Much of the focus on international financial architecture issues in 2002 was in terms of initiatives on **crisis prevention** and strengthening multilateral surveillance. In particular, the measures related to the IMF Financial Sector Assessment Programme (FSAP) and Report on Observance of Standards and Codes and their increased integration into the overall IMF surveillance process. In the area of FSAP, 44 countries had completed the FSAP surveillance exercise as at the end of 2002. Another 51 countries had committed to undertake the FSAP as part of the IMF surveillance exercise, of which 21 were underway.

Progress in IFA reforms to promote **private sector involvement (PSI) in crisis resolution** gathered momentum in 2002. The initial proposal by the United States in April for a "market-oriented" approach to sovereign debt restructuring through the use of collective action clauses (CACs) was complemented by an IMF plan on a statutory approach for a sovereign debt restructuring mechanism (SDRM). The work on PSI was considered important to develop a more orderly and predictable framework for sovereign debt restructuring. Although many issues, including legal and political types, need to be resolved, the international community has agreed to pursue a two-track approach, with focus on resolving the implementation issues on CACs and the SDRM.



## PRIVATE SECTOR INVOLVEMENT (PSI) INITIATIVES

### April 2002:

- The US Treasury proposed a decentralised and market-oriented approach to sovereign debt restructuring, through the inclusion of collective action clauses (CACs).
- The IMF revised its original framework proposed in November 2001, identifying the majority restructuring provision as the central feature. Independent arrangements for verification of creditor claims, dispute resolution and supervision voting would be required to make the features operational. Therefore, a statutory approach achieved through a universal treaty obligation, which could be established by amending the IMF's Articles of Agreement, was necessary.
- The Group of Seven adopted an integrated Action Plan to increase predictability regarding official policy actions in emerging markets. The Action Plan supported the use of CACs and the IMF statutory approach towards sovereign debt restructuring as they were viewed to be complementary and reinforcing.
- In the action plan to strengthen emerging market finance, the Institute of International Finance suggested initiating a Private Sector Consultative Group to provide a mechanism to frame a dialogue on individual crisis cases in order to sustain investor confidence and, where necessary, facilitate orderly restructuring.

### June 2002:

- The IMF introduced a two-track approach, combining the use of CACs and a statutory approach, via a treaty obligation, which might be achieved through an amendment of the IMF's Articles of Agreement, to set up a sovereign debt restructuring mechanism. Furthermore, the establishment of a single, exclusive dispute resolution forum, which would be independent from the IMF, would be set up to resolve disputes between creditors and the debtor in a fair manner.
- Leaders of six private sector groups of financial institutions released a set of general principles for crisis management in emerging markets, including greater use of CACs in sovereign debt contracts.

### September 2002:

- The Group of Ten Working Group on Contractual Clauses convened to address the documentation of sovereign debt contracts.

As part of IMF reforms, new guidelines on **IMF conditionality** were introduced in September 2002. These were aimed at streamlining IMF conditionality to promote better country ownership, and to enhance the effectiveness and success of IMF programmes. The new guidelines emphasised the need to enhance country ownership of reforms; focused conditionality on areas that were critical to achieve the macroeconomic objectives of the programme; took into account country specific circumstances; and provided a clearer division of coverage with other IFIs.

However, progress remained limited in addressing the issue of governance of the IMF. No consensus was reached for an adjustment in **IMF quotas** during the period of the 12th General Review of Quotas, which ended in January 2003. The IMF Executive Board was expected to continue its deliberations under the 13th General Review of Quotas. It was expected to review further the need to adjust IMF quotas to

ensure that the IMF had adequate resources as well as to realign IMF quotas to reflect recent developments in the global economy and promote a more balanced voting structure at the IMF.

## EXTERNAL RELATIONS WITH IMF

During its annual 2002 bilateral surveillance discussions on Malaysia, the IMF noted that Malaysia's macroeconomic policy strategy had helped the economy weather the impact of the global slowdown and set the foundation for a positive economic outlook. The IMF welcomed Malaysia's fiscal consolidation plans, the move towards a more market-oriented monetary framework, full implementation of the Financial Sector Masterplan, banking and corporate sector reforms, and anti-money laundering and combating terrorism financing measures. On the exchange rate, the IMF acknowledged that the ringgit peg was at an appropriate level, supported by strong underlying

## The IMF acknowledged the effectiveness of Malaysia's macroeconomic policies, which enabled Malaysia to weather the global slowdown and set the foundation for a positive outlook. The IMF has included Malaysia in its Financial Transactions Plan.

fundamentals, and had been an anchor of stability. Many Directors supported maintaining the current policy with the exchange rate peg as the stability anchor. Malaysia took note of some differing views in the IMF that greater flexibility should be allowed but emphasised that the exchange rate peg was viewed as serving the country well and was supported by the fundamentals.

