

Bank Negara Malaysia

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INFORMATION

Bank Negara
Malaysia




BANK NEGARA MALAYSIA

A consumer education programme by:



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA



PERSATUAN BANK BANK DALAM MALAYSIA
THE ASSOCIATION OF BANKS IN MALAYSIA

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BANK NEGARA MALAYSIA

The role of a
central bank
is entrusted with
Bank Negara Malaysia

Introduction

Most countries have established central banks as the monetary authority to oversee the financial system and the economy. While central banks may differ in terms of structure and modus operandi, they share the common responsibility of maintaining monetary and financial stability. For others, its responsibility extends to the development of the financial infrastructure and participating in the overall economic development of the nation. In Malaysia, the role of the central bank is entrusted with Bank Negara Malaysia.

The role and function of Bank Negara Malaysia, its operations and activities are described in this booklet.

**Monetary
stability**
refers to the stability
of the value of the
Malaysian currency,
the ringgit

FORMATION OF BANK NEGARA MALAYSIA

The Central Bank of Malaya Ordinance 1958 (CBO) (Central Bank of Malaya until the formation of Malaysia in 1963) was enacted on 23 October 1958, while the Central Bank of Malaysia was established on 24 January 1959. At the same time, the Banking Ordinance, 1958, which provided for the licensing and regulation of the business of banking in the Federation of Malaya also came into force. The CBO was revised in 1994 and is now the Central Bank of Malaysia Act 1958 (CBA).

OBJECTIVES OF BANK NEGARA MALAYSIA

The objectives of Bank Negara Malaysia as outlined in the CBA are:

- To promote monetary stability and a sound financial structure
- To act as a banker and financial adviser to the Government
- To issue currency and keep reserves safeguarding the value of the currency
- To influence the credit situation to the advantage of the country

Over the years, the roles and responsibilities of Bank Negara Malaysia have evolved and expanded. Today, Bank Negara Malaysia focuses on the three pillars of central banking, namely monetary stability, financial stability and the payments system. In addition, importance is given to the developmental role of Bank Negara Malaysia, in respect to economic management, institutional building and the development of the financial system.



MONETARY STABILITY

As the country's monetary authority, Bank Negara Malaysia is responsible to maintain monetary stability. Monetary stability refers to the stability of the value of the Malaysian currency, the ringgit. The best way to ensure that the value of the ringgit is preserved is by ensuring price stability, that is, to ensure that inflation in the country remains low and stable. By maintaining monetary stability through appropriate changes in monetary policy, Bank Negara Malaysia ensures that inflation is kept low and that the purchasing power of the ringgit is not diminished.

Why is monetary stability so important?

It is important because when there is monetary instability, prices are either rising (inflation) or falling (deflation) and this can result in distortions and undermine the long-term economic growth prospects of the country.

If inflation is too high, people will be concerned about the purchasing power of their money balances. This would result in a greater demand for real assets like houses and properties, which are thought to be more "inflation-proof". There would be less interest to invest in productive capacity of the economy. Similarly, savers would be less inclined to hold savings in the financial system if they expect that the value of their savings would be diminished. Fixed income earners will find that they are able to buy less goods and services and will experience a reduction in their standard of living. High inflation would also make exports more expensive to foreigners and this would reduce the competitiveness of the exports. Persistently high inflation would therefore reduce the growth potential of the economy.

Similarly, **when the rate of inflation is negative**, prices are falling and businesses find their profits shrinking. They may reduce their costs by cutting expenditure



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and laying off staff. Workers in turn would have less money to spend and thus reduce spending, resulting in a further reduction in the demand for goods and services. This creates a vicious circle of falling prices and contracting demand resulting in a contraction in the level of overall economic activity.

When there is price stability, the future value of savings and the future returns on investments are preserved. This gives savers the incentive to save while investors have greater confidence to undertake productive activities. Increased investment leads to an increase in the productive capacity of the economy and increased economic activity leads to new job creation. Therefore, by maintaining monetary or price stability, it creates a conducive environment that allows the economy to expand in a sustainable manner at close to its potential.

