Financial Markets Committee (FMC) Meeting
17 May 2022
Bank Negara Malaysia

Introduction

The FMC expressed recognition and appreciation towards outgoing FMC Chairperson, Assistant Governor Norzila Abdul Aziz for her leadership and invaluable contributions to the FMC from 2017 to 2022. The committee also expressed appreciation to outgoing committee member, En. Mohd Rashid for his commitment and contributions to the FMC from 2016 to 2022 as he takes on his newly appointed role in his organisation. The FMC welcomes the appointment of Assistant Governor Adnan Zaylani as the new Chairperson of FMC.

Summary of Highlights

The meeting discussed recent market developments and outlook, updates on ongoing initiatives and strategies to further enhance and deepen the onshore financial market.

1 Market outlook and key challenges

1.1 The meeting discussed global and domestic market outlooks with Fed normalisation path, rising inflation and policy divergence as the recurring theme. Despite recent bouts of volatility, the domestic financial market remains resilient with orderly adjustments amid sufficient trading liquidity. Activities in the government bond market remain healthy and witnessed renewed support by domestic institutional investors, with year-to-date daily average trading volume of RM3.7 bil (2021: RM3.8 bil). The FX market recorded year-to-date daily average FX turnover of USD12.8 bil (2021: USD11.3 bil) whereas exporters' conversion behaviour remains stable and consistent above 75% conversion rate pre- and post-liberalisation period.

1.2 Nevertheless, the meeting noted that multiple headwinds remain including hawkish stances by developed and regional central banks, risk of fiscal slippage, volatility in commodity prices, supply chain disruptions and a slower global economic growth and recovery outlook. FMC members shared that while the recent hike in the Overnight Policy Rate (OPR) by 25 bps may have come as a surprise to the market, it was well received overall given the firmer domestic growth. Members also reflected on the developments of the government bond market over the past 2 years, noting that it would be a suitable time to undertake a holistic assessment of the market and to deliberate on possible measures to further develop and deepen the market.

2 Financial benchmark reform

2.1 Members were updated on the launch of Malaysia Islamic Overnight Rate (MYOR-i) on 25 March 2022 to spur further development of the Islamic financial market. Members were briefed on progress on ongoing efforts by the Financial Markets Association of Malaysia (FMAM) to develop standard market conventions for Malaysia Overnight Rate (MYOR) derivatives including interest rate swaps and cross currency swaps, which will support interbank trading. Members noted that non-bank sector activity is predominantly driven by funding needs and further demand for MYOR products would be driven by the creation of a term MYOR.

2.2 The meeting noted the challenges of other jurisdictions in managing Interbank Offered Rate (IBOR) transition. Given Malaysia's multiple rate approach to local interest rate benchmarks, members acknowledged challenges in developing MYOR trading volume and recommended for this to be considered in the upcoming Kuala Lumpur Interbank Offered Rate (KLIBOR) review.

3 KLIBOR Fallbacks – ISDA protocol

3.1 Members were updated on the adoption of the ISDA 2021 Fallbacks Protocol by Malaysian financial market participants and feedback was sought on key factors for the low adoption rate. In comparison to the 2020 Fallbacks Protocol (LIBOR and other major IBORs) which was adhered to by 32 Malaysian institutions, only 8 Malaysian institutions adhered to the 2021 Protocol, which includes KLIBOR fallbacks. Members highlighted that financial market participants may not see the immediate need to adopt the 2021 protocol given their relatively lower exposure to the 6 benchmark rates contained within as opposed to the more widely used LIBOR and the current availability of KLIBOR with no definite cessation date.

3.2 Nonetheless, the meeting noted the importance of the 2021 Fallbacks Protocol to ensure contractual robustness leading up to the KLIBOR review in the second half of 2022 and agreed to encourage its adoption. The meeting was updated that FMAM has recommended the adoption of the protocol for all MYR KLIBOR derivatives via a circular sent to all Heads of Treasury in May 2022.

4 Foreign Exchange Policy (FEP) development

4.1 Members discussed on recommendations to enhance efficiency of the existing correspondent banking network to facilitate cross-border payments in ringgit by non-residents to Malaysia. Members deliberated on the proposal to streamline various access channels and due diligence requirements by allowing non-resident financial institutions which are currently not part of the

Appointed Overseas Office network to facilitate ringgit transactions on behalf of non-resident clients beyond international trade, including payments for income transfers and foreign direct investment into Malaysia.

