Financial Stability and Payment Systems Report 2010

Briefing to Analysts & Fund Managers

by
Dato' Mohd Razif Abd. Kadir
Deputy Governor

23 March 2011

Stability of the financial sector was preserved throughout 2010

- strong fundamentals contributed towards efficient financial intermediation

- orderly and efficient conditions in financial markets, and payments and settlements systems facilitated trade and domestic activities

Financial system continues to be resilient

- Strong capital and liquidity buffers
- Improved profitability
- High asset quality
- Have capacity to withstand extreme macroeconomic and financial conditions

Banking Sector (%)	2009	Jan'11
Capital Adequacy		
Risk-Weighted Capital Ratio	15.4	14.1
Core Capital Ratio	13.8	12.4
Capital Buffer (RM bil)	64.6	60.5
Profitability		
Return on Assets	1.2	1.8
Return on Equity	14.0	19.7
Asset Quality		
Net Non Performing Loan* Ratio	1.8	2.2
Liquidity Position		
Liquidity buffer (<1 mth, % of deposits)	18.2	14.8
Insurance/Takaful Sector (%)	**2009**	**2010**
Capital Adequacy		
Capital Adequacy Ratio^	225.7	224.6
Capital Buffer^ (RM bil)	18.6	18.6
Profitability		
Profit Before Tax (RM bil)	14.7	16.3

** 2011 position based on impairment methodology*

^ Conventional industry only

Banking system recorded RM22.8 bil in pre-tax profit

Conventional banking system: PBT of RM19.7 billion

Conventional Banking System	*2010 RM bil*	*2010 growth*
Net interest income	27.5	+15.8%
Fee/Commission-based income	8.1	+11.2%
Net trading & investment gains	7.4	+62.4%
Staff cost and overheads	20.2	+14.4%
Pre-tax profit	19.7	+37.1%

Islamic banking system: PBT of RM3.1 billion

Islamic Banking System	*2010 RM bil*	*2010 growth*
Net income	6.8	+12.2%
Fee/Commission-based income	0.7	+13.7%
Net trading & investment gains	0.4	+17.8%
Staff cost and overheads	3.6	+56.1%
Pre-tax profit	3.1	+16.9%

Insurance and takaful sector registered RM16.3 bil in pre-tax profit

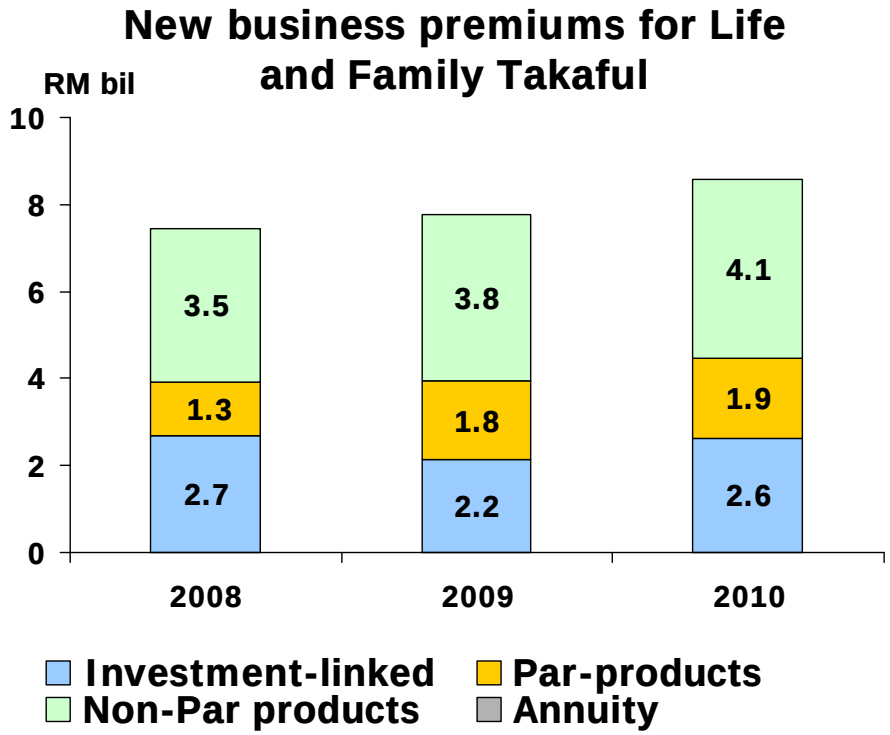
Life insurance & family takaful: Excess of income over outgo of RM14.1 bil

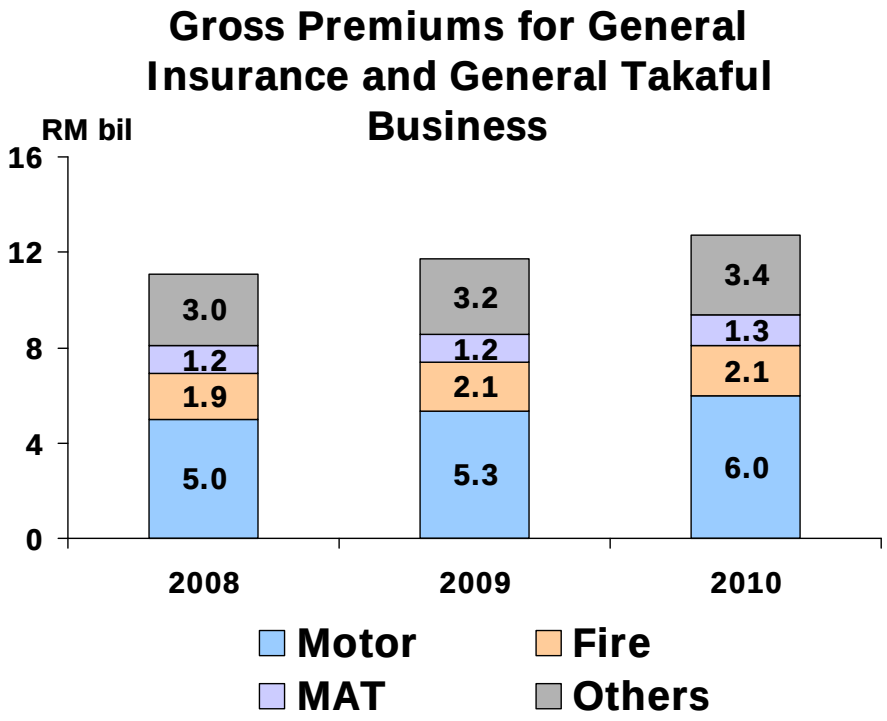
General insurance & takaful: Operating profits of RM2.2 bil

2010	Life Insurance		Family Takaful		Total	
	RM bil	growth	RM bil	growth	RM bil	growth
Net premiums/ contribution	21.9	15.9%	3.3	21.3%	25.2	11.5%
Net policy/ certificate benefits	13	9.2%	1.6	75.8%	14.6	14.7%
Net Investment income	5.4	10.2%	0.5	42.9%	5.9	11.5%
Net unrealised and capital gains	4.2	44.9%	0.01	-83.3%	4.3	46%
Excess income over outgo	12.7	16.5%	1.4	-15.6%	14.1	12.1%

2010	General Insurance		General Takaful		Total	
	RM bil	growth	RM bil	growth	RM bil	growth
Gross direct premiums/ contribution	15.2	8.6%	1.4	26.3%	16.6	10%
Net claims incurred	6.8	11.5%	0.5	34.5%	7.3	12.3%
Net Investment income	0.8	3.9%	0.1	17.7%	0.9	6.2%
Net unrealised and capital gains	0.06	-75%	0.04	96.7%	0.1	-68.1%
Operating Profit	1.9	2.7%	0.2	12.5%	2.1	3.8%

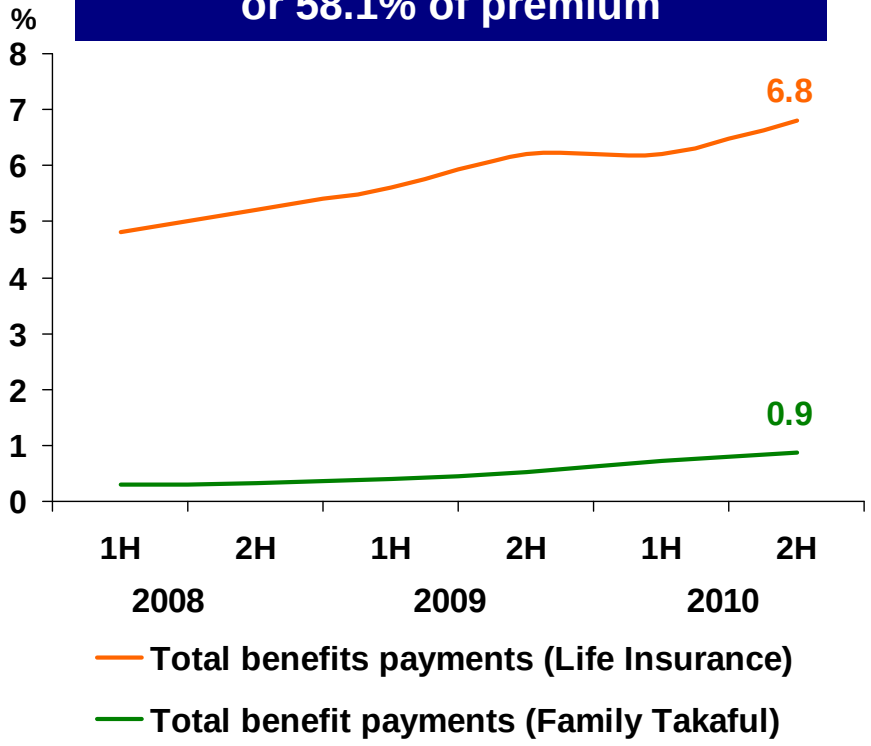
Premiums for insurance sector continued to grow, driven by investment-linked and motor businesses



