BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Financial Stability Review

Second Half 2024

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Preface

This Financial Stability Review – Second Half 2024 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 and contains box article(s) on topics of special interest.

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

This document uses data available up to 31 December 2024, unless otherwise stated.

Contents

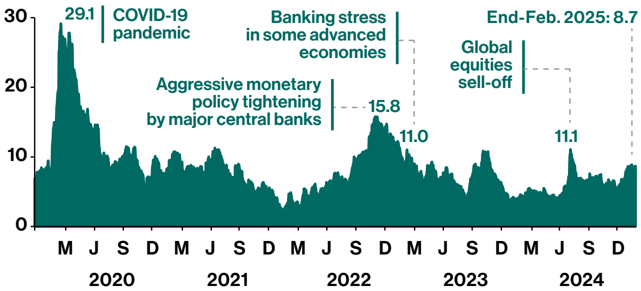
Key Highlights on
Financial Stability Review – Second Half 2024

Domestic financial markets remained orderly despite bouts of volatility

Slightly elevated market stress amid growing concern over escalating global trade tensions and disruptive AI innovations

Financial Market Stress Index (FMSI)

Stress level, % (Minimum=0, Maximum=100)



Spillovers to domestic financial stability are expected to be manageable, supported by ...

- Deep and liquid domestic capital markets
- Sustained demand for government bonds in the primary market
- Sound and resilient banking system
- Favourable economic prospects and domestic structural reforms

Financial institutions are well-capitalised with strong buffers to support financial intermediation for the economy

Banks continue to maintain strong capital and liquidity buffers

Banks

18.3%
Total Capital Ratio
(Jun. 2024: 18.5%)

160.7%
Liquidity Coverage Ratio
(Jun. 2024: 155.2%)

116.3%
Net Stable Funding Ratio
(Jun. 2024: 115.5%)

Insurers and takaful operators remained well-capitalised

Insurance

224%
Capital Adequacy Ratio
(Jun. 2024: 227%)

RM41.1 billion
Excess Capital Buffers
(Jun. 2024: RM37.4 billion)

Households and businesses' debt repayment capacity continued to be preserved supported by sustained economic activity

Households remained financially resilient amid favourable labour market conditions

Households

1.4x
Median Debt-to-Income Ratio
(Jun. 2024: 1.4x)

41%
Median Debt Service Ratio for New Loans
(2023: 40%)

2.1x
Financial-Asset-to-Debt Ratio
(Jun. 2024: 2.1x)

4.3%
Stage 2 Loans Ratio
(Jun. 2024: 4.4%)

Businesses continued to be resilient despite rising cost pressures

Businesses

6.4x
Interest Coverage Ratio
(Jun. 2024: 5.7x)

23.5%
Share of Firms-at-Risk (Overall Business)
(Jun. 2024: 27.7%)

1.6x
Cash-to-Short-Term-Debt Ratio
(Jun. 2024: 1.4x)

11.9%
Stage 2 Loan Ratio
(Jun. 2024: 12.4%)

Source: Bank Negara Malaysia, Bloomberg, Reuters and S&P Capital IQ

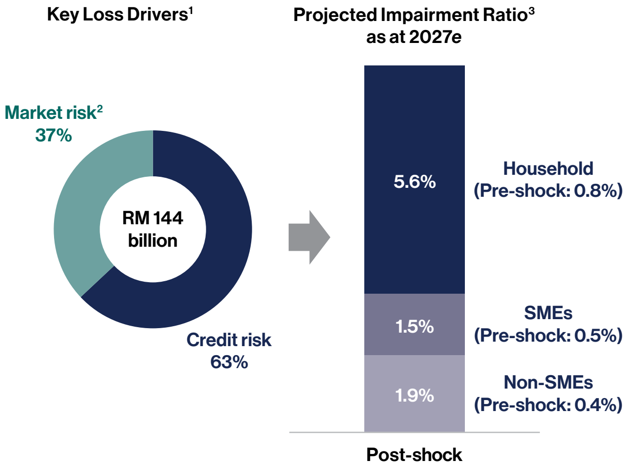
Latest stress test reaffirms financial institutions' ability to withstand adverse shocks and support economic growth

Two adverse scenarios more severe than the 2008 Global Financial Crisis and the 2020 pandemic were used to assess financial institutions' resilience

Stress Conditions		
	Adverse Scenario 1 : Severe GDP contraction followed by a rapid recovery	AS1
	Adverse Scenario 2 : Prolonged but milder GDP contraction followed by a sluggish recovery	AS2

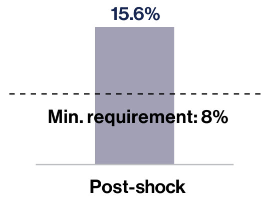
Credit risk remains the key driver of losses for the banking system

Banking System Losses Under AS2 (2025*e*–2027*e*)

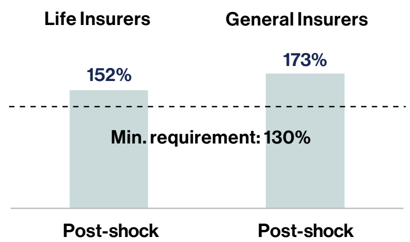


Aggregate post-shock[4] capital ratios remained above regulatory minima for banks and insurers

Banks: Total Capital Ratio Under AS2



Insurers: Capital Adequacy Ratio Under AS2



Box Article: Implementation of the Standardised Approach for Credit Risk (SA) – Key Revisions under Basel III and the Impact on Banks

The SA revision strengthens capital buffers that banks hold against shocks in two ways:

1 Improve the risk sensitivity and robustness of the SA in computing capital

Introduce new asset classes for corporate and real estate exposures with more granular asset classification and risk weights

- ✓ Better reflect underlying characteristic and risk profile of exposures
- ✓ Increase comparability with the Internal Ratings-based approach for Credit Risk (IRB)

2 Improve the quality and reliability of credit ratings used in capital computation

Introduce a due diligence requirement

- ✓ Risk management requirements to curb mechanistic reliance on external credit ratings

Expected impact on individual banks adopting the SA depends on their financing portfolios and risk profiles

	Financing Portfolios	Impact on Capital
Real Estate	Residential properties	▼ [5]
	Commercial properties	▼
	Land acquisition for development and development of properties	▲
Corporate	Corporate	▬
	Unrated specialised finance	▲
	Corporate SMEs	▼

▼ Reduced ▲ Increased ▬ Unchanged

At the industry level, total capital ratio of banks adopting the SA is expected to increase by 25 basis points[6]

e Estimated

[1] Loss numbers are consolidated losses from both domestic and overseas operations.
[2] Market risk for banks includes revaluation losses on bonds held in the fair value through other comprehensive income (FVOCI) portfolio.
[3] Impairment ratios reflect total impaired loans for each borrower segment as a share of total banking system loans.
[4] Refers to the lowest aggregate post-shock capital ratios over the 3-year stress test horizon.
[5] Assuming growth in property values remains stable.
[6] Based on the results from the Quantitative Impact Study for the position as at 31 December 2023.

Source: Bank Negara Malaysia

Overview

Overview

Global financial markets experienced heightened volatility towards the end of 2024, which is expected to continue in 2025. This was driven by ongoing uncertainties surrounding global monetary and trade policies as well as geopolitical developments. Domestic market stress continued to reflect these external developments, with the Financial Market Stress Index (FMSI) remaining at elevated levels compared to the first half of 2024. Notwithstanding this, domestic financial conditions remained orderly, with effective intermediation of two-way flows in the bond and equity markets. Funding conditions were further supported by healthy liquidity in the government bond market and narrowing corporate bond credit spreads. Interbank money market conditions also improved as banks' seasonal year-end funding demands eased. In the foreign exchange (FX) market, risks remain contingent upon global developments. Since the beginning of 2025, the ringgit has appreciated by 1.1% against the US dollar.[1] Ringgit performance will continue to be supported by Malaysia's strong economic fundamentals, alongside the ongoing implementation of structural reforms to boost the nation's competitiveness and growth potential.

Businesses were supported by sustained domestic and external demand conditions. However, cost pressures continued to weigh on businesses' financial performance in some sectors. Against this backdrop, healthy levels of cash buffers continued to support the overall debt-servicing ability of businesses. Correspondingly, the share of firms-at-risk showed broad-based improvement (December 2024: 23.5%; June 2024: 27.7%). While pockets of risks remained among small and medium enterprises (SMEs) given the persistent cost challenges, the share of delinquent SME loans declined further. A majority of SMEs that have exited repayment assistance programmes continue to be able to sustain their debt repayments. SMEs were also observed to demonstrate some agility in managing their cashflow such as renegotiating with suppliers or reducing their reliance on imported goods. Looking ahead, leading indicators suggest that risks of a widespread deterioration in credit quality are contained.

The share of business loans with increased credit risk (Stage 2 loans) declined further during the period. The overall business loan impairment ratio also declined to 3.1% of total business loans (June 2024: 3.5%). The favourable outlook for domestic demand and sustained exports are expected to continue to lend support to businesses amid the challenging operating environment.

Household resilience continued to be supported by favourable labour market conditions. Overall household debt growth was mainly driven by housing and car loans, while expansion in unsecured financing such as personal financing and credit card remained modest. Risks to households from buy now pay later (BNPL) schemes continued to be limited. While growing at a more rapid pace, outstanding BNPL exposures remained small at 0.2% of total household debt with stable repayment trends. Bank lending continues to be underpinned by sound underwriting standards and loan affordability assessments. This supported healthy debt-servicing capacity among households, with household credit growth closely tracking income levels. The median debt-to-income (DTI) ratio, a measure of borrower leverage, was stable at 1.4 times. The quality of borrowings also remained intact. Household loans with higher credit risk continued to decline to 4.3% of total household loans (June 2024: 4.4%). Some households with low financial buffers are more vulnerable and could face greater difficulties to service their debt amid rising costs of living. However, these borrowers continue to be limited to a small segment of household borrowers. Help for such borrowers also remains available through the Credit Counselling and Debt Management Agency (AKPK) and banks. Of note, the share of household borrowings under repayment assistance offered by banks and AKPK remained low at 1.9% of total banking system and development financial institution (DFI) loans.

