Objective

The Central Bank of Malaysia Act 2009, which came into force on 25 November 2009, enables Bank Negara Malaysia (BNM) to deal more effectively with emerging risks and challenges in discharging its roles and responsibilities as the nation's central bank. The Act provides greater clarity on BNM’s mandates and vests BNM with the necessary powers and instruments to achieve those mandates. The Act provides for a more robust governance framework, with a high level of accountability and transparency. Also, the Central Bank of Malaysia Act 2009 provides for BNM’s role to develop and promote Malaysia as an international Islamic financial centre.

The Principal Objects of the Central Bank of Malaysia (Bank Negara Malaysia) under the Central Bank of Malaysia Act 2009 are to promote monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy. The primary functions of BNM are:

i. to formulate and conduct monetary policy in Malaysia;
ii. to issue currency in Malaysia;
iii. to regulate and supervise financial institutions which are subject to the laws enforced by BNM;
iv. to provide oversight over money and foreign exchange markets;
v. to exercise oversight over payment systems;
vi. to promote a sound, progressive and inclusive financial system;
vii. to hold and manage the foreign reserves of Malaysia;
viii. to promote an exchange rate regime consistent with the fundamentals of the economy; and
ix. to act as financial adviser, banker and financial agent of the Government.

In addition to the above, BNM administers and enforces the following Acts:

- The Banking and Financial Institutions Act 1989 (BAFIA) provides for the licensing, and regulation and supervision of institutions conducting banking, finance company, merchant banking, discount house and money-broking businesses.
- The Islamic Banking Act 1983 provides for the licensing, regulation and supervision of Islamic banks and international Islamic banks.
- The Insurance Act 1996 provides for the licensing, regulation and supervision of insurance business (including reinsurance), insurance broking business, adjusting business and financial advisory business.
- The Takaful Act 1984 provides for the registration and regulation of takaful business, international takaful business and for other purposes relating to or connected with takaful carried out by the takaful operator, international takaful operator, takaful agent, takaful adjuster and takaful broker.
• The **Money Services Business Act 2011 (MSBA)** was enacted to provide for the licensing, regulation and supervision of money services business, which comprises the money-changing, remittance and wholesale currency businesses. The MSBA aims for a more dynamic, competitive and professional money services business industry, while strengthening safeguards against money laundering, terrorist financing and illegal activities.

• The **Exchange Control Act 1953** governs dealings in gold and foreign currencies, payments, issuance of securities outside Malaysia and trade settlements. The Act also empowers the Controller of Foreign Exchange to grant permission on the foregoing.

• The **Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLATFA)** contains provisions for the offence of money laundering, the measures to be taken for the prevention of money laundering and terrorism financing offences, and provides for the forfeiture of terrorist property and property derived from, or involved in money laundering and terrorism financing offences. The Minister of Finance has appointed BNM as the competent authority for the purposes of administering the AMLATFA. BNM has established the Financial Intelligence Unit to perform these functions and exercise its powers under the AMLATFA.

• The **Development Financial Institutions Act 2002 (DFIA)** provides for the regulation and supervision of development financial institutions (DFIs) prescribed under the DFIA. The DFIA, which came into force on 15 February 2002, aims to ensure effective and dynamic supervision of the DFIs.

• The **Payment Systems Act 2003 (PSA)**, which came into force on 1 November 2003, provides for the regulation and supervision of payment systems and payment instruments. The objective of the PSA is to ensure that both the infrastructure and operations of the national payment systems are reliable and efficient, and that public interest is safeguarded.

**Policy-Making Body**

BNM is governed by a Board of Directors. The current Board of Directors consists of the Governor of the Central Bank who is the Chairman, the Deputy Governors of the Central Bank, the Secretary-General to the Treasury and five other Directors.

**Release of Policy Information**

Information on monetary and financial policies is released, from time to time, in the form of Monetary Policy Statements (MPSs) and press releases. The Monetary Policy Committee (MPC) meets at least six times a year. An MPS is issued on the same day as the corresponding MPC meeting.