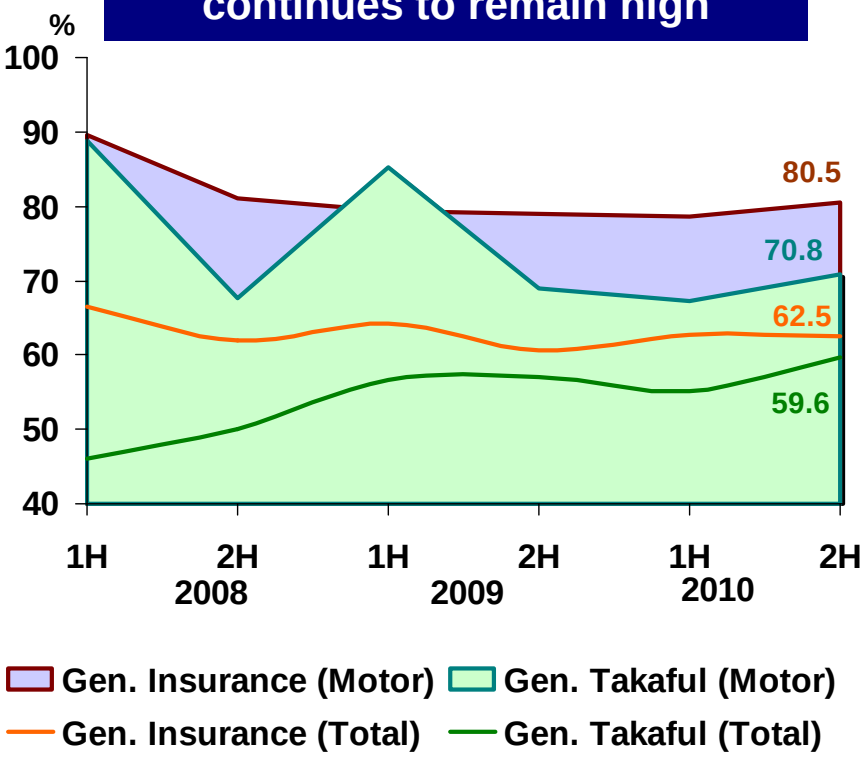


Manageable trend in payouts of benefits and claims

Total benefit payments of RM13 bil or 58.1% of premium



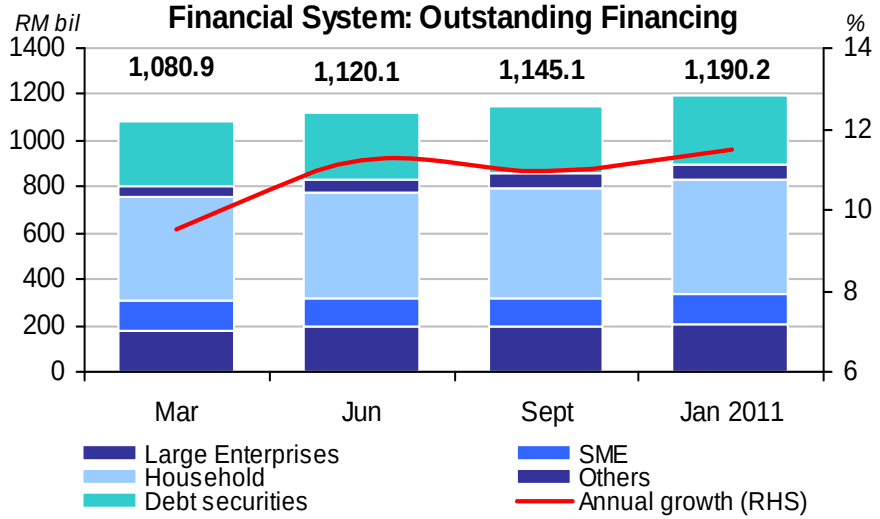
Claims experience in motor continues to remain high

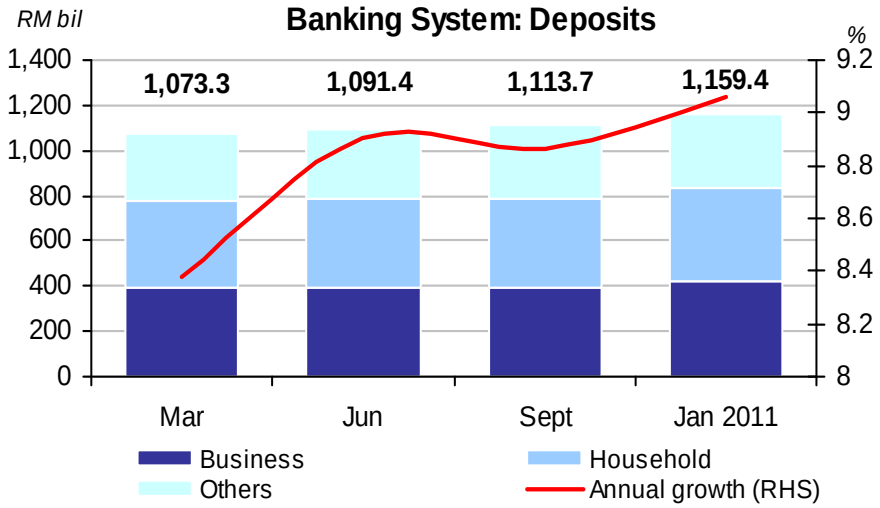


New motor cover framework that is being formulated to preserve access to affordable motor cover while ensuring its sustainability over the longer term

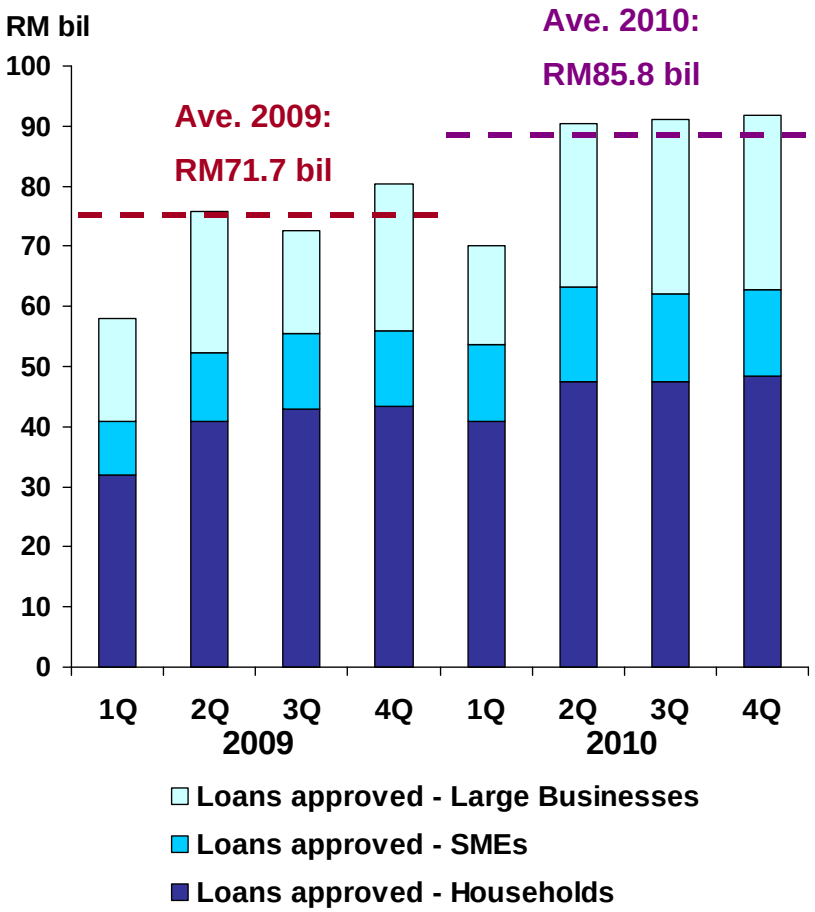
Continued access to financing by all sectors

- Outstanding banking system financing grew by 13.1%
  - Continued expansion to all segments, including SMEs
- Bank deposits increased by 9.1%
  - Loan-to-deposit ratio stable at 81.2%
- Favourable condition since 2H 2010 facilitated fund raising in PDS market
  - New corporate debt securities and sukuk issuances of RM76 bil
  - Danajamin approved RM4.6 bil worth of guarantees





Higher new loans to large businesses and SMEs

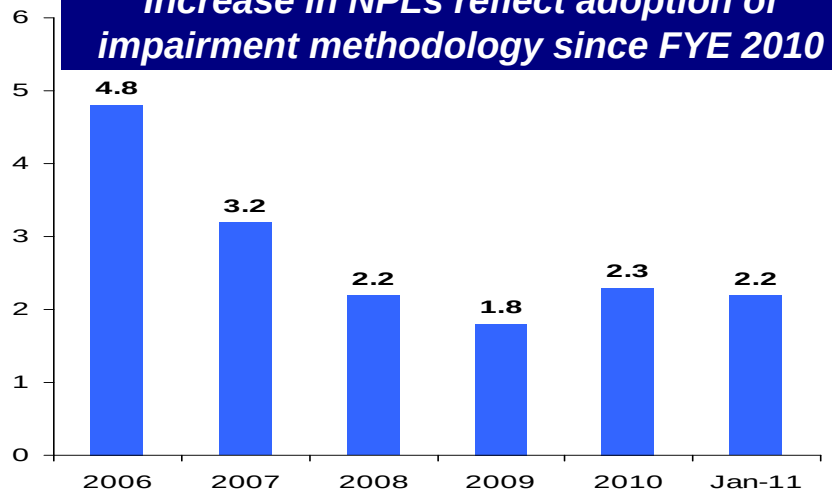


- Outstanding loans to businesses grew 10.1% to RM336.9 bil
  - More moderate growth of 2.8% for SME loans
  - Adjusting for graduated accounts of business reclassification as large enterprises, SME loans had grew by 11.5%

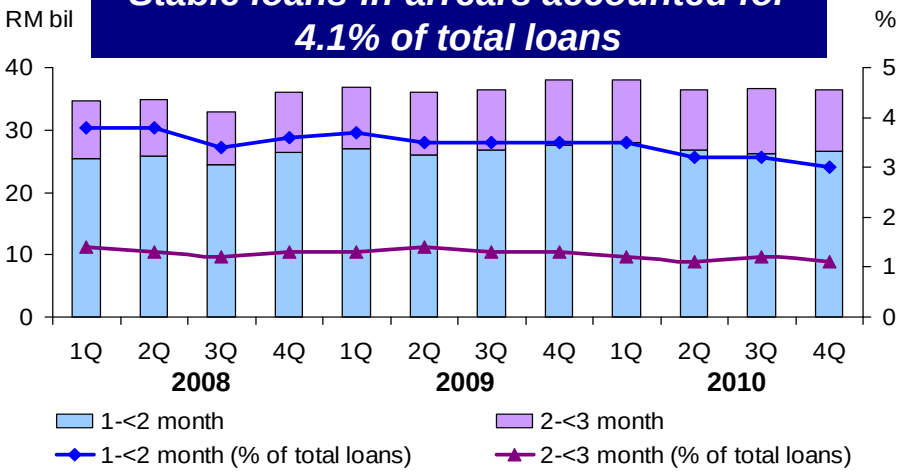
- Bulk of new approvals to:
  - Manufacturing (RM22 bil)
  - Construction (RM25.5 bil)
  - Wholesale & retail (RM18.9 bil)
  - Real estate activities (RM18.5 bil)

Overall financing quality remained intact

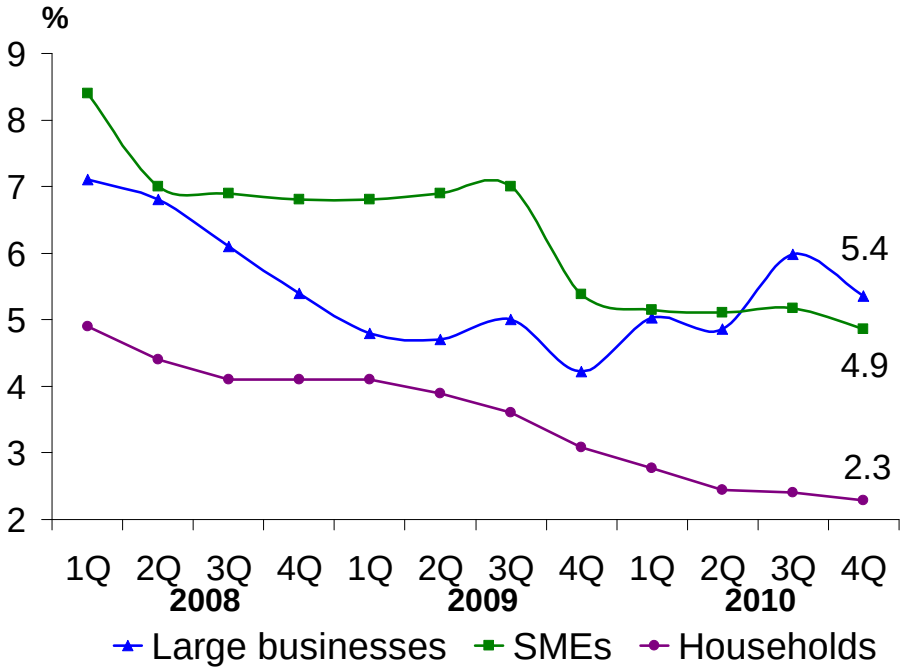
Increase in NPLs reflect adoption of impairment methodology since FYE 2010



