



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

Financial Stability  
Review  
First Half

**2023**

**F S R**



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

# Preface

This Financial Stability Review – First Half 2023 provides Bank Negara Malaysia's assessment on current and potential risks to financial stability and the resilience of the Malaysian financial system to sustain its financial intermediation role in the economy. It also reports on any actions that have been taken to manage risks to financial stability.

This publication is intended to promote greater awareness on issues and developments affecting financial stability.

This document uses data available up to 30 June 2023, unless otherwise stated.



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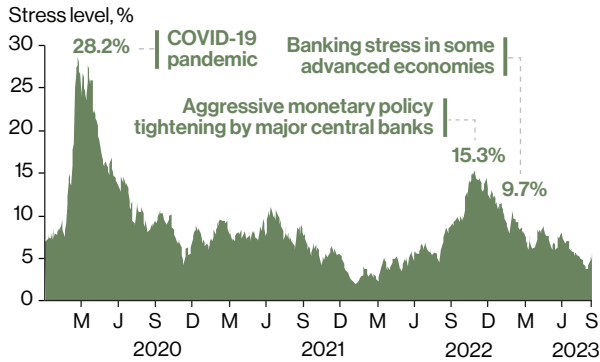
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# Key Highlights on Financial Stability Review – First Half 2023

## Domestic financial market conditions remained resilient despite heightened global market volatility

Financial market stress declined since end-March as global banking sector stresses subsided

### Financial Market Stress Index (FMSI)

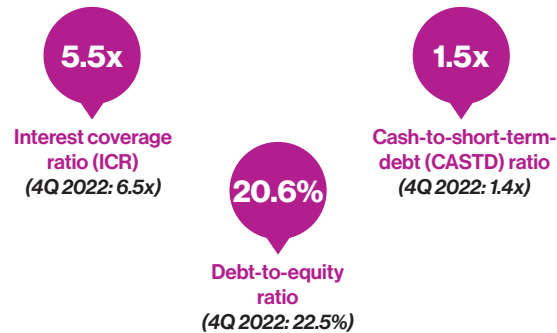


Orderly domestic market conditions continued to be preserved, supported by several key factors

- 1 Deep and liquid domestic capital markets
- 2 Active market risk management and hedging strategies by financial institutions
- 3 Resilient domestic institutional investors
- 4 Manageable FX exposures and sufficient FX buffers

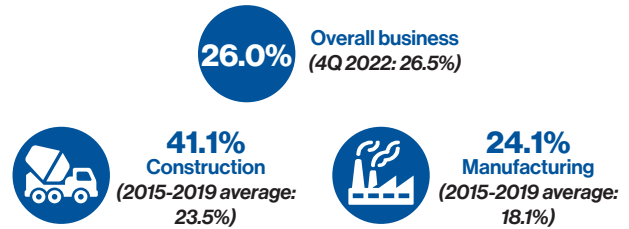
## Domestic business activity improved but businesses continued to face a challenging operating environment

Overall business sector remained financially sound...



...but in some sectors, a larger share of firms still face heightened risks from high input costs and weak external demand

Share of firms-at-risk<sup>1</sup>



<sup>1</sup> Firms-at-risk refers to firms with an interest coverage ratio below the prudent threshold of two times.

## SMEs have been more affected but credit risks remain manageable

SME impairments increased within banks' expectations...

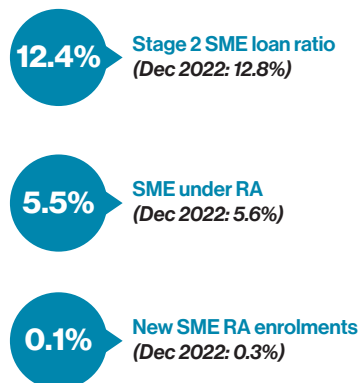


...driven by firms in wholesale and retail, construction, and agriculture sectors

	Loans-in-arrears <sup>2</sup> (% of SME loans to the sector)	Outstanding SME loans (% of total banking system loans)
Wholesale and retail	1.8	5.1
Construction	4.5	2.1
Agriculture	6.2	0.5

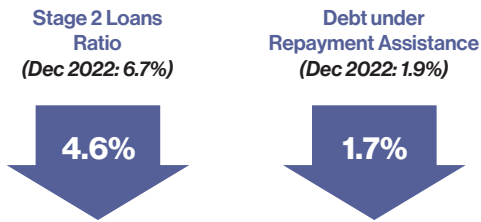
<sup>2</sup> Refers to loans with 3 months or more in-arrears equivalent to more than 90 days past due.

Risks not expected to lead to a widespread deterioration in credit quality

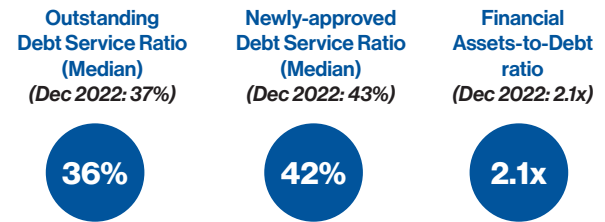


## Households' debt-servicing capacity continued to be supported by employment and steady wage growth

Loans with higher credit risk and under repayment assistance have further declined



Debt-servicing levels and financial buffers remain healthy and broadly stable

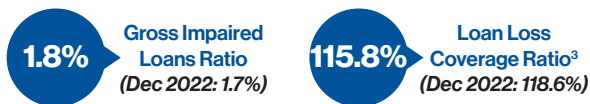


## Financial institutions remained well-capitalised with strong buffers to support financial intermediation activities

Banking system's capital and liquidity buffers remain well above regulatory minima



Banks continue to maintain prudent provisioning buffers to absorb potential unexpected losses



Insurers and takaful operators remained well-capitalised, above the regulatory minimum



## Financial institutions continue to intensify efforts to combat cyber and financial threats, and align with sustainability goals

Robust countermeasures undertaken to counter fraud threats



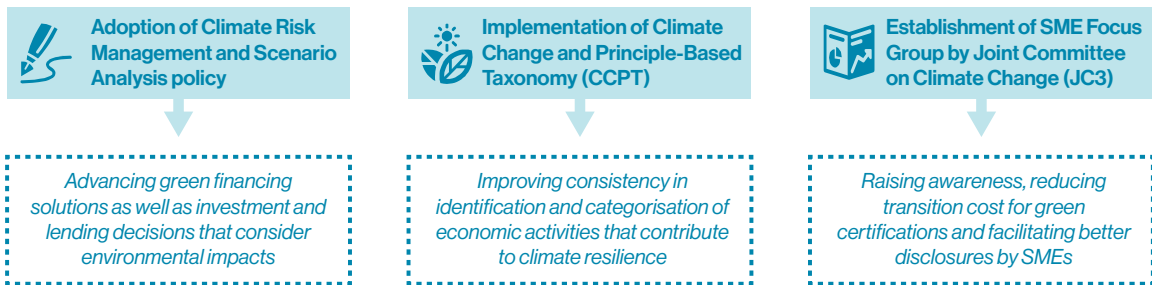
Enhanced capability to trace and recover stolen funds following the establishment of National Scam Response Centre

- 997 hotline facilitated efforts to trace suspected fraudulent activity and flag mule accounts
- Over 40,000 mule accounts disrupted by financial institutions since October 2022



Strengthened expectations on Risk Management in Technology (RMiT) to safeguard against risks from cloud adoption and fortify e-banking defences against cybercrimes

Financial institutions are also aligning business operations with environmental and sustainability goals



<sup>3</sup>Including regulatory reserves.

Source: Bank Negara Malaysia



# Overview





# Overview

In the first half of 2023, global financial markets continued to be significantly influenced by shifting expectations around developments in major economies that could indicate changes in the path of monetary policy. More recently, China's property sector downturn and a slower-than-expected pace of China's economic recovery have also contributed to financial market volatility. Domestic market stress levels have declined since end-March as contagion fears associated with global banking sector stress subsided. Towards the end of September however, there was a slight uptick in the domestic market stress levels amid renewed expectations for the US Federal Reserve (Fed) to hold interest rates higher for longer. Stress levels, nonetheless, remained well below the peak observed at the onset of the pandemic in March 2020. Domestic market conditions have remained orderly, supported by two-way flows in the bond and equity markets. Conditions in the interbank money market also improved with the easing of banks' seasonal year-end funding demands and diminishing expectations of further Overnight Policy Rate (OPR) hikes. In the domestic foreign exchange (FX) market, the ringgit continued to be primarily influenced by external developments. FX risk exposures in the corporate and banking sectors remain manageable, underpinned by sizeable FX liquid asset buffers held by banks and largely hedged FX exposures of corporates.

Domestic business activity has improved considerably. However, some sectors continue to face challenges arising from elevated input costs and weak external demand. Businesses have remained generally resilient against these challenges. Measures of overall debt-servicing capacity remained healthy, while the share of firms-at-risk has also declined. Stronger liquidity buffers built up during the pandemic have further supported business resilience.

Small and medium enterprises (SMEs) have been more affected by challenging operating conditions, although emerging risks observed among SMEs

in the wholesale and retail trade, construction and agriculture subsectors are within banks' expectations. Total SME loans identified as having higher credit risk (classified as Stage 2) remains small (2.1%) as a share of overall banking system loans. Most SMEs that have exited repayment assistance programmes also continue to be able to sustain their loan repayments. The credit quality of overall business loans was sound with impairments remaining low (1% of total banking system loans). Going forward, uncertainties surrounding global and domestic growth outlooks and cost challenges are expected to persist in the near term, with climate-related risks and opportunities increasingly becoming important considerations for businesses. Most businesses are expected to be better placed to respond to potential new shocks given improvements in business leverage, healthy cash buffers and more agile business models.

Household resilience continued to be supported by improvements in income and employment conditions. The median debt-to-income (DTI) ratio for overall households had been broadly stable at 1.4 times amid sound lending standards maintained by banks. Other measures of households' debt repayment ability also indicate limited new risks, with the median debt service ratios (DSRs) for newly approved and outstanding household loans remaining prudent at 42% and 36%, respectively. Additionally, the share of household loans under Stage 2 has declined further to 4.6% (or 2.7% of banking system loans) from 6.7% as at December 2022. Banks expect some deterioration in asset quality among higher risk borrowers amid higher borrowing costs and as existing repayment assistance programmes extended during the pandemic come to an end. These include lower-income borrowers and those employed in business sectors that continue to face challenges from the external environment. Banks continue to be vigilant over these risks and expect any deterioration to be well within existing provisioning and capital buffers.

The banking system remains well-capitalised. The total capital ratio of the banking system stood at 18.5% at the end of June 2023, with capital buffers of RM138.5 billion in excess of the regulatory minimum. Banks also continued to maintain strong liquidity buffers that ensure their resilience against both short- and longer-term liquidity shocks. The aggregate Liquidity Coverage Ratio and Net Stable Funding Ratio remained well above regulatory minima at 154.4% and 117.0%, respectively. Meanwhile, profitability improved at a more moderate pace during the period amid higher funding costs. Banks' profitability continued to be sustained by loan growth and to a lower extent, trading and investment activities. Annualised credit costs have reverted to pre-pandemic levels, although banks have generally maintained higher than historical provisioning buffers given ongoing uncertainties in the operating environment. Sustained profits have continued to strengthen banks' buffers against negative shocks, enabling them to support lending to the economy and avoid a broad-based tightening of credit conditions during periods of heightened stress.

The insurance and takaful sector similarly remained resilient, with an aggregate capital adequacy ratio of 225% and excess capital buffers of RM38.8 billion as at end-June 2023. Overall profitability of insurance and takaful funds improved primarily due to better underwriting performance. Profitability was also supported by sustained investment income and unrealised gains from lower bond yields. Medical and surrender payouts continued to weigh on underwriting performance of life insurance and family takaful business amid rising utilisation rates, higher hospital admissions and higher average cost

of claims in selected segments. In the general insurance and takaful sector, the financial impact of climate-related risks continued to be observed as profitability was adversely affected by flood events, in addition to normalising motor claims from the lows seen during the pandemic. Ongoing reforms to improve transparency and address fraud in the motor insurance and repairs sectors are helping to create conditions for a smooth transition to better risk-based pricing. Meanwhile, harder reinsurance market conditions have not so far materially affected domestic insurance and takaful rates or coverage. This is largely owing to generally prudent underwriting practices observed by insurers and takaful operators, and adequate capital buffers.

Preserving operational and cyber resilience remains a key focus of the Bank and financial institutions. Through coordinated efforts with law enforcement agencies, financial institutions now have the capacity to better identify and act on mule accounts used in financial scams. Increasing public cooperation in reporting fraud incidents and raising awareness of the risks of deliberately allowing bank accounts to be used for fraudulent activities remain a priority for the Bank and financial institutions. Financial institutions continue to make progress in managing risks associated with climate change, primarily through sustainable investment and lending practices as well as expanding green financial solutions. To this end, addressing data needs and capacity building in climate risk management continue to be an ongoing priority for financial institutions, through collaborative efforts supported by the Joint Committee on Climate Change (JC3) with private industry and government agencies.

# Key Developments in the First Half of 2023

7	Market Risk
11	Credit Risk
21	Operational Risk



# Key Developments in the First Half of 2023

## MARKET RISK

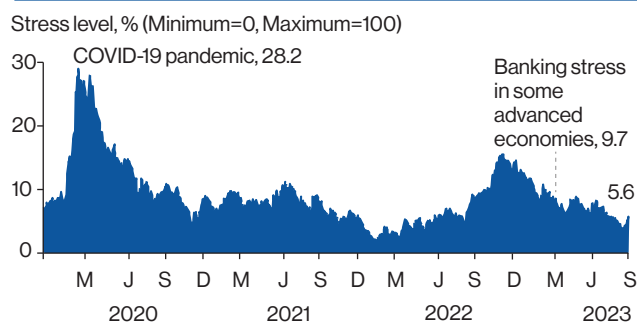
### Domestic financial markets remained orderly despite volatile global market conditions

Global financial markets continued to be significantly influenced by shifting expectations around developments in major economies that could signal turning points in the path of monetary policy. Heightened risk aversion from the episodes of US and European banking stress in March has however abated, although investors remain cautious about underlying vulnerabilities in the non-bank financial sector that could be amplified by higher interest rates. Continuing stress in the property sector and a slower-than-expected pace of recovery in China have also contributed to elevated financial market volatility particularly for economies heavily reliant on Chinese trade. While direct risks from struggling property developers in China to the global financial system are expected to be largely contained, a significant slowdown in the Chinese economy would heighten risks in global financial markets.

Domestic financial markets have remained orderly despite the global volatility. Overall domestic market stress levels, as measured by the Financial Market Stress Index (FMSI) (Chart 1.1), have declined since end-March as contagion fears associated with banking system stresses in some advanced economies subsided. Spillover risks from the global banking sector stress have had limited impact on domestic financial markets. Although some banks reported more cautious institutional investor appetite for new issuances of domestic Additional Tier 1 (AT1) capital instruments,

the take-up of recent AT1 issuance by domestic banks remained healthy. Markets also benefitted from improved investor sentiment in the second half of July amid data releases pointing to more benign global inflation and continued strength in global labour market conditions. More recently however, the FMSI increased slightly amid renewed expectations for the US Federal Reserve (Fed) to hold interest rates higher for longer following the September 2023 Federal Open Market Committee meeting. Stress levels, nonetheless, remained well below the peak observed at the onset of the pandemic in March 2020.

**Chart 1.1: Financial Market – Financial Market Stress Index (FMSI)**

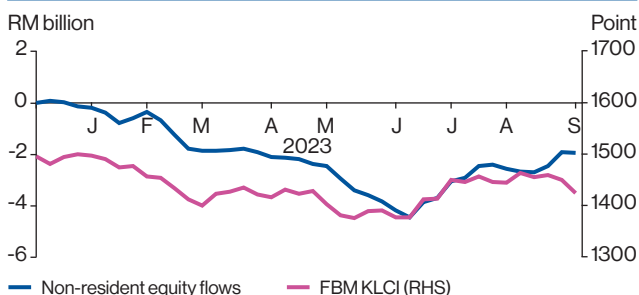


Source: Bloomberg, Reuters and Bank Negara Malaysia estimates

Amid improving investor sentiment in recent months, the domestic equity market recorded non-resident inflows from July, partially reversing earlier outflows. Year-to-date (YTD) net outflows by non-residents up to September were correspondingly lower at RM2.0 billion<sup>1</sup> (1H 2023: -RM4.2 billion; 2022: +RM4.4 billion) (Chart 1.2). The utilities, property and construction sectors were among the sectors that recorded significant gains – reflecting positive sentiments from the announcement of the National Energy Transition Roadmap, sustained property market activity and continued progress in the implementation of large infrastructure projects.