Information on monetary and financial policies and statistics are available on BNM’s website: [http://www.bnm.gov.my](http://www.bnm.gov.my) and BNM’s publications, which can also be downloaded from BNM’s website.
**Monetary Policy Objectives**

The objective of monetary policy is to maintain price stability, while giving due regard to the developments in the economy. Sections 23, 25 and 26 of the Central Bank of Malaysia Act 2009 stipulate that the MPC is responsible for formulating monetary policy as well as policies for the conduct of monetary policy operations, and BNM shall implement the decisions of the MPC.

**Monetary Policy in 2011**

The Overnight Policy Rate (OPR) was raised by 25 basis points to 3.00% in May 2011. The decision to further normalise monetary conditions and raise the OPR was made as growth was expected to remain on a steady growth path, and given the upside risks to inflation. Monetary conditions were also normalised to prevent the build-up of financial imbalances. While headline inflation edged higher on account of higher food and fuel prices, heightened uncertainties surrounding global growth and financial market conditions led to greater downside risks to domestic growth.

The OPR was left unchanged for the remainder of the year.

The Statutory Reserve Requirement (SRR) was raised by 300 basis points between March and July 2011 from 1% to 4% as a pre-emptive measure to manage the significant build-up of liquidity arising from foreign capital inflows. The rise in liquidity in the domestic financial system had to be managed carefully to mitigate risks to macroeconomic and financial stability.

**Policy Signals**

The OPR is the indicator of BNM’s monetary policy stance.

**Policy Indicators**

BNM monitors a broad range of real, monetary and financial indicators to gauge the current and prospective state of inflationary pressures and the strength of economic activity. BNM also monitors the stock and flow of liquidity in the financial system, and evaluates the impact of past monetary policy decisions.

**Monetary Instruments**

The framework for monetary operations and liquidity management comprises the conventional and Islamic interbank money markets. Also, the range of available monetary policy instruments has widened, especially with respect to BNM’s debt securities and Islamic money market instruments.

Total surplus liquidity absorbed was RM366.6 billion as at end December 2011, of which conventional borrowings accounted for 78% of total borrowings, while Islamic instruments accounted for the remaining 22%. As at December 2011, monetary instruments used in the conventional money market comprised uncollateralised money market borrowings (31%), repo borrowings (6%), Bank Negara Monetary Notes (20%) and other instruments (21%).

In 2011, BNM had introduced two new Islamic monetary instruments, namely the Bank Negara Monetary Notes-Istithmar (BNMN-Istithmar) and Bank Negara Monetary Notes-Bai Bithaman Ajil (BNMN-BBA).
Issuance of BNMN-Istithmar is based on the Istithmar (investment) concept, which refers to portfolio investments into a combined structure of sale and lease-back of assets (Ijarah) and commodity mark-up sale transaction (Murabahah). This hybrid structure is globally accepted and it is tradable in the secondary market. Meanwhile, BNMN-BBA represents indebtedness arising from deferred payment on commodity Murabahah sale transactions between the issuers and investors. However, BNMN-BBA does not have secondary market tradability features to meet specific requirements by certain Islamic banks. The key objectives of issuing BNMN-Istithmar and BNMN-BBA are to increase the efficiency and flexibility in liquidity management in the Islamic money market by expanding the Shariah concept used in BNM’s Islamic monetary operation.

In line with regional trends, Malaysia experienced significant capital inflows in 2011, especially in the first half of the year. The trend of ringgit appreciation continued up to July 2011, supported by positive developments in the region amidst a general weakness in the US dollar. Subsequently, a series of negative developments, especially out of the Euro area prompted some deleveraging activity, which started in August 2011.

Although the amount of capital inflows and outflows were significant during the year, the Malaysian banking system was able to absorb the increased exchange rate volatility and effectively intermediate the capital flows. In 2011 as a whole, the ringgit depreciated by 2.69% against the US dollar, while the international reserves ended the year at USD133.6 billion.