Stable loans-in-arrears accounted for 4.1% of total loans

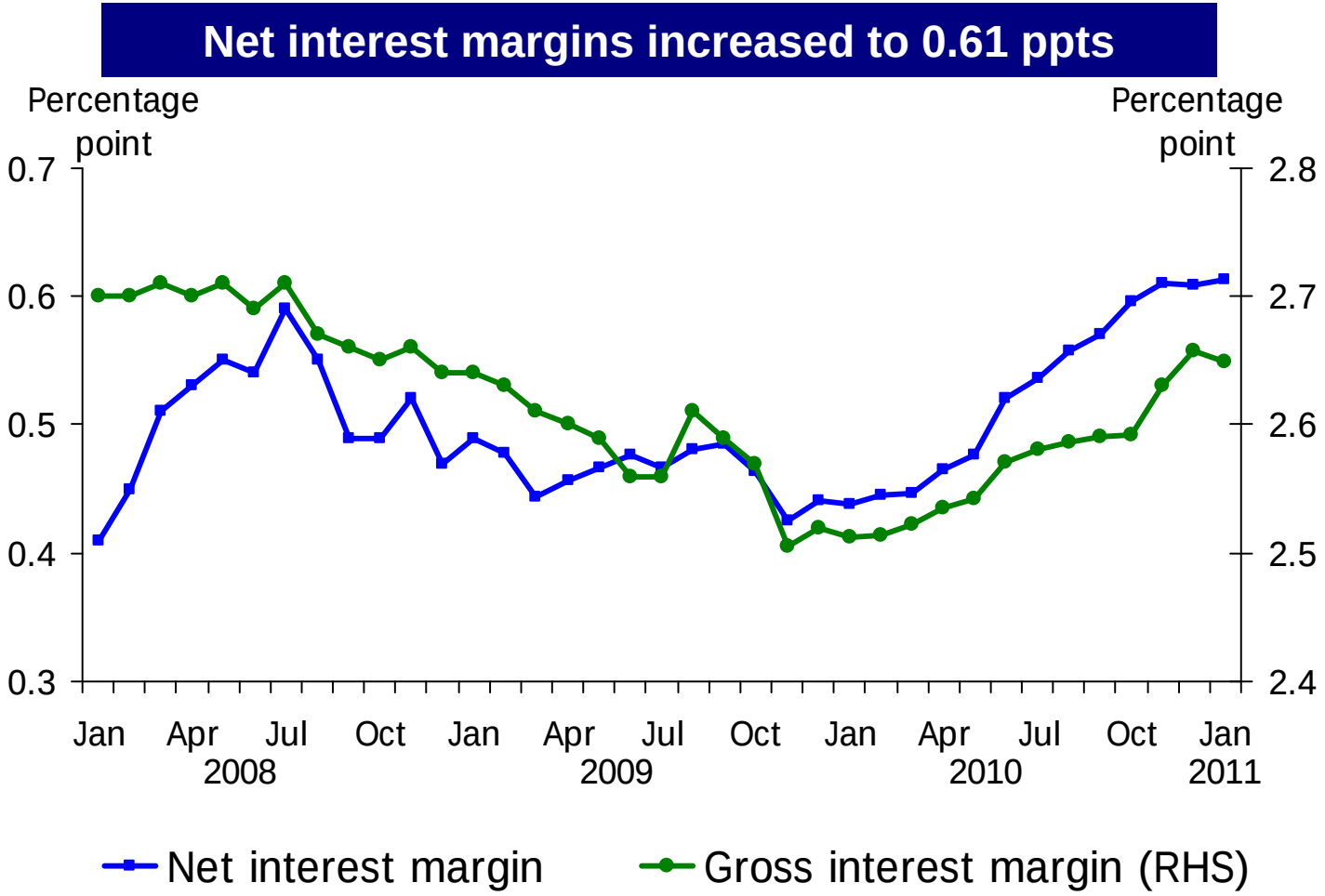


Increase in NPLs of large businesses amid adoption of impairment classification under FRS139



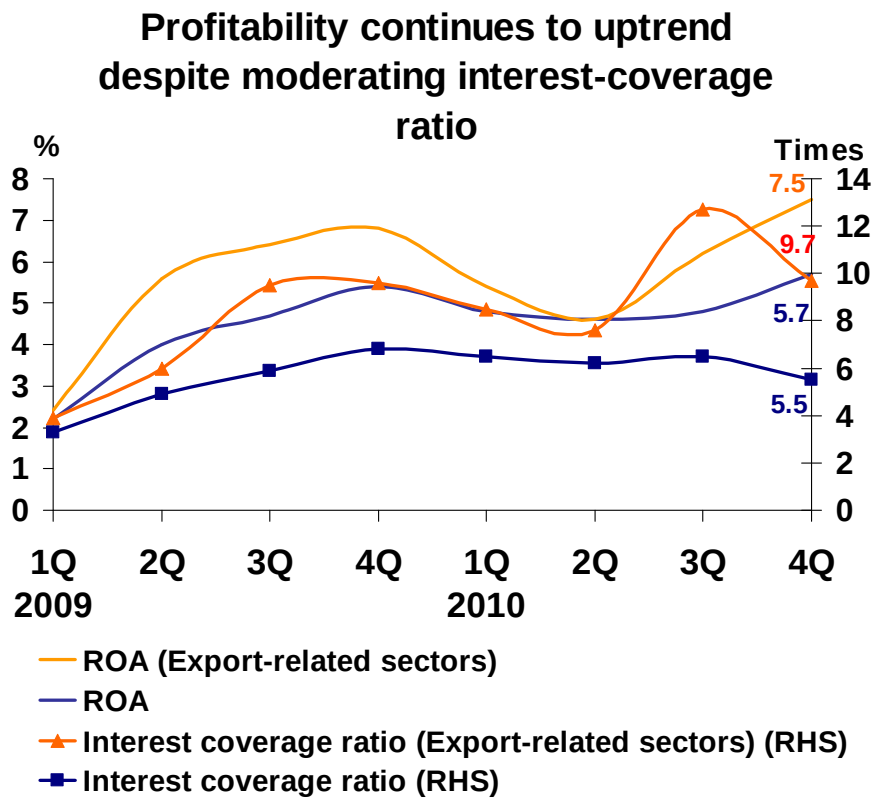
- **New NPLs average at RM2.4 billion a month**
- **Loan loss coverage at 90.7%**

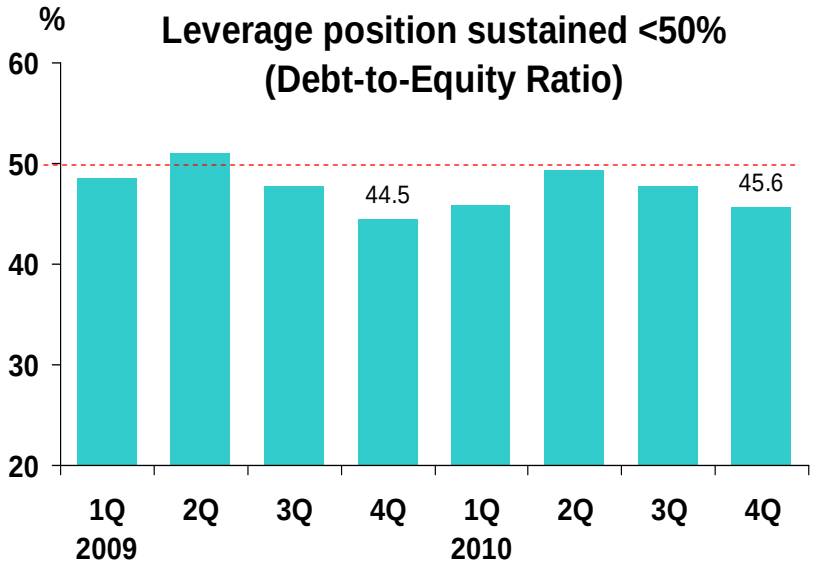
Margins rebounded on sustained financing activities and lower impairment provisions



Manageable credit risk from business

- sustained debt servicing capacity of businesses





Improved downgrade-to-upgrade ratio

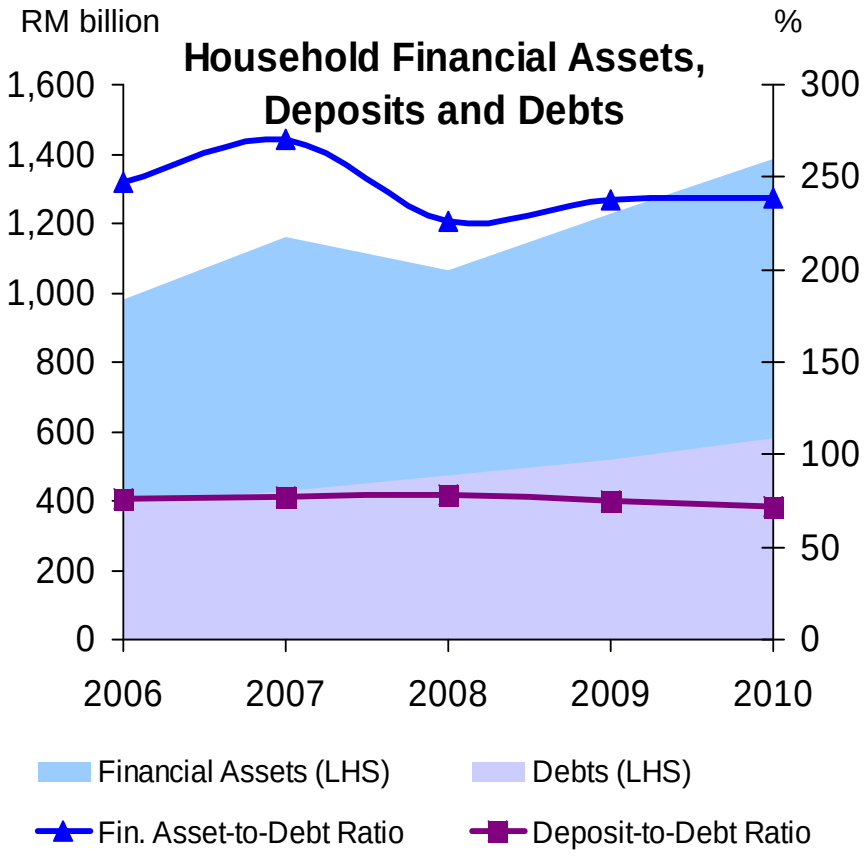
Year	Downgrades	Upgrades	Ratio
2009	23	11	2.09
2010	22	15	1.47

Source: RAM and MARC

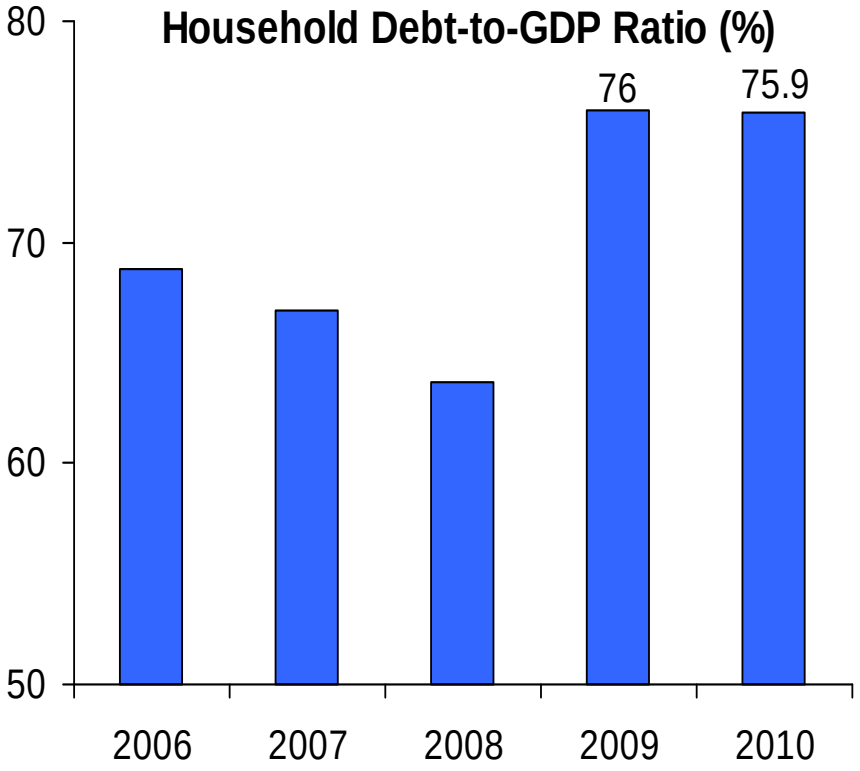
**Export-related sectors include timber & wood-based products, textiles & apparels, rubber gloves, plantation & agriculture, packaging materials, O&G, furniture, E&E, chemicals & chemical products*

Rising household indebtedness supported by strong financial buffers...