In the case of Malaysia, surveillance by the IMF was co-ordinated mainly through the Article IV consultation process. An IMF team also visited the Labuan Offshore International Financial Centre to assess the extent to which the regulatory and supervisory arrangements for the Labuan offshore financial sector complied with internationally accepted standards.

The recognition of Malaysia's economic fundamentals and strong balance of payments position was evidenced by **Malaysia's inclusion in the IMF's Financial Transactions Plan (FTP)** for the period September-November 2002 and December 2002-February 2003. Under the FTP, selected IMF members with strong balance of payments and reserve positions may be called upon to provide foreign exchange resources to support the IMF's financial operations. Malaysia's inclusion in the FTP was based on the IMF's assessment of Malaysia's positive economic outlook, and that the financial position was sufficiently strong to be called upon to support the IMF's financial activities.

In response to requests from the IMF, officers from Bank Negara Malaysia also participated in IMF missions to Egypt and Zambia to assist in the FSAPs, specifically in the area of banking supervision and Islamic banking.

### FINANCIAL SECTOR LIBERALISATION

**World Trade Organisation Negotiations to further liberalise the services sector**, including the financial services sector, continued at the **WTO**. The negotiations were formally launched on 25 February 2000 and the continuation of the negotiations became part of the Doha Development Agenda<sup>8</sup> with the launch

of the new round of multilateral trade negotiations at the Fourth WTO Ministerial Conference in Doha, Qatar, on 9-14 November 2001. By end-March 2003, the services negotiations would have concluded two years of its "request and offer" phase since the phase began on 28 March 2001, where negotiations were to be based on requests for market opening submitted by member countries to a trading partner and offers submitted by the trading partner.

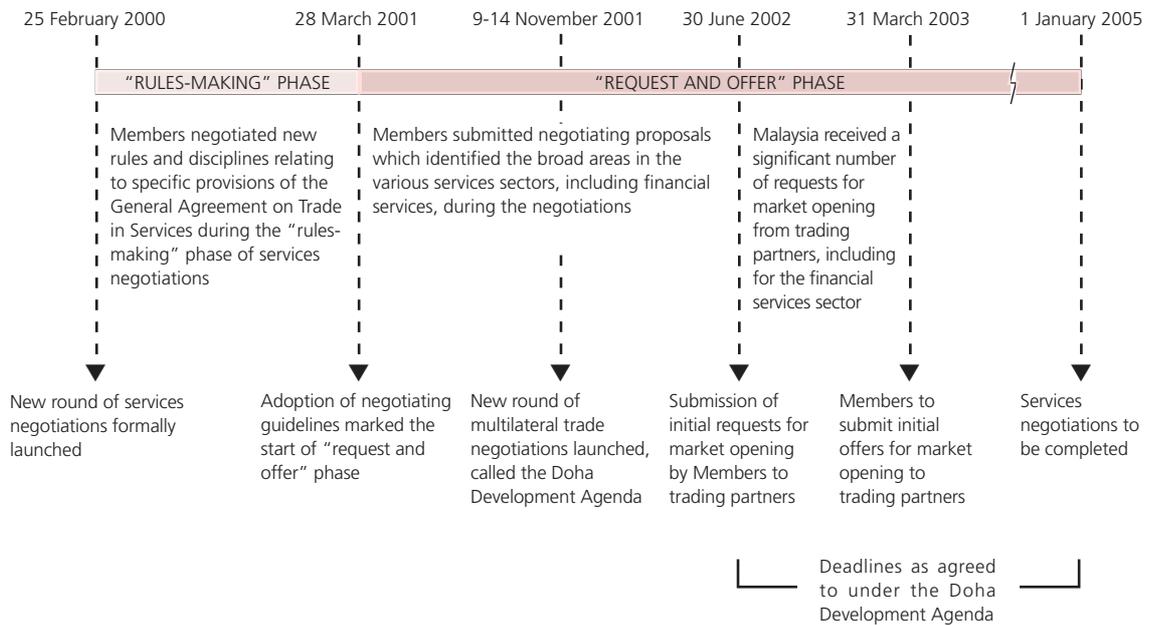
Bank Negara Malaysia continued to participate as a key agency in the Malaysian WTO services negotiation team in 2002, a year which saw Malaysia receiving a significant number of requests for market opening in the services sector from its trading partners, especially in the financial services sector. For the first time, Malaysia submitted requests to a number of partner countries for the further liberalisation of their services sectors, including in the area of financial services.