<sup>1</sup> All data in the Market Risk section are as at 29 September 2023, unless stated otherwise.

**Chart 1.2: Financial Market – Cumulative Non-resident Equity Flows and Performance of the Domestic Equity Market**



Source: Bloomberg

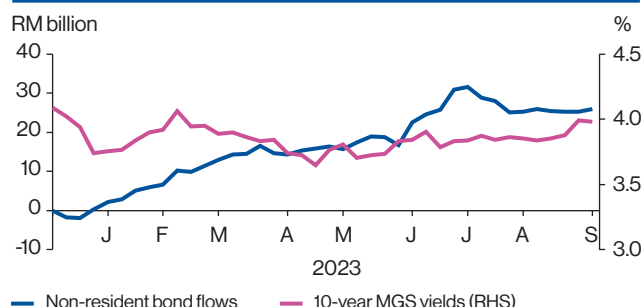
Domestic institutional investors<sup>2</sup> remained net buyers of domestic equities, offsetting non-resident outflows with a net purchase of RM0.7 billion between April and September 2023 (YTD: RM2.4 billion). Retail investors also remained key players in the market, although retail transactions continue to decline as a share of total market activity (April-September 2023: 26.9% of total value traded in equity market; peak 2020: 40.3%; 2015-2019 average: 18.5%). Market observers expect a further moderation in retail activity as the exceptional conditions during the pandemic which spurred higher-than-average activity return to normalcy. These include the normalisation of interest rates from historical lows and the expiry of various stimulus programmes. The paring down of retail equity investments has so far been gradual, given that the bulk of retail investments has not been funded through leverage. This is expected to continue to support orderly market conditions and limit risks to households from debt-related stress due to volatile equity prices. Consistent with earlier observations, household loans to purchase quoted shares remain low and stable, accounting for only 0.5% of banking system loans.

### Government bond market continued to record non-resident inflows

The domestic government bond market recorded net non-resident inflows (April-September 2023: RM11.7 billion; April-September 2022: -RM10.0 billion), amid the attractive total returns of domestic

government bonds (Chart 1.3). The inflows from non-residents were also observed following the affirmation of Malaysia’s sovereign ratings by Moody’s Investors Service and S&P Global Ratings in April and June, respectively. The share of non-resident holdings in the government bond market stood at 23.0%, a moderate increase over the level recorded at the end of 2022 (December 2022: 22.2%; 2015-2019 average: 27.0%). Importantly, the share of more stable non-resident holdings<sup>3</sup> has remained broadly unchanged. This will continue to mitigate excessive volatility in market conditions. Market liquidity remained healthy with sustained demand for government bonds in the primary market, as evidenced by the healthy average bid-to-cover ratio of 2.1 times between April and September 2023 (2015-2019 average: 2.3 times). The 10-year Malaysian Government Securities (MGS) yields increased slightly by 8.0 basis points (bps) between April and September 2023 (2022: +50.8 bps), averaging at 3.8%. Meanwhile, average daily trading volume in the secondary market also improved, averaging RM4.7 billion between April and September 2023 (2015-2019 average: RM3.1 billion). Domestic institutional investors also increased their purchase of government bonds compared to the same period last year (January-September 2023: RM62.8 billion;<sup>4</sup> January-September 2022: RM50.6 billion), in line with the higher government bond issuances during the period.

**Chart 1.3: Financial Market – Cumulative Non-resident Bond Flows and Performance of the Domestic Bond Market**



Source: Bank Negara Malaysia and Bloomberg

<sup>2</sup> Domestic institutional investors include banks, non-bank financial institutions (NBFIs) and insurers and takaful operators (ITOs).

<sup>3</sup> Refers to holdings by non-resident central banks, governments, pension funds and insurance companies.

<sup>4</sup> Data for purchase of government bonds by ITOs is as at 31 July 2023.

The corporate bond market continued to provide conducive and stable funding conditions for businesses. Credit spreads between 10-year AAA-rated papers and 10-year MGS have narrowed further compared to pre-pandemic levels (April-September 2023 average: 42.2 bps; April-September 2022 average: 48.9 bps; 2015-2019 average: 55.4 bps), reflecting sustained demand for corporate bonds by yield-seeking investors. Gross corporate bond issuances amounted to RM55.2 billion between April and August 2023, above levels recorded in the same period last year (April-August 2022: RM51.6 billion). Issuances remained of high quality, with AAA-rated papers continuing to account for the largest proportion of corporate bonds.

Conditions in the interbank money market improved with the easing of seasonal year-end funding demands by banks alongside diminishing market expectations of further OPR hikes. Overall banking system liquidity stood at RM142.0 billion as of September 2023, with the spread between the 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) and OPR closely tracking its long-term average of about 45 bps.

While overall banking liquidity has remained ample in recent years, there has been a notable increase in total overnight surplus liquidity placed with the Bank since the start of the pandemic. By the end of 2022, the overnight surplus liquidity reached RM101 billion and has remained around RM70 billion to RM80 billion since (2015-2019 average: RM39 billion). This shift primarily reflected a preference by financial institutions for shorter-term placements amid the interest rate hike cycle. As part of the Bank's liquidity management operations, the Bank increased its issuance of term Bank Negara Interbank Bills (BNIBs) to reduce the high overnight balances. This would also help to improve efficiency and price discovery in the interbank funding market by encouraging more active interbank trading activities. Interbank trading volume has since picked up as a proportion of banks' surplus overnight balances. A similar trend was also observed in the secured interbank funding market with the repo volume across tenures increasing by 32%. The Bank continues to

monitor developments that may influence liquidity conditions, with a primary focus of maintaining an appropriate level of domestic liquidity to facilitate efficient intermediation in the interbank money market.

Between April and September 2023, the ringgit weakened by 6.0% against the US dollar to 4.6953. The ringgit's movement continued to be primarily influenced by developments in the global financial markets including uncertainties surrounding the US debt ceiling, combined with strong US economic and labour market data, and evolving market expectations of higher terminal interest rates by the Fed. These external developments led to a temporary decline in global risk appetite. However, once uncertainties in global financial markets subsided, the improvement in investor sentiment provided positive support for the ringgit as seen in the stronger ringgit performance at the start of the third quarter of 2023. Despite being a highly diversified economy with diversified trade partners, weaker-than-expected growth in China led to a renewed weakness in the ringgit against the US dollar, consistent with movements of other regional currencies.

Notwithstanding these global developments, the domestic FX market remains conducive for financial intermediation. Daily onshore trading volume remains healthy, averaging at USD15.4 billion in 2023 (2022: USD13.7 billion). While the average 1-month USD/MYR implied volatility for the year stood above levels recorded in recent periods at 5.4% (2022: 4.5%; 3-year average: 4.8%), it remains well below the peak recorded during the pandemic (March 2020: 8.1%). Ringgit volatility also remains lower than most regional currencies. An orderly movement in the ringgit exchange rate is important to promote confidence for businesses undertaking investment decisions and the efficient allocation of resources. The conversion of foreign currency export proceeds into ringgit in the first half of 2023 remained stable within the long-term average range of 60% to 70% of total proceeds, sustaining support for the ringgit. Over the near term, ringgit movement will continue to be largely driven by external developments including expectations on the Fed's monetary policy path and the outlook for global growth.

## CREDIT RISK

### Businesses in some segments continued to face persisting operating headwinds

Domestic business activity has improved considerably. Consumer-related businesses benefitted from the sustained growth in household spending, while the steady flow of inbound tourist arrivals as well as domestic tourism further supported tourism-related subsectors. Notwithstanding these improvements, businesses continued to face a challenging operating environment. Elevated input costs and weak external demand have continued to weigh on business profitability, particularly those in the manufacturing and construction sectors. Despite some easing since the start of the year, input costs remained elevated due to higher imported prices, a weaker ringgit exchange rate as well as higher electricity<sup>5</sup> and labour costs. The median cost of goods sold ratio<sup>6</sup> for the construction and manufacturing sectors remained above pre-pandemic levels (2Q 2023: 77.8%; 2015 - 2019 average: 75.9%). Some property developers also reported cashflow challenges due to delayed payments from contract awarders. In the commercial real estate sector, persistent oversupply issues continued to suppress occupancy and rental rates for office and retail space.

Firms have generally remained resilient against these headwinds. The debt-servicing capacity of businesses, as measured by the median interest coverage ratio (ICR), remained healthy and comfortably above the prudent threshold of two times, while the aggregate share of firms-at-risk<sup>7</sup> has trended lower in the recent quarter (Chart 1.4). Strong liquidity buffers built up during the pandemic have further supported business resilience.

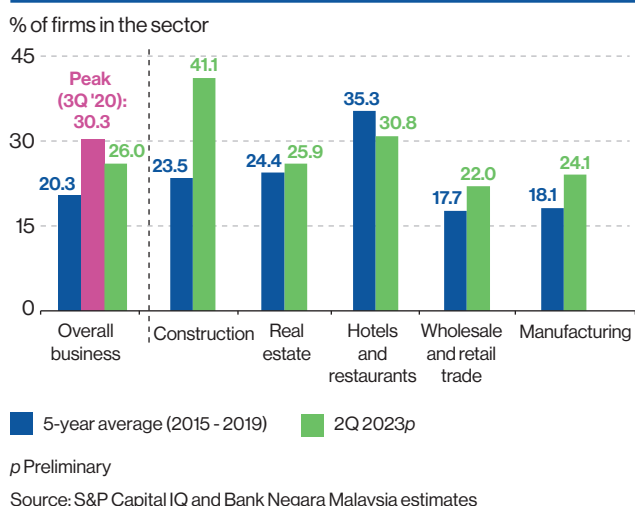
<sup>5</sup> Imbalance Cost Pass-Through (ICPT) is a mechanism under the Incentive Based Regulation (IBR) framework which allows Tenaga Nasional Berhad (TNB) to reflect changes in fuel and other generation-related costs in a user's electricity tariff every six months. Since 2023, ICPT surcharge rate for non-SMEs has increased in line with the implementation of a more targeted subsidy scheme.

<sup>6</sup> Cost of goods sold (COGS) ratio is calculated by taking a firm's COGS divided by its revenue. A higher ratio indicates that COGS makes up a higher proportion of revenue.

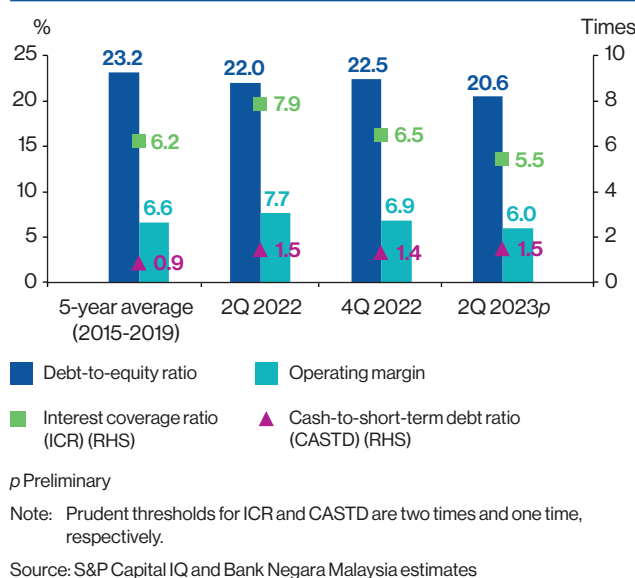
<sup>7</sup> Firms-at-risk refers to firms with interest coverage ratio below the prudent threshold of two times.

Larger businesses – particularly those with economies of scale, more efficient inventory management and larger cash buffers – have been better able to navigate these challenges. However, smaller firms continued to be disproportionately affected given their thinner buffers, limited economies of scale and lower bargaining positions (further details elaborated under the assessment of business credit quality below). Reflecting the uneven impact of demand and cost factors on firms, overall business profitability declined below the average profitability recorded before the pandemic (Chart 1.5).

**Chart 1.4: Business Sector – Firms-at-risk for Selected Sectors**



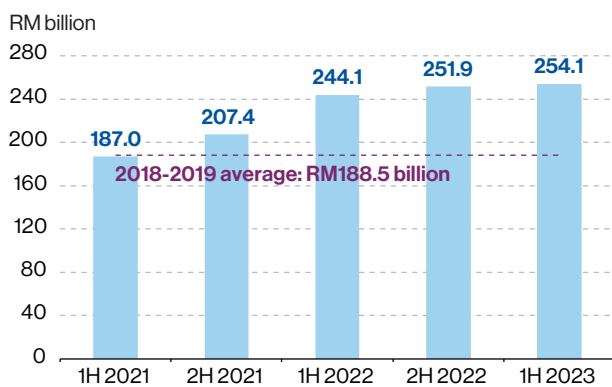
**Chart 1.5: Business Sector – Key Financial Performance Indicators**



## Credit quality of businesses generally remained sound

Businesses continued to be cautious in taking on new debt amid uncertainties in the operating environment and higher interest rates. Business loans expanded at a slower pace of 0.7% in the first half of 2023 (December 2022: 3.5%). This was mainly due to lower demand for financing by large corporates, particularly export-oriented firms, amid the weaker outlook on external demand. In contrast, financing to SMEs grew at a faster pace of 6.4% (December 2022: 5.8%), supported by sustained disbursements to SMEs that are more reliant on financing to meet working capital and investment needs (Chart 1.6). In line with the more prudent management of debt by large corporates, overall business leverage improved further, with the

**Chart 1.6: Business Sector – SME Financing Disbursements**

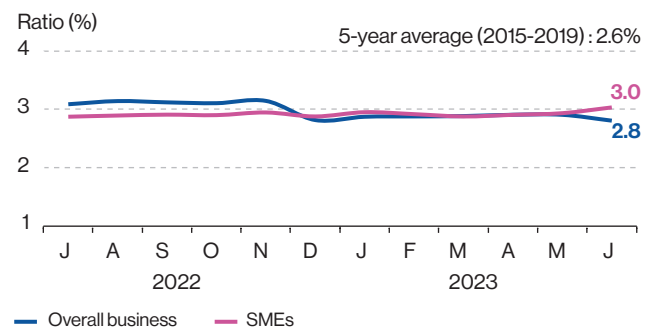


Source: Bank Negara Malaysia

median debt-to-equity ratio declining to the lowest level reported since 2017. Going forward, credit conditions are expected to remain conducive for businesses. The supply of bank credit to viable businesses continues to be forthcoming, supported by a strong banking system, ample liquidity and expectations of an improving growth outlook going into 2024. Banks continue to maintain healthy business loan growth targets. Financing to SMEs is further supported by facilities under BNM's Fund for SMEs.<sup>8</sup>

The credit quality of business loans generally remained sound. The overall business loan impairment ratio was unchanged at 2.8% of business loans (2015 – 2019 average: 2.6%), or 1% of total banking system loans (Chart 1.7). Impaired SME loans however, edged higher to 3% of total SME loans (December 2022: 2.9%), or 0.5% of total banking system loans, amid emerging signs of financial vulnerabilities in some pockets of SME borrowers which drove higher missed repayments in the first half of 2023 (Table 1.1).

**Chart 1.7: Business Sector – Gross Impaired Loans**



Source: Bank Negara Malaysia

**Table 1.1: Business Sector – SME Loans-in-Arrears<sup>1</sup> for Selected Sectors**

Sector	Outstanding Loans (% of total banking system loans)	Loans-in-Arrears <sup>1</sup> (% of SME loans to the sector)	
		Dec 2022	Jun 2023
Wholesale and retail trade	5.1	1.5	1.8
Retail food and beverages	0.1	0.7	1.6
Construction	2.1	3.8	4.5
Agriculture	0.5	2.3	6.2

<sup>1</sup> Refers to loans with 3 months or more in-arrears, equivalent to more than 90 days past due.

Source: Bank Negara Malaysia

<sup>8</sup> About RM9.2 billion (from a total allocation of RM32.4 billion) remained available as at end-June 2023.