Household financial assets are 2.4 times of household debts



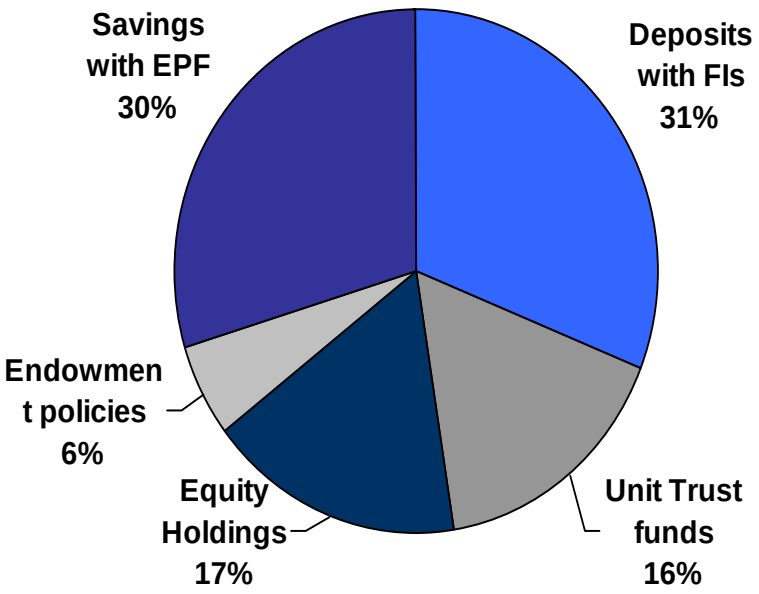
Household debt-to-GDP ratio unchanged at 75.9%



...and high level of liquid assets, while bulk of borrowings are for purchase of assets

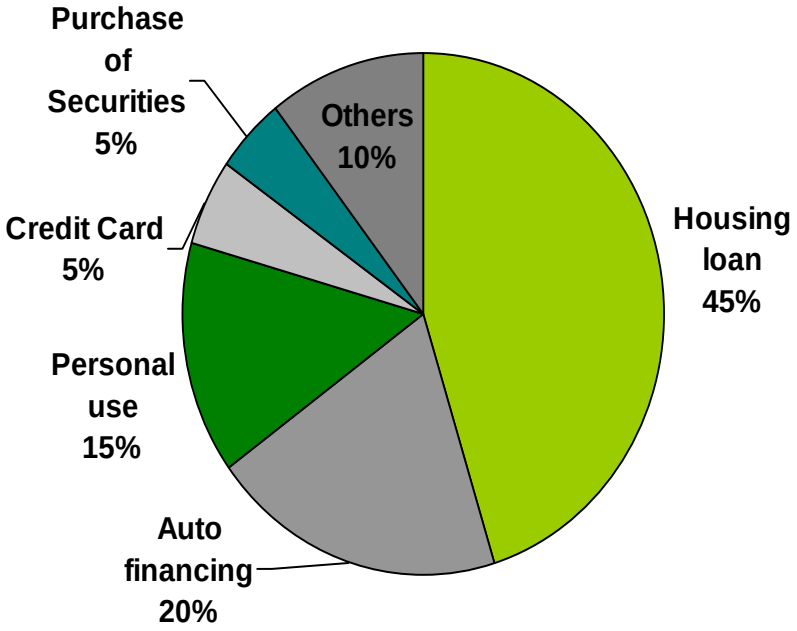
Liquid assets accounted for 64.6% of financial assets

Composition of HH Financial Assets (RM1,386 bil)

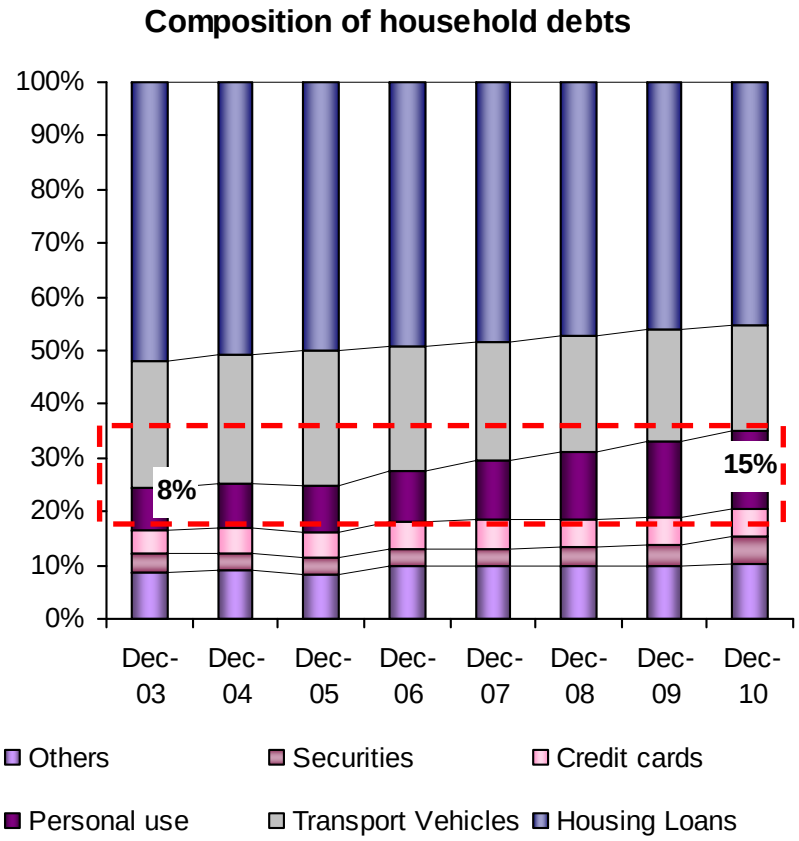


Secured financing constitute 64.9% of household debt

Composition of HH Financial Debts (RM581 bil)



Personal financing grew 17.5% driven by salary deduction scheme

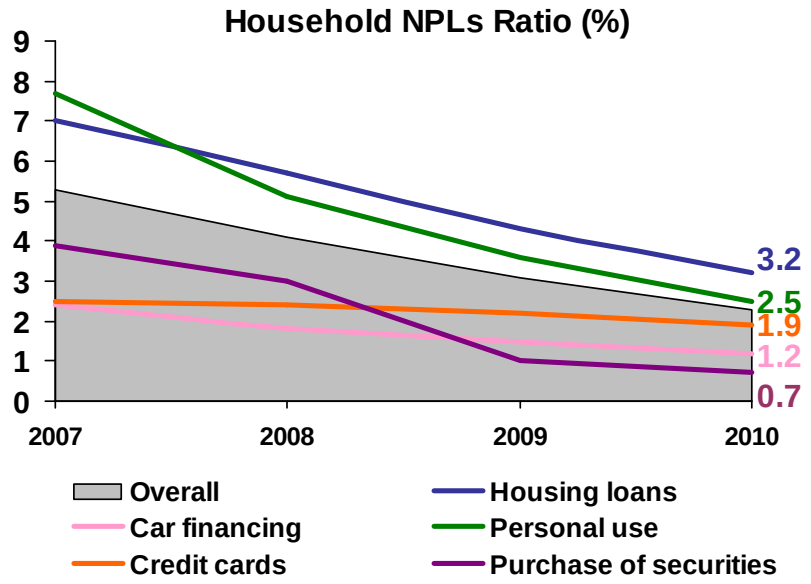


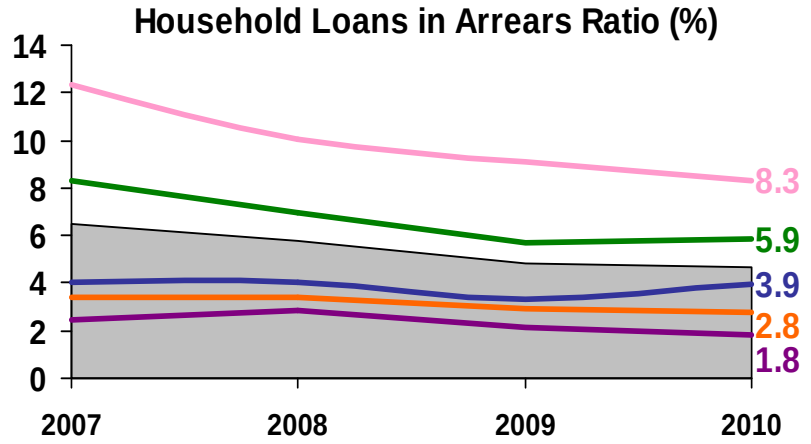
- Personal financing (PF) accounted for 14.6% of household debts
  - Personal financing by banks grew at lower rate of 13%
  - Account for less than 5% of banks' loans
  - NPL ratio of 2.5%

- Driven by development financial institutions, cooperatives and building societies
  - Approx. 80% under salary deduction schemes

Household loan quality remained intact

- Debt servicing capacity of households remains sound
  - Delinquencies continued to improve
  - Banking system gross NPL ratio: 2.3% (2009: 3.1%)
  - LIAs at 4.7% of total banking system loans
- Banks maintain prudent loan underwriting standards and risk management practices
- Supported by comprehensive credit information system and infrastructure





Comprehensive and pre-emptive strategies to preserve household sector resilience

Prudential policies

- **Loan-to-value ratio of 70% applied to 3rd housing loans onwards**
- **New credit card guidelines**
  - *Higher minimum income eligibility from RM18k to RM24k per annum*
  - *Limit on no. of cards and credit limit for cardholders earning ≤RM36k per annum*
- **Increased risk-weights for housing loans with LTV >90% and personal financing with tenure >5 years**

Targeted financial education programme by AKPK

- Including advisory and support arrangements

Standards on prudent and responsible lending practices

- Suitability and affordability assessments

Intensive supervisory oversight

Ensuring prudent and responsible conduct for retail financing as part of measures to preserve household sector resilience

- Inculcate responsible lending practices by financial institutions in dealing with retail customers

- Requirements NOT intended nor expected to hamper credit availability

- Key requirements include
  - Suitability and affordability assessment
  - Verification of customers' income
  - Product disclosure sheet to facilitate informed decision making
  - Compensation of sales and marketing personnel to take into account fair dealing conduct