Banks continued to maintain healthy liquidity buffers to ensure resilience against both short- and long-term shocks. The aggregate Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) stood at 160.7% and 116.3% respectively. Banks' profitability continued to be supported by higher interest income amid robust loan

[1] Data as of 10 March 2025.

growth and a slower pace of increase in interest expense. Despite improving asset quality, banks remained prudent in their provisioning practices. This reflected banks' continued vigilance, particularly over the potential impact of cost challenges on higher-risk borrower segments in both the household and business sectors. Banks remained well-capitalised against unexpected shocks, with the banking system's total capital ratio remaining healthy at 18.3% and capital buffers of RM136.8 billion, well above the regulatory minimum. This will continue to firmly support financial intermediation in the economy.

The insurance and takaful sector similarly remained resilient. The life insurance and family takaful funds recorded greater underwriting losses in the second half of 2024 due to elevated medical payouts. Overall profitability for the whole of 2024 was supported by the stronger equity market performance for the year. In addressing rising premiums of medical and health insurance/takaful (MHIT) policies, interim measures have been put in place by the insurance and takaful industry to assist affected individuals. Over the longer term, structural reforms to address underlying drivers of medical inflation will be crucial in ensuring the sustainability of MHIT business and continued access to protection against healthcare financing needs for the public. In the general insurance and takaful sector, gains in operating profits were mainly attributed to better underwriting performance in the motor segment. Overall, the insurance and takaful sector remained supported by strong capital and liquidity positions. The aggregate capital adequacy ratio of insurers and takaful operators (ITOs) stood at 224%, with excess capital buffers of RM41 billion.

The latest macro solvency stress tests conducted by BNM, which incorporated additional downside risks, continue to affirm the resilience of financial institutions against unexpected losses from severe macroeconomic and financial shocks. The stress tests revealed that the post-shock aggregate capital ratios for banks (15.6%), life insurers (152%) and general insurers (173%) remain above regulatory minima at the end of the stress horizon.

Maintaining cyber and operational resilience remains a key focus of BNM and financial institutions, particularly given the rapidly changing cyber threat landscape. Financial institutions continue to invest significant resources to ensure that adequate risk controls are in place and remain effective in managing emerging cyber risks. Banks are also developing more robust and integrated business continuity testing to preserve their ability to ensure uninterrupted service availability in an environment of increasingly complex inter-dependencies.

Key Developments in the Second Half of 2024

Key Developments in the Second Half of 2024

MARKET RISK

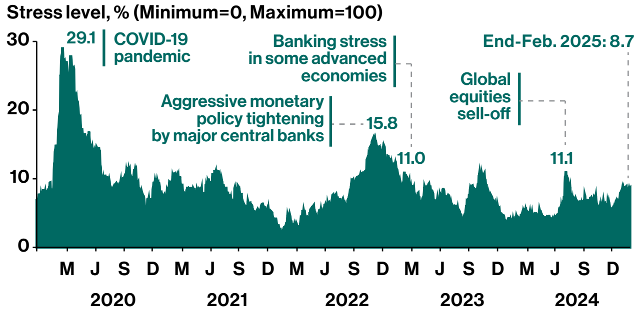
Domestic financial markets remained orderly despite bouts of volatility

Since the last Financial Stability Review in October 2024, major central banks have continued their respective monetary policy easing cycles as global inflation continued to moderate.[1] While loosening global financial conditions initially provided support to global financial markets, market volatility increased towards the end of 2024. This heightened volatility was fuelled by the uncertainty over the US' new administration policies, investors' expectations of a slowdown in US monetary policy easing and escalating geopolitical tensions in key regions. These factors are expected to continue contributing to heightened volatility of global financial markets in 2025.

As a small and open economy, Malaysia was not insulated from these external developments. Domestic market stress levels, as measured by the Financial Market Stress Index (FMSI), were elevated during the second half of 2024 relative to the first half of the year arising from these external headwinds (Chart 1.1). More recently in 2025, the FMSI increased slightly due to heightened volatility in the foreign exchange (FX) and equity markets. This was driven by market concerns on the possible escalation of global trade tensions and a potentially significant turning point in artificial intelligence (AI) development from China. Nevertheless, spillovers to domestic financial stability are expected to remain broadly contained. Orderly domestic market conditions will continue to be sustained given Malaysia's deep and liquid financial markets and sound banking system, providing sufficient buffer against global volatility.

[1] All data and assessments in the Market Risk section are from 1 October 2024 until 28 February 2025, unless stated otherwise.

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

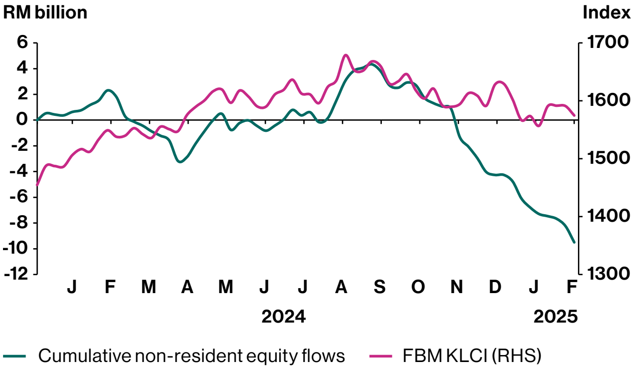


Source: Bloomberg, Reuters and Bank Negara Malaysia estimates

In 2024, the FBM KLCI gained 12.9% amid sustained economic performance, strong domestic corporate earnings and spillovers from data centre-related investments. The construction (+60.7%), utilities (+38.3%) and property (+31.5%) sectors were the top performers during the year, significantly benefitting from positive market sentiment towards equities linked to investments in the data centre space. Furthermore, the continued implementation of public investment initiatives under the various national master plans also contributed to the outperformance of the property and construction sectors. Despite the significant gains in the FBM KLCI, the domestic equity market experienced non-resident outflows amounting to RM4.2 billion in 2024 (2023: -RM2.3 billion, 2015–19 average: -RM7 billion) (Chart 1.2). In line with regional peers, this trend was driven mainly by the risk-off sentiment towards equities from emerging markets, including Malaysia, amid heightened global uncertainties.

Entering 2025, non-residents continued to be net sellers in the domestic equity market (January–February 2025: -RM5.3 billion), bringing the total non-resident investor outflows between October 2024 and February 2025 to RM13 billion (October 2023–February 2024: net inflows of RM1.6 billion). This was largely offset by support from domestic institutional[2] and retail investors who remained net buyers of domestic equities, with a total net purchase of RM12.6 billion during the period (October 2023–February 2024: -RM1.1 billion).

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



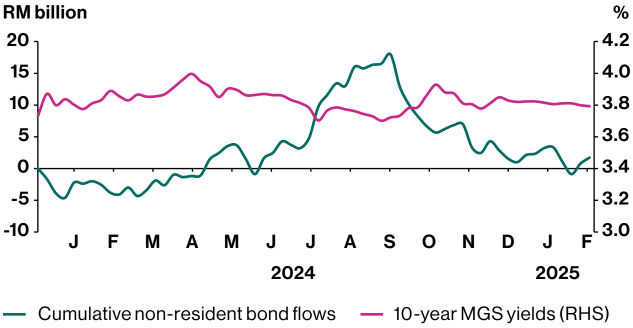
Source: Bloomberg

Non-resident flows in the government bond market remained largely influenced by external factors.

The 10-year Malaysian Government Securities (MGS) yields remained relatively stable, averaging at 3.8% between October 2024 and February 2025, despite higher non-resident outflows of RM13.9 billion during the period (October 2023–February 2024: -RM2.6 billion; 2024: RM1.3 billion) (Chart 1.3). The outflows followed a rise in 10-year US Treasuries (UST) yields, driven by market expectations of delayed and fewer interest rate reductions in the US and global uncertainties on potential trade restrictions. Consequently, yield differentials between 10-year MGS and 10-year UST widened to -41.5 basis points (bps) as at end-February 2025 (end-September 2024: -7 bps). Throughout this period, MGS yields continued to remain stable amid sustained market liquidity as demand by domestic institutional investors remained strong (October 2024–February 2025: net purchase of RM41.2 billion; October 2023–February 2024: RM36.6 billion; 2024: RM57.4 billion). This was also reflected in the healthy average bid-to-cover ratio of 2.5 times for government bonds in the primary market (2015–19 average: 2.3 times).

[2] Domestic institutional investors include banks, non-bank financial institutions (NBFIs) and insurers and takaful operators (ITOs).

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



Source: Bank Negara Malaysia and Bloomberg

Funding conditions in the corporate bond market remained conducive for fundraising, with RM37.6 billion raised between October 2024 and January 2025 (October 2023–January 2024: RM37.7 billion). Credit spreads between 10-year AAA-rated papers and 10-year MGS continued to narrow to 16 bps on average during the period (2024 average: 20 bps; 2023 average: 44.1 bps), reflecting sustained demand for corporate bonds by yield-seeking investors. Gross corporate bond issuances were sustained in 2024, amounting to RM121.6 billion (2023: RM117 billion). Issuances remained concentrated in high-quality papers, with government-guaranteed (GG) and AAA-rated papers accounting for more than half of the outstanding corporate bonds.

Total banking system liquidity declined in the second half of 2024, ranging between RM89 billion and RM108 billion (1H 2024: between RM97 billion and RM127 billion) amid increased festive demand for banknotes, particularly towards the year-end. Liquidity conditions however remained supportive of intermediation activity. This was supported by BNM's overnight reverse repo lending operations to ensure that overnight rates remain stable. The Malaysia Overnight Rate (MYOR) benchmark traded between 3.00% and 3.01% while the average overnight interbank rate (AOIR) ranged between 3.00% and 3.05%, both trading close to the Overnight Policy Rate (OPR) between October 2024 and February 2025. In addition to the existing regular 1-month and 3-month reverse repo facilities, BNM started offering the 7-day reverse repo facility daily since September 2024, with a standard issuance size of RM2 billion. The shorter borrowing tenure provides additional flexibility to banks in managing the maturity profile of their short-term funding. BNM's reverse repo lending facilities are done through auctions, ensuring that transactions are conducted at market rates.

In the unsecured term interbank market, rates generally trended higher between October 2024 and February 2025. Notably, the 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) rose to a high of 3.73% in December 2024, corresponding to movements in the more sparsely traded 3-month rate as banks shored up their buffers to meet seasonal year-end demands for liquidity. Since then, the 3-month KLIBOR has fallen back to 3.66% as at end-February. There were no significant changes in the more liquid 1-month unsecured rate during the period, with 1-month KLIBOR ranging between 3.27% and 3.29%. Meanwhile, in the term secured lending segment, trading volumes increased by 64% in 2024 to RM280 billion (2023: RM170 billion). This was driven by increased participation and interest of onshore banks to borrow and lend in the repo market. The 3-month secured interbank rates remained stable within the range of 3.37% to 3.52% (1H 2024: 3.37%–3.52%). BNM 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. As in the past, BNM stands ready to provide liquidity to banks via the reverse repo facility.