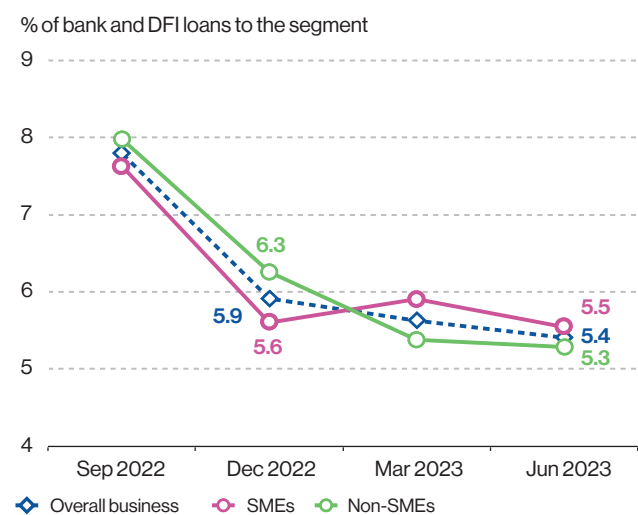
## Key Developments in the First Half of 2023

- Wholesale and retail:** Small and micro-SMEs in the sector are finding it more challenging to adapt to the post-pandemic business environment. Food and beverages (F&B) operators, for example, faced higher overhead costs to maintain physical premises as more consumers return to in-person shopping and dining experiences. Additionally, recovering small standalone businesses also face intense competition from the larger retail chain stores that have better economies of scale.
- Construction:** Profit margins of SMEs in the construction sector continue to be affected by elevated material costs, particularly for contracts awarded pre-pandemic under lower cost assumptions. Despite some contracts providing for price variations, such clauses may only cover selected materials and up to a certain quantum. While labour shortages have eased, labour costs remain elevated as firms have to compete for foreign labour with other sectors such as the palm oil, manufacturing and F&B sectors. In addition, delayed payments from contract awarders, coupled with tighter credit terms by suppliers, are driving tighter cashflows for SME contractors.
- Agriculture:** SMEs in the sector were affected by lower production arising from ageing oil palm trees, hot weather conditions and a decline in average selling prices. Labour shortages continue to persist due to a lack of experienced workers, keeping labour costs elevated. The weaker ringgit also led to the cost of inputs, such as fertilisers, remaining high.

Correspondingly, more SMEs were observed to have sought early assistance from the Small Debt Resolution Scheme (SDRS).<sup>9</sup> The number of applications for SDRS in the first half of 2023 increased by 20% (+254 applications) compared to the corresponding period in 2022, although it remains small as a share of total SME loan accounts in the banking system (0.03%).

At present, these emerging risks are within banks' expectations and are not expected to lead to a widespread deterioration in credit quality. Banks' credit reviews continue to indicate that most SMEs in the above subsectors will be able to maintain their loan repayments through challenging conditions in the near term. The share of SME loans under Stage 2 correspondingly improved further to 12.4% (December 2022: 12.8%; March 2022 (peak): 16.5%). Further improvements could be more modest given that more than 40% of Stage 2 SME loans are associated with borrowers in the vulnerable sectors above. This remains a small share of total banking system loans (0.89%). The share of SME loans under repayment assistance programmes also declined further to 5.5% of total SME loans or 0.9% of total banking system and development financial institution (DFI) loans (Chart 1.8), while new enrolments remained limited at 0.1% of total SME loans (December 2022: 0.3%). Most of the SMEs that have exited repayment assistance programmes have thus far been able to resume and sustain loan repayments.

**Chart 1.8: Business Sector – Share of R&R Loans by Segment**



Note: Beginning 1 January 2023, the R&R data used is based on updated statistical reporting requirements to reflect more accurate data definition and reporting methodology.

Source: Bank Negara Malaysia

<sup>9</sup> SDRS was established in 2003 as a platform for financial institutions and viable SMEs to work out debt rehabilitation solutions without resorting to legal recourse, allowing SMEs to focus on plans to revive their businesses.

Larger corporates with strong financials continued to have access to domestic debt markets. Outstanding corporate bonds grew by 5.2% (December 2022: 4.8%) in the first half of 2023. The quality of corporate bond issuers remained strong. During the period, only four issuers (2022: 6 issuers), or 0.6% of total outstanding domestic bonds, were downgraded due to firm-specific vulnerabilities. Non-financial corporate external borrowings, which make up 27.2% of overall business debt, increased to RM485.3 billion (December 2022: RM461.1 billion), due mainly to exchange rate valuations. Although almost 85% of corporate external borrowings are in foreign currency, the risks from such exposures remained manageable given prudent FX risk management practices generally observed by large resident corporates. The bulk of corporates' external debt is hedged, either financially or naturally. This limits FX risks arising from currency mismatches. Rollover risks associated with total corporate external exposures also remained low as approximately 70% of the total exposures have medium- to long-term maturities. Furthermore, more than one-third of these exposures are with related counterparties which would afford greater debt management flexibilities. At the aggregate level, non-financial corporate external exposures continue to be well-covered by assets, with corporate external assets standing at 1.2 times of corporate external debt.

Going forward, improvements in business conditions are expected in sectors supporting the

tourism industry such as recreation and hotels, and consumer essentials such as healthcare and education. More broadly however, businesses are likely to experience continued headwinds amid moderating global growth and as earlier tailwinds from the post-pandemic recovery taper. Businesses also cited higher cost of businesses – among others from higher electricity tariffs, higher employment costs, and the weak ringgit – as downside risks that may further compress profit margins in an environment where consumers are also more price-sensitive due to elevated costs of living. In addition, businesses are increasingly factoring in climate-related risks and opportunities in response to the higher frequency of extreme weather events, greater clarity on national sustainability strategies and shifting imperatives among financiers, key markets and consumers.

Most businesses are expected to be able to withstand a potential worsening in the operating environment. Improvements in terms of lower business leverage, healthy cash buffers and more agile business models would also suggest that firms may be better placed to respond to new shocks. Consistent with this, banks do not expect a broad-based tightening in lending standards in the near term. In the unlikely event of a large increase in business defaults, stress tests carried out by the Bank earlier this year affirmed that banks have sufficient capital buffers to absorb significant credit losses arising from the business sector.<sup>10</sup>

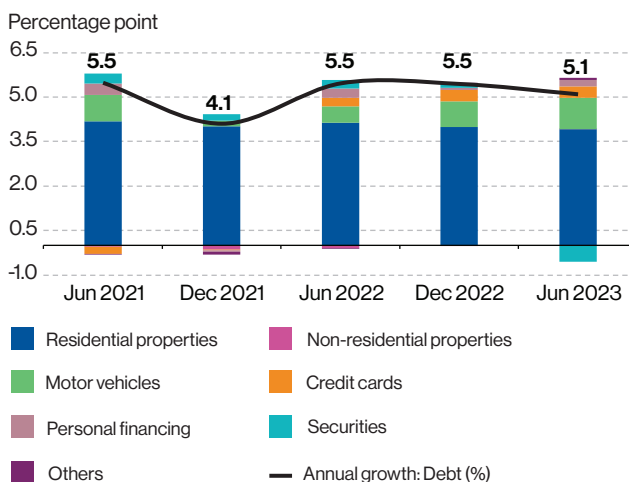
<sup>10</sup> Refer to the section on 'Assessing the Resilience of Financial Institutions' in the BNM Financial Stability Review for Second Half 2022 for further details.

## Overall credit risks from the household sector remained manageable, supported by continued employment and wage growth

Household debt<sup>11</sup> expanded by 5.1% on an annual basis (December 2022: 5.5%) (Chart 1.9). Growth in household debt continued to be driven primarily by housing and car loans. This is in line with continued improvements in private sector wages, which increased by 4.1%, while existing measures to encourage home ownership have also sustained demand for house purchases. Car financing growth continued to pick up in pace, driven by the ongoing fulfilment of backlog orders<sup>12</sup> and strong car sales as newer models were launched during the period.

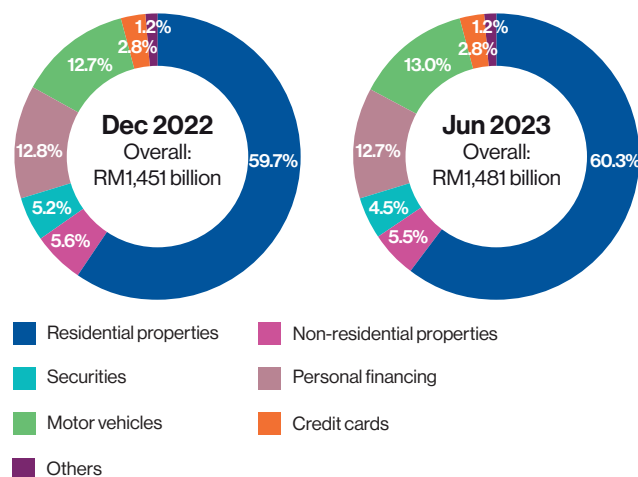
Consumption loans also grew in tandem with the ongoing recovery in consumer spending levels and the introduction of the Employees Provident Fund (EPF) Account 2 Support Facility (FSA2)<sup>13</sup> (further elaborated below). The share of consumption loans to household debt has, however, remained broadly unchanged (Chart 1.10). Risks from the growth in credit card debt have also been well-contained. Outstanding credit card debt is near pre-pandemic levels. Credit card users continue to be largely transactors, with credit card cash advances and revolving balances remaining below pre-pandemic levels (June 2023: 78% and 91%, respectively, of June 2019 levels). Amid narrowing spreads between investment returns and financing costs, loans for the purchase of securities recorded a sharp decline (-10.2%; December 2022: +2.8%). This was mainly driven by lower financing for the purchase of Amanah Saham Bumiputera units as borrowers pared down existing debt and had lower appetite for new leveraged purchases. As at June 2023, the ratio of household debt-to-GDP was broadly stable at 81.9% (December 2022: 81.0%) (Chart 1.11).

Chart 1.9: Household Sector – Annual Growth of Debt



Source: Bank Negara Malaysia

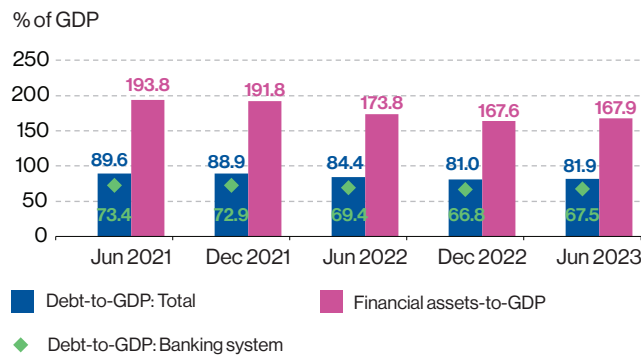
Chart 1.10: Household Sector – Composition of Debt by Purpose



Note: Figures may not add up due to rounding.

Source: Bank Negara Malaysia

Chart 1.11: Household Sector – Key Ratios



Source: Bank Negara Malaysia, Bursa Malaysia, Department of Statistics, Malaysia, Employees Provident Fund and Securities Commission Malaysia

<sup>11</sup> Extended by both banks and non-bank financial institutions.

<sup>12</sup> These backlog orders are mostly from the Sales and Service Tax (SST) exemption period i.e. for vehicles that are booked from 15 June 2020 to 30 June 2022 and are registered by 31 March 2023.

<sup>13</sup> EPF FSA2 enables EPF members to make advance application for Age 50 or Age 55 Conditional Withdrawal ahead of their retirement age, to support their application for personal financing from participating banking institutions. Application for Phase 1 began on 7 April 2023 and will remain open for 1 year, applicable to members aged 40 to 54 years old.

Outstanding household loans extended by banks grew 5.4% in the first half of 2023 (December 2022: 5.9%). The bulk (69.7%) of this debt continues to be held by borrowers earning a monthly income of above RM5,000 (Chart 1.12). Despite higher financing rates, the median debt-to-income (DTI) ratios for households across all income groups were broadly stable (Chart 1.13) amid sound lending standards maintained by banks. Other measures of debt-servicing capacity also remained healthy. The median debt service ratios (DSRs) of newly approved and outstanding household loans stood at 42% and 36%, respectively (December 2022: 43% and 37%), preserving healthy buffers for households to support loan servicing. Two-thirds of newly approved loans in the first half of 2023 were associated with borrowers having DSRs below 60%. Meanwhile, the share of borrowers with DSRs exceeding 60%, who could be more susceptible to repayment stress, has remained stable at around a quarter of total household borrowers. The bulk (67%) of these credit exposures is held by middle- and high-income<sup>14</sup> borrowers who typically have larger financial buffers to sustain loan repayments in the event of financial shocks. Impairments among high-DSR borrowers have correspondingly remained low (June 2023: 1.3% of outstanding loans of borrowers in this segment; December 2022: 1.2%). Banks expect some deterioration in asset quality among higher-risk borrowers as repayment assistance extended to borrowers during the pandemic come to an end. Borrowers employed in sectors that continue to face challenges from the external environment are likely to be more affected. Notwithstanding this, banks continue to hold significant buffers against potential credit losses and remain well-positioned to facilitate debt workouts for affected borrowers.

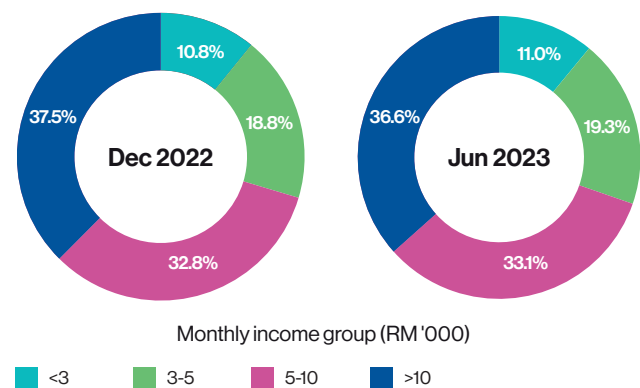
The introduction of the EPF FSA2 programme in April 2023 seeks to help EPF members<sup>15</sup> who are facing temporary liquidity issues to meet their needs for cash flow through personal financing from participating banks at a lower cost and with minimal impact on their retirement savings. This programme is targeted at EPF members who have savings in Account 2 and are supported with reasonable income to ensure they can repay the financing without compromising their retirement income adequacy

<sup>14</sup> The middle-income group refers to individuals earning a monthly income of between RM5,000 to RM10,000 while the high-income group includes individuals earning above RM10,000 per month. Individuals with monthly income less than RM5,000 are categorised as lower-income.

<sup>15</sup> Eligible EPF members must have a minimum amount of RM3,000 in their EPF Account 2. EPF members can apply for a maximum financing amount of RM50,000, subject to EPF Account 2 balance at the point of application, with a repayment tenure of up to 10 years.

and security. As of July 2023, 2.7% of eligible EPF members obtained financing under the first phase of the programme. This amounted to 56,849 loan accounts (or 0.24% of total household loan accounts) with a total value of RM1.15 billion (0.08% of total household loans). Consistent with the stated intention of the programme, participating banks are required to conduct affordability assessments before approving loans under the programme to mitigate risks of borrowers falling into future financial hardship due to inadequate savings for retirement. A significant share (70%) of these borrowings therefore have prudent DSRs below 60%. The Government had earlier announced plans to launch the second phase of the programme for eligible EPF members below 40 years of age. Under conservative assumptions of a take-up rate three times higher than currently observed in the first phase, aggregate household debt is not expected to increase materially.

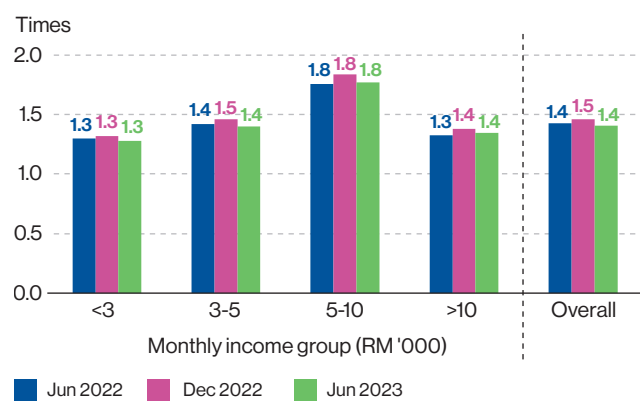
**Chart 1.12: Household Sector – Composition of Banking System Debt by Income Group**



Note: 1. Figures exclude loan accounts with incomplete income information.  
2. Figures may not add up due to rounding.