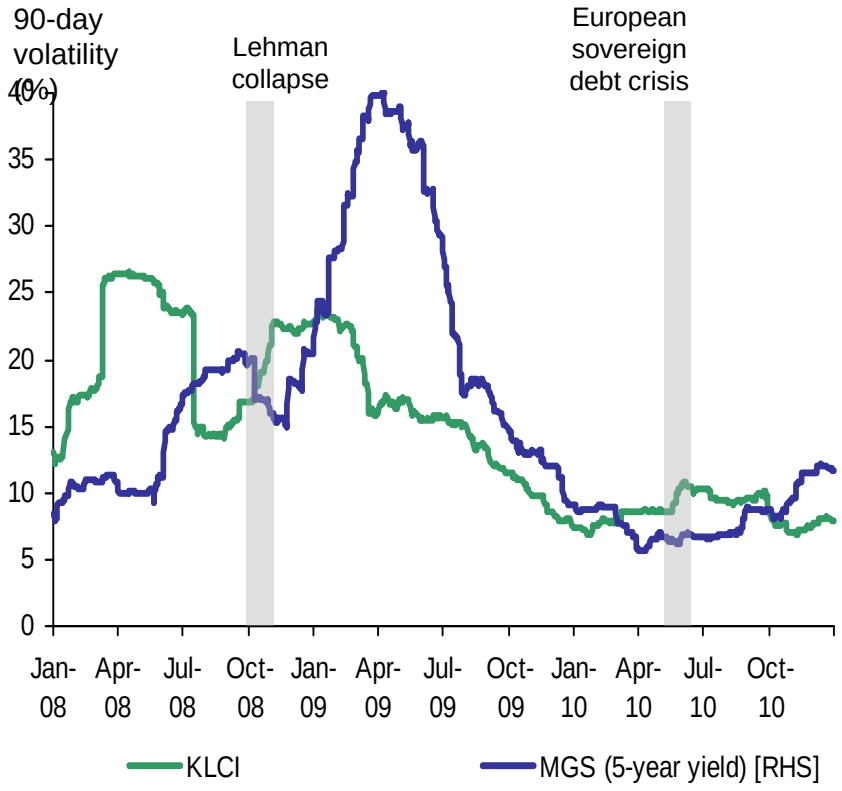
- Complete submissions should not result in processing delays

Key contents of product disclosure sheet

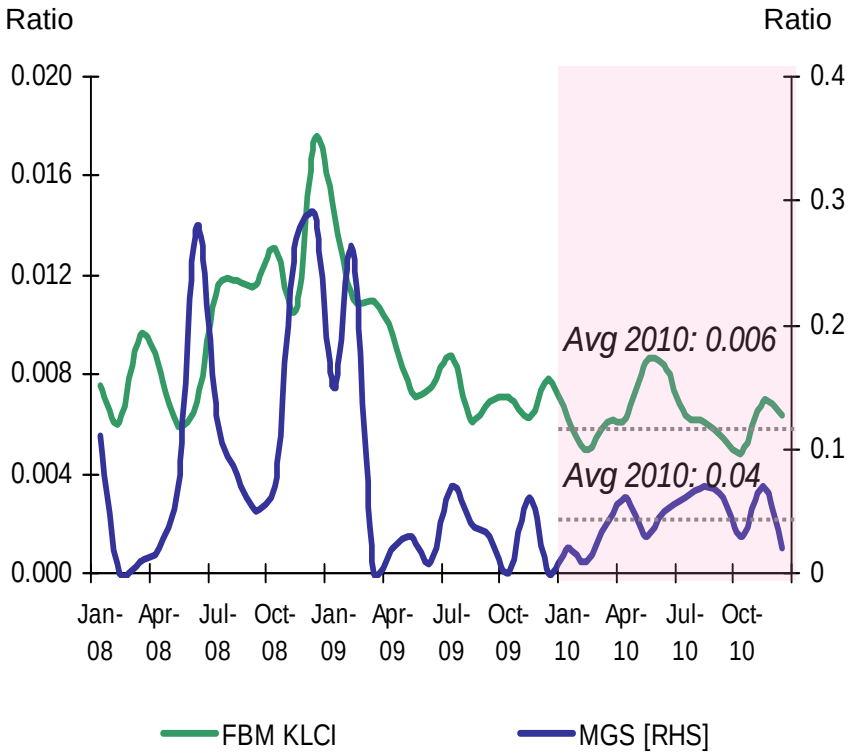
- Borrowing rate, variable / fixed rate, tenure, repayment structure
- Repayment obligation
  - Installment amount, total repayment (entire duration), changes to installment amount for 100-200bps increase in borrowing rate
- Applicable charges
  - Stamp duty, disbursement fee, processing fee
- Implications of non-repayment
  - Late payment penalty, review of borrowing rate, legal implications
- Risk associated with the product
- Assistance and redress mechanism

Financial markets exhibited enhanced capacity to intermediate larger and more volatile portfolio flows

Volatility of asset prices remained low

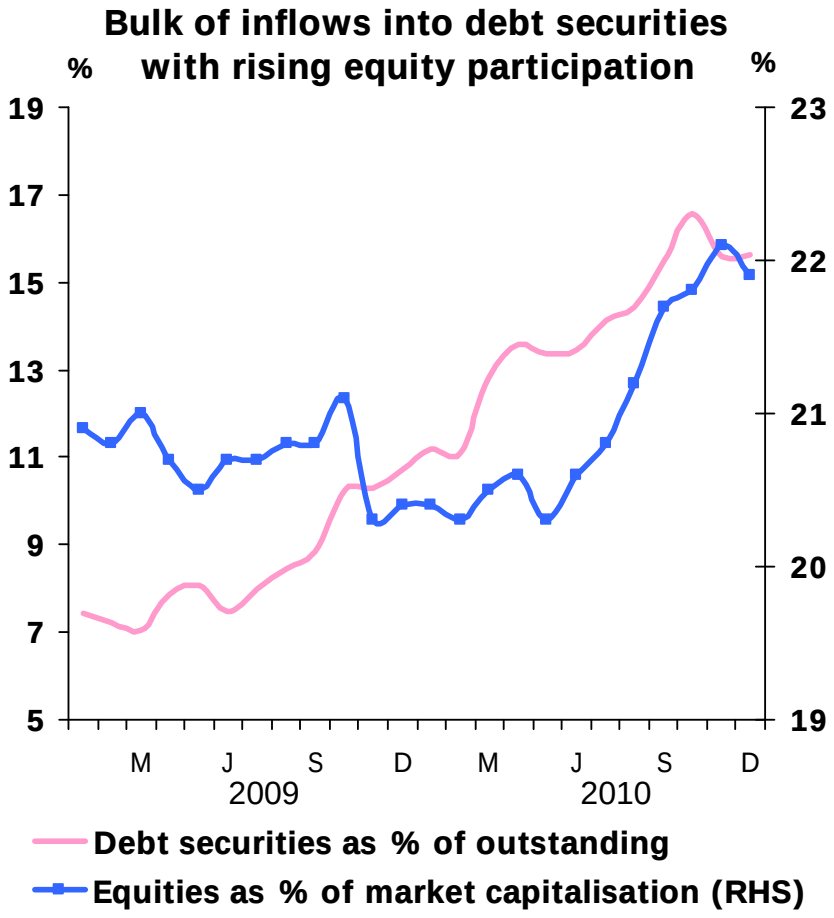


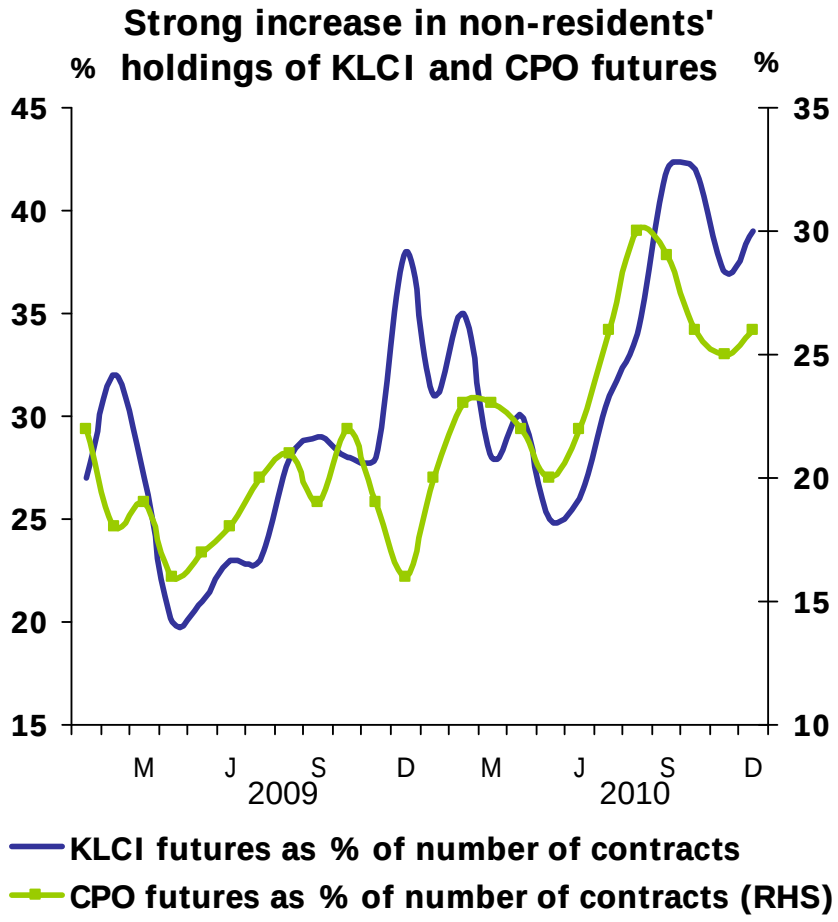
Returns-to-turnover ratio was lower, denoting higher resilience



Source: Bloomberg

Portfolio inflows channeled to more diversified asset classes





No material changes in risk-taking by FIs

Banking System: Securities Portfolio

(RM bil)	2008	2009	2010
Dealing Securities	**51.7**	**46.4**	**69.2**
Investment Securities	**163.5**	**199.3**	**201.6**
Shares	*1.8*	*2.2*	*3.1*
MGS	*61.4*	*90.7*	*84.0*
BNM Debt	*15.3*	*14.0*	*47.2*
PDS	*59.2*	*60.1*	*59.9*