Foreign participation has always been significant in the Malaysian domestic financial sector. Malaysia's commitments with regard to liberalisation under the WTO General Agreement on Trade in Services (GATS) continued to reflect the existing policies on foreign ownership. In the banking sector, the bound commitments for foreign presence was maintained at an aggregate maximum of 30% of the total equity of a domestic banking institution. In the insurance sector, existing foreign shareholders were allowed to increase ownership subject to a maximum 51% of the equity of the insurance company. New entry of foreign insurance companies was also allowed through participation of up to 30% of the total equity of a locally-incorporated insurance company.

Policies in liberalising the financial services sector had resulted in significant presence of foreign services providers in the Malaysian financial sector. In line with the commitments at the WTO, 13 fully foreign-owned banks continued to operate in Malaysia. In addition, at the end of 2002, foreigners owned an average of 23% of the total equity in four domestically-owned banks. On an aggregate basis, foreigners accounted for about 33%

<sup>8</sup> See Bank Negara Malaysia Annual Report 2001 for more on the Doha Development Agenda.

### Timeline of WTO Negotiations on Trade in Services



### Avenues for foreign participation in the financial services sector broadened to include participation through strategic alliances with domestic entities.

of total commercial bank assets. In the insurance sector, out of a total of 54 insurance companies, 23 companies were majority foreign-owned. The foreign market share in the insurance industry remained high and accounted for 77% of life insurance premiums and 40% of general insurance premiums. Other than through equity participation, foreign participation had taken other forms, such as participation through strategic alliances with local entities. In the insurance sector, there were 10 bancassurance arrangements involving locally-incorporated foreign-owned banks, of which nine were established with domestically-owned insurance companies. Discussions on strategic alliances with the banking sector are on-going.

#### ASEAN Framework Agreement on Services

The "Protocol to Implement the Second Package of Commitments on Financial Services" was signed by the ASEAN Finance Ministers at their meeting on 5-6 April 2002, following the conclusion of the second round of financial services negotiations under the ASEAN Framework Agreement on Services (AFAS). This marked the successful **implementation of the ASEAN members' GATS-plus commitments** on financial services (that is, liberalisation measures beyond those made under the GATS). Similar to the first round of negotiations under AFAS, which was concluded in 1998, Malaysia undertook a commitment in the area of employment of expatriates.

The third round of negotiations on financial services under AFAS was also launched at the ASEAN Finance Ministers' Meeting to begin in 2002 and was expected to be concluded by 2004. Negotiations to further liberalise the financial services sector among the ASEAN countries would be undertaken at the "Working Committee on ASEAN Financial Liberalisation under AFAS".

#### REGIONAL CO-OPERATION

During 2002, the APEC, ASEM, Developing 8 (D-8)<sup>9</sup>, SEANZA and EMEAP groupings continued with their policy dialogues. These collaborative efforts provided opportunities for regional policy makers to exchange experiences and technical knowledge on areas pertinent to financial sector development and stability. These areas included the development of payment systems, countering money laundering and terrorist financing, financial market discipline as well as conventional and Islamic insurance.

In the ASEAN and ASEAN Plus Three dialogues, there was a shift in focus towards enhanced **regional economic and financial surveillance** in response to heightened risks and uncertainties in the global environment. Surveillance issues included

<sup>9</sup> Comprises Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan and Turkey.

macroeconomic management for regional economies, liberalisation, global price deflation and financial stability. The regional surveillance process was important to identify emerging issues and potential problems that would in turn enable regional economies to take prompt corrective action at the national level and jointly at the regional level. The discussions contributed to increased awareness among regional economies on the need to be vigilant and the importance of strengthening regional financial co-operation.

As a result, the **ASEAN Plus Three Finance and Central Bank Deputies** agreed to devote more attention to regional surveillance issues. For this purpose, an additional meeting would be convened

arrangements for adopting a common currency arrangement. The report provided a comprehensive assessment on the costs and benefits and suitability of ASEAN for a common currency, as well as the preconditions and requisite level of regional integration required to move towards the objective of a single currency. The report was received favourably by the ACBF, and would be tabled at the next ASEAN Finance Ministers' Meeting in Manila in April 2003.