Source: Bank Negara Malaysia

**Chart 1.13: Household Sector – Median Debt-to-Income Ratios by Income Group**

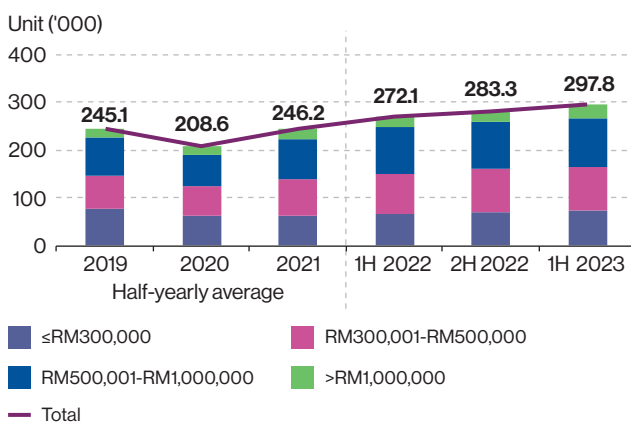


Source: Bank Negara Malaysia

## Key Developments in the First Half of 2023

Housing debt remains the largest share (60.3%) of household debt. Despite the normalisation of OPR, financing activity for the purchase of residential properties remained forthcoming. Higher financing activity was recorded for properties across all price segments in the first half of 2023 (Chart 1.14). Reflecting prudent loan affordability assessments maintained by banks, the median DSR of new housing loans remained broadly stable at 54% (December 2022: 53.3%), while the overall approval rate trended higher to 77.6% (2022: 75.8%; 2015-2019 average: 75.9%). This continued to be largely driven by higher approvals for first-time homebuyers (June 2023: approval rate of 72%; December 2022: 70.1%; December 2019: 66.3%), in line with overall improvements in household income.

**Chart 1.14: Property Market – Volume of Housing Loan Applications by Price Segment**



Source: Bank Negara Malaysia

Risks from a sharp fall in house prices have also receded further on the back of sustained improvements in the residential property market (see box on “Developments in the Residential Property Market”). The normalisation of interest rates further mitigates risks from yield-seeking or speculative activity that could worsen affordability issues and compound supply-demand imbalances in the housing market going forward. Owner-occupiers<sup>16</sup> who have stronger incentives to service their loans continued to drive overall growth of house financing, accounting for the bulk (75.8%) of the increase in housing debt. The median loan-to-value (LTV) ratio of outstanding housing loans also remained stable (June 2023: 65.9%; December 2022: 65.5%) and continues to provide comfortable buffers for borrowers and banks against a decline in house prices in the event downside risks to prices materialise.

Credit risk among individual property investors,<sup>17</sup> who are more likely to default if their mortgages fall into negative equity or if rental income is lost, remains low. Housing loan growth in this segment continued to moderate (4.4%; December 2022: 5.2%; 2015-2019 average: 10.1%). The bulk (82.9%) of new housing loans to individual property investors were extended to those earning more than RM5,000 a month, who are generally more able to withstand income shocks. The median LTV ratio of outstanding housing loans of individual property investors also remained low at 62.3% (December 2022: 62.0%), further limiting potential losses.

<sup>16</sup> Proxied by individual borrowers with one housing loan. Includes first-time home buyers as well.

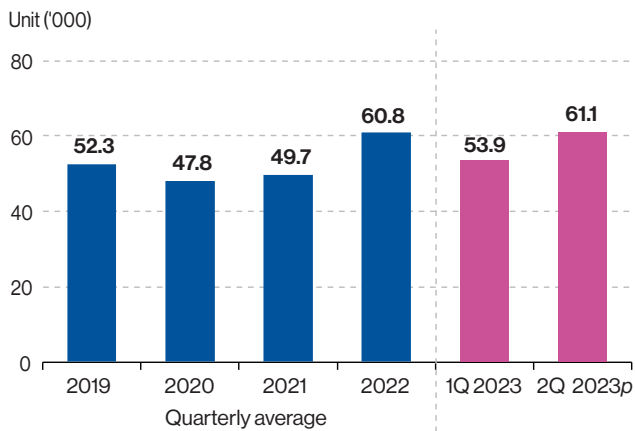
<sup>17</sup> Individual property investor refers to an individual borrower with more than one housing loan.

## Developments in the Residential Property Market

The overall residential property market remained broadly steady in the first half of 2023, supported by favourable labour market conditions, coupled with measures to promote home ownership. Total market transactions continued to hover above the pre-pandemic average, driven by the mass market segment. Houses priced RM500,000 and below accounted for close to 80% of total transactions in the first half of 2023 (Chart 1.15). The oversupply condition continued to gradually ease, with the number of unsold housing units declining further (141,855; 4Q 2021 (peak): 183,918; 2015-2019 average: 130,210) (Chart 1.16).<sup>18</sup> While the improvements were rather broad-based across property types and price segments, more significant declines in unsold units were observed in the high-rise segment, particularly among units priced between RM500,000 and RM1 million. Despite the strong demand in the mass market housing segment, the share of incoming supply of newly launched residential properties priced RM500,000 and below in the first half of 2023 was sharply lower (58.0%<sup>p</sup> of total newly launched units; 2022: 71.1%). This may be reflective of improved confidence among property developers seeking to manage higher overall cost, which in turn, could continue to aggravate the shortage in supply of affordable houses.

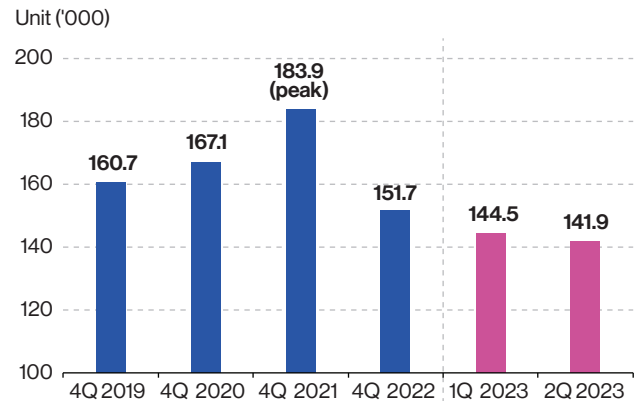
<sup>p</sup> Preliminary number.

<sup>18</sup> Comprises overhang and unsold under construction for residential units, serviced apartments and SOHO units.

**Chart 1.15: Property Market – Housing Transaction Volume**

<sup>p</sup> Preliminary

Source: National Property Information Centre (NAPIC)

**Chart 1.16: Property Market – Volume of Unsold Housing Units**

Note: Figures include both overhang and unsold under construction for residential, serviced apartments, and small office, home office (SOHO) units.

Source: National Property Information Centre (NAPIC)

House prices<sup>19</sup> expanded at a faster rate of 4.8% in the first quarter of 2023 (4Q 2022: 3.9%) but remained below the 2015-2019 long-term average of 5.3%. Beyond the improvements in income and employment conditions, the housing market has benefitted from stamp duty exemptions provided under the Malaysian Home Ownership Initiative.<sup>20</sup> Although asking prices from sellers in the secondary market<sup>21</sup> remain high, potential buyers are becoming more discerning in their purchase decisions as interest rates normalise. Property investors with three or more housing loans also continue to be subjected to a lower LTV limit of 70%. Market observers expect these factors to moderate house price growth going forward. In the primary market, improvements in house price transparency are also needed to address the artificial inflation of house prices and encourage further adjustments in the supply of housing towards the more affordable price segments.

House prices in all states in Malaysia remain well above the affordability levels of most households, with the median house price relative to median income<sup>22</sup> continuing to fall within the 'seriously unaffordable' range at 4.3 times as at end-2022 (2020: 4.7 times).<sup>23</sup> Housing unaffordability remains a major barrier for households to access home financing, with 86.1% of loan rejections attributable to high house prices (and therefore loan values) that are beyond their financial means even with the availability of loan guarantee schemes.<sup>24</sup>

In ensuring the sustainability of the housing market and continued affordability of homes for the masses, broader reforms remain imperative. These include, among others:

- Accelerating the establishment of an integrated housing database for the planning and allocation of housing that is more in line with household income, characteristics, and preferences;
- Strengthening requirements for developers to provide greater transparency around disclosed/advertised house prices with separate disclosures of discounts/rebates to improve decision-making by potential buyers, developers, as well as lenders; and
- Expediting the implementation of the Residential Tenancy Act to promote a more vibrant rental market as a viable option of choice alongside home ownership for households.

<sup>19</sup> As measured by the Malaysian House Price Index.

<sup>20</sup> This initiative provides a full exemption from stamp duty for first-time property buyers who purchase residential properties valued at RM500,000 or below until the end of 2025. Additionally, buyers of residential properties priced between RM500,000 and RM1 million can avail of a 75% stamp duty exemption under the same initiative until 31 December 2023.

<sup>21</sup> Secondary market refers to the resale of existing properties rather than sale of new properties directly from developers (i.e., primary market). Transactions in the secondary market accounted for 79.4% of total transactions in 1H 2023.

<sup>22</sup> Based on the Median Multiple approach, as recommended by the World Bank as well as the United Nations (UN). It is the ratio of median house price to the median annual household income. A house is considered 'affordable' if the house price is not more than 3 times the annual income.

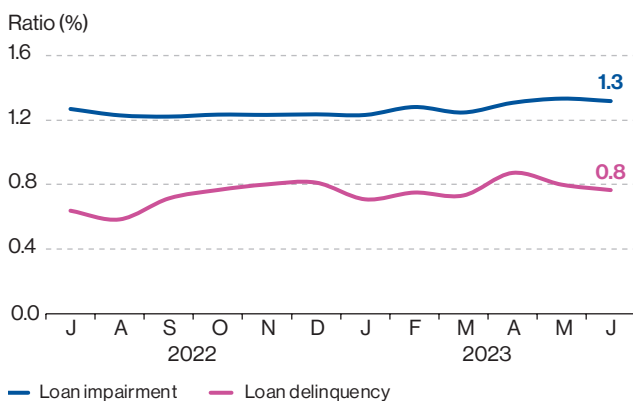
<sup>23</sup> While the affordability levels vary across states, Melaka previously stood out as the only state in the country for having house prices that are within the affordable range in 2020. However, this is no longer the case with the increase in the median house price-to-income ratio for Melaka in 2022 to above 3 times.

<sup>24</sup> Such as Skim Rumah Pertamaku by Cagamas Berhad (available up to end-March 2023) and Syarikat Jaminan Kredit Perumahan Berhad (SJKP).

## Overall household resilience remains intact against the backdrop of higher interest rates and cost of living pressures, but vulnerabilities remain in some borrower segments

The quality of household borrowings remained in line with banks' expectations. The household loan impairment ratio edged slightly higher to 1.3% (December 2022: 1.2%) (Chart 1.17) as some borrowers continue to face financial strains amid higher borrowing costs following the normalisation of interest rates. This is more notable for households whose incomes have yet to fully recover after the pandemic and are further strained by higher costs of living.

**Chart 1.17: Household Sector – Loan Impairment and Delinquency Ratios in the Banking System**

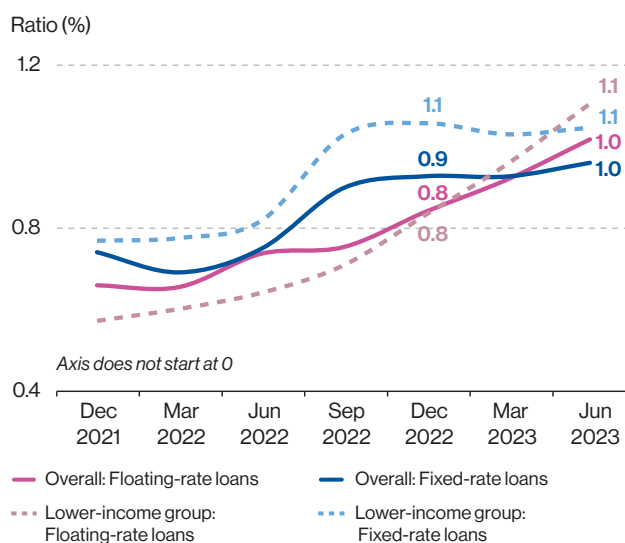


Source: Bank Negara Malaysia

There is limited evidence of new pockets of vulnerabilities emerging in the household sector. The share of household borrowings under repayment assistance remains low (June 2023: 1.7%; December 2022: 1.9% of total banking system and DFI loans). Newly restructured or rescheduled (R&R) household loans also remain small, at RM3.4 billion or equivalent to 0.15% of total banking system and DFI loans. Of this, exposures with no prior history of repayment assistance only amounted to RM1.2 billion (or 0.05% of total banking system and DFI loans), indicating that new pockets of vulnerabilities remain limited.

As expected, higher incidences of missed repayments were observed on floating-rate loans compared to fixed-rate loans (Chart 1.18). This was primarily driven by a small segment of vulnerable household borrowers who were previously under repayment assistance programmes or are currently under R&R. For households not previously or currently under these programmes, the increase in missed payments remains marginal, with no discernible difference observed in the performance of floating- versus fixed-rate loans. To some extent, lower-income borrowers, who are more vulnerable to financial distress, are partly shielded from OPR increases given their higher share of fixed-rate loans (54.4% of total loan accounts of lower-income borrowers), mainly comprising of car loans and personal financing. However, around 50% of lower-income borrowers also have at least one floating-rate loan account (usually a housing loan) which would be affected by OPR changes. The performance of floating-rate loans among lower-income borrowers have showed a more pronounced deterioration in the first half of 2023, compared with overall household borrowers. Notwithstanding this, overall impairments among lower-income borrowers remain low (June 2023: 1.3%; December 2022: 1.1%).

**Chart 1.18: Household Sector – 3 Months-in-Arrears (MIA-3) Ratio by Floating-Rate and Fixed-Rate Loans**



Note: Refers to loans with 3 months or more in-arrears.

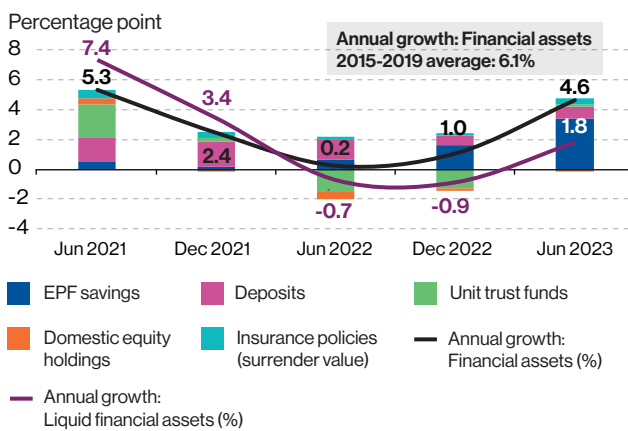
Source: Bank Negara Malaysia

Household financial assets continued to grow in the first half of 2023 (4.6%; December 2022: 1.0%; 2015-2019 average: 6.1%) supported by growth in EPF savings and deposits (Chart 1.19). In particular, EPF savings among households steadily increased in 2023 following the conclusion of EPF special withdrawal schemes and improving labour market conditions.<sup>25</sup> This was partly offset by the lower valuation of domestic equity holdings during the same period. Overall, households continued to hold financial assets in excess of

debt, with the aggregate value of financial assets remaining steady at 2.1 times of total household debt (December 2022: 2.1 times; December 2019: 2.2 times). This continues to support overall household resilience despite persisting pockets of vulnerabilities noted above.

Looking ahead, banks remain vigilant over a further deterioration in the quality of household borrowings, given ongoing challenges faced by borrowers in the vulnerable and higher-risk segments. However, any deterioration is expected to be well within banks' existing provisioning and capital buffers. The share of household loans classified as Stage 2 (identified as having higher credit risk) improved further (June 2023: 4.6%; December 2022: 6.7%). This is largely reflective of the reclassification of a greater share of household borrowers from Stage 2 to Stage 1 after observing a consistent track record (at least 6 to 12 months) of repayments upon exiting repayment assistance programmes. Favourable labour market conditions and the continued availability of assistance for viable borrowers will continue to lend support to overall debt-servicing capacity. New borrowers enrolled in Credit Counselling and Debt Management Agency's (AKPK's) Debt Management Programme and the volume of registered bankruptcy cases and petition filings remained low in the first half of 2023.

**Chart 1.19: Household Sector – Annual Growth of Financial Assets**



Source: Bank Negara Malaysia, Bursa Malaysia, Employees Provident Fund and Securities Commission Malaysia

<sup>25</sup> In the first half of 2023, contributions in EPF amounted to RM50.48 billion, representing an increase of 16.8% from RM43.23 billion in 1H 2022, and an increase of 30.6% from RM38.66 billion recorded in 1H 2019.