For 2024 as a whole, the ringgit appreciated by 2.7% to 4.4722 against the US dollar. The ringgit's positive performance was mainly driven by realisation of interest rate cuts by the US Federal Reserve, coordinated efforts between the Government and BNM to encourage repatriation and conversion of foreign currency income from resident entities, engagements with exporters and importers, as well as positive prospects of the Malaysian economy and policy reforms introduced by the Government. Liquidity improved further, with the daily onshore trading volume in the domestic FX market rising to USD17.6 billion in 2024 (2023: USD15.5 billion). While average ringgit volatility was higher between August and December 2024 at 5.7%, it remained below recent peaks (December 2022: 6.6%; March 2020: 8.1%). Year-to-date,[3] the ringgit has strengthened by 1.1% against the US dollar. Looking ahead, ringgit movement will continue to be largely driven by external developments. While financial markets could experience episodes of volatility due to global policy uncertainties, Malaysia's favourable economic prospects and domestic structural reforms, complemented by ongoing initiatives to encourage flows, will continue to provide enduring support to the ringgit.

[3] Data as of 10 March 2025.

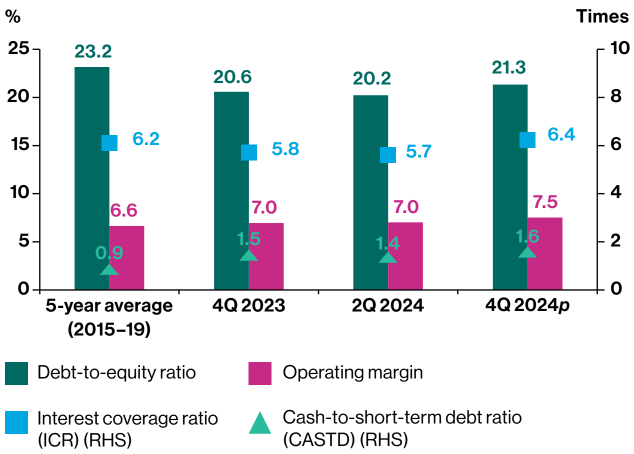
CREDIT RISK

Businesses remained resilient despite elevated cost pressures

Businesses continued to be resilient in the second half of 2024, underpinned by sustained domestic demand and continued growth in external demand. Firms in the construction sector experienced an uplift from new industrial and housing, as well as the ongoing multi-year infrastructure projects. Export-oriented firms continued to benefit from the global trade expansion and the technology upcycle. These developments supported revenue and helped businesses improve their debt-servicing ability, as measured by the median interest coverage ratio[4] (ICR) of 6.4 times (Chart 1.4). The overall share of firms-at-risk[5] correspondingly improved to 23.5% (June 2024: 27.7%) (Chart 1.5).

Operating margins have also recovered above pre-pandemic levels although businesses continued to face cost pressures. On aggregate, firms continued to report higher aggregate input costs, as measured by the median cost of goods sold ratio[6] of 76.9% (June 2024: 75.8%; 2015–19 average: 75.9%). While the relatively stronger

Chart 1.4: Business Sector – Key Financial Performance Indicators



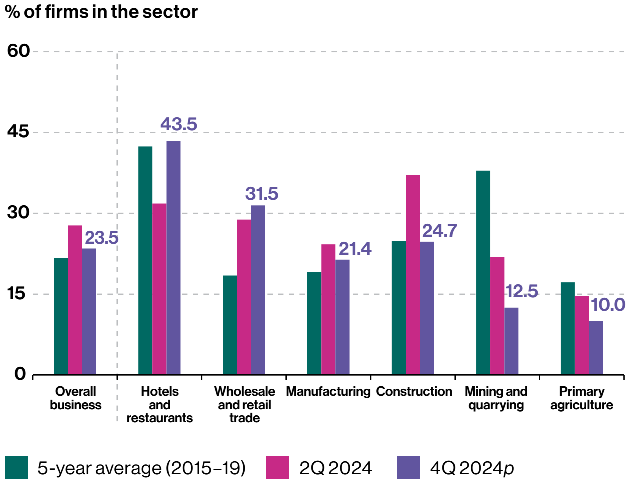
p Preliminary

Note: Prudent thresholds for ICR and CASTD are two times and one time, respectively.

Source: S&P Capital IQ and Bank Negara Malaysia estimates

ringgit compared to a year ago and the stabilisation of global commodity prices helped offset some of these pressures, firms in the manufacturing, wholesale and retail, as well as hotels and restaurants sectors faced persisting higher materials, labour and operating costs. Reflecting this, the share of firms-at-risk in these sectors also remained elevated. Looking ahead, continued cost challenges, the uncertainty surrounding global trade policies as well as domestic policy developments could continue to weigh on business performance, potentially delaying more sustained improvements in firms-at-risk. Notwithstanding this, debt-servicing capacity, including for firms in sectors still facing cost pressures, has continued to be supported by healthy cash buffers with the cash-to-short term debt ratio close to or above historical levels (Chart 1.6).

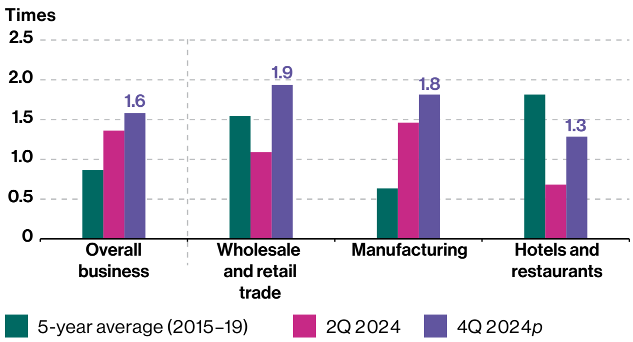
Chart 1.5: Business Sector – Firms-at-risk for Selected Sectors



p Preliminary

Source: S&P Capital IQ and Bank Negara Malaysia estimates

Chart 1.6: Business Sector – Cash-to-Short-term Debt for Selected Sectors



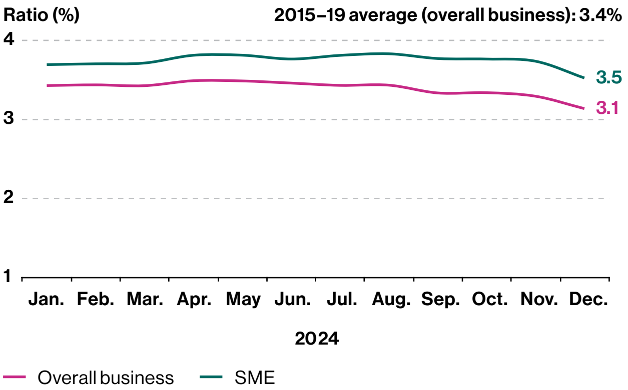
p Preliminary

Source: S&P Capital IQ and Bank Negara Malaysia estimates

4 Prudent threshold for interest coverage ratio is two times.
5 Firms-at-risk refers to firms with interest coverage ratio below the prudent threshold of two times.
6 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.

The credit quality of business loans continued to improve in the second half of 2024, reflecting broad-based improvement across non-SME and SME borrowers. The overall business loan impairment ratio declined to 3.1% of total business loans (June 2024: 3.5%) (Chart 1.7). The leading indicator of loans with significant increase in credit risks (Stage 2 loans) has also improved (December 2024: 11.9% of business loans; June 2024: 12.4%). Nonetheless, pockets of risks remained among SME borrowers given persistently elevated costs. SMEs have adopted multiple strategies to manage their cashflow (see information box on 'SMEs' Strategies to Navigate an Elevated Cost Environment') which is a good indication of firms' ability to meet current obligations, including loan repayments. Consistent with this, most SMEs remained resilient with the share of delinquent[7] SME loans declining further to 1.6% (June 2024: 1.7%). The share of loans under repayment assistance correspondingly also continued to trend lower to 4.2% of total SME loans (June 2024: 4.7%), or 0.7% of total banking system and development financial institution (DFI) loans. The vast majority of SMEs that have exited repayment assistance have been able to resume and sustain prompt repayment of their loans. New enrolments into rescheduling and restructuring (R&R) programmes by banks also continued to remain small at 0.2% of total SME loans. The number of new SMEs enrolled into the Credit Counselling and Debt Management Agency's (AKPK) repayment assistance schemes (RAS) continued to rise since AKPK took over the Small Debt Resolution Scheme (SDRS) in 2020 (Chart 1.8). This has been partly attributable to greater awareness of AKPK as an alternative channel for distressed borrowers to help manage their debt. Other indicators do not appear to suggest a broader increase in SMEs facing financial distress, as corroborated by a much slower rate of increase in new SME enrolments with AKPK's RAS. The share of debt managed under the schemes also remained very small at only 0.1% of total SME loans.

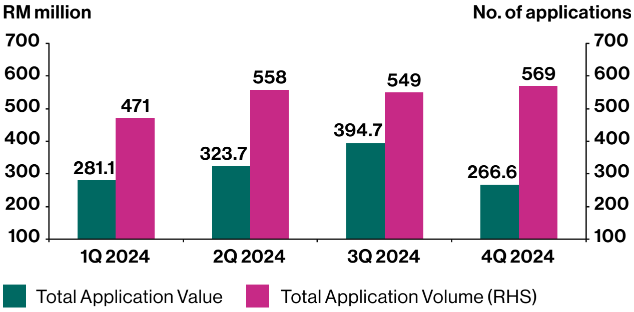
Chart 1.7: Business Sector – Gross Impaired Loans



Note: Data refers to banking system and development financial institution (DFI) loans.

Source: Bank Negara Malaysia

Chart 1.8: Business Sector – SME Applications for AKPK Repayment Assistance



Note: The AKPK Repayment Assistance total application value has been revised following the adoption of a system that reflects the latest requirements with more accurate data capture and reporting methodology.