Concomitant to the surveillance process, the **ASEAN Plus Three** member countries made further progress in expanding the CMI network during 2002. In line with the objective of the CMI to provide timely short-term financial support to member countries facing temporary liquidity problems, Bank Negara

### The CMI network of Bilateral Swap Arrangements (BSAs) expanded further with a total of 12 BSAs valued at US\$ 31.5 billion being concluded as at end-February 2003 and available to ASEAN+3 member countries in times of need.

in the second half of each year to enable the Deputies to focus their discussions on peer review and policy issues. This was in line with the recommendation of the ASEAN Plus Three "Study Group to Examine Ways of Enhancing the Effectiveness of Economic Reviews and Policy Dialogue" which was co-chaired by the Ministry of Finance, Japan and Bank Negara Malaysia. In addition, the Deputies also deliberated on the various modalities that could be used for further enhancing regional surveillance and the peer review process.

During 2002, the Governors of the ASEAN Central Bank Forum convened their inaugural meeting in Yogyakarta on 29 July 2002. This forum of ASEAN Central Bank Governors' Meeting would complement the surveillance process conducted under the ASEAN Finance Ministers' process. At the meeting, the Governors concluded that more emphasis should be placed on the review of the supervisory process of the financial system as well as on closer cross-border co-ordination and co-operation among supervisors.

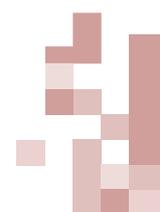
At the 10th ASEAN Central Bank Forum (ACBF) which was held in Yangon, Myanmar on 21 October 2002, Bank Negara Malaysia, as chair of the ASEAN Currency and Exchange Rate Mechanism Task Force, briefed the ACBF Deputies on the findings and recommendations of the Task Force on the suitability, preconditions and necessary institutional

Malaysia entered into a US\$1 billion BSA with the Bank of Korea on 26 July 2002 and a US\$1.5 billion BSA with the People's Bank of China on 9 October 2002. As at end-February 2003, the ASEAN Plus Three countries as a group, had established a network of 12 BSAs with a combined total value of US\$31.5 billion, which would be available to member countries in times of need.

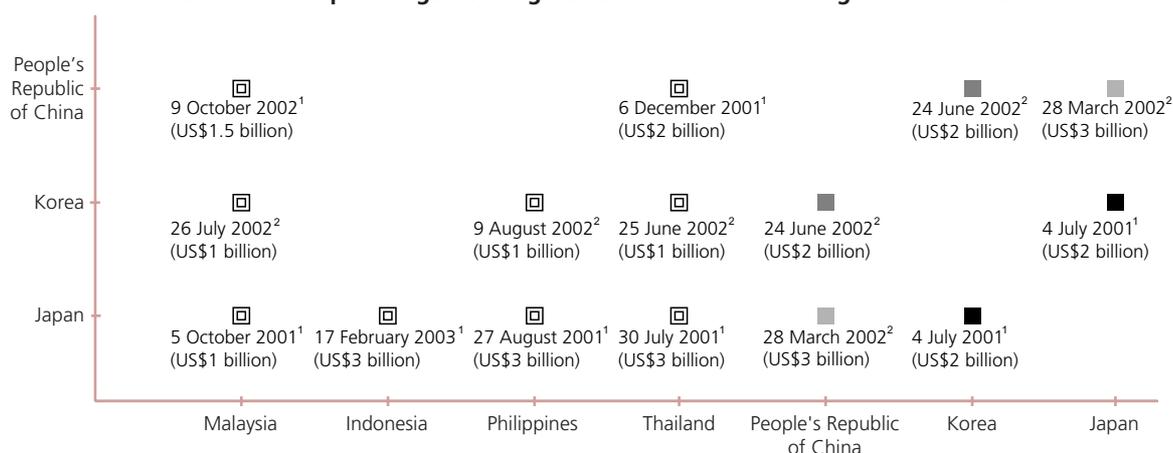
### Co-operation in capacity-building and training

continued to feature prominently in the regional fora in 2002. The SEACEN Research and Training Centre, a premier training institution in the region, continued to provide specialised training on policy and operational aspects of central banking, in particular on banking supervision. During the year, SEACEN also targeted its training in areas relevant to the current challenges facing central banks, such as credit risk management and Basel II capital requirements. The SEACEN programmes have enabled an increasing number of central bank staff to be equipped with the requisite skills and knowledge to better deal with the challenges of financial innovation and liberalisation.