## OPERATIONAL RISK

### Financial institutions remained operationally resilient despite challenges

Financial institutions continue to invest significant resources in managing technology and cyber-related risks. During the period, financial institutions continued to advance the implementation of more robust fraud countermeasures to protect their customers against online banking fraud, in line with the Bank's directives in September 2022.<sup>26</sup> Following the launch of the National Scam Response Centre (NSRC)<sup>27</sup> in October 2022, financial institutions with the cooperation of law enforcement agencies now have better capabilities to identify and act on mule accounts<sup>28</sup> used to facilitate financial scams. Immediate information obtained from affected victims via the 997 hotline has also facilitated efforts to trace suspected fraudulent activity in mule accounts. Since October 2022, over 40,000 mule accounts have been disrupted by financial institutions, making it more difficult for fraudsters to perpetrate fraud and scams. As mule accounts are operated with the cooperation of account owners, often for a fee, they can be hard to identify in the absence of reported fraud incidents. Increasing public awareness of the risks, including criminal prosecution, of knowingly allowing bank accounts to be used for fraudulent activities therefore continues to be an important priority to protect the financial system and public from financial fraud.

Financial institutions are expected to continuously monitor evolving threats and ensure that their digital services can withstand new forms of attacks directed at their information technology (IT) infrastructure and/or customer devices. Given the increasing use of cloud for critical services, the Risk Management in Technology (RMiT) policy document

was also updated on 1 June 2023 to include additional expectations on cloud risk management for financial institutions. Separately, an ongoing focused review of financial institutions' Application Programming Interface (API) security practices is expected to further improve the industry's cyber controls. The Bank is also improving its cyber risk surveillance efforts via the introduction of a set of Cyber Key Risk Indicators (KRIs)<sup>29</sup> to enhance monitoring and identify risk hotspots within the industry. Relevant aggregated threat information is then shared back with the industry via the Financial Sector Cyber Threat Intelligence Platform (FinTIP).<sup>30</sup>

Financial institutions are also making further progress in aligning business operations with environmental and sustainability goals. In addition to mitigating associated financial risks, these efforts are critical to manage increasing legal and reputational risks. As of February 2023, 41 financial groups (or 62% of financial groups) comprising banking and insurance/takaful entities have announced net zero or carbon neutral targets. Towards meeting these targets, financial institutions are taking measures to align business strategies and meet expectations set out by the Bank in the Climate Risk Management and Scenario Analysis policy document. This includes enhancing investment and lending considerations to take into account environmental impacts, and expanding green financial solutions that include support for customers to transition towards more sustainable practices.

Addressing data needs and building capacity in climate risk management remain an ongoing priority for financial institutions to deliver on climate goals, support transition activities and effectively manage risks associated with greenwashing. Collaborative efforts through industry associations and forums are helping to address these issues. Apart from an ongoing focus on improving the consistency of classifications under the Climate Change and Principle-based Taxonomy (CCPT),<sup>31</sup> the Joint Committee on Climate Change (JC3) recently

<sup>26</sup> For details on the additional key measures to further strengthen safeguards against financial scams, please refer to the announcement by BNM Governor during the launch of the virtual Financial Crime Exhibition on 26 September 2022.

<sup>27</sup> NSRC was set up by the Government to tackle the growing number of cyber fraud cases in Malaysia. NSRC is a joint effort among the National Anti-Financial Crime Centre (NFCC), Royal Malaysia Police (RMP), the Bank, Malaysian Communications and Multimedia Commission (MCMC), financial institutions and telecommunication companies.

<sup>28</sup> A mule account is a bank account in which an account holder allows criminals to hold or transfer money that is acquired illegally.

<sup>29</sup> Selected conglomerate banks are required to report their Cyber KRIs to the Bank on a quarterly basis, beginning from the second quarter of 2023.

<sup>30</sup> The FinTIP was established by the Bank in 2021 as a cyber threat intelligence and collaboration platform for the financial industry. The platform facilitates cyber threat information collation, aggregation, analysis and sharing from multiple trusted sources.

<sup>31</sup> Refer to Spotlight Article on 'Implementation Progress of the CCPT in the Financial Sector' in the BNM Financial Stability Review for Second Half 2022 for further details.

established a Small and Medium Enterprise (SME) Focus Group. This Focus Group facilitates a more focused and targeted approach in raising awareness, reducing the transition cost for green certifications and facilitating better disclosures by SMEs. In addition, the JC3 also continues to support the implementation of initial green pilot projects and capital market initiatives to expand sustainable and transition finance.

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## Payment and settlement systems continued to be resilient

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The Real-time Electronic Transfer of Funds and Securities System (RENTAS)<sup>32</sup> and major retail payment systems (RPS) continued to be resilient, with no cyber incidents detected in the first half of 2023. During the period, the Bank and Payments Network Malaysia Sdn. Bhd. (PayNet) as the payment system operators of RENTAS and major

RPS, respectively, continued to undertake measures to further strengthen cyber threat and defence management capabilities. This included ongoing exercises to update and test the business continuity plan under a range of cyber threat scenarios.

Following the recognition of the real-time Retail Payments Platform (RPP) as a Designated Payment System (DPS) under the Financial Services Act 2013 and Islamic Financial Services Act 2013 effective 10 February 2023, the RPP successfully completed a major upgrade exercise, boosting its operational capacity and overall performance to support the rising trend of credit transfers. The RPP also continues to support growing cross-border payments, with the roll-out of cross-border interlinkages with Singapore on 31 March 2023. This marks the third bilateral arrangement for Quick Response (QR) payments, following successful collaborations with Thailand and Indonesia in June 2021 and January 2022, respectively.

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<sup>32</sup> RENTAS is a real-time gross settlement system for interbank fund transfers, debt securities settlement and depository services for scripless debt securities.



# Financial Institution Soundness and Resilience

25	The Banking Sector
33	Insurance and Takaful Sector



# Financial Institution Soundness and Resilience

## THE BANKING SECTOR

### Banks continue to maintain strong liquidity buffers

Banks' aggregate Liquidity Coverage Ratio (LCR) (Chart 2.1) and Net Stable Funding Ratio (NSFR) (Chart 2.2) remained broadly stable and above regulatory minima, standing at 154.4% and 117.0% respectively as at end-June 2023 (December 2022: 151.5% and 118.2%, respectively). This is supported by large amounts of high-quality liquid assets (HQLA) held by banks (June 2023: RM744.3 billion; December 2022: RM753.2 billion), mostly in central bank placements and government bonds which can be pledged in the interbank market or with the Bank for additional liquidity during times of stress. Further, all banks continue to have access to the standing facility and Restricted Committed Liquidity Facility (RCLF)<sup>1</sup> with the Bank to meet liquidity needs. To reinforce sound standards of liquidity management across all banks, the Bank published proposed principles capturing existing and enhanced supervisory expectations on the management of liquidity risk by banks for consultation in August 2023. The principles require banks to continually assess their exposures to liquidity risk and ensure that robust and comprehensive liquidity management frameworks, including contingency funding plans, are in place to manage liquidity needs under a range of stress scenarios.

<sup>1</sup> The RCLF was introduced by the Bank in 2016 to allow banks to obtain liquidity for tenures greater than 1 month from the Bank. Banks that intend to use the RCLF will be charged a fixed facility rate and will be required to designate a pool of unencumbered eligible securities that would be sufficient to support the total size of the RCLF.

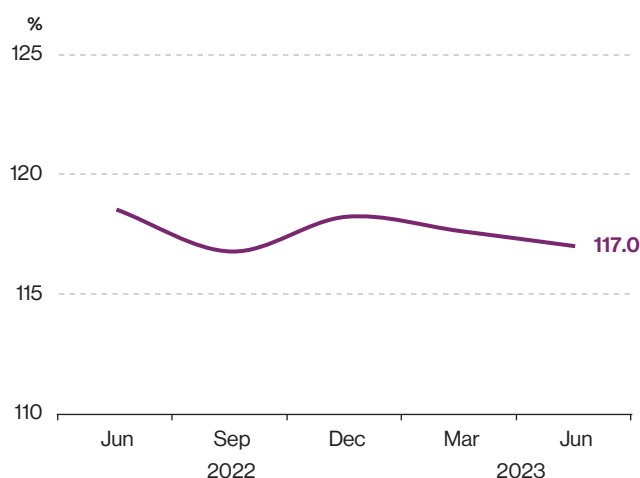
Chart 2.1: Banking System – Liquidity Coverage Ratio



Note: 1. MYR LCR is calculated based on HQLA and expected net cash outflows denominated in ringgit.  
2. Overall LCR is calculated based on HQLA and expected net cash outflows denominated in all currencies.

Source: Bank Negara Malaysia

Chart 2.2: Banking System – Net Stable Funding Ratio



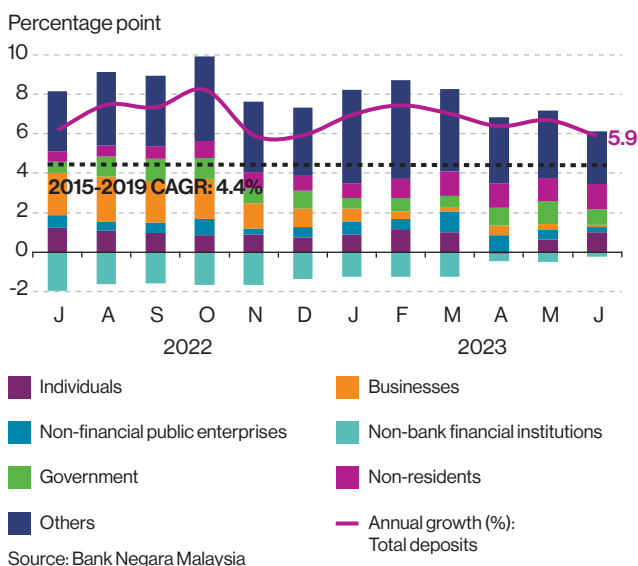
Source: Bank Negara Malaysia

Banks recorded healthy deposit growth of 5.9% (Chart 2.3), with individuals and businesses continuing to form the bulk of the funding base (36.3% and 32.9% of total deposits, respectively). In recent months, depositors' preferences shifted back towards longer-tenure fixed deposits in search of better returns. Consequently, the composition of fixed deposits (including Commodity Murabahah) increased to almost half of total banking system deposits, moving closer towards pre-pandemic levels (49.5%; 2015-2019 average: 51.2%) (Chart 2.4). This has improved the stability of banks' funding. The larger share of better remunerated fixed deposits, coupled with the gradual increase in OPR, has increased funding costs for banks, with the average cost of funds rising by 40 bps to 2.85% between December 2022 and June 2023 (Chart 2.5). Deposit competition remained elevated, but

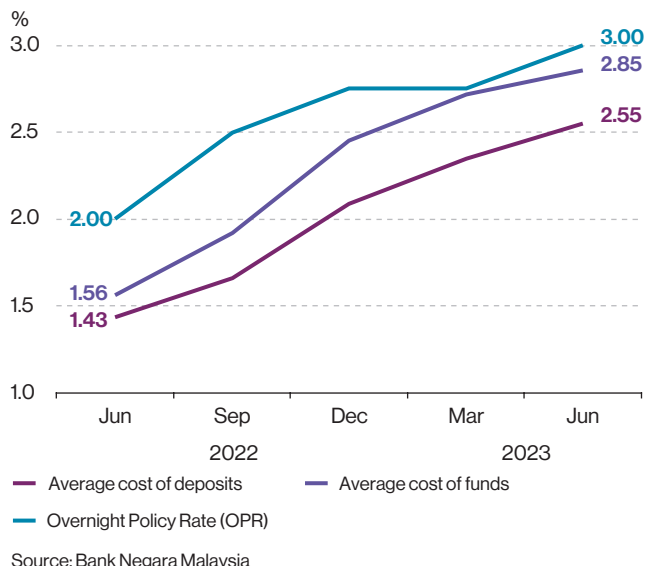
has eased in recent months with a number of banks revising board and promotional rates lower amid comfortable liquidity buffers. The issuance of Bank Negara Interbank Bills (BNIB) by the Bank should further encourage better price discovery in the interbank funding market in support of efficient liquidity management by banks.

Higher funding rates have not so far led to a broad-based tightening of credit conditions. Bank lending to households and businesses expanded at a healthy rate (+4.4%; December 2022: +5.7%) (Chart 2.6). The weighted average lending rates for new business and retail loans increased at a more modest pace compared to earlier periods, with healthy competition observed among banks, and have declined for some segments of business and household loans (Table 2.1).

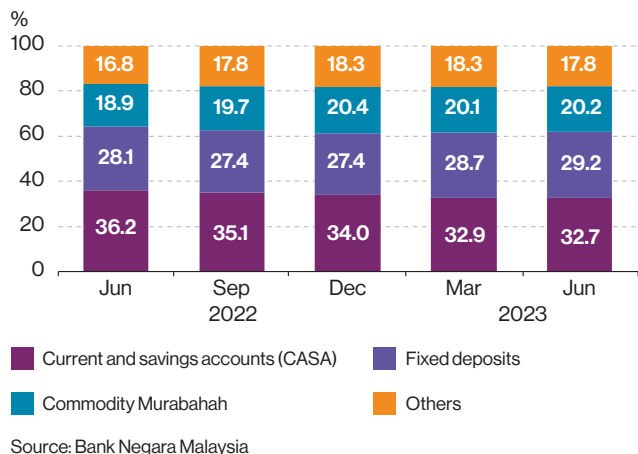
**Chart 2.3: Banking System – Contribution to Growth in Deposits Accepted**



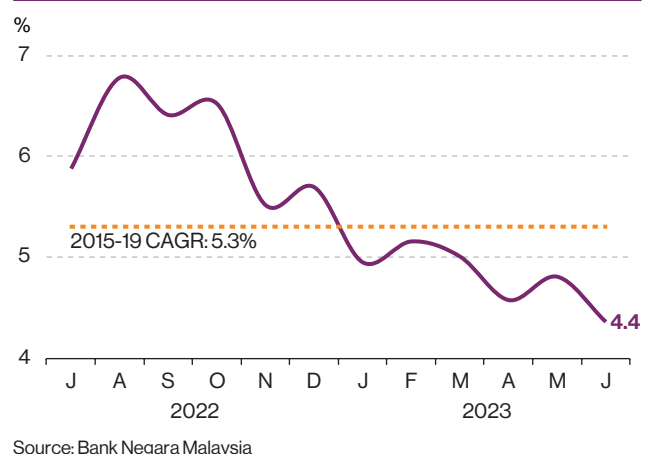
**Chart 2.5: Banking System – Average Cost of Deposits, Average Cost of Funds and OPR**



**Chart 2.4: Banking System – Composition of Deposits by Type**



**Chart 2.6: Banking System – Annual Loan Growth**



**Table 2.1: Weighted Average Lending Rate (ALR) for New Loans (%; range)**

Segment	2021	2022	June 2023
Businesses <sup>1,2</sup>	3.89 – 4.76	4.91 – 5.60	4.86 – 5.89
Households <sup>3</sup>	3.06 – 6.73	4.01 – 7.64	4.19 – 8.96

<sup>1</sup> A 3-month moving average was applied to both the aggregate and business-related sectors to address data fluctuations.  
<sup>2</sup> Business loans only take into account loans granted to domestic business enterprises.  
<sup>3</sup> Household loans only take into account loans granted to individuals.