4.2 Members also discussed the trend and demand for onshore foreign currency investment products by resident corporates. Members provided insights that most corporates typically maintain foreign currency funds for near-term payment obligations and any excess funds are typically placed in plain-vanilla treasury and money market deposits on short-term basis.

5 Enhancing and deepening onshore financial market

5.1 Establishment of FMC subcommittees

5.1.1 As part of FMC's efforts to further develop the onshore financial markets, members agreed for the establishment of two subcommittees: the Bond Market Subcommittee and the Islamic Financial Market Subcommittee. These subcommittees are expected to deliberate and formulate respective market development initiatives with greater depth and detail, including to assume selected outstanding initiatives of the FMC. The creation of these subcommittees also underlines the importance of both of these markets in the context of the overall development of the domestic financial markets. With the outstanding Malaysian government bond market at RM985 billion as at end-April 2022, the fourth largest market in Asia (ex China and Japan), as well as considering developments amidst the recent COVID-19 pandemic, the Bond Market Subcommittee is also to undertake an overall market review and develop potential recommendations to ensure that the domestic bond market continues to function and intermediate efficiently. The Islamic Financial Market Subcommittee, meanwhile, will review the current landscape to identify and address challenges to the continued growth and development of the Islamic financial market, particularly in light of the growing importance of Malaysia's Islamic Banking sector as well as the significance of Malaysia's Islamic capital market, both domestically and globally.

5.1.2 Members concurred with the proposal to appoint Encik Mohamad Ali Iqbal, Director, Investment Operations and Financial Market Department of Bank Negara Malaysia as the Chairperson of the Bond Market Subcommittee and Encik Hanif Ghulam, Executive Director, Group Treasury, Affin Bank Group as the Chairperson of the Islamic Financial Market Subcommittee.

5.1.3 FMC deliberated on various aspects of the subcommittees, including member composition, potential work plan as well as expected tenor for the subcommittees, details of which will be finalised and circulated to FMC members.

5.2 Sustainable Development Goal (SDG) government sukuk issuance

5.2.1 Members were updated that the planned SDG Sukuk by the Government will be issued in the form of a Malaysian Government Investment Issue (MGII) to minimise market fragmentation as MGII is widely accepted in the market. Information on the SDG Sukuk's use of proceeds will be available in its information page on the Fully Automated System for Issuing/Tendering (FAST), global certificate and prospectus.

5.2.2 Members were briefed on survey results pertaining to market fragmentation and demand, preferences on benchmark tenors and underlying Commodity Murabahah assets. Additional feedback was also received on inclusion in bond indices, investors understanding of MGII principles and liquidity challenges from buy-and-hold strategies. The survey results and strategies for issuance will be discussed in greater detail at the Bond Market subcommittee.

5.3 Securities Borrowing and Lending (SBL) market development

5.3.1 Members discussed possible strategies to enhance SBL activities in the bond market including widening the scope of SBL participants. FMAM shared that repurchase agreements (repos) are more commonly used in the bond market compared to SBL, which is more prevalent for equities.

5.4 Repo market development

5.4.1 Members were briefed on the survey results on repo market conventions, which revealed a strong preference for a shift to immediate coupon repayment (i.e. manufactured payment) across all repo tenors and counterparty types. Strategies for the transition, along with other feedback and potential developmental topics (e.g. desirability of a tri-party repo market) will be deliberated on at the Bond Market subcommittee.

5.5 Development of Islamic financial market

5.5.1 Members were updated on the development progress of Wakalah, a new interbank funding instrument introduced by the Association of Islamic Banking and Financial Institutions Malaysia (AIBIM). The Wakalah paper is scheduled to be tabled to BNM's Shariah Advisory Council by end of June 2022. Upon approval, the instrument will be launched to the market.

5.5.2 Members noted the progress of Practice/Guidance Notes for Collateralised Commodity Murabahah (CCM) / Sell and Buy Back Agreement (SBBA). Legal opinion on contract enforceability for CCM was circulated in Q4 2021 and FMAM is expected to issue an update once the proposed amendment of the Netting Act has been ordained. As for SBBA, the draft Practice Note has been circulated for feedback from industry players and the final recommended draft is expected to be issued by Q3 2022 upon receiving approval from AIBIM's Shariah Committee. Members also recommended that onshore banks continue promoting CCM and SBBA transactions in line with market readiness to ensure a more vibrant Islamic funding market.