Bank Negara Malaysia conducts its monetary policy by influencing the level of interest rates that borrowers have to pay on their loans and that depositors earn on their

deposits. When the economy is overheating and the threat of inflation is high, monetary policy will be tightened by withdrawing funds from the banking system and raising interest rates. The higher interest rates will encourage people to save more and spend less. It would also make it more expensive for people to borrow money. This will cause consumption and investment to slow down to a level that is more sustainable and reduce the prospect for high inflation. Conversely, when economic conditions are weak, funds will be injected into the banking system to reduce interest rates. With lower interest rates, spending and borrowing would increase. The resulting increase in consumption and investment would stimulate further economic activity, leading to higher income, employment and economic growth.

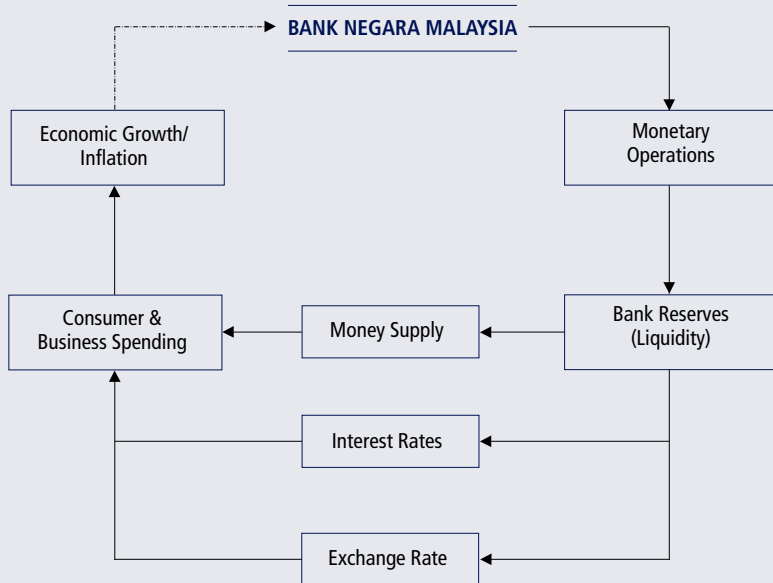
Bank Negara Malaysia has a number of monetary instruments at its disposal to inject and withdraw funds to influence the level of interest rates in the financial system. Examples of these instruments would include the purchase and sale of

Bank Negara Malaysia and Malaysian Government papers, changes in the statutory reserve requirements and direct lending and borrowing in the interbank market.

Malaysia is one of the most open economies in the world. This means that the performance of the Malaysian economy is significantly influenced by developments outside its borders. The economic performance of Malaysia's trading partners would affect the demand for Malaysia's exports. By maintaining a low inflation rate relative to our trading partners, monetary policy contributes to making Malaysian goods competitive internationally.

Bank Negara Malaysia also manages the **foreign exchange reserves** of the country to ensure that Malaysia is able to meet its international obligations, thereby cushioning any temporary shifts in inflows and outflows in Malaysia's balance of payments and thus promote a stable and fundamentally sound ringgit exchange rate. The exchange control policies in Malaysia are directed at ensuring the stability of the

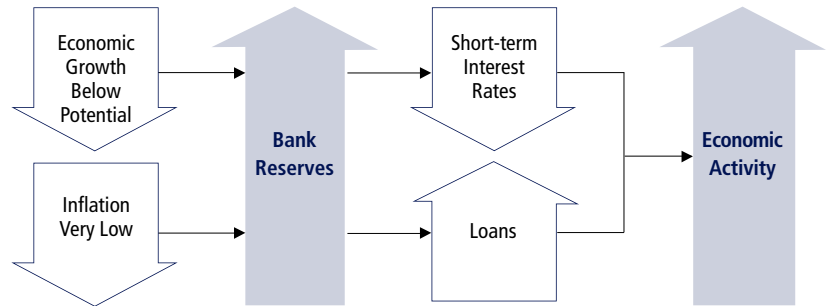
How Bank Negara Malaysia's Monetary Policy Affects the Economy and Inflation



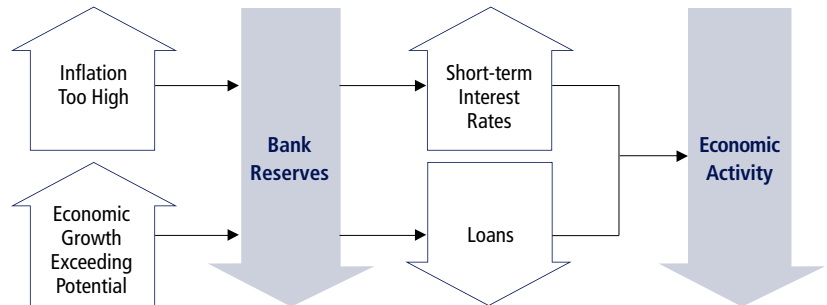
ringgit as well as encouraging the use of the country's financial resources for productive purposes. There is generally free movement of funds into and out of the country subject to certain prudential regulations administered by Bank Negara Malaysia under the Exchange Control Act 1953.