Source: Bank Negara Malaysia

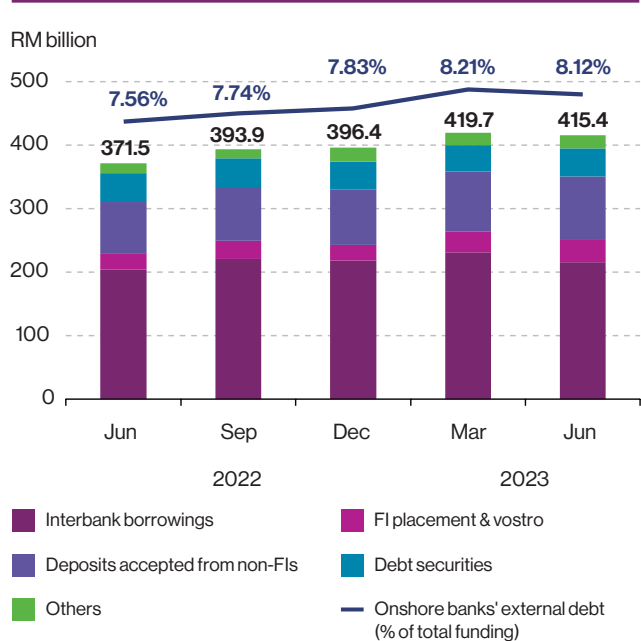
### Contagion risks from exposures to external counterparties remained manageable despite depreciation of ringgit

Banking system external debt increased by RM18.9 billion in the first half of 2023 to RM415.4 billion (Chart 2.7). The increase primarily reflected revaluation effects driven by the depreciation of the ringgit, particularly in the second quarter of 2023. Excluding these revaluation effects, banks' net external borrowings declined in the first half of 2023 as domestic foreign currency (FCY) liquidity conditions remained relatively stable, reducing the need for banks to source FCY funding from international interbank markets. At the same time, maturing intragroup borrowings by banks in the Labuan International Business and Financial Centre (LIBFC) also contributed to the decline in interbank borrowings. Overall risk associated with banks' external debt remained low. The bulk (79.2%; December 2022: 78.3%) of total banking system external debt exposures continued to be with related counterparties or in the form of long-term, stable debt. Most of banks' FCY interbank borrowings – the largest component of banks' external debt – are sourced from parents or overseas subsidiaries, limiting rollover or withdrawal risks.

Banks continued to remain resilient against foreign exchange (FX) risk. Risks from FCY

mismatches, as measured by the overall FX net open position (NOP), continued to remain manageable at 3.8% of total capital (December 2022: 3.4%; 2020-2022 average: 4.2%) despite increased market volatility during the period (Chart 2.8).

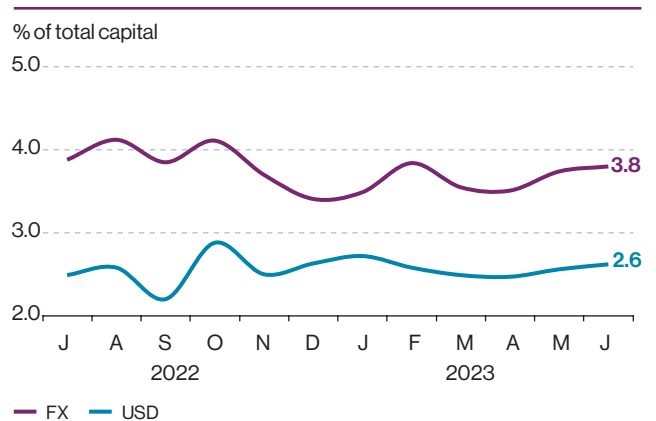
**Chart 2.7: Banks' External Debt – by Instrument**



Note: Banks' external debt in this context refers to external debt of DBGs, LIFBs and banks in the Labuan International Business and Financial Centre (LIBFC).

Source: Bank Negara Malaysia

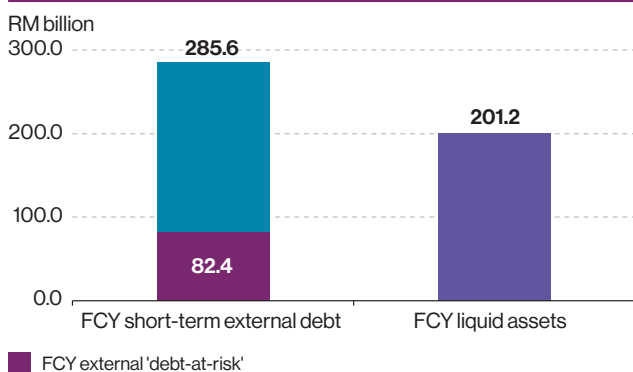
**Chart 2.8: Banking System – FX and USD Net Open Positions**



Source: Bank Negara Malaysia

Banks also maintained sizeable FCY liquid asset buffers, sufficient to cover up to 2.4 times (December 2022: 2.6 times) total FCY external debt-at-risk<sup>2</sup> (Chart 2.9). In addition, roughly one fifth of total banking system external debt is denominated in ringgit and is thus insulated from exchange rate volatility (Chart 2.10).

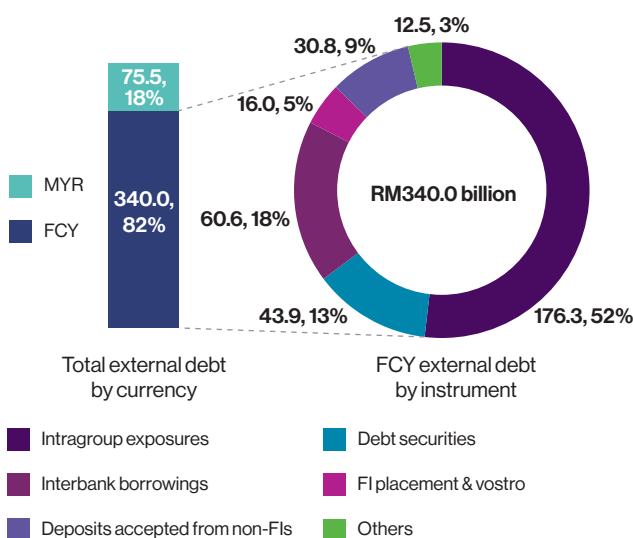
**Chart 2.9: Banking System – FCY External ‘Debt-at-Risk’ and Liquid Assets**



Note: Liquid assets comprise cash and cash equivalents, unencumbered debt securities held and interbank placements.

Source: Bank Negara Malaysia

**Chart 2.10: Banks' External Debt – by Currency and Instrument (RM billion, % share)**



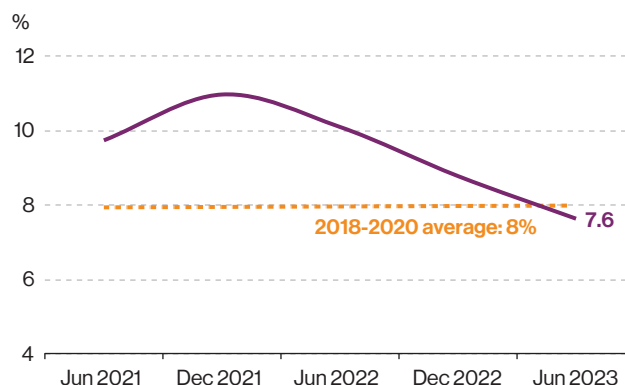
Source: Bank Negara Malaysia

<sup>2</sup> Banks' external debt-at-risk comprises financial institutions' deposits, interbank borrowings and short-term loans from unrelated non-resident counterparties, which are considered to be more susceptible to sudden withdrawal shocks.

## Asset quality remained manageable amid unwinding of repayment assistance programmes

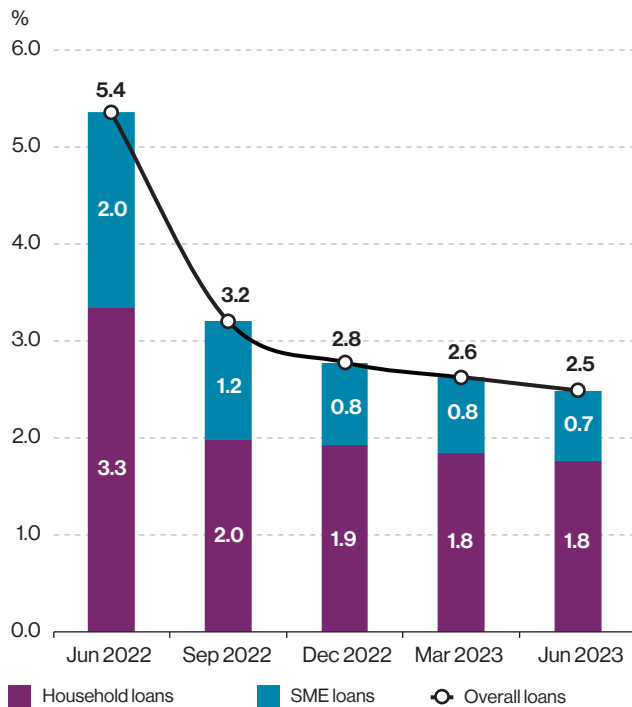
Banks' outlook for credit risk improved further in the first half of 2023. The share of loans classified under Stage 2 continued to decline and is now below pre-pandemic levels at 7.6% of total banking system loans (Chart 2.11). Loans under repayment assistance programmes also declined, with the vast majority of borrowers who exited repayment assistance programmes being able to resume and sustain regular loan repayments (Chart 2.12). Loans that were newly restructured or rescheduled during the period remained low, indicating limited new areas of vulnerabilities. In line with this, increases in loan delinquencies have been comfortably within banks' expectations. While higher interest rates and cost pressures could increase financial strains for some borrowers, the overall increase in impairments has been modest. The gross impaired loans ratio rose marginally to 1.8% of total loans (Chart 2.13), mainly driven by a small number of vulnerable retail and SME borrowers that have smaller cash buffers and continue to face challenging business conditions. While banks do not expect increasing widespread vulnerabilities, they remain vigilant in monitoring their higher risk borrowers as the impact of higher interest rates, higher costs of living and a challenging operating environment continue to pose downside risks to impairments over the medium-term. Borrowers that could be more at risk include lower income households, firms in the construction and export-dependent sectors and larger corporates with pre-existing financial vulnerabilities. Banks' exposures to property developers in China are small and hence, do not pose immediate concerns arising from the recent property market stress in China. These exposures only account for 0.1% of total loans and bonds and are well covered by banks' provisioning buffers.

**Chart 2.11: Banking System – Stage 2 Loans Ratio**



Source: Bank Negara Malaysia

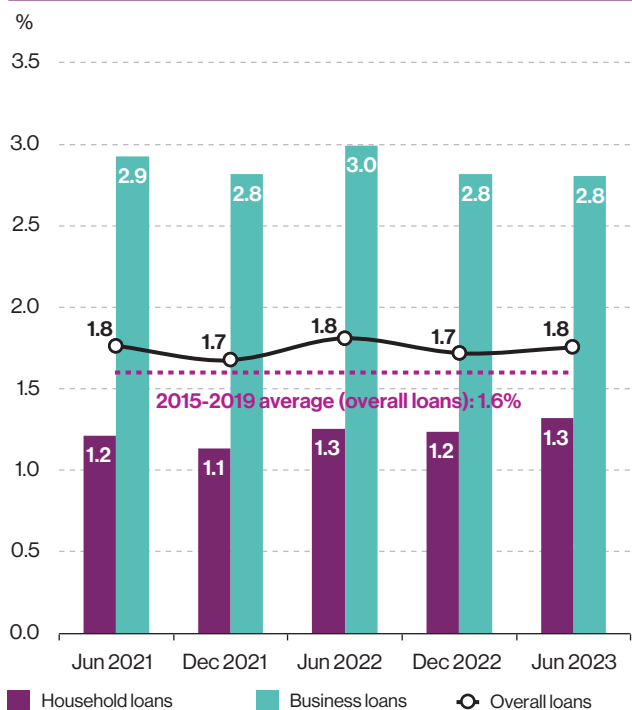
**Chart 2.12: Banking System – Share of Loans under Repayment Assistance**



Note: Beginning 1 January 2023, the R&R data used is based on updated statistical reporting requirements to reflect more accurate data definition and reporting methodology.

Source: Bank Negara Malaysia

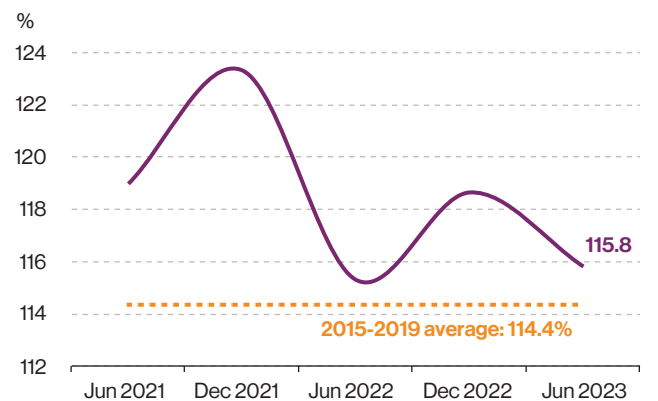
**Chart 2.13: Banking System – Gross Impaired Loans Ratio**



Source: Bank Negara Malaysia

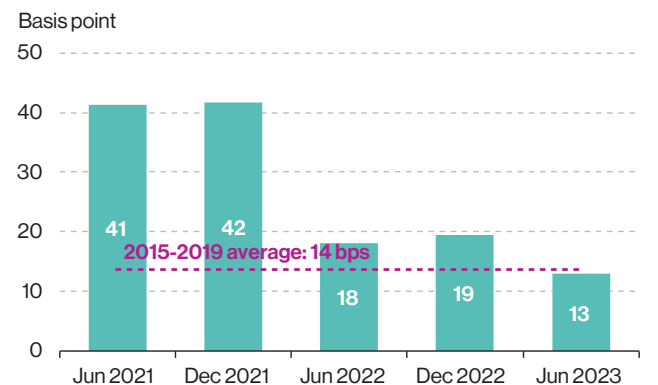
At the aggregate level, the banking system loan loss coverage ratio (including regulatory reserves) stood at 115.8% (December 2022: 118.6%) (Chart 2.14). Some banks have recalibrated their internal provisioning models to incorporate COVID-19 effects on borrowers that are more affected by the pandemic. Banks have remained prudent in approaching these changes and have not reflected effects from temporary support measures deployed during the pandemic that could underestimate observed default and loss rates. Overall banking system provisions have accordingly been sustained above pre-pandemic historical average levels at 1.6% of total loans (December 2022: 1.7%; 2015-2019 average: 1.3%). The use of management overlays remains prevalent among banks to account for uncertainty in the current operating environment, particularly for high-risk borrowers. Annualised credit costs, however, remained low due to high levels of pre-existing provision buffers and are now back to the historical average observed before the pandemic (Chart 2.15).

**Chart 2.14: Banking System – Loan Loss Coverage Ratio (Including Regulatory Reserves)**



Source: Bank Negara Malaysia

**Chart 2.15: Banking System – Annualised Credit Cost Ratio**

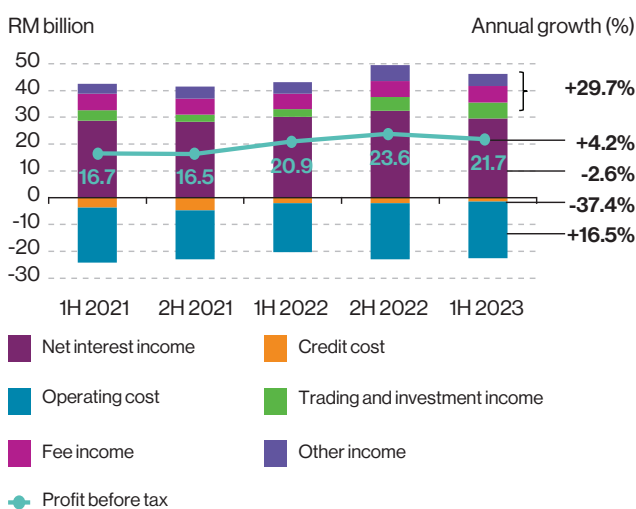


Source: Bank Negara Malaysia

## Moderation in banks' earnings growth due to narrowing net interest margins

Banking system profits continued to increase year-on-year but were lower relative to the second half of 2022 (Chart 2.16). Profitability continued to be supported by lending activities amid some compression in interest margins due to higher funding costs. Sustained trading and investment income further supported banks' profitability. In recent periods, banks have increased their holdings of government bonds, particularly for longer-tenures over five years, to benefit from higher yields (June 2023: 10.1% of total banking system assets; 2015-2019 average: 6.8%). The higher government bond holdings have exposed banks to higher interest rate risks.<sup>3</sup> However, banks continue to manage these risks actively within established risk tolerance limits. Almost half of government bonds purchased in this period are also held at amortised cost (June 2023: 48.9%; 2015-2019 average: 16.7%). This has helped to reduce fluctuations in banks' capital positions in an environment of higher interest rates.