SEACEN also collaborated with the Asian Development Bank (ADB) to undertake the APEC initiative to extend training on banking supervision to APEC member countries. In this regard, Malaysia hosted the 3rd SEACEN/Fed/World Bank/APEC Seminar for Senior Bank Supervisors from Asia-Pacific Economies and the 4th SEACEN/World Bank/APEC Conference of Directors of Supervision.



## Bilateral Swap Arrangement Agreements under the Chiang Mai Initiative



Dates indicate when the agreements have been signed and the maximum drawing amount for each agreement is indicated in parentheses. The combined total size of the 12 bilateral swap arrangement (BSAs) agreements is US\$31.5 billion (based on the overall availability under the BSAs, where the maximum drawing amount under two-way swap arrangements was counted twice to reflect the swap amount available to both parties under the agreement).

<sup>1</sup>A one-way swap arrangement where the requesting country under the agreement can request the swap-providing country to enter into a swap transaction

<sup>2</sup>A two-way swap arrangement where either party could request the other party to enter into a swap transaction under the agreement

□ Agreements signed between the Plus Three countries (People's Republic of China, Japan and Korea) and ASEAN countries

■ Agreements signed among the Plus Three countries

Note: Matching colour markers indicate the same agreement signed between two Plus Three countries

The EMEAP Governors agreed to promote greater financial co-operation, while the ASEAN Plus Three members expanded the CMI network in 2002. Regional co-operation in capacity building and training also expanded. The issue of anti-money laundering measures dominated many regional meetings.

Bank Negara Malaysia continued to administer the **SEACEN Trust Fund Scholarship Scheme** which provided opportunities for officers from eligible central banks in the region to participate in the SEACEN Centre's training programmes. During the year, the SEACEN Trust Fund awarded sixteen scholarships to SEACEN member central banks, and one to a SEACEN observer central bank.

Bank Negara Malaysia hosted the 7th EMEAP Governors' Meeting in Kuala Lumpur on 27 July 2002. The meeting provided an opportunity for the EMEAP Governors to review recent economic and financial developments in the regional and global environment. The Governors noted that growth in the EMEAP region would continue to improve in 2002, and that there was significant potential for further increases in intra-Asian trade and investment flows. The Governors also exchanged views and experiences on the various modalities adopted in the EMEAP region on financial restructuring and reform. In assessing the role of EMEAP in a changing global environment, it was agreed that EMEAP had an important role in fostering closer regional co-operation in central banking operations and in strengthening the financial system in

the region. The Governors also met with the Prime Minister of Malaysia to exchange views on issues of common interest in the regional economies.

At the meeting, the EMEAP Governors also agreed on the need to promote greater financial co-operation, particularly on modalities to recycle Asian savings for Asian development. Members of EMEAP also discussed the **issues and potential risks posed by the Basel II capital requirements** on the Asian economies, particularly the emerging market economies. The Group would raise common issues and concerns to provide feedback from the perspective of emerging economies to the Basel Committee on Banking Supervision on the New Capital Accord. A meeting of the EMEAP Working Group on Banking Supervision was organised in Kuala Lumpur in August 2002 between the regulators and representatives of the banking community in the Asia Pacific region and the Basel Committee. Arising from this meeting, it was agreed that Bank Negara Malaysia would conduct a survey on EMEAP member countries' required timeframe for the implementation of the new Basel II capital requirements.

### Assessment of Malaysia's Anti-Money Laundering Programme by the APG

Overall, the report was positive and took cognisance of the progress made by Malaysia in establishing an appropriate anti-money laundering programme in a relatively short period. The significant developments noted were:

- the creation of the National Co-ordination Committee to Counter Money Laundering; and
- the enactment of the Anti-Money Laundering Act 2001 and the Mutual Assistance in Criminal Matters Act 2002.

Malaysia had taken the necessary measures to comply with most of the recommendations to ensure the effectiveness of the national anti-money laundering efforts.

The APG's evaluation team assessed Malaysia's anti-money laundering programme on 9-12 July 2001. The report on this mutually agreed evaluation was presented and adopted at the APG's 5th annual meeting in June 2002. The evaluation process was designed to examine the areas where the standard benchmarks were met, to identify weaknesses and to make appropriate recommendations with a view to rectification and improvement, where necessary.