**FINANCIAL STABILITY**

**Authorities Responsible for Financial Stability and Supervision of the Financial Sector and Institutional Coverage of the Financial Supervisory Authorities**

BNM is the key authority responsible for the financial stability and supervision of the financial sector. Other authorities that contribute to financial stability are the Labuan Financial Services Authority (LFSA), the Securities Commission of Malaysia (SC) and the Malaysia Deposit Insurance Corporation (PIDM). The Securities Commission of Malaysia is responsible for the promotion of a fair, efficient, secure and transparent capital market and is ultimately responsible for investor protection. It also ensures proper conduct by market institutions. PIDM contributes towards financial stability through the administration of the deposit insurance system for the banking sector and the protection scheme for the insurance and takaful sector as well as the promotion of sound risk management practices by the financial industry. The institutional coverage of these supervisory institutions, among others, are as follows:

- **BNM**
  - Commercial banks, investment banks, Islamic banks, international Islamic banks, development financial institutions, money-brokers, insurance and reinsurance companies, insurance and takaful brokers, loss adjusters, financial advisers, takaful, retakaful and international takaful operators, payment system operators, payment instrument issuers and licensees conducting money-
changing, remittance and wholesale currency business.

- On 21 December 2011, BNM launched the Financial Sector Blueprint (FSBP). The FSBP outlines the strategic direction for the Malaysian financial sector in the next decade from 2011 to 2020, with recommendations focused on achieving strategic outcomes in nine critical areas: (i) effective intermediation for a high value-added high-income economy; (ii) the development of deep and dynamic financial markets; (iii) greater shared prosperity through financial inclusion; (iv) strengthening regional and international financial integration; (v) internationalisation of Islamic finance; (vi) safeguarding the stability of the financial system; (vii) achieving greater economic efficiency through electronic payments; (viii) empowered consumers; and (ix) talent development for the financial sector.

**LFSA**

- Offshore commercial banks, offshore Islamic banks, offshore insurance and insurance related business, offshore trust and fund management.

**SC**

- Stockbroking companies, exchanges, clearing houses, central depositories, universal brokers, investment banks (for market conduct) and fund management companies.
- The Capital Market & Services Act was amended in September 2011 to introduce provisions to enable effective management of systemic risks and to oversee private retirement schemes.

**PIDM**

- Commercial banks and Islamic banks, insurance companies and takaful operators.
- Provides deposit insurance coverage of up to RM250,000 (effective from 1 January 2011) for deposits in commercial banks and Islamic banks including current and savings deposit accounts, fixed deposits, joint accounts/trust accounts and foreign currency deposits.
- The Takaful and Insurance Benefit Protection System (TIPS) under the revised PIDM Act, which replaced the existing Insurance Guarantee Scheme Fund (IGSF) administered by BNM, operates as an explicit compensation scheme to protect consumers of the insurance and Takaful industry in the event of a failure of an insurer or takaful operator. Under the scheme, the limits are generally adequate to protect the vast majority of policyholders in full, while retaining sufficient incentives for policyholders of high-value policies (with a substantial level of benefits) to be more vigilant in selecting the institutions to provide them with insurance coverage. Protection for policyholders and takaful participants is further enhanced under TIPS with PIDM’s intervention and resolution powers, which include arrangements to transfer policies/certificates from a distressed insurer or takaful operator to another insurer or takaful operator.
Supervisory Approach of Bank Negara Malaysia

Maintaining financial system stability through the promotion of a resilient and progressive financial industry remains a key agenda of BNM. With the continuous evolution of the financial landscape and greater volatility in the financial markets, focus continues to be placed on ensuring that the supervisory approach and framework adopted are forward-looking and responsive to the dynamic and challenging economic conditions and effectively support the prompt identification and resolution of emerging risks and vulnerabilities, which may potentially impact on the solvency of individual financial institutions and consequently have a destabilising effect on the financial system and real economy as a whole.