Source: Credit Counselling and Debt Management Agency (AKPK)

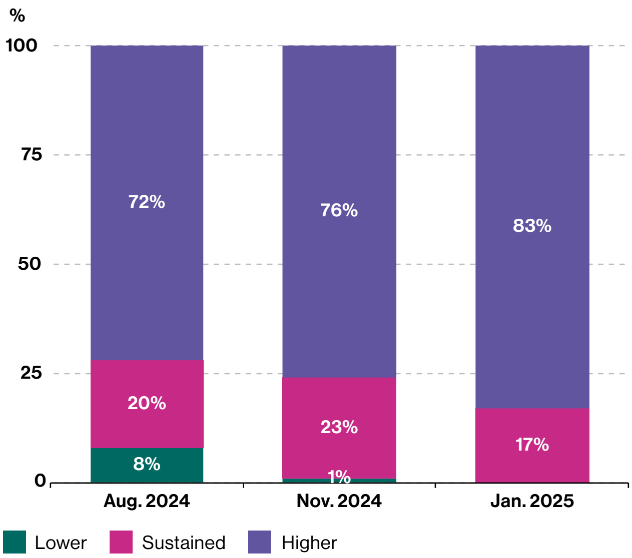
[7] Refers to loans with one or two months in arrears, or between 30 and 90 days past due.

SMEs' Strategies to Navigate an Elevated Cost Environment

BNM expanded its regional surveillance to include assessments on SME credit risk in the second half of 2024. Direct engagements with SMEs[8] were conducted via BNM Regional Offices to gauge real-time financial conditions and challenges faced by SMEs.

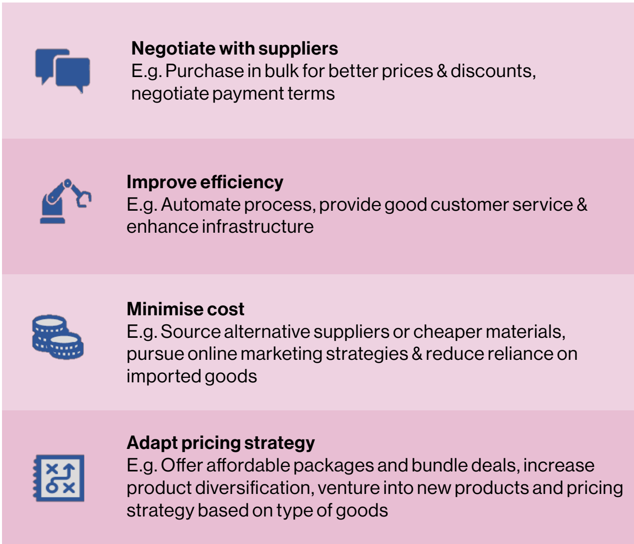
Based on the engagements, most SMEs cited concerns on elevated costs in the second half of 2024 despite having a resilient growth outlook. The higher input cost environment is expected to continue in 2025 (Chart 1.9), stemming mainly from rising global commodity and raw material prices as well as increasing operating costs (e.g. labour costs due to higher minimum wage and utility cost due to the electricity tariff hike). In the near term, a majority of SMEs planned to maintain prices to remain competitive by adopting alternative strategies to manage cost pressures (Diagram 1.1).

Chart 1.9: Business Sector – SMEs' Business Cost Outlook for 2025



Source: Bank Negara Malaysia's engagements with SMEs

Diagram 1.1: Business Sector – Strategies Adopted by SMEs to Cope with Elevated Costs



Source: Bank Negara Malaysia's engagements with SMEs

8 A total of 240 SME businesses across the country were engaged between August 2024–January 2025, covering the areas of business performance and challenges, access to finance as well as loan repayment behaviour of the SMEs.

The credit quality of borrowings of larger corporates generally improved amid firm economic growth. For the top 25 percent of listed firms (by asset size), the median ICR was comfortably above the prudent threshold at 6.1 times (June 2024: 5.6 times). The quality of corporate bond issuers also remained strong, with only six issuers (June 2024: five issuers), or 0.9% of total outstanding domestic corporate bonds downgraded in the second half of 2024.

Corporates' external borrowings increased to RM588.3 billion in the second half of the year (June 2024: RM569.1 billion). Around 60% of external borrowings comprise lower risk exposures in the form of intercompany loans, which are accorded flexible terms, and trade credits. Risks are further mitigated by the large share of corporate external debt exposures (71%) which have longer maturities of more than one year, thus reducing rollover risk. These exposures also remained adequately covered by assets, with corporate external assets at one time of corporate external debt. As at end-2024, the external debt-at-risk[9] for corporates declined to RM7.8 billion (2023: RM9.2 billion) which is equivalent to only 1.3% of total corporate external debt. Additionally, risks from a currency mismatch are assessed to be limited as most of the exposures of large resident-controlled corporates are hedged either naturally or financially. The share of large resident-controlled corporates' external borrowings that may be susceptible to exchange rate volatility remained stable at

9 Corporate external debt-at-risk refers to offshore loans raised and bonds issued by high-risk corporate borrowers. These borrowers are classified as high-risk when more than 50% of their total domestic loan exposures are classified in Stage 2 and Stage 3.

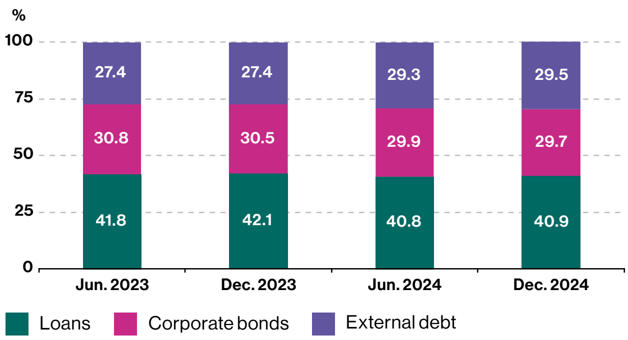
23% of these corporates' total external debt,[10] equivalent to only 1.7% of total business debt. Moreover, the small number of unhedged borrowers have minimal domestic borrowings (less than 0.6% of total domestic banking loans), thus limiting contagion risks to domestic financial stability. In the period ahead, global uncertainties and geopolitical developments could increase FX risks faced by corporates during episodes of heightened volatility in financial markets. However, risks are expected to remain contained given the above mitigating factors.

Financing conditions remained supportive of business needs, with businesses continuing to utilise a stable mix of funding sources (Chart 1.10). Business loans grew by 5.1% (June 2024: 5.7%), driven mainly by investment-related loans amid the favourable economic conditions. In line with this, corporate bond issuances also increased, resulting in a slightly higher annual growth of outstanding corporate bonds of 3.3% (June 2024: 3.2%). The increase was driven mainly by the construction and manufacturing sectors for working capital and new investments, as firms took advantage of the relatively cheaper borrowing cost in the capital market given the narrowing of corporate bond spreads.

Looking ahead, risks are expected to remain manageable given the favourable outlook for domestic demand and exports, although there are continued concerns over challenging operating conditions. These include the uncertainty surrounding geopolitical tensions and international trade policies, as well as elevated cost environment, which will have a bearing on the near-term financial outlook for businesses.

Stress tests[11] conducted by BNM affirmed that banks' capital buffers are sufficient to absorb a potential increase in credit losses from the business sector under adverse stress scenarios. Furthermore, the SDRS and corporate debt resolution mechanisms via the Companies (Amendment) Act 2024 continue to provide restructuring options for distressed but viable firms.

Chart 1.10: Business Sector – Composition of Debt by Type



Note: Figures may not add up due to rounding.
Source: Bank Negara Malaysia

[10] Corporate external debt from these large resident-controlled corporates consists of borrowings from non-related entities, as well as bonds and notes. It excludes low risk external debt such as intercompany loans, which are normally more flexible, and trade credits, which are backed by export earnings.

[11] Refer to section on 'Assessing the Resilience of Financial Institutions' for more details.

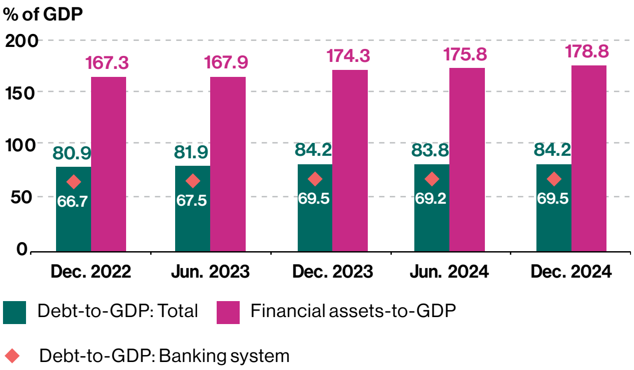
Steady expansion in household debt, with favourable labour market conditions and improving economic activity supporting household resilience

The aggregate household debt-to-GDP ratio edged higher to 84.2% (Chart 1.11) as household debt[12] continued to expand at a steady pace of 5.9% (Chart 1.12) in the second half of 2024, in line with continued improvements in labour market conditions and economic activity. The growth in overall debt was mainly driven by housing and car loans, collectively comprising 74.6% (Chart 1.13) of household debt. Housing loan growth was bolstered by robust activity in the residential property market amid measures to encourage homeownership, with further incentives announced in Budget 2025[13] expected to provide continued support into 2025 (see Information Box on 'Developments in the Property Market'). Meanwhile, the take-up of car loans was sustained by strong car sales in 2024.[14]

Despite sustained household spending recorded in the second half of 2024, the take-up of unsecured financing such as personal financing and credit card debt remained relatively stable as indicated by the year-on-year growth of 3.5% and 8% as of December 2024 (June 2024: 3.3% and 8.9%) respectively. The combined share of personal financing and credit card debt has remained largely unchanged at 15.3% (June 2024: 15.2%) of total household debt. Of note, the expansion in both personal financing and credit card debt was minimal among the lower-income segment and predominantly driven by higher-income borrowers. The latest Financial Capability and Inclusion Demand Side (FCI) survey[15] indicated that despite being more affected by cost pressures, lower-income households are more likely to turn to family or savings rather than borrowing from financial institutions, in the event of shocks. A closer look at credit card usage indicators also points to a declining share of revolving credit. The proportion of outstanding credit card balances that are not paid in full when they are due continued to decline (2H 2024 average: 48.2%; 1H 2024 average: 49%), while the share of revolvers[16] as a proportion of total credit cardholders has remained broadly stable (2H 2024 average: 24%; 1H 2024 average: 24.2%).

Two notable developments during the period warrant continued vigilance. Following the implementation of the upward revision of civil servant salaries, an uptick in personal financing disbursements to civil servant borrowers has been observed since December 2024. Monthly personal financing disbursements to civil servant borrowers increased sharply to an average of RM6.4 billion in December 2024 and January 2025 (2023–24 monthly average: RM3.6 billion), outstripping personal financing disbursements to other borrowers which expanded more moderately at an average of RM4.5 billion in the same period (2023–24 monthly average: RM4.1 billion). Banks generally continue to observe prudent lending standards, including conducting affordability assessments that also take into account minimum net disposable income in addition to limits on debt service ratio (DSR). Secondly, organised fraudsters have targeted borrowers with repayment arrears, mostly civil servants, to refinance their existing debt while significantly increasing their debt exposures with the false promise of lucrative returns from dubious investment schemes. Both developments have so far been contained with banks increasing their vigilance during credit assessments alongside an intensification of financial education efforts. Crucially, sound lending standards observed by banks will remain key to support household resilience, particularly among non-prime borrowers[17] in an environment of rising costs of living.