To effectively manage the financial and economic conditions, Bank Negara Malaysia collects data and information about the domestic economy, the financial system and the international environment. Economists at Bank Negara Malaysia analyse these developments to provide the assessment which becomes the basis for the policy making process. The sources of information are diverse and include publications of a wide range of domestic and international agencies and regular dialogues with various groups from the private sector. An important source of information is also from the financial sector. Being able to monitor closely the activities of the financial institutions allow Bank Negara Malaysia to monitor efficiently the impact of its policy measures.

When Bank Negara Malaysia wants to **STIMULATE** the economy



When Bank Negara Malaysia wants to **CONSTRAIN** the economy



FINANCIAL STABILITY

Financial stability refers to an environment where institutions in a financial system are strong and can continue to meet their contractual obligations without interruption or without any external assistance. Market participants can also confidently enter into transactions at prices that do not change substantially over short periods when there has not been any changes in market fundamentals.

Why is financial stability important?

Financial stability creates a conducive environment for businesses to undertake their activities and for savers and investors to enter into short-term or long term contracts.

As the financial sector has a central role in promoting economic growth, it is important that the financial system is strong, resilient and efficient in mobilising savings and undertaking lending activities. It is vital that this intermediation process

continues uninterrupted even in periods of economic difficulties.

As the nation's regulatory authority, one of the fundamental roles of Bank Negara Malaysia is to develop a sound banking system that responds to the changing needs of the economy and society, a system that is made up of strong and resilient financial players and well-functioning financial markets. In the context of preserving financial stability, Bank Negara Malaysia has also been entrusted to regulate and develop the insurance sector to be an effective mobiliser of long term savings and provide wide range of insurance products while protecting the interest of policy owners. The overall objective of financial stability has been achieved not only through the formulation of strong legal, regulatory and supervisory framework, but also through the development and strengthening of new institutions and system infrastructure.

Financial stability
creates a conducive environment for businesses to undertake their activities and for savers and investors to enter into contracts

Developing the
**institutions
and market
infrastructure**
are part of Bank
Negara Malaysia's
developmental role





Regulatory rules have been continuously enhanced with the adoption of international standards to instil appropriate risk management system to enable financial institutions to undertake their intermediation function effectively. The enactment of new laws such as the Banking and Financial Institutions Act in 1989 and the Insurance Act in 1996 has enhanced Bank Negara Malaysia's regulatory authority over the financial system. Similarly, the enactment of the Islamic Banking Act in 1983 has given Bank Negara Malaysia additional mandate to supervise new types of institutions, namely the Islamic banks. In addition, to avoid widespread failure and maintain public confidence in the financial system, particularly the banking system, Bank Negara Malaysia also extends the lender of last resort facility (whereby banking institutions in need of funds could come to Bank Negara Malaysia to sell their securities) to assist banking institutions in dealing with short-term liquidity problems.

Bank Negara Malaysia's regulatory and supervisory role was extended in 1988 when the insurance industry was brought under the supervision of Bank Negara Malaysia. Recently, this regulatory oversight was further extended to six development financial institutions with the enactment of the Development Financial Institutions Act in 2001. In addition, a separate legislation was enacted to protect the financial sector from being used as a conduit for money laundering activities. The Anti-Money Laundering Act (AMLA) came into force in January 2002 and Bank Negara Malaysia was appointed as the competent authority to implement the national anti-money laundering programme.

Regulatory rules are complemented with regular examinations of financial institutions and their close monitoring. The on-site and off-site supervision of all financial institutions under the purview of Bank Negara Malaysia is a vital process in

ensuring financial stability. Bank Negara Malaysia adopts the risk-based supervision approach, whereby financial institutions are assessed and monitored based on risk profiles and adequacy of risk management systems. Pre-emptive strategies are formulated to address any adverse trend or weakness that could threaten the stability of an individual financial institution or the financial system as a whole. The supervisory framework is continuously enhanced in line with changes in the economic environment.