The APG's main purpose is to ensure the implementation of internationally accepted anti-money laundering standards in the legal, financial and law enforcement sectors, and to conduct mutual evaluations to encourage members' compliance with these standards.

During 2002, the issue of **anti-money laundering measures** dominated the agenda of many regional fora, including the Manila Framework Group. The intensity and scope of coverage contributed to improved understanding of the need for such measures. At the ASEAN Regional Forum, Bank Negara Malaysia, on behalf of Malaysia, co-hosted with the United States, the "Workshop on Financial

Payments Arrangement (BPA) among developing countries. As a result, two new BPA agreements were signed in 2002, bringing the total number to 23 agreements since the inception of the BPA in 1988.

Trade transactions under BPA had contributed to increased mutual understanding of the business practices and environment of the trading partners.

### Bank Negara Malaysia signed 2 new BPAs and 2 new POCPA agreements in 2002. Such agreements facilitate and strengthen bilateral trade and banking relations.

Measures against Terrorism" in Honolulu, Hawaii on 24-26 March 2002. The workshop helped to raise awareness of member countries' national financial measures and readiness to curb money-laundering activities. Malaysia also shared its experiences in implementing anti-money laundering measures at the **ASEM forum**. Such measures included the passage of comprehensive anti-money laundering laws, creation of a Financial Intelligence Unit and increased co-operation among law enforcement agencies.

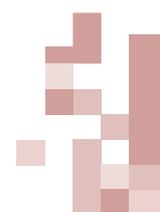
This had resulted in an improvement in the business confidence between exporters and importers and between the banking communities of the partner countries, which had facilitated trade through normal channels as well, outside the ambit of the BPAs.

In addition to the BPA agreements, Bank Negara Malaysia also signed two new Palm Oil Credit and Payments Arrangement (POCPA) agreements in 2002, resulting in a total of 12 agreements concluded since 1992. POCPA is part of an overall scheme initiated by the Government of Malaysia (through the Ministry of Primary Industries) to promote the export of palm oil and its derivatives to the developing countries. Under the POCPA scheme, developing countries would be able to import palm oil from Malaysia on deferred payment terms for a period of two years.

#### BILATERAL CO-OPERATION

##### Bilateral Payments Arrangement and Palm Oil Credit and Payments Arrangement

As part of Malaysia's on-going efforts to diversify its trade to non-traditional markets, Bank Negara Malaysia continued to promote the Bilateral



As part of a new initiative to diversify the modes of settlement of international trade, Malaysia embarked on a study on the viability of using gold as a medium of settlement for net monetary obligations arising from bilateral trade between Malaysia and its bilateral trading partners. It was envisaged that a settlement system based on gold would enable trading partners to conserve their pool of foreign exchange reserves.

#### **Bank Negara Malaysia Technical Assistance and Information Exchange**

During 2002, Bank Negara Malaysia continued to implement its technical assistance programme as part of its efforts to strengthen co-operation among central banks and monetary authorities.

Towards this end, under the Malaysian Technical Co-operation Programme (MTCP) established in 1980, the Central Bank extended places to 14 officers from 12 central banks to participate in its annual flagship-learning programme, the Central Banking Course (CBC). The CBC, held for the twenty-first time in 2002, aimed to provide participants with an appreciation and understanding of approaches and constraints in achieving key central banking objectives

in maintaining monetary stability, preserving financial stability in the face of financial deepening and liberalisation and fostering sustainable economic growth. During the year, the Central Bank also received 68 visiting foreign delegations from central banks, government agencies and private sector organisations. Discussions were generally on specific issues on banking and corporate sector restructuring, development and monitoring credit bureau systems and anti-money laundering legislation. The Central Bank also responded to requests from countries for technical assistance in banking, corporate and financial sector reforms and debt management strategies.

In line with Malaysia's efforts to further strengthen bilateral relations and co-operation with its bilateral partners, the Central Bank also participated in a number of the Government's Joint Commission Meetings (JCMs) with other countries in 2002. During the year, the Central Bank participated in JCMs with Cuba, India, Indonesia, Iran, Kyrgyz Republic, Sudan, Tunisia and Vietnam. The issues discussed included technical co-operation in banking and finance, trade and economic relations, science and technology, transport and telecommunications and tourism.