Chart 1.11: Household Sector – Key Ratios



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

[12] Extended by both banks and non-bank financial institutions.

[13] This includes individual income tax relief of up to RM 7,000 for first-time home buyers purchasing properties below RM500,000 and up to RM5,000 for first-time home buyers purchasing properties between RM500,000 and RM750,000. The relief allows claims for a maximum of three years (i.e. the first three consecutive years of mortgage interest payments) for properties purchased between January 2025 and December 2027.

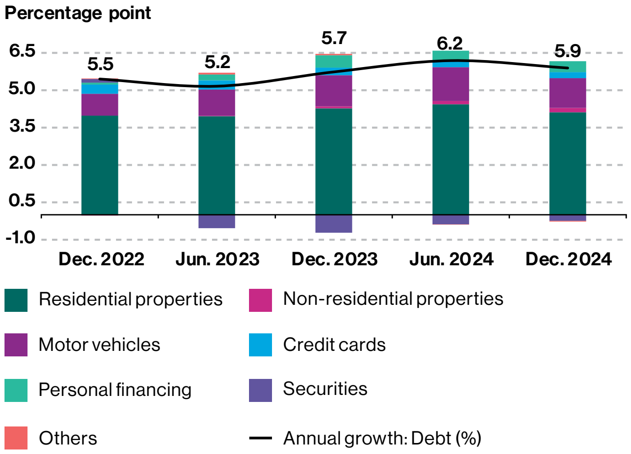
[14] Sales of new motor vehicles surpassed 800,000 units in 2024, driven mainly by the passenger cars subsegment. The strong sales figures were further supported by resilient domestic economy and successful new model launches (source: Malaysian Automotive Association).

[15] See the Feature Article on 'Financial Capability and Inclusion Demand Side Survey 2024' in BNM's Annual Report 2024 for more details.

[16] Refers to credit cardholders who only pay a portion of their outstanding balance due.

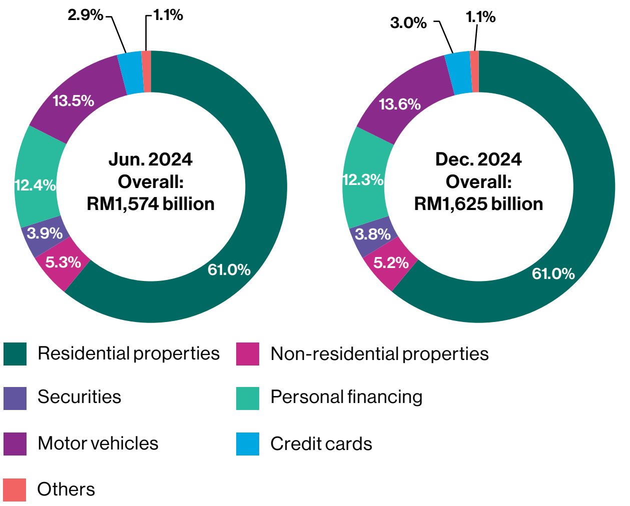
[17] Refers to less-creditworthy borrowers, including those with records of missed repayments.

Chart 1.12: Household Sector – Annual Growth of Debt



Source: Bank Negara Malaysia

Chart 1.13: Household Sector – Composition of Debt by Purpose

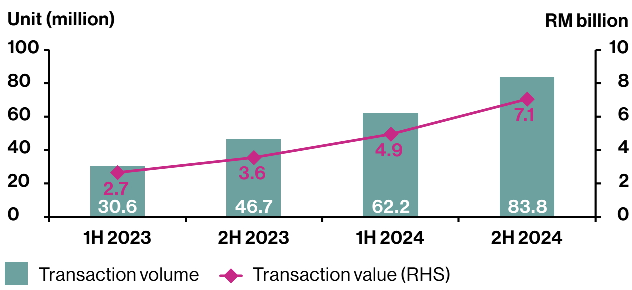


Note: Figures may not add up due to rounding.

Source: Bank Negara Malaysia

Buy now pay later[18] (BNPL) schemes continued to see sustained interest among consumers. While BNPL activity has grown rapidly, total outstanding BNPL debt remained a small proportion of overall household debt at RM2.8 billion, equivalent to 0.2% of total household debt as of December 2024. In the second half of 2024, the total amount of purchases made via BNPL, both in terms of transaction volume and value, increased to 83.8 million transactions and RM7.1 billion (1H 2024: 62.2 million transactions and RM4.9 billion) respectively (Chart 1.14).[19] As of end-December 2024, the number of active[20] users reached 5.1 million (June 2024: 4.3 million). BNPL providers have also been observed to offer facilities for higher-value transactions alongside longer instalment periods of up to 24 months (compared to the typical one to six months previously observed). Nonetheless, risks associated with BNPL remain contained. The level of BNPL overdue amount[21] remained low at 2.9% of total BNPL outstanding balances during the period (June 2024: 2.6%). BNPL providers also continue to observe practices that serve to mitigate concerns over broader risks from distressed borrowers. These include observing lower credit limits for new users, immediately suspending facilities upon a missed repayment, and proactively managing credit limits of users with anticipated repayment difficulties. Furthermore, the enactment of the Consumer Credit Act (CCA) in 2025 will enable the establishment of the Consumer Credit Commission to regulate and supervise non-bank credit providers and credit service providers which are currently not regulated, including businesses offering BNPL schemes. This will strengthen existing regulatory and supervisory arrangements for the protection of credit consumers.

Chart 1.14: Household Sector – BNPL Transaction Value and Volume



Note: Data refers to BNPL transactions with non-bank providers.

Source: Consumer Credit Oversight Board Task Force

Lending to households continued to be underpinned by sound credit underwriting standards. Overall household indebtedness continued to track income levels with the median debt-to-income (DTI) ratio (a measure of borrower leverage) remaining stable across borrowers at 1.4 times in 2024 (June 2024: 1.4 times; December 2023: 1.4 times). Borrowers' debt-servicing capacity, as

[18] All BNPL figures refer to transactions made by users of non-bank BNPL providers only.

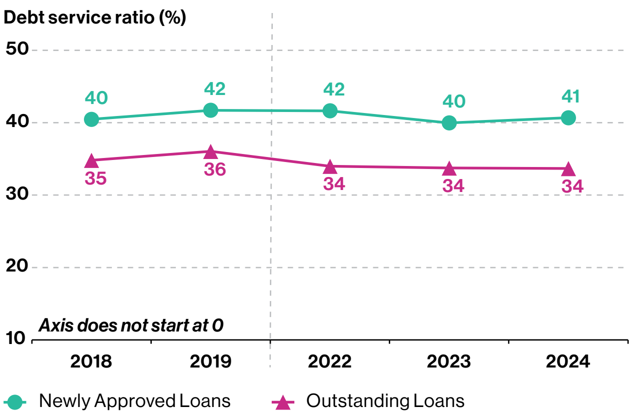
[19] The transactions were diversified across different merchant sectors, such as retail, food and restaurant, professional and commercial services, and transportation.

[20] Refers to BNPL accountholders with at least one BNPL transaction in the past 12 months. A credit consumer may own multiple BNPL accounts with different providers.

[21] Refers to BNPL accounts with one or more days past due.

measured by the DSR, also remained healthy with limited evidence of borrowers overstretching themselves to take on new credit. The median DSRs[22] of borrowers with newly approved loans and outstanding loans remained relatively stable at 41% and 34% in 2024 (2023: 40% and 34%) respectively, providing adequate buffers for households to meet their loan obligations (Chart 1.15). The share of borrowers deemed riskier[23] correspondingly remained small, accounting for 6.5% of total household borrowers (June 2024: 6.1%). Impairments among these borrowers remained low at 1% of their total exposures (June 2024: 1.2%).

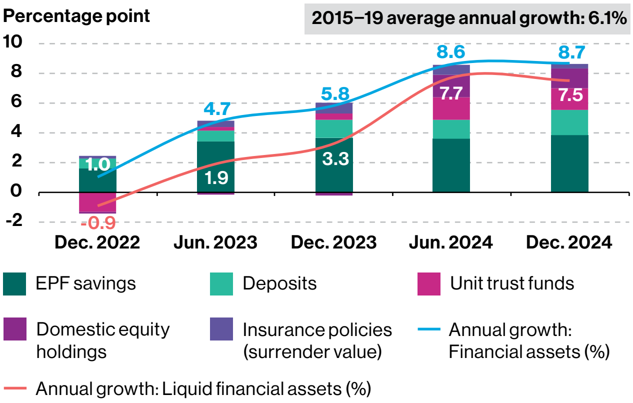
Chart 1.15: Household Sector – Median Debt Service Ratio of Borrowers with Newly Approved Loans and Outstanding Loans



Source: Bank Negara Malaysia

Household balance sheets remained sound. On aggregate, household financial assets remained in excess of debt by 2.1 times, providing households with healthy buffers against adverse shocks. In line with improvements in employment and income conditions, household financial assets grew strongly (8.7%; June 2024: 8.6%; 2015–19 average: 6.1%) (Chart 1.16) driven by (i) higher savings held in the Employees Provident Fund (EPF) and deposits, and (ii) improved valuation of domestic equity holdings amid the favourable market performance of Bursa Malaysia in 2024. Collectively, savings held in the EPF and deposits accounted for 67.6% of total financial assets. Growth in EPF savings was also bolstered by higher voluntary contributions by members including through the i-Saraan scheme.[24] Although the introduction of Akaun Fleksibel allows EPF members to withdraw savings for their short-term needs, only 31% of the total eligible members were reported to have availed of this flexibility to date.[25] Meanwhile, retail participation in the domestic equity market has returned to pre-pandemic levels at 19% in the second half of 2024 (1H 2024: 22%; 2015–19 average: 19.3%). This would reduce the impact of equity price movements on household balance sheets. As observed previously, loans for the purchase of quoted securities also remained small at 0.5% of total banking system loans (June 2024: 0.5%).