Bank Negara Malaysia also maintains close relationship with supervisors in other countries to ensure that developments abroad, especially in countries where Malaysia has a banking presence and countries of foreign banks in Malaysia, would not threaten the stability of the Malaysian financial system.

DEVELOPMENTAL ROLE

As a central bank in an emerging economy, Bank Negara Malaysia has an important developmental role. This role ranges from developing the necessary institutions and market infrastructure for the development of a modern and strong financial system to contributing to the strengthening of the foundation of the economy. In strengthening the financial market infrastructure, Bank Negara Malaysia has built a strong payment systems. These systems are regularly "upgraded" to address the impact of technology on the banking system. To promote a good credit culture among banking institutions, Bank Negara Malaysia also operates the Central Credit Reference Information System. The first of its kind in this region, this system collects and disseminates credit information on all borrowers. This allows banking institutions to make informed decisions on loan applications.

On the institutional front, Bank Negara Malaysia plays a significant role in establishing new institutions. Specialised institutions that were set up to fill gaps in the financial system were the Credit Guarantee Corporation Malaysia Berhad (CGC) and the National Savings Bank (to meet the needs of small borrowers) and Bank Industri dan Teknologi Malaysia Berhad (to provide financing for capital goods exports and development of the shipping industry). In developing the capital market, Bank Negara Malaysia nurtured the group of brokers into the National Malayan Stock Exchange and later the Kuala Lumpur Stock Exchange. Deepening the capital market was achieved through the setting up of the National Mortgage Corporation (Cagamas), and later the Securities Commission to regulate capital market activities. Bank Negara Malaysia played an instrumental role in setting up the Labuan Offshore Financial Services Authority (LOFSA) to supervise the offshore financial sector and

today, plays a catalytic role in expanding the scope of its activities.

Bank Negara Malaysia had also played an active role in designing the mechanism to deal with the impact of the Asian financial crisis in 1997-98 involving the setting up of Pengurusan Danaharta Nasional Berhad to purchase bad loans from financial institutions, Danamodal Nasional Berhad to recapitalise banking institutions, and the Corporate Debt Restructuring Committee to restructure large corporate debts. Bank Negara Malaysia was also instrumental in designing and implementing the selective exchange control measures introduced in September 1998. The aim of the controls was to insulate the Malaysian economy from the instability in the international financial markets and restore stability in the ringgit exchange rate. The stability accorded by the controls allowed for successful implementation of various pro-growth measures and accelerated the financial sector restructuring process.

Bank Negara
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As the financial system becomes increasingly diversified and integrated with the international financial systems over recent years, the task of maintaining financial stability has also called for the continuation of the role of Bank Negara Malaysia in economic development. In the more recent period, greater attention is being accorded to the development of small-and medium-sized enterprises (SMEs). To enhance the contribution of SMEs, Bank Negara Malaysia produced a comprehensive report on strategies for development of SMEs to the Government in 2002. In addition, various funds have been established by Bank Negara Malaysia to promote the development of selected sectors of the economy. Alternative modes of financing such as venture capital are being developed to support the development of new growth areas. The need to maintain financial stability, therefore, goes hand-in-hand with the need to have balanced economic growth and development.

Moving forward, the task of maintaining financial stability would become more challenging. Bank Negara Malaysia recognises the need to be well positioned to manage the forces of change brought about by globalisation, liberalisation, more volatile global financial markets and the rapid advances in information technology. All of these are expected to have major impact on the financial system. The key is to take early actions in solving any emerging problems, keeping the right balance between the multiple functions of ensuring monetary stability and the regulatory and developmental role. A clear vision and direction for the development of financial sector is necessary for this purpose. It is for this reason that Bank Negara Malaysia has laid down a 10-year masterplan in 2001 for the development of financial sector that provides the blue print for the future landscape for the sector and recommends measures to be undertaken to develop an efficient, dynamic and resilient financial sector that would be able to meet the requirements of the changing economy.