**Chart 2.16: Banking System – Income, Cost and Profit Before Tax**



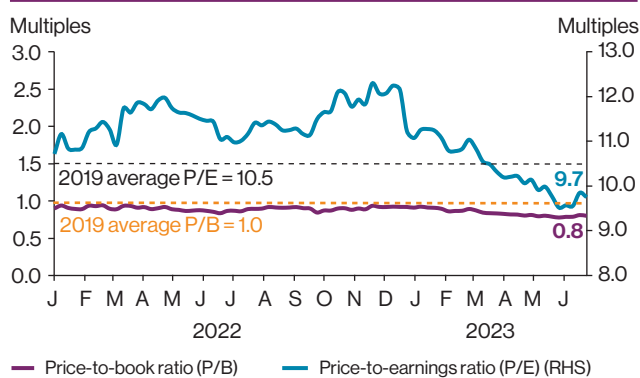
Note: 1. Annual growth computed based on figures for 1H 2022 and 1H 2023.  
2. Figures may not add up due to rounding.

Source: Bank Negara Malaysia

<sup>3</sup> Interest rate risk in the banking book (IRRBB) reflects the current or prospective risk to the bank's capital and earnings arising from adverse movements in interest rates that affect the banks' banking book positions. It is measured as a percentage of banks' capital (June 2023; 7.6%, December 2022: 7.0%).

Returns on asset and equity of the banking system declined to 1.3% and 11.6%, respectively (December 2022: 1.4% and 12.3%, respectively). Similarly, market valuations of listed banks, as measured by the price-to-book (P/B) and price-to-earnings (P/E) ratios, trended lower to 0.8 and 9.7, respectively (Chart 2.17) amid ongoing uncertainties around the economic growth outlook and financial market developments affecting funding conditions for banks. Despite banks' continued profitability and strong buffers, market valuations have trended below their pre-pandemic averages since end-March, owing to spillover fears from banking system stresses in some advanced economies as well as less optimistic global growth prospects.

**Chart 2.17: Banking System – Price-to-Book and Price-to-Earnings Ratios of Publicly Listed Banks in Malaysia**



Note: Refers to median ratio of all publicly listed banks in Malaysia.

Source: Bloomberg

Looking ahead, an intensification of deposit competition to support loan growth could exert further pressure on banks' funding costs. Funding costs could also rise as banks continue to price in the latest round of policy rate hikes. Shifts in investor expectations of major economies' monetary policies and resultant volatility in the global bond market could expose banks to more interest rate and FX risks, thus affecting banks' trading and investment income. On the upside, banks expect asset quality to continue to perform better than earlier expected. Banks also have considerable buffers built up before and during the pandemic which would continue to cushion any adverse impact on profitability from market developments.

## Banks maintained strong capital buffers to absorb potential unexpected losses and support credit intermediation

The banking system's total capital ratio remained strong at 18.5% of total risk-weighted assets (December 2022: 19.0%). Capital buffers in excess of regulatory minima stood at RM138.5 billion (Chart 2.18). The sound capitalisation levels continue to underpin banks' capacity to absorb unexpected losses and meet the financing needs of the economy, even during economic downturns. The large capital buffers have also enabled banks to sustain dividend payouts, which in turn have supported returns on household savings held through large institutional funds such as EPF, Permodalan Nasional Berhad and Lembaga Tabung Haji. Banks' capital buffers were further supported by revaluation gains from securities classified as fair value through other comprehensive income (FVOCI) as domestic bond markets stabilised. Despite recent stress episodes in the global banking sector, domestic banks still see sustained take-ups of their recent capital issuances, both in the primary and secondary markets. Issuances of Additional Tier 1 (AT1) and Tier 2 capital by banks in the first half of 2023 amounted to RM1.7 billion (December 2022: RM1.7 billion).

**Chart 2.18: Banking System – Capitalisation**



Note: Excess total capital refers to total capital above the regulatory minimum, which includes the capital conservation buffer requirement of 2.5% and bank-specific higher minimum requirements.

Source: Bank Negara Malaysia

Based on the Bank's latest assessment using end-2022 data submissions, the list of banking groups designated as domestic systemically important banks (D-SIBs) and their respective higher loss absorbency (HLA) requirements remain unchanged (Table 2.2). All D-SIBs continued to maintain Common Equity Tier 1 (CET1) capital ratios comfortably above regulatory minima, including HLA requirements.

**Table 2.2: D-SIBs HLA Requirement**

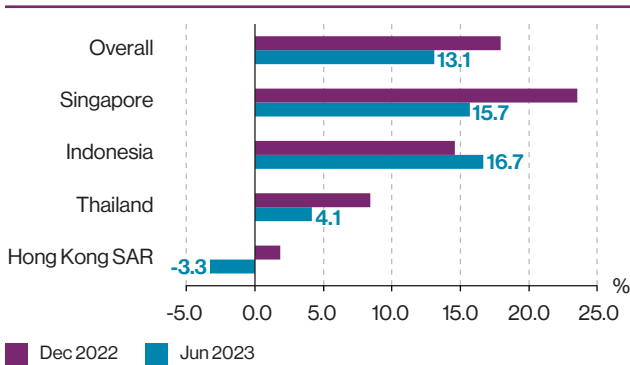
D-SIBs	HLA Requirement (% of risk-weighted assets)
Malayan Banking Berhad	1.0
CIMB Group Holdings Berhad	1.0
Public Bank Berhad	0.5

Source: Bank Negara Malaysia

## Contagion risk from DBGs' overseas operations remains limited

The profitability of domestic banking groups' (DBGs) overseas operations declined in the first half of 2023, reflecting tighter monetary policy conditions in the major jurisdictions they operate in (Chart 2.19). This was mainly seen in Singapore and Thailand as local funding markets continue to price in interest rate hikes carried out in 2022. The two markets make up 61% of Malaysian banks' overseas presence by asset size (Chart 2.20). Nevertheless, profitability from overseas operations continued to be supported by sustained net interest income amid improvements in loan growth (June 2023: 10.1%; December 2022: 9.1%). The share of loans under repayment assistance programmes in most jurisdictions has similarly fallen (June 2023: 1.7% of total overseas operations loans; December 2022: 2.0%). Repayment trends also improved in most jurisdictions, leading to sustained asset quality (Chart 2.21). Thus far, credit risks from DBGs' overseas operations appear well-managed in an environment of inflationary pressures and monetary policy tightening. Impairment ratios are expected to gradually improve as remaining borrowers under repayment assistance recover their financial standing and exit repayment assistance programmes.

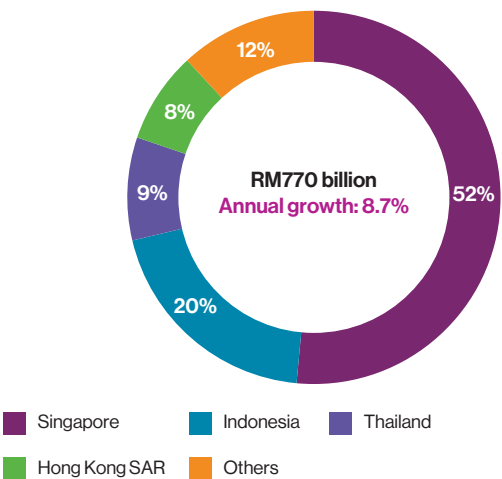
**Chart 2.19: Banking System – Return on Equity of Overseas Operations by Jurisdiction**



Note: 1. Overall average ROE is weighted by the asset size of selected overseas operations.  
2. Average ROE is weighted by the asset size of each domestic banking group's overseas operations in respective jurisdictions.

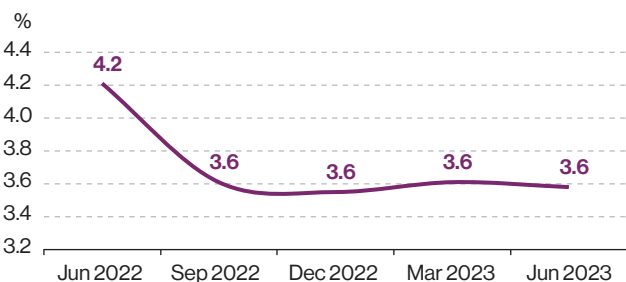
Source: Bank Negara Malaysia

**Chart 2.20: Banking System – Asset Profile of Major Overseas Operations**



Source: Bank Negara Malaysia

**Chart 2.21: Banking System – Gross Impaired Loans Ratio of Overseas Operations**

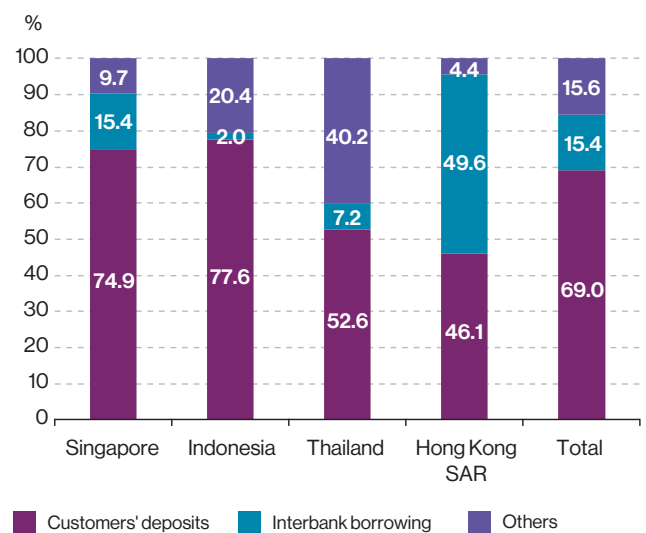


Note: The average gross impaired loans ratio is weighted by the asset size of selected overseas operations.

Source: Bank Negara Malaysia

Liquidity risks posed by DBGs' overseas operations also remain limited. All major overseas operations continue to maintain stable funding sources, mostly in stable deposits (Chart 2.22) and remain compliant with regulatory requirements in the country of operations. Additionally, overseas subsidiaries continue to independently maintain large capital buffers to absorb unexpected losses without depending on parental support (Chart 2.23). Collectively, these factors will serve to limit contagion risks from overseas operations to domestic banks in Malaysia.

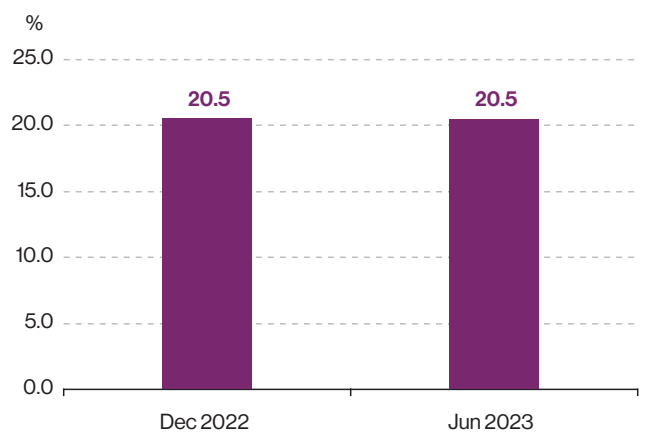
**Chart 2.22: Banking System – Funding Profile of Major Overseas Operations**



Note: Figures may not add up due to rounding.

Source: Bank Negara Malaysia

**Chart 2.23: Banking System – Total Capital Ratio of Overseas Operations**



Note: The average total capital ratio is weighted by the asset size of selected overseas operations.

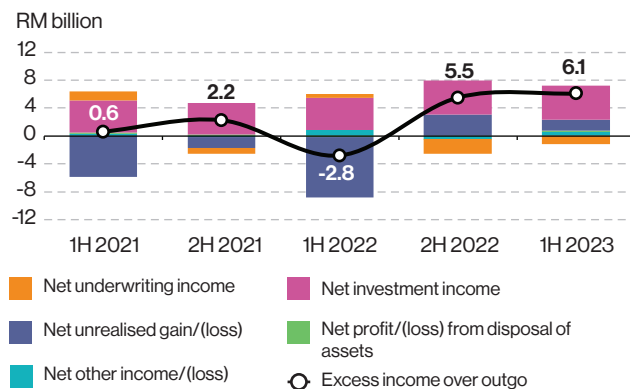
Source: Bank Negara Malaysia

## THE INSURANCE AND TAKAFUL SECTOR

### Aggregate profitability of insurance and takaful funds improved on better underwriting performance

Overall profitability of life insurance and family takaful funds improved in the first half of 2023, mainly due to better underwriting performance (Chart 2.24). Profitability was also supported by sustained investment income and unrealised gains from a decline in bond yields, although this was partly offset by the weaker performance of equities.

**Chart 2.24: Life Insurance and Family Takaful Fund – Composition of Income and Outgo**



Note: 1. Data excludes investment-linked unit funds.  
2. Net underwriting income refers to excess of net premium after deducting benefit payouts, agency remuneration and management expenses.

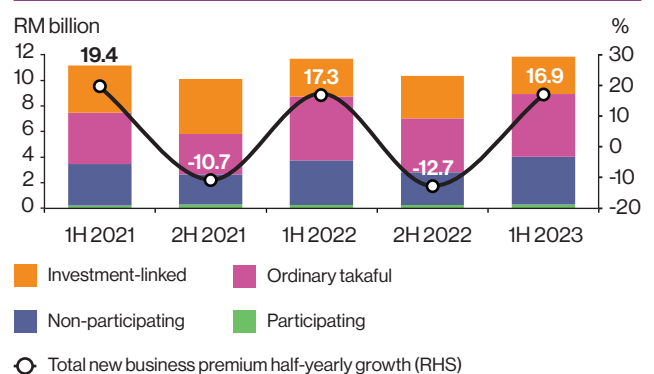
Source: Bank Negara Malaysia

The improvement in underwriting performance mainly reflected seasonally lower maturity and vested benefit payouts usually observed in the first half of the year. Insurers and takaful operators (ITOs), however, continued to record net underwriting losses, driven by the continued increase in medical and surrender payouts (1H 2023: RM7.4 billion; 2H 2022: RM6.8 billion; 1H 2022: RM5.7 billion). The higher medical payouts

were attributable to rising utilisation rates for medical treatment, and higher hospital admissions related to respiratory and infectious diseases. Average cost of claims for hospitalisation and surgical insurance products has also risen based on data submitted by several ITOs as part of their planned re-pricing exercises in 2023 to improve the sustainability of the medical insurance and takaful portfolios. To ensure affordability and fair outcomes for policyholders, ITOs are expected to moderate the quantum of re-pricing by either staggering premium<sup>4</sup> adjustments over several years or switching to shorter re-pricing cycles with smaller quantum of adjustments. This would serve to ease short-term financial strains on policyholders and enable better financial planning.

New business premiums continued to record positive growth (Chart 2.25). After adjusting for seasonal trends, new premiums for life insurance and family takaful business expanded by 2.4% compared to the same period last year. The growth was driven primarily by an increased take-up of standalone medical and group employee benefit plans, partly supported by initiatives to widen financial protection for individuals with lower income. In contrast, investment-linked new business premiums recorded a decline relative to the first half of 2022, reflecting higher uncertainties in the investment outlook.

**Chart 2.25: Life Insurance and Family Takaful Sector – New Business Premium Growth and Product Composition**

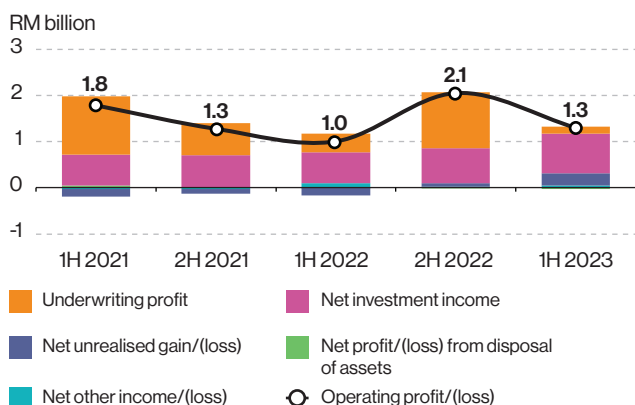


Source: Bank Negara Malaysia

<sup>4</sup> Refers to both insurance premium and takaful contributions, unless stated otherwise.