Chart 1.16: Household Sector – Annual Growth of Financial Assets

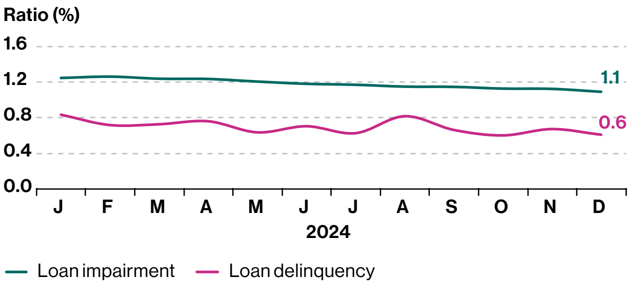


Source: Bank Negara Malaysia, Bursa Malaysia, Employees Provident Fund and Securities Commission Malaysia

The quality of borrowings improved against the backdrop of favourable labour market conditions and sustained income growth. Loan delinquencies and impairments have declined across all income groups and most loan purposes (Chart 1.17). New signs of stress also remain muted with the share of household loans classified as Stage 2 (identified as having higher credit risk) declining further to 4.3% (June 2024: 4.4%; peak (December 2021): 8%). Vulnerabilities remain confined to a small segment of borrowers with low buffers and who are more impacted by rising costs or changes in their financial circumstances (such as income reduction, job loss or having to deal with unanticipated expenses). While the take-up of loan assistance offered by banks and AKPK continues to be high, driven by intensified efforts to proactively assist borrowers facing financial difficulties, the share of new loans under assistance remained small at 0.3% of total banking system and DFI loans (June 2024: 0.3%). Overall, the total share of household borrowings under repayment assistance (banks' R&R and AKPK's Debt Management Programme, DMP) continued to decline and remained low at 1.9% of total banking system and DFI loans (June 2024: 2%).

[22] Beginning June 2024, DSR figures have been revised following refinements to improve the accuracy in capturing the debt servicing burden of borrowers with joint loan accounts. Thus, DSR figures may not be directly comparable to those reported in previous publications.
[23] Refers to borrowers with high DSR (exceeding 60%) and low net disposable income (below RM1,000).
[24] A voluntary contribution for self-employed persons and casual workers without fixed income.
[25] A total of RM12.2 billion has been withdrawn from EPF Akaun Fleksibel as of December 2024. This involves 31% of EPF members below the age of 55 years old (source: Employees Provident Fund).

Chart 1.17: Household Sector – Loan Impairment and Delinquency Ratios



Note: Data refers to banking system and development financial institution (DFI) loans.

Source: Bank Negara Malaysia

Moving forward, households' debt-servicing capacity will continue to be supported by favourable labour market conditions and sustained income growth. Continued efforts to rationalise blanket government subsidies in 2025 are not expected to significantly affect household financial resilience given corresponding income support measures that are anticipated to still be available to most households.

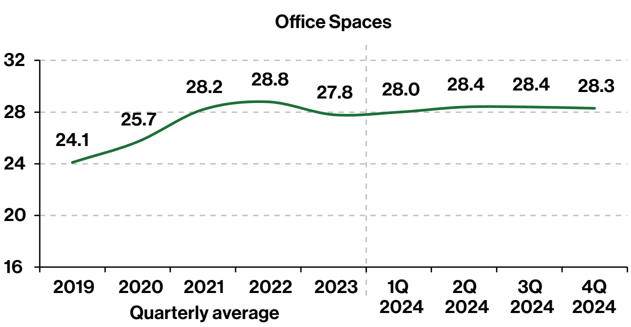
Income growth, supported by policies such as the upward revision of the minimum wage and civil servant salaries, is expected to further improve households' resilience. While improvements in household income may in turn contribute to a faster pace of debt expansion commensurate with the higher borrowing capacity of households, credit risk is expected to be contained given the sound lending practices of financial institutions.

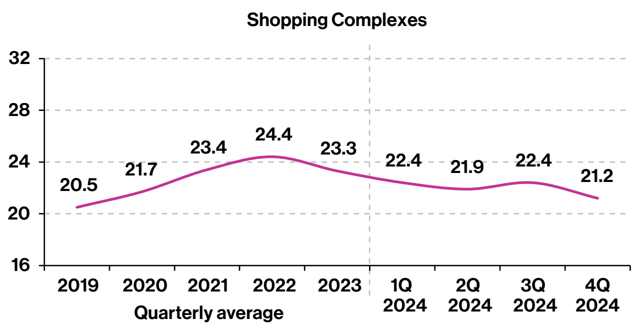
Stress tests conducted by BNM show that under adverse scenarios of high unemployment rate and high inflation, some segments of vulnerable borrowers such as lower-income borrowers and highly-indebted borrowers with thin financial buffers remain susceptible to financial distress. The latest stress test showed that up to 5.6% of total banking system loans from the household sector are at risk of defaulting by end-2027, in the event of severe labour market shocks with the unemployment rate reaching as high as 6%. However, this remains within the comfortable range of banks' excess capital buffers (refer to the section on 'Assessing the Resilience of Financial Institutions' for more details).

Developments in the Property Market

In the non-residential property (NRP) sector, risks remained contained despite continued challenges in the office space and shopping complex (OSSC) segments in the second half of 2024. Concerns surrounding elevated vacancy rates for office spaces remained as new supply continued to outstrip demand. The total stock of office space[26] in the Klang Valley increased further to 121.7 million square feet in the fourth quarter of 2024 (2Q 2024: 121 million square feet). Continued observations of preferences for more flexible tenancy contracts and hybrid work arrangements suggest adjustments in supply still have some way to go. As at the fourth quarter of 2024, vacancy rates in the office space segment remained elevated at 28.3% (3Q 2024: 28.4%; 2Q 2024: 28.4%). Meanwhile, the shopping complex segment improved slightly during the period as observed by the marginal decline in vacancy rates amid higher footfall and favourable demand conditions (Chart 1.18).

Chart 1.18: Property Market – Vacancy Rate of Office Spaces and Shopping Complexes



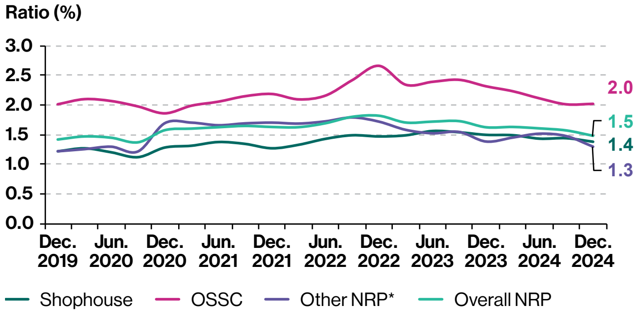


Source: National Property Information Centre (NAPIC) and Bank Negara Malaysia estimates

[26] Source: Jones Lang Wootton.

Risks to financial stability arising from the longstanding weaknesses observed in the OSSC segments are assessed to remain contained. Exposures of the banking system to the OSSC segments are limited, representing only a small share of total banking system loans (2.5%; June 2024: 2.6%). The asset quality of OSSC loans remained stable with an impairment ratio of 2% as at end-December 2024 (June 2024: 2.1%) (Chart 1.19). The median outstanding loan-to-value (LTV) ratio for the OSSC segments also remained prudent (December 2024: 59.5%; June 2024: 58.9%). Looking ahead, the short-term outlook for OSSC remains cautious given existing weaknesses in the segments.

Chart 1.19: Property Market – Loan Impairment by Type of Non-residential Property Purchased

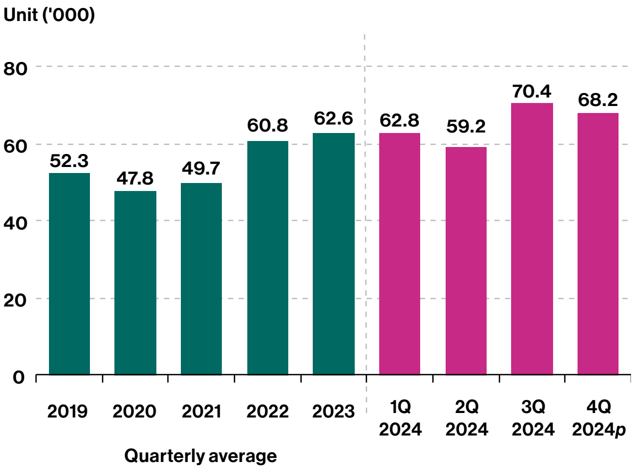


* Refers to loans for the purchase of industrial buildings, factories and land.

Source: Bank Negara Malaysia

In the residential property sector, market activity was robust in the second half of 2024, supported by conducive labour market and income conditions, availability of financing and ongoing incentives to promote homeownership. Market transactions increased, mainly driven by the mass-market segment (houses priced RM500,000 and below) (Chart 1.20). The number of overhang units[27] continued to decline (Chart 1.21). Nevertheless, unsold housing units under construction[28] continued to rise in 2024, reflecting the increase in new launches from previous years (2024*p*: 75,784 units; 2023: 66,576 units; 2021–22 average: 54,707 units).[29]

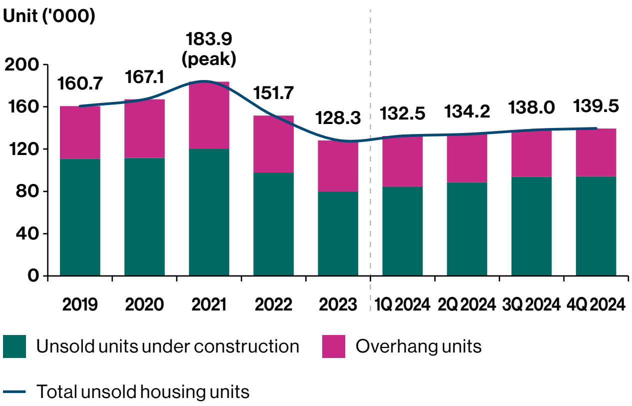
Chart 1.20: Property Market – Housing Transaction Volume



p Preliminary

Source: National Property Information Centre (NAPIC)

Chart 1.21: Property Market – Volume of Unsold Housing Units



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

Source: National Property Information Centre (NAPIC) and Bank Negara Malaysia estimates

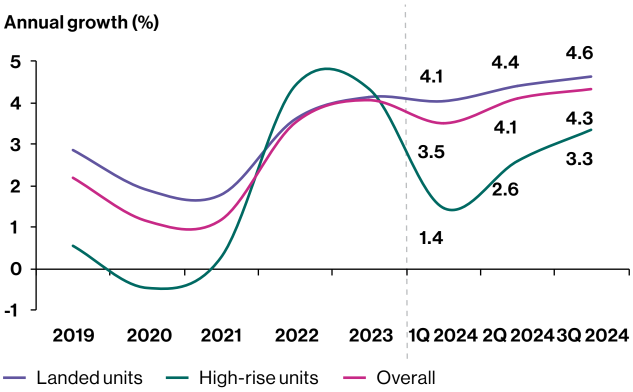
[27] Overhang units denote properties that are unsold for at least nine months after launch but are completed and have received a Certificate of Completion and Compliance.