PAYMENTS SYSTEM

The payments system is an important part of the financial system. It provides a means of transferring funds between parties and for commercial transactions to be conducted effectively and efficiently. Bank Negara Malaysia is entrusted with the role of ensuring that the payments system of the country is stable and operates smoothly.

Why is the smooth functioning of the payments system important?

Any failure of a financial institution to settle its obligations in a timely manner would result in spillover effects, resulting in other financial institutions not being able to settle their financial obligations.

Bank Negara Malaysia has the important role of ensuring the safety and efficiency of the payments system. Bank Negara Malaysia therefore:

- Oversees the payments system. This includes formulating policies and guidelines to regulate the payments system
- Operates the payments system. Bank Negara Malaysia operates the real time gross settlement system (RENTAS) and the cheque clearing system (SPICK)
- Facilitates further development of the payments system. Bank Negara Malaysia encourages the payments industry to adopt best practices, international standards and cutting edge technologies in enhancing the payments system

OTHER RESPONSIBILITIES OF BANK NEGARA MALAYSIA

Bank Negara Malaysia serves as the economic and financial adviser to the Government and also participates in international meetings to strengthen co-operation with other countries as well as to discuss the important issues from the perspective of emerging market economies.

Role of economic adviser

In its role as the economic and financial adviser to the Government, Bank Negara Malaysia analyses and assesses the developments in the international and domestic economy and highlights the areas that need to be addressed. Bank Negara Malaysia undertakes economic intelligence and surveillance and carries out forecasts on the economic condition

of the country. Based on these assessments, Bank Negara Malaysia presents policy recommendations at regular briefings to the Minister of Finance as well as at various economic policy making forums at the national level.

Role of financial adviser

Bank Negara Malaysia does not provide financing to the Government. However, as the financial adviser to the Government, Bank Negara Malaysia gives regular advice to the Government on the management of its domestic and external debts and the terms and timing of Government loan programmes. Bank Negara Malaysia also act as the agent for the Government in negotiations and concluding of loan agreements. Bank Negara Malaysia is also responsible for trading, registering, settlement and redemption of Government securities through its computerised systems (RENTAS, FAST and BIDS).

International Relations

Bank Negara Malaysia also participates in a number of international meetings. Amongst them are the meetings of the South-East Asian Nations (ASEAN), ASEAN +3 (which includes China, Korea and Japan), South-East Asian Central Banks (SEACEN), Executive Meeting of East Asia and Pacific (EMEAP), the Asia-Pacific Economic Co-operation (APEC) and the international agencies including the Bank for International Settlements.

The participation in the meetings are to strengthen co-operation with the international and financial community in key areas such as surveillance, macroeconomic management and measures to enhance financial stability. It is to bring key issues which are important from a national or regional perspective to the forefront in order that Malaysian interests and interests of emerging market economies are given due consideration.

Bank Negara Malaysia
serves as the **economic
and financial adviser**
to the Government

THE ORGANISATION OF BANK NEGARA MALAYSIA

Bank Negara Malaysia is a statutory body which is wholly owned by the Federal Government. It started operations in 1959 with a paid-up capital of RM20 million which has since increased to its present level of RM100 million in 1977.

The constitution, functions, duties and powers of Bank Negara Malaysia are set out in the CBA. The administration of Bank Negara Malaysia is organised to meet its principal objectives, with clear lines of responsibility. The Governor of Bank Negara Malaysia is also the chief executive officer and the Governor is assisted by two Deputy Governors and five Assistant Governors. The CBA provides that the Governor shall be appointed by the Yang di-Pertuan Agong and the Deputy Governors by the Minister of Finance.

Bank Negara Malaysia is required to have a Board of Directors under the CBA. Like

any other board of directors of a private organisation, the Board is entrusted with the responsibilities of setting the policy direction of Bank Negara Malaysia and the general administration of the affairs of the Bank. The CBA requires the Board of Directors to inform the Minister of Finance of the monetary and banking policies pursued or intended to be pursued by it.

There are eight members on the Board of Directors. The ex-officio members of the Board are the Governor, the Deputy Governors and the Secretary-General to the Treasury. The other directors are persons of standing and experience in banking and economic affairs. All members except the Deputy Governors are appointed by His Majesty, the Yang di-Pertuan Agong and hold office for a maximum term of three years but are eligible for reappointment. The Governor is the chairman of the Board and the Board is required to meet at least once a month.



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