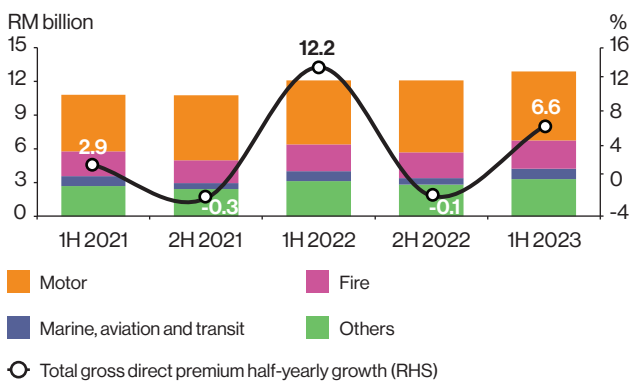
For general insurance and takaful funds, operating profits in the first half of 2023 experienced a decline (Chart 2.26) driven by markedly lower reported underwriting profit. This was attributed to higher net claims from the fire and motor segments. Notably, climate-related risks continue to affect general ITOs financially. This primarily stems from flood events that tend to occur towards the end of the year and sometimes extend into the new year. Consequently, flood-related claims covered under fire policies have had a notable impact on ITOs' underwriting performance, particularly in the first and fourth quarters of the year. Multiple large fire claims also contributed to higher claims recorded during this period. In the motor segment, claims continued to normalise from the lows seen during the pandemic, coinciding with increased mobility. Some improvement in investment performance along with sustained premium growth (Chart 2.27), however, helped shore up general ITOs' profitability.

**Chart 2.26: General Insurance and Takaful Fund – Composition of Operating Profits**



Source: Bank Negara Malaysia

**Chart 2.27: General Insurance and Takaful Sector – Gross Direct Premium Growth and Product Composition**



Note: Marine, aviation and transit include offshore oil-related.

Source: Bank Negara Malaysia

Higher rates and tighter underwriting conditions in the global reinsurance market have continued to drive a hard market environment during recent reinsurance contract renewals. Market observers expect this to continue into 2024. Reinsurers are also expressing expectations of stronger underwriting discipline from general ITOs in view of unfavourable results from domestic reinsurance treaty contracts in recent years. While this is exerting some pressure on underwriting margins in certain business segments, the overall impact on general ITOs' financial positions remains muted – supported by general pricing discipline observed among ITOs, prudent underwriting practices and sufficient surplus capital. There has been little impact from harder reinsurance conditions on coverage or premiums associated with personal business lines, although loss-making commercial portfolios<sup>5</sup> have experienced small increases in premiums. The general insurance/takaful industry also appears to have the capacity to support climate transition activities, with several ITOs providing coverage for risks associated with solar energy generation and clean technologies. This is being further encouraged with the ongoing implementation of the CCPT in the financial sector.

In June 2023, the Bank published the revised policy document on Operating Cost Controls for General Insurance and Takaful Business. Changes made have been mainly to improve consistency in the application of regulatory requirements and provide additional operational flexibility for ITOs to manage their cost structures applied to agents and other intermediaries. These changes are not expected to have a significant competitive or financial impact on general ITOs given that key controls applied to major business segments remain in place under the revised policy document.

The Bank continues to closely monitor developments in premium rate adjustments amid the liberalisation of the motor and fire tariffs, to ensure that any adjustments (upwards or downwards) do not create market dislocations that could affect access to coverage or disproportionately impact segments of the covered population. Almost all general ITOs, representing a combined market share of 98%

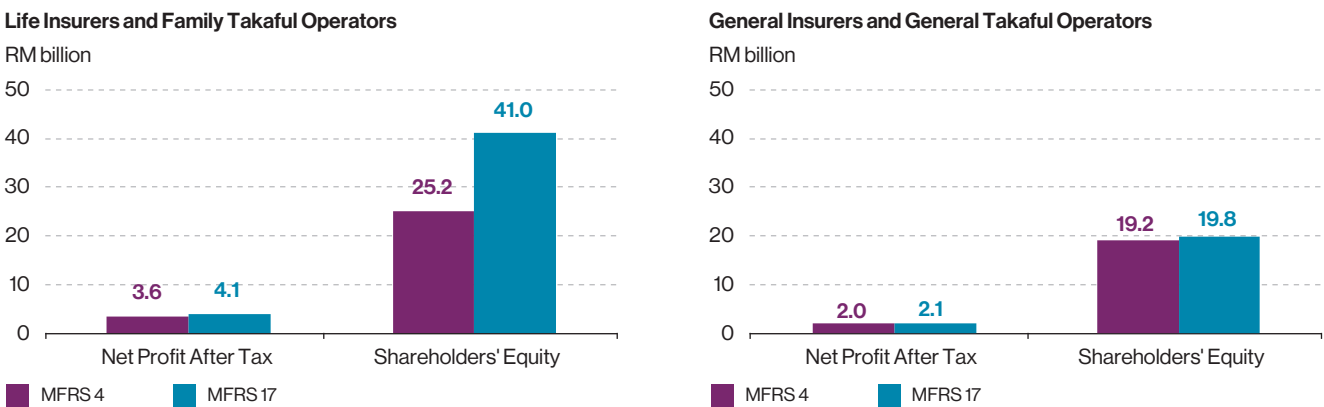
<sup>5</sup> Particularly for high-risk construction classes (class 2 and 3 under the fire tariff) which consist of buildings constructed with higher proportion of combustible materials.

of total motor and fire gross premium income, are already operating under Phase 2A of the liberalisation roadmap.<sup>6</sup> Pricing adjustments by these ITOs have continued to be gradual and more reflective of the underlying risk profiles. In some motor sub-segments, premium rates remain below technical pricing levels (based on loss experience) to maintain the affordability of insurance/takaful coverage. Ongoing reforms to improve transparency and address fraud in the motor insurance and repairs sectors will continue to be critical to better align pricing with risk, while ensuring the long-term sustainability of motor insurance coverage for all income segments of the population.

With the Malaysian Financial Reporting Standard (MFRS) 17 Insurance Contracts coming into force on 1 January 2023,<sup>7</sup> the Bank continues to monitor the impact of the new accounting standard on the industry. Based on the Bank's latest survey<sup>8</sup> of ITOs, the aggregate impact of measurement and reporting changes under MFRS 17 on life and family ITOs has been largely positive, while the impact on general

ITOs have been more neutral. Overall, for the 2022 full year financial results, life and family ITOs' total reported annual net profit after tax and shareholders' equity under MFRS 17 increased by 15.2% and 62.7%, respectively, while for general ITOs, these metrics have increased by 3.8% and 3.4% compared to under MFRS 4 (Chart 2.28). The impact of the change is more varied for life and family ITOs, as the financial outcomes under the MFRS 17 measurement model depend on the duration of the contracts, profit margin at inception and participation features of insurance contracts. These elements can differ significantly between individual life and family ITOs depending on their business strategy. In contrast, for general ITOs, the financial outcomes are broadly similar to that reported under MFRS 4 due to the shorter-term duration of contracts underwritten. ITOs do not expect changes to their business direction or strategy in the short term in response to the adoption of MFRS 17, but they expect to be better positioned to consider relevant adjustments or shifts to their business strategy in the coming years as implementation of the standard becomes more mature.

**Chart 2.28: Comparison of ITOs' 2022 Annual Net Profit After Tax and Shareholders' Equity Following Adoption of MFRS 17**



Note: Based on data collected via the Bank's survey which covered 40 out of 48 direct ITOs.

Source: Bank Negara Malaysia

<sup>6</sup> ITOs that meet the Bank's expectations and requirements on reforms to the motor claims ecosystem will progressively be accorded greater pricing flexibilities for motor and fire insurance/takaful products under two phases, i.e., Phase 2A, followed by Phase 2B.

<sup>7</sup> MFRS 17 Insurance Contracts contains more comprehensive accounting treatments for insurance and takaful contracts and will supersede MFRS 4 Insurance Contracts.

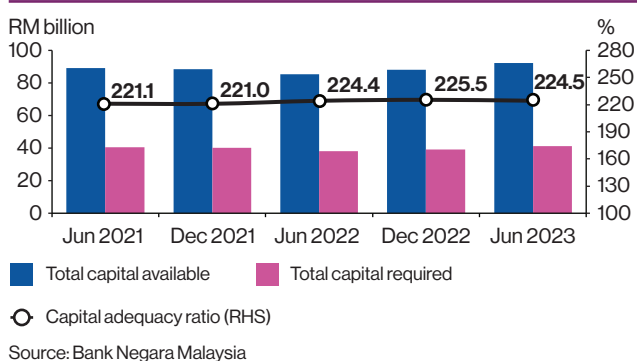
<sup>8</sup> The survey covered 40 direct life and general insurers as well as family and general takaful operators out of a total of 48 ITOs.

The insurance and takaful sector remains resilient, supported by strong capital and liquidity positions. The aggregate industry capital adequacy ratio stood at 225% as at end-June 2023, well above the regulatory minimum of 130% (Chart 2.29). Aggregate capital buffers in excess of regulatory requirements also remained strong at RM38.8 billion.

Looking ahead, ITOs remain susceptible to financial market volatility given their sizeable bond and equity investments. This could also continue to dampen new business growth from investment-linked policies. The sustained upward pressure on medical costs is also expected to weigh on ITOs' overall profitability, although ITOs expect headline growth in this segment to continue to benefit from greater awareness on the need for insurance. Climate-related risk

considerations are expected to become more prominent – both from the effects of higher climate-related claims, and potential changes in reinsurance capacity.

**Chart 2.29: Insurance and Takaful Sector – Capital Adequacy Ratio**



**Annex**





Table A.1

## Key Financial Soundness Indicators

	As at end				
	1H 2021	2H 2021	1H 2022	2H 2022	1H 2023p
	% (or otherwise stated)				
<b>Banking System</b>					
Total Capital Ratio	18.6	19.2	18.4	19	18.5
Tier 1 Capital Ratio	15.4	16	15.2	15.8	15.4
Common Equity Tier 1 Capital Ratio	14.9	15.5	14.7	15.2	14.8
Return on Assets <sup>1</sup>	1.1	1.1	1.3	1.4	1.3
Return on Equity <sup>1</sup>	9.7	9.5	11.8	12.3	11.6
Liquidity Coverage Ratio	149.1	153.4	148.3	151.5	154.4
Net Impaired Loans Ratio <sup>2</sup>	1.0	1.1	1.1	1.1	1.1
Capital Charge on Interest Rate Risk in the Trading Book to Capital Base	1.0	0.9	0.9	0.9	1.0
FX Net Open Position to Capital Base	4.4	3.8	4.1	3.4	3.8
Equity Holdings to Capital Base	1.3	1.3	1.3	1.2	1.2
<b>Insurance and Takaful Sector</b>					
Capital Adequacy Ratio	221.1	221.0	224.4	225.5	224.5
Life Insurance and Family Takaful					
Excess Income over Outgo (RM billion) <sup>3</sup>	0.6	2.2	-2.8	5.5	6.1
New Business Premium / Contribution (RM billion)	11.8	10.5	12.3	10.8	12.6
Capital Adequacy Ratio	207.9	210.7	217.3	216.4	215.8
General Insurance and General Takaful					
Operating Profit (RM billion)	1.8	1.3	1.0	2.1	1.3
Underwriting Profit (RM billion)	1.3	0.7	0.4	1.2	0.2
Gross Direct Premium / Contribution (RM billion)	10.8	10.8	12.1	12.1	12.9
Claims Ratio	52.7	56.5	63.8	52.0	60.7
Capital Adequacy Ratio	270.9	256.6	246.2	249.5	247.7
<b>Household (HH) Sector</b>					
HH Debt (RM billion)	1,338.6	1,376.4	1,409.1	1,451.4	1,481.0
HH Financial Assets (RM billion)	2,896.0	2,971.3	2,901.9	3,002.0	3,036.0
HH Debt-to-GDP Ratio	89.6	88.9	84.4	81.0	81.9
HH Financial Assets-to-Total HH Debt Ratio	216.3	215.9	205.9	206.8	205.0
HH Liquid Financial Assets-to-Total HH Debt Ratio	145.8	144.0	137.5	135.4	133.2
Impaired Loans Ratio of HH Sector (Bank Loans) <sup>2</sup>	1.2	1.1	1.3	1.2	1.3
Impaired Loans Ratio of HH Sector (Non-Bank Loans) <sup>4</sup>	1.5	1.0	1.1	1.1	1.3
<b>Business Sector</b>					
Return on Assets	2.2	2.5	2.7	2.5	2.1
Return on Equity	4.1	4.2	4.6	4.5	3.4
Debt-to-Equity Ratio	22.7	22.9	22.0	22.5	20.6
Interest Coverage Ratio (times)	7.0	7.3	7.9	6.5	5.5
Operating Margin	7.6	7.4	7.7	6.9	6.0
Impaired Loans Ratio of Business Sector <sup>2</sup>	2.9	2.8	3.0	2.8	2.8
<b>Development Financial Institutions<sup>5</sup></b>					
Lending to Targeted Sectors (% change)	6.2	3.6	3.0	1.3	2.4
Deposits Mobilised (% change)	7.5	1.4	2.3	3.9	1.8
Impaired Loans Ratio	5.5	4.8	5.4	5.5	5.9
Return on Assets	1.3	1.1	1.0	1.1	1.2

<sup>1</sup> Banking system profits are aggregated at the entity level and adjusted for dividend income received from domestic banking subsidiaries.

<sup>2</sup> Based on Stage 3 loans under the Malaysian Financial Reporting Standard 9 (MFRS 9).

<sup>3</sup> Excess income over outgo excludes investment-linked unit funds to reflect the core performance of ITOs' profitability more accurately and thus, may not be directly comparable to the data reported in previous publications.

<sup>4</sup> Based on loans with 3 months or more in-arrears.

<sup>5</sup> Refers to development financial institutions under the Development Financial Institutions Act 2002.

p Preliminary

Note: Figures may not necessarily add up due to rounding.

Source: Bank Negara Malaysia, Bursa Malaysia, Department of Statistics Malaysia, Employees Provident Fund, Securities Commission Malaysia, S&P Capital IQ.

Table A.2

**Key Financial Indicators: Islamic Banking and Takaful Sectors**

	As at end				
	1H 2021	2H 2021	1H 2022	2H 2022	1H 2023 <sup>p</sup>
<b>Islamic Banking System</b>	RM million (or otherwise stated)				
Total Assets <sup>1</sup>	1,139,095.2	1,191,622.4	1,236,239.2	1,316,121.5	1,343,223.8
% of total assets of entire banking system <sup>1</sup>	35.1	35.5	35.5	36.3	36.2
Total Financing <sup>1</sup>	841,507.2	879,159.0	915,901.3	974,383.5	993,226.8
% of total loans / financing of entire banking system <sup>1</sup>	41.5	42.3	43.0	44.5	44.7
Total Deposits and Investment Accounts <sup>1</sup>	933,749.8	968,918.4	1,001,104.9	1,058,671.8	1,075,999.2
Total Deposits <sup>1</sup>	820,390.9	844,293.4	865,763.1	926,471.6	933,153.2
Total Investment Accounts <sup>1</sup>	113,358.9	124,625.0	135,341.8	132,200.2	142,845.9
% of total deposits and investment accounts of entire banking system <sup>1</sup>	39.7	39.8	40.2	41.6	41.6
	%				
Total Capital Ratio	18.4	19.2	18.3	18.9	18.2
Tier 1 Capital Ratio	14.8	15.5	14.5	15.5	14.8
Common Equity Tier 1 Capital Ratio	14.3	15.0	14.0	14.8	14.1
Return on Assets	1.3	1.1	1.2	1.3	1.0
Net Impaired Financing Ratio	0.9	0.9	1.0	1.0	1.1
<b>Takaful Sector</b>	RM million (or otherwise stated)				
Takaful Fund Assets	43,223.1	45,803.0	46,780.0	49,864.4	52,464.9
Family	38,272.5	40,258.9	41,182.8	43,645.1	45,972.0
General	4,950.6	5,544.1	5,597.2	6,219.4	6,492.9
% of insurance and takaful industry	12.3	12.6	13.2	13.4	13.7
Net Contribution Income	7,189.0	6,614.6	8,588.5	7,715.3	8,973.5
Family	5,776.3	5,093.2	6,886.3	5,853.9	7,053.3
General	1,412.8	1,521.5	1,702.1	1,861.4	1,920.2
% of insurance and takaful industry	21.9	19.4	24.3	21.6	24.8
Family Takaful					
New Business Contribution	4,682.1	3,817.5	5,439.9	4,618.9	5,225.6
General Takaful					
Gross Direct Contribution	1,861.7	1,966.4	2,229.5	2,407.2	2,679.0
Claims Ratio (%)	51.8	50.7	60.0	61.0	64.3

<sup>1</sup> Including development financial institutions under the Development Financial Institutions Act 2002.

<sup>p</sup> Preliminary

Note: Figures may not necessarily add up due to rounding.

Source: Bank Negara Malaysia