[28] Unsold units under construction refer to properties that are unsold for at least nine months after launch but are still under construction.

[29] Excludes new launches of serviced apartments. Figures for 2024 are preliminary and often revised upwards in subsequent data releases, typically over the next two quarters.

Despite strong market activity, house price growth remained within a moderate range in the third quarter of 2024 (4.3%; 2Q 2024: 4.1%) (Chart 1.22). However, during the same period, the serviced apartment segment[30] registered a notable moderation in price growth, in contrast to the stronger overall price growth for high-rise units as defined in the Malaysian House Price Index (MHPI). Currently, the serviced apartment segment already forms 34.8% of total unsold housing units[31] despite comprising only 6.3% of the total estimated existing stock of dwelling units.[32] Coupled with persistent incoming supply, risks of a price adjustment remain for the segment. The direct risk from overall unsold units is, however, assessed to be low as loan exposures to developers with unsold properties, including serviced apartments, form only 0.9% of total banking system loans. Improving demand conditions have also limited broader spillovers to the residential property market that could stem from a prolonged period of weak house price growth due to unresolved unsold properties.

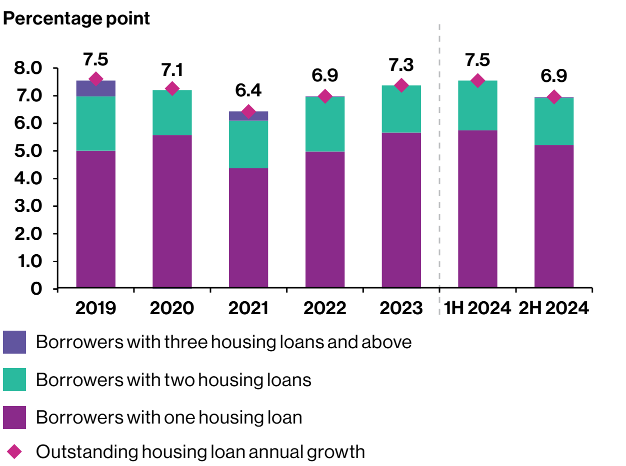
Chart 1.22: Property Market – Annual Growth of Malaysian House Price Index (MHPI) by Type



Note: High-rise units include condominiums, apartments and flats, but exclude serviced apartments.

Source: National Property Information Centre (NAPIC) and Bank Negara Malaysia estimates

Chart 1.23: Property Market – Contribution to Annual Growth of Housing Loans by Type of Borrower



Source: Bank Negara Malaysia

Banks remained forthcoming in providing financing to the residential property market. Financing for residential property construction, which further supports new launches in the market, expanded at 12.9% (June 2024: 4%; 2015–19 average: 9.5%). Overall outstanding housing loans grew by 6.9% year-on-year (June 2024: 7.5%), of which loans to owner-occupiers (proxied by individual borrowers with one housing loan, including first-time home buyers) contributed 5.2 percentage points to the annual growth. Signs of credit-fuelled investment activity were limited, as the contribution to housing loan growth from borrowers with three or more housing loans remained small (December 2024: 0.03 percentage points; June 2024: -0.01 percentage points) (Chart 1.23). On asset quality, housing loans were largely performing across all borrower types, in tandem with positive income growth. Sustained repayment capacity was observed, with the overall impairment ratio remaining low at 1.2% as at December 2024 (June 2024: 1.3%). Of note, individual property investors[33] were observed to exhibit low impairment ratios (0.9%), even when compared to owner-occupiers (1.3%). This appears consistent with the profile of investors, 80% of whom earn more than RM5,000 monthly.

The median LTV ratio of overall outstanding housing loans remained prudent, providing adequate cushion against a possible house price correction (December 2024: 69.7%; June 2024: 68.9%). With current stable economic conditions, risks of a severe price correction remain unlikely. Downside risks to financial stability emanating from the property market are assessed to remain low in the near term, underpinned by sound lending standards.

[30] As per the National Property Information Centre's (NAPIC) Serviced Apartment Price Index (SA-PI). This index was recently introduced by NAPIC in September 2024. In the third quarter of 2024, prices of serviced apartments grew by 2% in the Klang Valley, 3.9% in Johor Bahru and -0.1% in Pulau Pinang (4Q 2023: 5.4%, 4.7% and 3.7% respectively). Klang Valley consists of Kuala Lumpur and Selangor.
[31] Total unsold housing units here includes overall residential properties and serviced apartments.
[32] Over three-fifths of all unsold serviced apartment units are in the above RM500,000 price category.
[33] Individual property investors refer to borrowers with two or more outstanding housing loans.

OPERATIONAL RISK

Financial institutions remained operationally resilent

Preserving the operational and cyber resilience of financial institutions remained one of the key focus areas for BNM. In the second half of 2024, financial losses from operational risks reported by financial institutions continued to be small, accounting for only 0.03% of total banking system capital (1H 2024: 0.05%; 2H 2023: 0.03%). Financial institutions remain vigilant against operational disruptions, particularly given the rapidly evolving cyber threat landscape.

During the period, several cyber incidents were reported by the industry, although most of these were of minimal to low severity. The number of distributed denial of service (DDoS) attacks increased slightly, posing a persistent threat to the availability of financial institutions' online services. Financial institutions have in place adequate business continuity plans (BCP) to ensure their readiness to swiftly respond and recover from cyber incidents and minimise operational disruptions. BNM also continues to proactively monitor the cyber threat landscape and has intensified supervisory measures to combat and address these growing threats. These include updating policy requirements to address emerging risks and conducting targeted reviews to evaluate financial institutions' incident response capabilities.

Technical[34] and security debt[35] can contribute to an increase in the vulnerability of the financial industry to cyber threats. Given this, BNM has consistently required financial institutions to bolster their multi-layered defences. This includes ensuring that the rapid digitalisation of business processes is accompanied by adequate resources and expertise to manage execution risks and support operational resilience on a continuing basis amid evolving technological and cyber risks. Financial institutions' annual information technology (IT) expenditure has increased over the years, with a CAGR of 22% for the past three years. Notably, IT expenditure continues to represent a growing share of overall annual expenditure (2024: 23.3% of annual expenditure; 2023: 19.1%; 2022: 18.7%), reflecting its increasing strategic importance for financial institutions. The bulk of expenditures are towards:

- implementing technology refresh efforts, such as the replacement and adoption of better cybersecurity solutions;
- enhancing the management of IT infrastructure and network monitoring;
- augmenting threat intelligence and security monitoring services; and
- increasing training for IT and cybersecurity staff as well as key oversight and control functions to manage emerging cyber risks and trends.

The increase in annual IT expenditure was driven by major upgrades of data centre infrastructure to ensure operational resilience during peak periods, and the rapid pace of product innovation which has contributed to the heightened complexity of financial institutions' IT infrastructure operations. Several banks have launched multi-year programmes to modernise their IT systems. These include re-architecting their network and server infrastructures for better centralised control, agility and flexibility. Some banks continue to enhance IT operational efficiency such as through the adoption of cloud-based security solutions. Major banks primarily allocate capital expenditure to upgrade core systems approaching end-of-life, ensure a secure IT environment and enhance system capacity and backup infrastructure. In addition, development financial institutions and insurers and takaful operators are upgrading data centre capabilities to ensure prompt service recovery during peak periods, following regulatory expectations for high service availability to maintain public confidence. This is also amid a broader adoption of international standards and frameworks for robust information security management.[36]

As part of the increased efforts to ensure that financial institutions' BCP are comprehensive under a range of scenarios, banks were required to further develop more robust and integrated BCP testing. This will help preserve the continuity of banks' critical services and operations in an environment of increasingly complex inter-dependencies.

Financial institutions have identified managing cyber threats, ensuring regulatory compliance and mitigating

[34] Technical debt refers to the trade-off in IT where fixes, upgrades or improvements are delayed or implemented sub-optimally to meet deadlines or budget constraints. This results in additional future costs and effort to address accumulated and compounded issues.

[35] Security debt is a subset of technical debt that focuses on security, occurring when security best practices and protocols are deprioritised in favour of faster development or prioritisation in other areas. Over time, this leads to the gradual accumulation of vulnerabilities in the environment, making systems harder to defend and leading to higher costs and risks in the future.

[36] These include the ISO/IEC 27001 Information Security Management System (ISMS), the US National Institute of Standards and Technology (NIST) Cybersecurity Framework, and Payment Card Industry Data Security Standard (PCI DSS).

social engineering tactics by fraud criminals as their core priorities in managing operational risks for 2025.[37] This is amid increasing sophistication in the modus operandi of threats to the industry and heightened expectations for financial institutions to be able to assure continuous service availability and secure digital services. These risks are at the top of the list due to their rapidly evolving nature, in line with the constantly changing landscape of the financial sector (Diagram 1.2).

To facilitate a more comprehensive and streamlined surveillance of operational risks within the financial system moving forward, BNM has further enhanced the centralised reporting of operational risks to the Operational Risk Reporting (ORR) system to capture more operational risk-related data. The ORR system supports the reporting and assessment of operational risk incidents to BNM, as well as monitoring of incident response actions by financial institutions. It covers fraud, conduct and disruptive incidents occurring in financial institutions. With the increased interfaces between critical banking operations and payment ecosystems, the recent onboarding of payment system regulatees to the ORR system will also provide a more comprehensive view of the overall exposure and resiliency of the financial sector towards operational risks.

Payment and settlement systems continued to maintain high system availability.

The Real-time Electronic Transfer of Funds and Securities System (RENTAS) and major retail payment systems (RPS) continued to maintain a high level of operational resilience and system availability throughout the second half of 2024. There was no major operational or cyber incident during this period. As part of continuous efforts to maintain system resiliency, further enhancements to the business continuity management of RENTAS and major RPS were made to improve system recovery measures in the event of extreme but plausible cyber attacks. Further details on the oversight of payment services can be found in the chapter on 'Promoting Safe and Efficient Payments and Remittance Services' in BNM's Annual Report 2024.