Against this backdrop, in 2011, BNM’s risk-based supervisory framework was further refined. The framework was also accorded a dedicated name, Supervisory Risk-based Framework (SuRF). The refinements made include enhancing the supervisory intervention framework to promote greater granularity and clarity in terms of the appropriate level of intensity of supervisory intervention actions to be taken on financial institutions. The Supervisory Intervention Guide (SIG) currently breaks down supervisory intervention actions into 6 stages, compared to 5 stages previously, in ascending intensity, beginning with “Stage 0” for well run institutions to “Stage 5” for institutions with severe problems and concerns.

Refinement was also made to the classification and assessment of risks inherent in an institution’s significant activities. Legal and regulatory risk was carved out from the broader operational risk to become a standalone inherent risk category so as to give greater prominence to the risk, particularly in relation to anti-money laundering/counter terrorist financing, and consumer and market conduct aspects of a financial institution’s operations as well as its compliance with the applicable laws and regulations. The move resulted in a more direct linking of legal and regulatory risk assessment to the assessment of compliance functions within financial institutions, which is one of the six Risk Management Control Functions assessed under the framework.

BNM’s supervisory approach and framework have continued to be underpinned by comprehensive and holistic risk assessments of individual financial institutions, both at the entity and group level. The universal nature of SuRF makes it applicable to all types of financial institutions, thereby ensuring that similar risks are assessed and addressed consistently across the financial industry. This in turn enables the seamless consolidated supervision of financial conglomerates. SuRF also facilitates the appropriate allocation of supervisory attention and resources to institutions and areas that are of high risk.

Under SuRF, risk assessment is driven by the significant activities carried out by a financial institution. Supervisors assess the risks inherent in the activities and the robustness of risk control and
oversight functions put in place by the institution to mitigate the risks. The residual risks at the institution-wide level are then assessed against the institution’s earnings and capital strengths to yield the Composite Risk Rating (CRR), which represents the institution’s safety and soundness. To assess the quality of the risk control function, supervisors carry out an assessment of the institution’s Operational Management, which is a group of personnel who are involved in the day-to-day running of a given significant activity including taking and managing risks. On the other hand, to assess the quality of risk oversight functions, supervisors carry out an assessment of the oversight and checks provided by the board and senior management, internal auditors, risk management department/unit, compliance department/unit, and information and communication department/unit. This represents an outfit which provides independent analysis and reporting of performance-related information to assist in the monitoring and decision-making by the board and senior management.

The assessment of financial institutions’ capital adequacy takes into account the profile of the institutions’ residual risks in line with the propositions of Basel II. Propositions set forth in Basel III have also been adopted in assessing the liquidity strength of financial institutions. SuRF places reliance on the work of risk oversight functions within financial institutions as well as on the work of third parties such as external auditors and actuaries where appropriate to avoid the duplication of efforts. For this purpose, the parties are regularly engaged to increase awareness and clarity of BNM’s expectations on their roles and the degree of reliance to be placed on their work for supervisory purposes. This is aimed at achieving an effective and efficient supervisory process while minimising the supervisory burden on financial institutions. For the supervision of domestic financial conglomerates with cross border operations, and locally-incorporated foreign banks’/international Islamic banks’ branches, supervisors engage and collaborate with the host and home supervisory authorities, respectively. The collaboration takes the form of bilateral meetings and supervisory colleges where supervisory information is exchanged and working arrangements are established. This aims to ensure that supervisory assessments made by both parties are premised on a holistic and comprehensive information set and better facilitate the cross-border resolution and management of problem financial institutions, if any.

To ensure the reasonableness and consistency of assessments made by supervisors, a quality assurance arrangement was instituted. Supervisory assessments carried out by supervisors are subject to panel reviews either within the respective supervision departments only or extended to a sectoral review, depending on the specific circumstances.