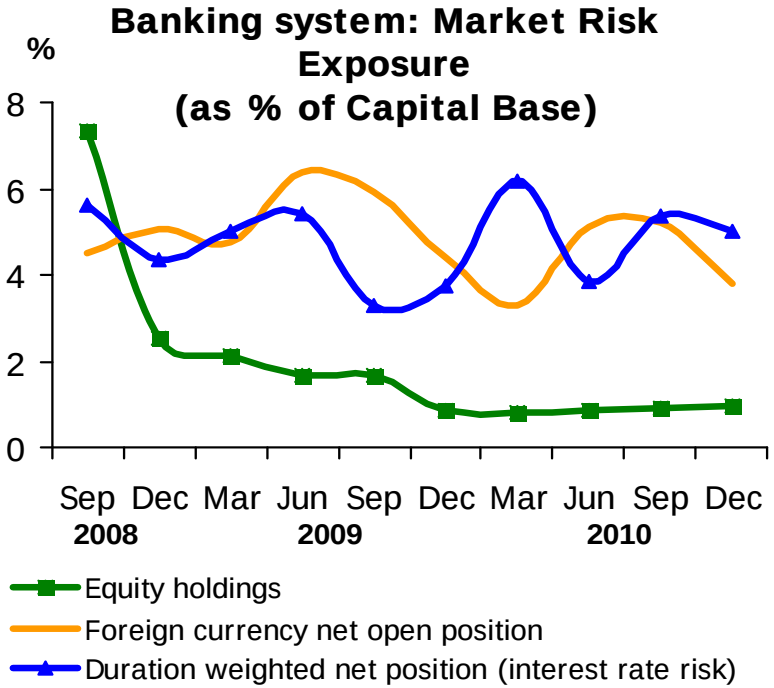
Insurance Sector: Securities Portfolio

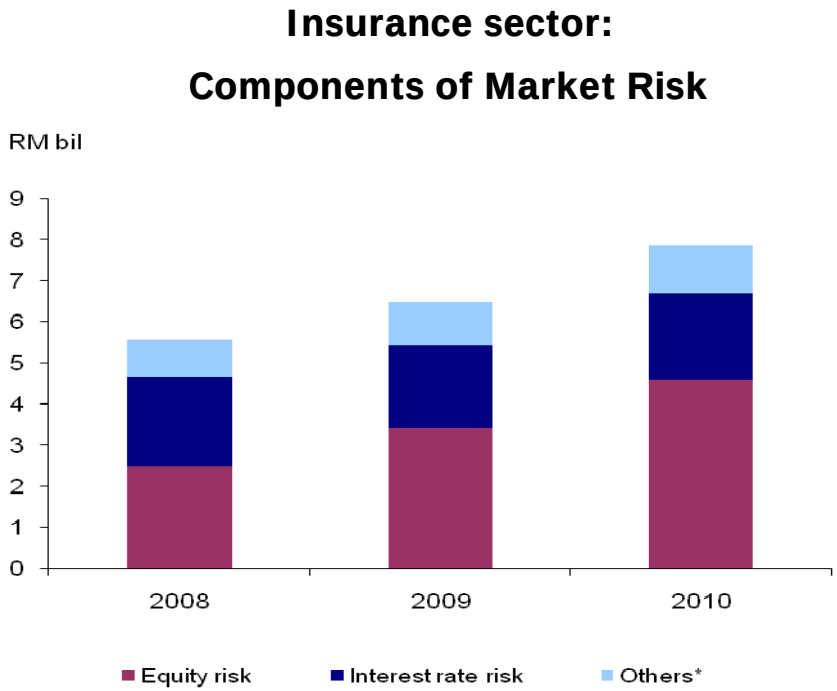
(RM bil)	2008	2009	2010
Investment Securities	**72.2**	**87.8**	**101.7**
Shares	*12.4*	*20.0*	*21.3*
MGS	*16.2*	*15.7*	*22.1*
BNM Debt	*0.09*	*0.02*	*1.23*
PDS	*43.6*	*52.1*	*57.0*

- Trading portfolio of banks grew 49.2% in 2010
  - Due primarily to higher holdings of BNM papers (+237.1%)

- Equity holdings increased slightly to 16.5% of assets (2009: 13.5%)
- Helps reduce mismatch in returns

Rise in market risk exposures of FIs is manageable

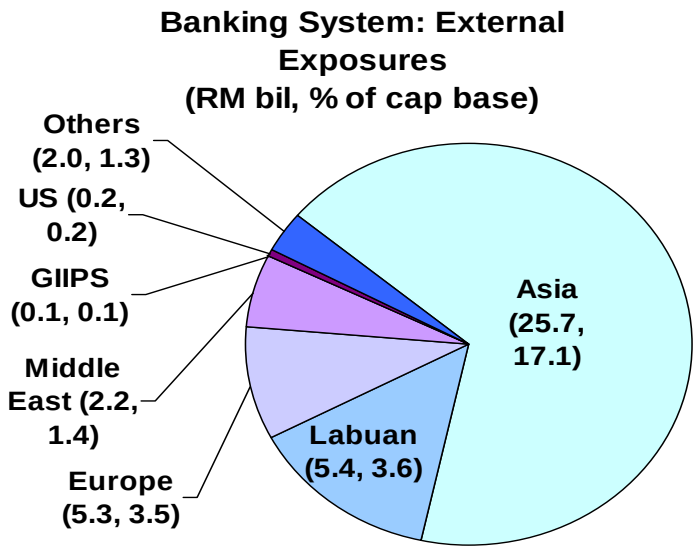


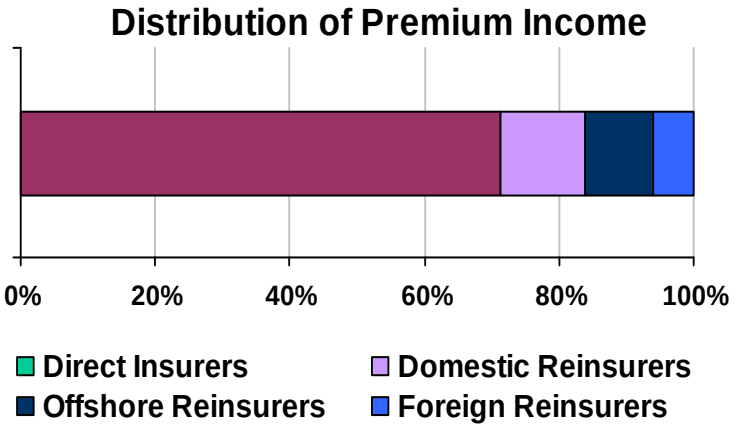


- FCY exposures edged up to 3.8% of capital base, more active hedging by customers
  - Stable FCY deposits from non-residents

Limited impact from developments in Europe and MENA*

- Banks' exposures at 18.3% of external exposures or 5% of capital base
  - No adverse spillovers from interbank funding strains in Europe
  - Regional operations of domestic banks' unaffected due to strong fundamentals
- Counterparty risks to European reinsurers well-contained
  - High net retention ratio of 71.4%
  - Reinsurance exposures to Europe only 8.5% of total capital available for general insurance
- Under scenario of widespread sovereign default by GIIPS^, potential credit losses will remain below 0.05% and 0.0006% of banks and insurance sectors' capital buffers respectively





** MENA – Middle East and North Africa*
^ GIIPS – Greece, Ireland, Italy, Portugal and Spain

Malaysian financial institutions have continued to strengthen their regional presence

Enhanced capacity to expand overseas

Key Drivers for Expansion Abroad

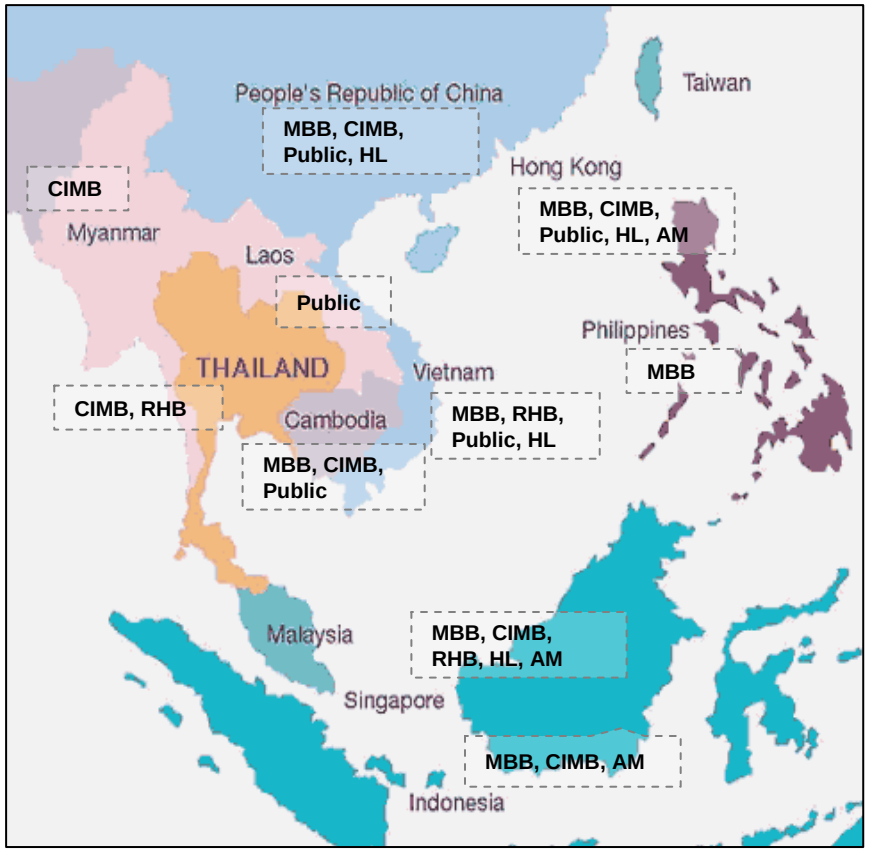
- Intensified domestic competition
- Rising needs of internationalisation of local firms
- Greater trade & investment linkages
- Growth opportunities in new markets

Domestic banking groups have **presence in 19 countries worldwide** with a higher share of overseas assets and income

	2002	2010
Assets	RM3.3 bil	RM258 bil
Revenue	-4.3%	16.7%*

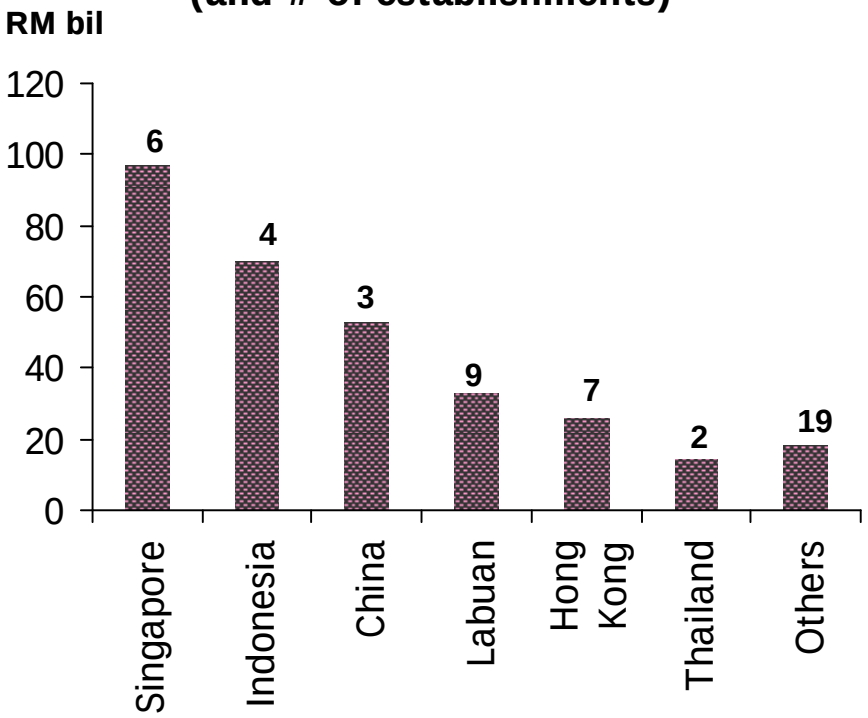
** 2009*

Expanded overseas presence of domestic banking groups in East Asia

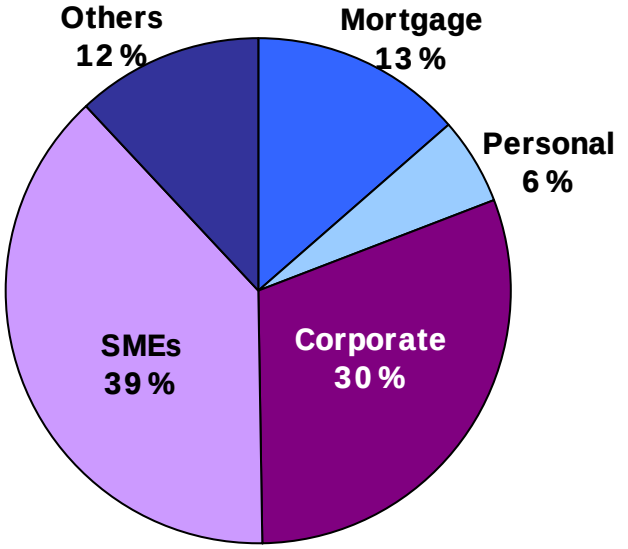


Overseas operations remained well capitalised

Banking System: Assets of Overseas Operations (and # of establishments)



Banking System: Loan Composition of Overseas Operations



Key Financial Soundness Indicators

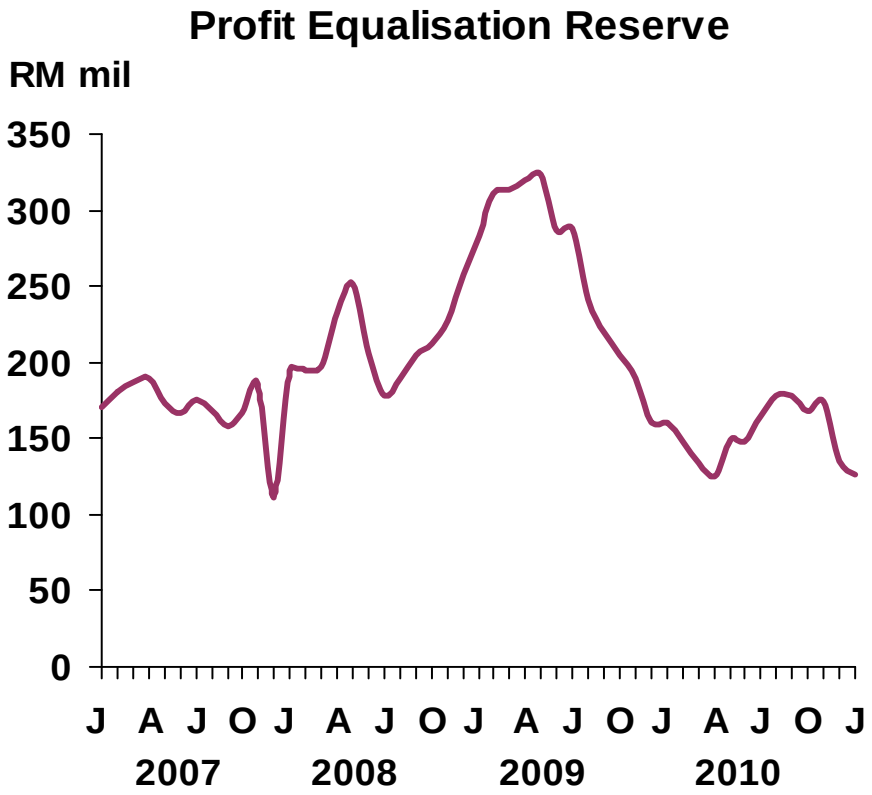
RWCR: 11.9% - 33.6%

Overall NPL ratio: 3.3%

Overall RoA: 1.0%

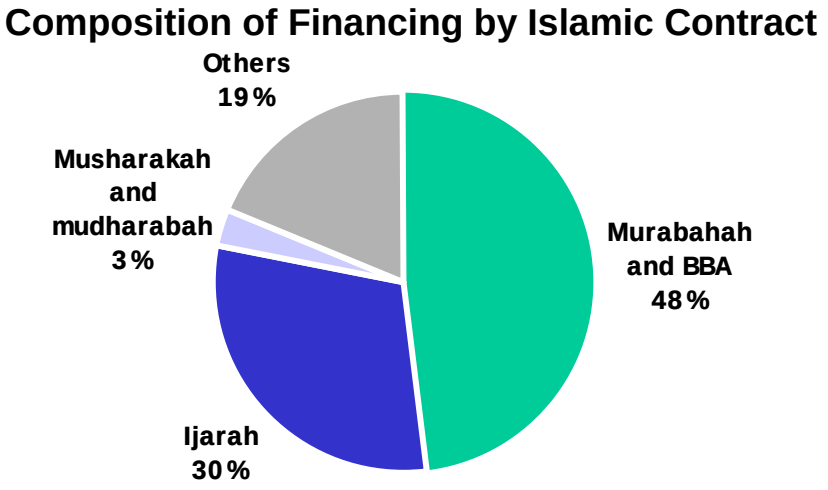
Islamic banks: Effective management of displaced commercial risk

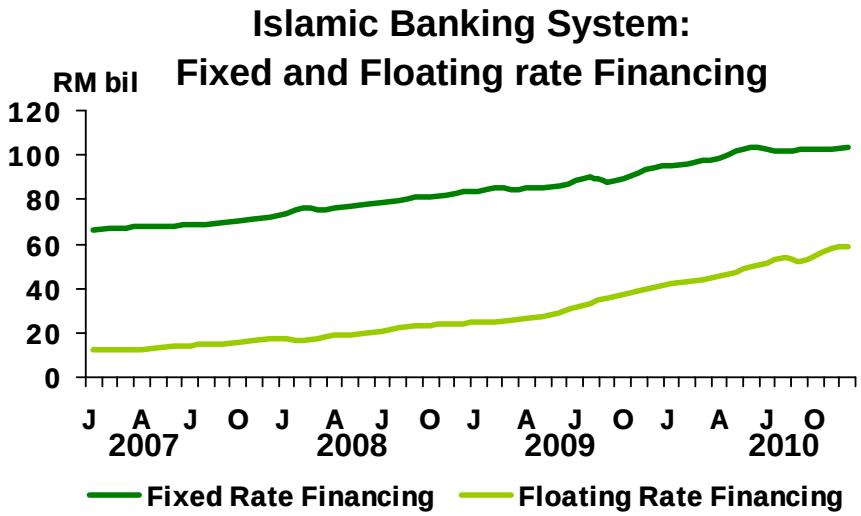
- Total deposits grew 15.7% to RM218.4 bil
  - 33% of deposits are mudharabah general investment accounts
- Active management of displaced commercial risk
  - Profit equalisation reserves of RM126.6 mil



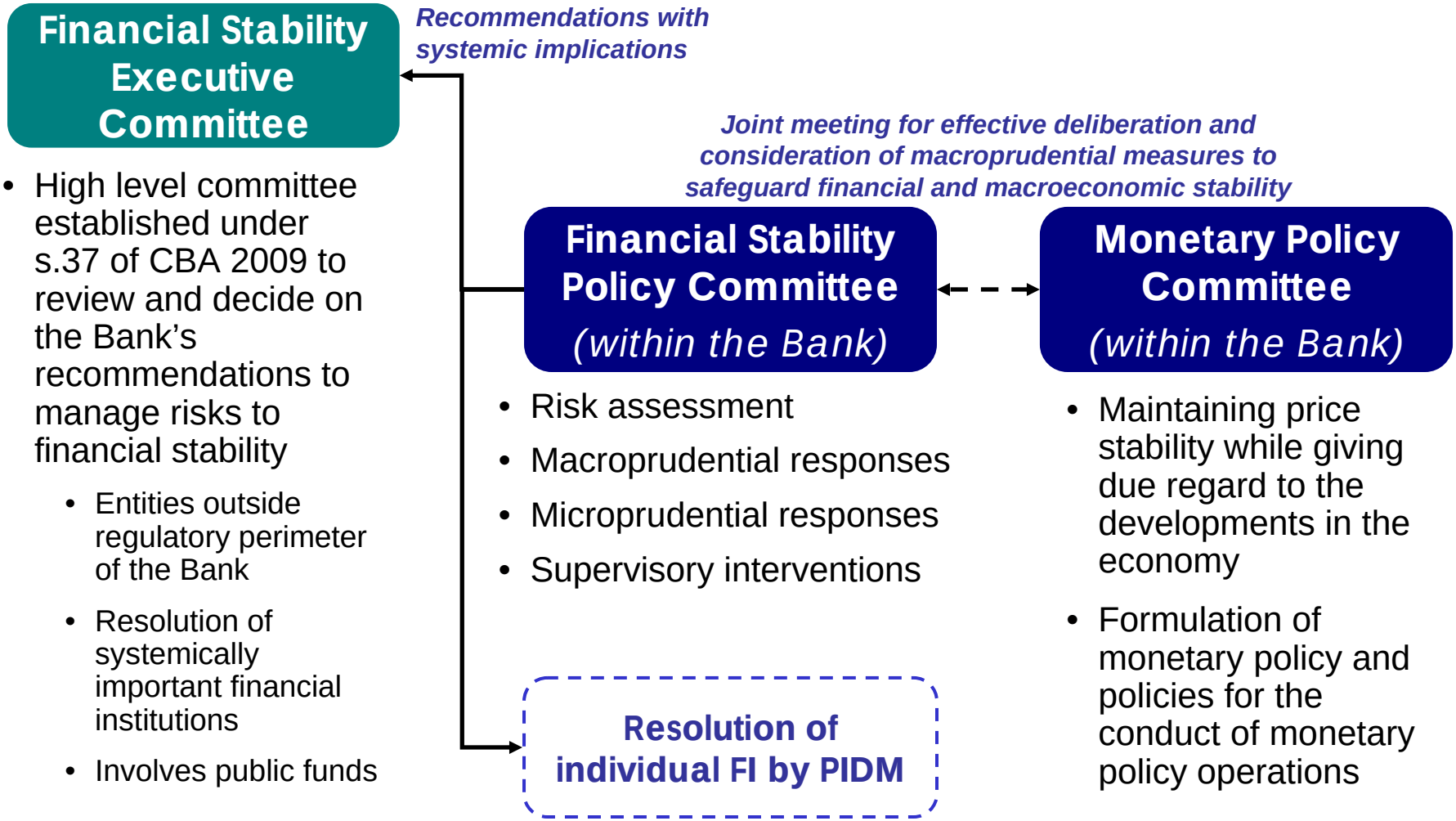
Islamic banks: Active management of repricing gap risk

- 63.8% of assets on fixed-rate
- Risks increasingly hedged by Islamic Profit Rate Swap (IPRS)
- Variable rate financing e.g. *musharakah mutanaqisah* (diminishing partnership) and *ijarah* (leasing) contracts increasing in volume
  - Increased by 44.1% to RM58.6 bil