The Supervisory Practices Unit, established in 2009 to develop and upkeep the supervisory framework and practices, has continued to ensure that the supervisory approach and framework adopted are enhanced to correspond with developments in the environment, industry and regulatory/supervisory sphere, and remain robust and effective in achieving BNM’s supervisory mandate.
Macro Surveillance Framework

In preserving the resilience of the financial system, an effective supervisory framework needs to be complemented with a robust macro surveillance framework that facilitates the identification of emerging risks and issues at the macro and system wide as well as a responsive crisis containment and management framework.

The macro surveillance framework therefore is complementary to and integrated with the micro surveillance oversight functions of BNM. These complementary functions, conducted in an integrated manner, ensure a more holistic approach in identifying potential threats to financial stability. The framework also interacts with macro prudential and micro prudential regulations and incorporates an assessment of institutions that are systemic but are outside the regulatory purview of the Bank. This is performed through:

- A holistic risk assessment approach that enables the early identification of potential risks and emerging vulnerabilities as well as financial excesses that could threaten financial stability;
- Risk mitigation/reduction approach that aims at enhancing the resilience and tolerance of the system towards shocks and disturbances, or at minimising the potential impact on overall stability; and
- Continuous capacity enhancement on macro surveillance and prudential framework.

In view of the many sources from which systemic risks can emanate, enhanced procedures and arrangements have been put in place to leverage on existing surveillance arrangements by domestic and cross-border authorities and agencies in the assessment of regional financial vulnerabilities and global conditions, such as with the:

- Securities Commission of Malaysia, Malaysia Deposit Insurance Corporation and other national authorities;
- International financial institutions and regulatory bodies (e.g. the International Monetary Fund, World Bank, Financial Stability Board, Bank for International Settlements); and
- Central bank groupings (e.g. the Monetary and Financial Stability Committee under EMEAP and the SEACEN grouping).

The Central Bank of Malaysia Act 2009 enhances BNM’s capacity to undertake its financial stability function through specific provisions empowering BNM to seek information and act pre-emptively to avert risks to financial stability. The expanded powers also allow BNM to undertake surveillance and the timely resolution of entities that are not regulated by BNM as well as the engagement and collaboration with other domestic and international authorities to achieve greater coordination towards maintaining financial system stability.

In December 2011, BNM announced the adoption of the Basel III capital and liquidity standards in Malaysia. The reform package is expected to be implemented in Malaysia in accordance with the globally-agreed levels and an implementation timeline which provides for a gradual phase-in of the standards beginning 2013 until 2019. The
focus of BNM's efforts in 2012 will be on aligning the existing definition of capital rules in Malaysia with that under Basel III as well as the initiation of an observation period for the liquidity standards and leverage ratio.

**CURRENT MONETARY OFFICIALS**  
*(as of 1 January 2012)*

**Governor**  
Tan Sri Dato’ Sri Dr. Zeti Akhtar Aziz

**Deputy Governors**  
Dato’ Muhammad bin Ibrahim  
Ms. Nor Shamsiah binti Mohd Yunus

**Board of Directors**  
Tan Sri Dato’ Sri Dr. Zeti Akhtar Aziz  
Dato’ Muhammad bin Ibrahim  
Ms. Nor Shamsiah binti Mohd Yunus  
Tan Sri Dato’ Sri Dr. Wan Abdul Aziz bin Wan Abdullah  
Datuk Oh Siew Nam  
Tan Sri Datuk Amar Haji Bujang bin Mohd Nor  
Dato’ N. Sadasivan  
Tan Sri Dato’ Seri Dr. Sulaiman bin Mahbob  
Mr. Chin Kwai Yoon

**Assistant Governors**  
Dr. Sukhdave Singh  
Mr. Bakarudin bin Ishak  
Ms. Norzila binti Abdul Aziz  
Ms. Jessica Chew Cheng Lian  
Mr. Donald Joshua Jaganathan  
Mr. Abu Hassan Alshari bin Yahaya  
Mr. Marzunisham bin Omar

**Secretary to the Board**  
Mr. Abu Hassan Alshari bin Yahaya

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