Strengthened governance and decision making framework for financial stability

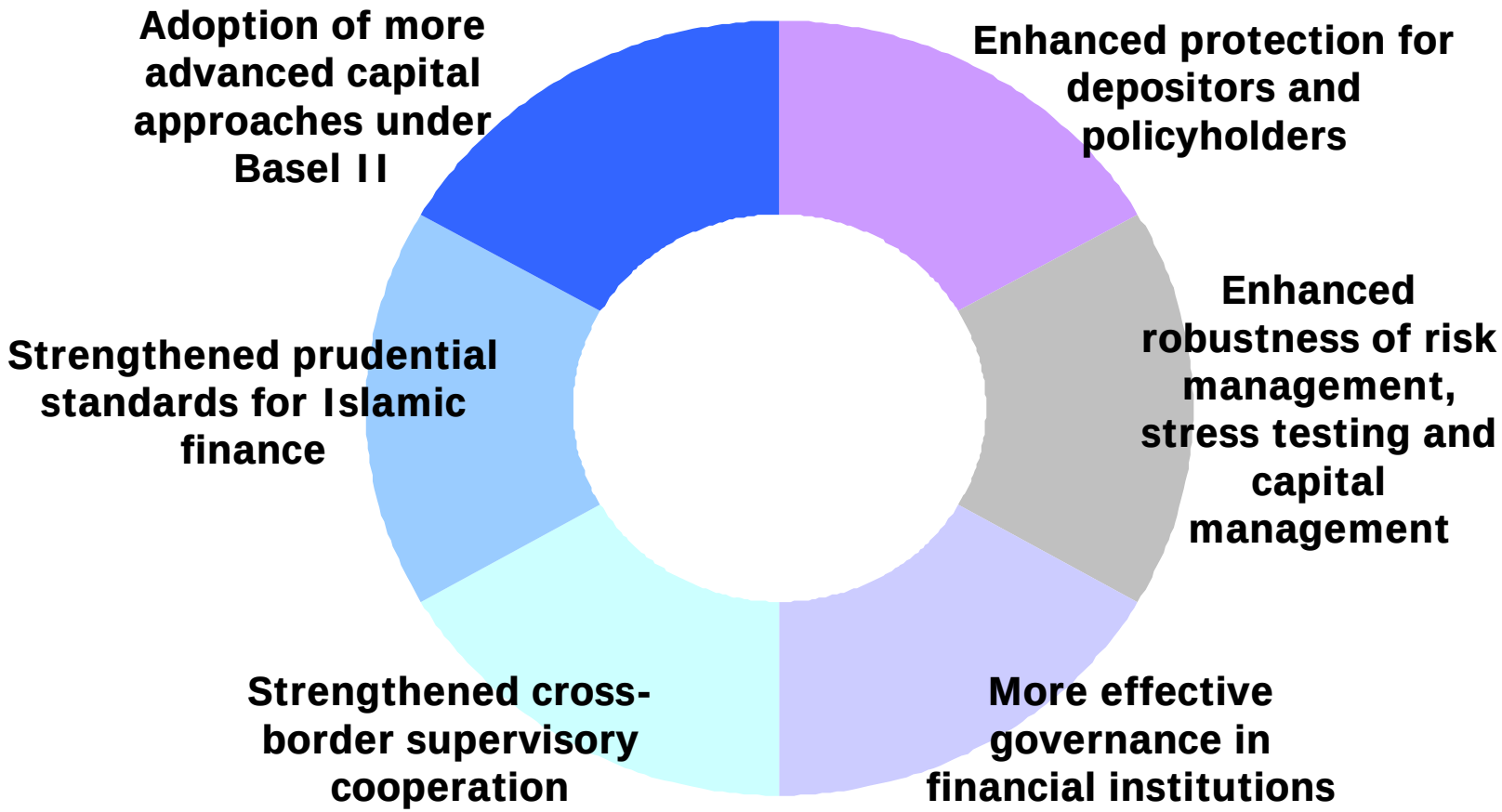


- High level committee established under s.37 of CBA 2009 to review and decide on the Bank's recommendations to manage risks to financial stability
  - Entities outside regulatory perimeter of the Bank
  - Resolution of systemically important financial institutions
  - Involves public funds

- Risk assessment
- Macroprudential responses
- Microprudential responses
- Supervisory interventions

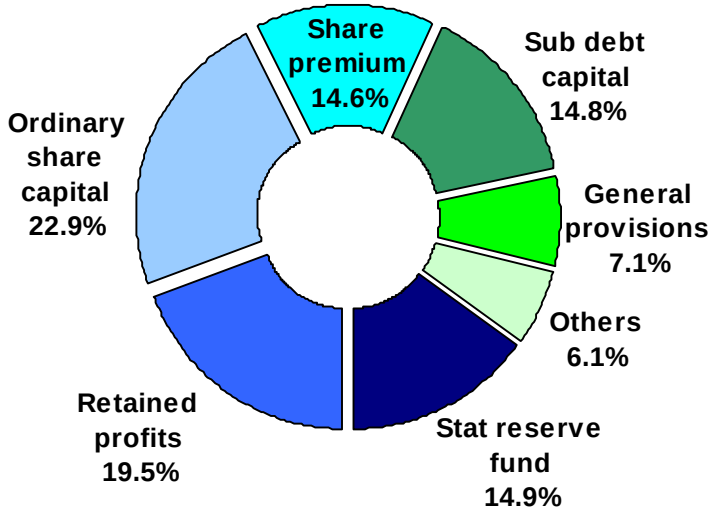
- Maintaining price stability while giving due regard to the developments in the economy
- Formulation of monetary policy and policies for the conduct of monetary policy operations

Foundations for financial stability were further strengthened

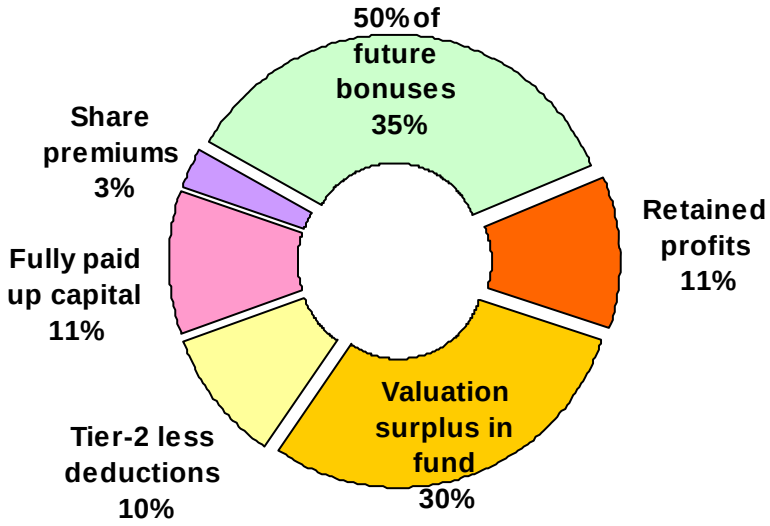


High quality capitalisation with >RM80 bil financial buffers

Composition of Banking Sector Capital



Composition of Insurance and Takaful Sector Capital



More than 70% of the financial sector's total capital comprise of equity, reserves and retained profits

Malaysian banking system well-positioned to meet Basel III requirements

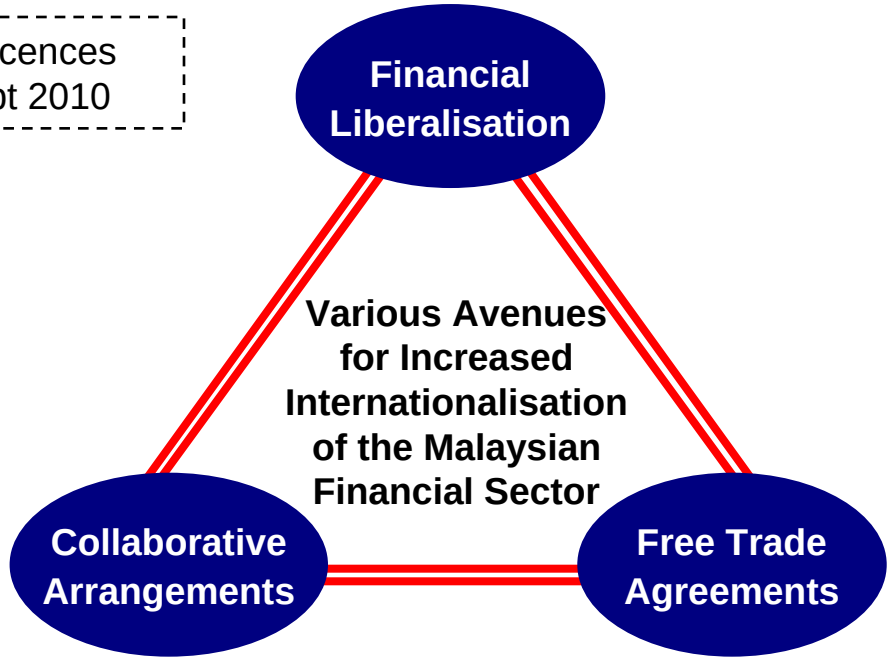
- Strong and high quality of bank capital
- Minimum liquidity standards have been in place since 2000
  - Banks to further strengthen buffers going forward
  - Currently, banks have liquidity buffer of 14.8% (maturities <1 month)
- Implementation strategy for Basel III to be communicated to industry in 2011
  - Consider specific characteristics of domestic market
  - Minimise impact on bank lending and economic growth

	Common equity	Tier 1 capital	Total capital	Leverage
Minimum requirement	**4.5%**	**6%**	**8%**	**3%**
Minimum requirement + conservation buffer	**7%**	**8.5%**	**10.5%**	**-**
Estimated current position of banking system	**9.3%**	**10.8%**	**14.5%**	**5.9%**

Malaysian financial sector increasingly integrated with the global financial system facilitating our economic linkages with the world

- New players with significant value propositions to contribute to economic and financial development
- Increased diversity of financial institutions operating onshore
- Liberal foreign exchange policies to facilitate foreign investment

+ 4 new family takaful licences were issued on 1 Sept 2010



- Regulatory & supervisory cooperation
- Capacity building & human capital development
- Currency swap agreements

Push for areas that can further interests of Malaysian financial institutions overseas

Ensure sufficient safeguards to preserve economic & financial stability

Malaysia maintains a leading role in development of Islamic finance

Malaysia tops global league tables in sukuk equity and fund management

Sukuk market

Rank	Countries
1	**Malaysia**
2	UAE
3	Saudi Arabia
4	Indonesia
5	Bahrain

Equity market

Rank	Countries
1	**Malaysia**
2	Indonesia
3	UAE
4	Saudi Arabia
5	Kuwait

Fund management

Rank	Countries
1	**Malaysia**
2	Saudi Arabia
3	Kuwait
4	Cayman Islands
5	Bahrain

Takaful

Rank	Countries
1	Iran
2	**Malaysia**
3	UAE
4	Saudi Arabia
5	Bahrain

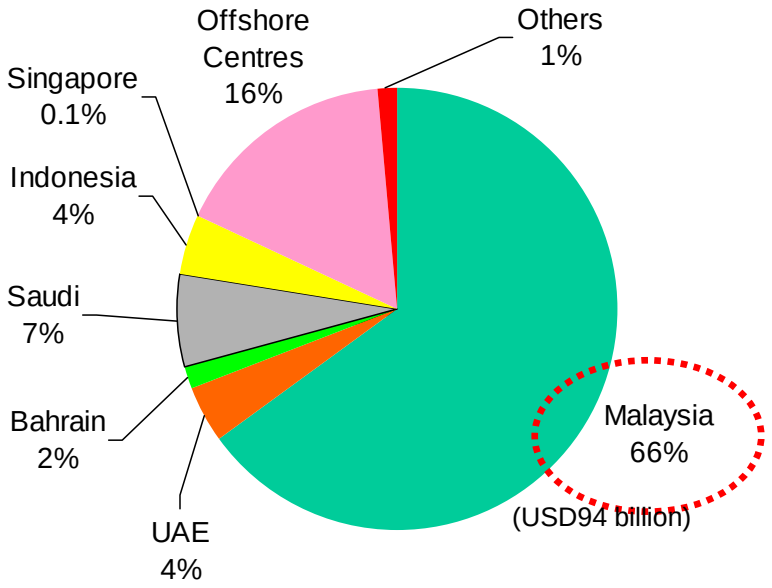
Islamic banking

Rank	Countries
1	Iran
2	Saudi Arabia
3	**Malaysia**
4	UAE
5	Kuwait

Source: "Gateway to Asia: Malaysia, international Islamic finance hub" by Pricewaterhouse Coopers 2010

…and home to largest sukuk market

Global Sukuk Outstanding by Country*
USD148 billion



*Source: Bloomberg Professional Services Terminal, as at end-2010

Outlook for domestic financial stability in 2011 remains positive

- Risks to financial stability largely externally driven
- Pre-emptive measures and strong financial buffers ensure that financial system is well-placed with capacity and flexibility to respond to emerging risks
- Macrosurveillance and supervisory activities in 2011 will focus on:
  - Ensuring prudent and responsible risk-taking and market conduct by FIs
  - Ensuring resilience and robustness of major payment and settlement systems
  - Active engagement in global regulatory and accounting reforms
  - Further strengthening of regulatory laws and prudential guidelines
  - Promoting closer domestic, regional and global cooperation and coordination

Moving forward...

The new financial sector blueprint will build on the strong foundations of the Malaysian financial system to:

- *remain resilient in withstanding any potential disruptions in the financial system and broader economy;*
- *to best serve the needs of a high value-added and high income economy;*

while further promoting financial inclusion and regional financial integration.