Diagram 1.2: Key Operational Risks and Mitigating Actions

Cyber Threats	The pervasiveness of cybercrime-as-a-service, combined with the emergence of AI-driven attacks, make cyber threats more complicated and sophisticated.	• Strengthened requirements on third-party and supply chain cyber risk management. • Improved preparedness and response to cyber incidents through industry-wide cyber drills. • Increased cyber threat intelligence sharing via FinTIP.
Regulatory Non-Adherence	Stricter regulations and increasing public scrutiny are increasing demands on financial institutions to ensure compliance, particularly in regulatory reporting and ensuring the availability of online services.	• Regular industry engagements to facilitate alignment and promote sharing of best practices. • Strengthened internal control functions for timely identification and rectification of compliance gaps. • Intensified supervisory oversight on IT risk management by financial institutions.
Social Engineering	Evolving scam modus operandi, such as rogue application scams, are increasingly deceiving customers into revealing their banking credentials or other sensitive information.	• Continuously raising public awareness of scam modus operandi via multi-channel approach. • Cross-sectoral collaboration via the National Fraud Portal (NFP) for expedited fraud response. • Improved fraud detection capabilities in financial institutions to detect and block suspicious transactions.
Human Errors	The growing volume of transactions, coupled with evolving internal processes post-digitalisation, increases the risk of errors and operational lapses.	• Strengthened internal controls and more frequent updates to standard operating procedures (SOPs) to reflect process changes. • Continuous capacity building for staff to reduce operational lapses. • Use of analytic tools to detect and prevent recurring errors.
Business Disruptions	Greater reliance on technology, systems and third-party service providers (TPSPs) exposes financial institutions to risks of service disruptions and system outages.	• Enhanced monitoring of critical systems performance and potential threats, including critical services delivered or supported by TPSPs. • Robust business continuity and disaster recovery plans, which are regularly tested to ensure effectiveness.

Source: Bank Negara Malaysia

[37] Based on the 2024/2025 Emerging Operational Risk Survey conducted by BNM.

Financial Institution Soundness and Resilience

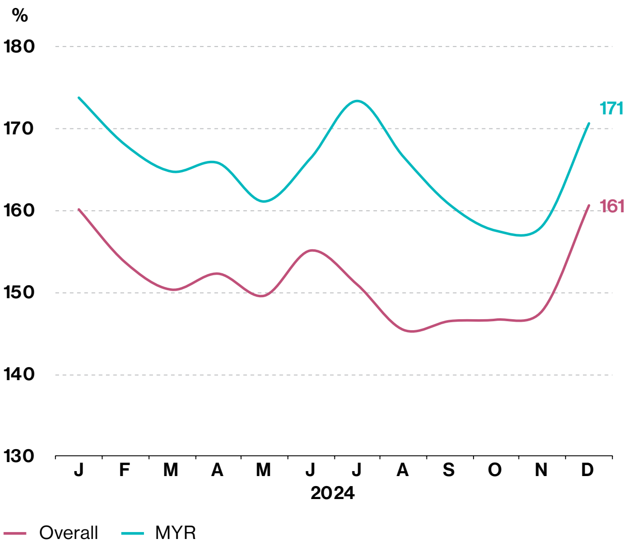
Financial Institution Soundness and Resilience

THE BANKING SECTOR

Banking system liquidity remained supportive of financial intermediation

Banks' liquidity and funding positions remained resilient against potential liquidity shocks in the second half of 2024. The aggregate Liquidity Coverage Ratio (LCR) (Chart 2.1) and Net Stable Funding Ratio (NSFR) (Chart 2.2) remained healthy and above regulatory minima, at 160.7% and 116.3% respectively as at end-December 2024 (June 2024: 155.2% and 115.5% respectively). Banks continued to hold adequate high-quality liquid assets (HQLA) (RM761.1 billion; June 2024: RM762.8 billion), mostly in the form of central bank placements and government bonds, which can be pledged in the interbank market or with BNM for access to additional liquidity.

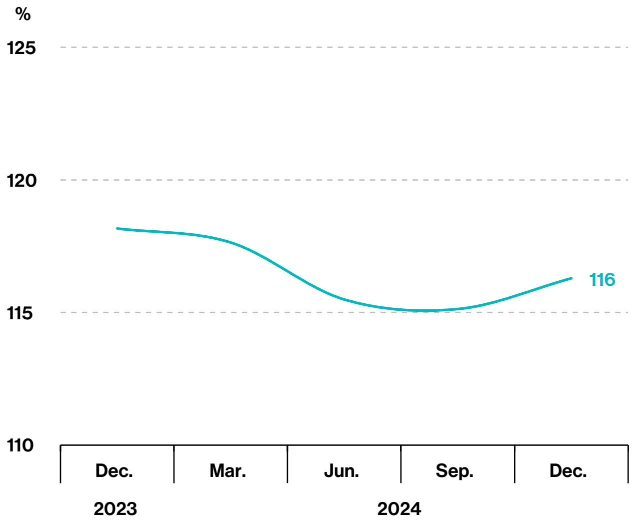
Chart 2.1: Banking System – Liquidity Coverage Ratio



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

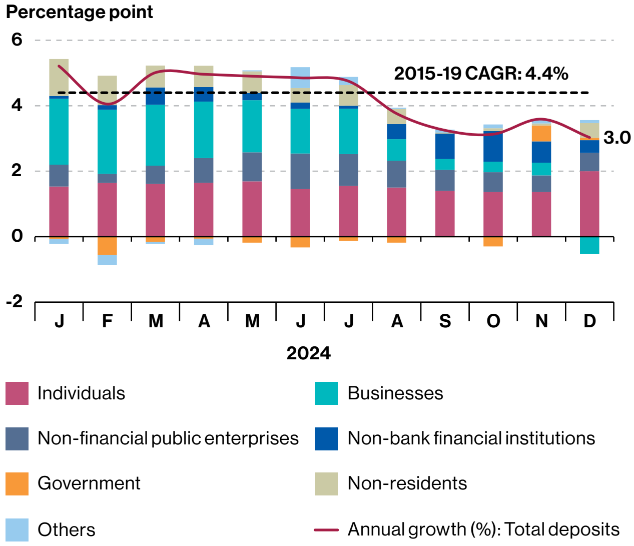
Banking system deposits grew at a slower pace of 3% in the second half of 2024 (2015–19 CAGR: 4.4%) (Chart 2.3), driven by the slower growth of deposits of resident businesses (including non-financial public enterprises) (year-on-year growth: 0.1%; June 2024: 7.5%).[1] This partly reflected higher costs and debt repayment by businesses. In terms of type of deposits, fixed deposits (including Commodity Murabahah[2]) form nearly half of the total banking system deposits (December 2024: 49%; June 2024: 48.7%; 2015–19 average: 51.2%) (Chart 2.4), providing banks with a source of more stable funding. Stress tests[3] conducted by BNM further affirmed the banking system's resilience against liquidity shocks.

[1] The share of deposits of resident individuals and businesses (including non-financial public enterprises) out of banks' total deposits remained stable at 36.5% (June 2024: 36%) and 33.2% (June 2024: 33.7%) respectively.

[2] As at end-December 2024, Commodity Murabahah stood at RM538.5 billion, making up 21% of total banking system deposits.

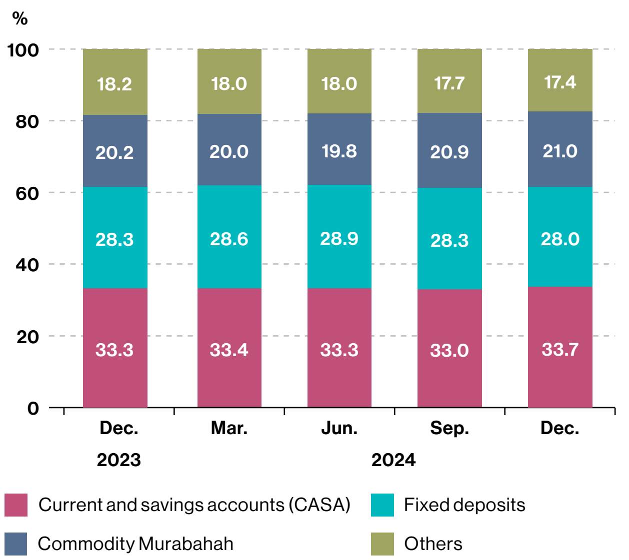
[3] Refer to the section on 'Assessing the Resilience of Financial Institutions' for more details.

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



Source: Bank Negara Malaysia

Chart 2.4: Banking System – Composition of Deposits by Type

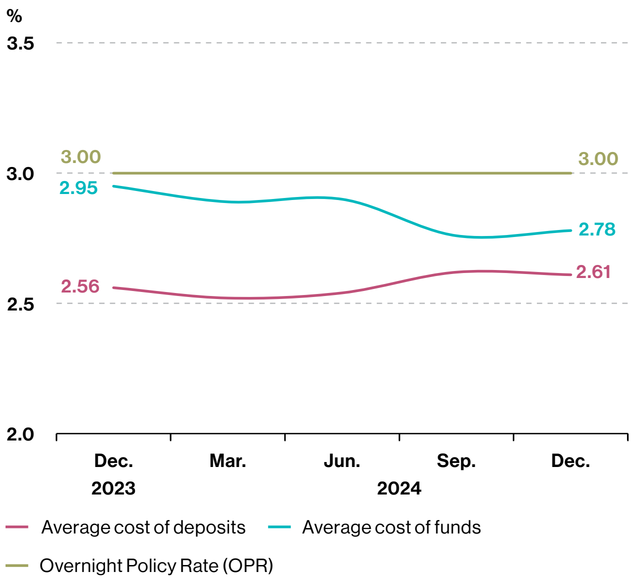


Source: Bank Negara Malaysia

The seasonal trend in deposit competition picked up towards the end of 2024 as banks built up liquidity buffers in anticipation of year-end withdrawals, especially from large depositors. Consequently, interest rates on corporate deposits rose in the fourth quarter. The increase in corporate deposit rates was, however, offset by the declining retail fixed deposit board rates[4] following measures by banks to actively manage their cost of funds. The declining average cost of money market funds (December 2024: 3.77%; December 2023: 3.92%) amid global policy rate cuts also eased banks' foreign currency (FCY) funding costs. As a result, banks' average cost of funds declined to 2.78% in December 2024 (June 2024: 2.90%) (Chart 2.5). Consistent with this, there was little evidence of a notable tightening in credit conditions. Banks continued to lend at a healthy rate (+5.5%; June 2024: +6.4%) (Chart 2.6).

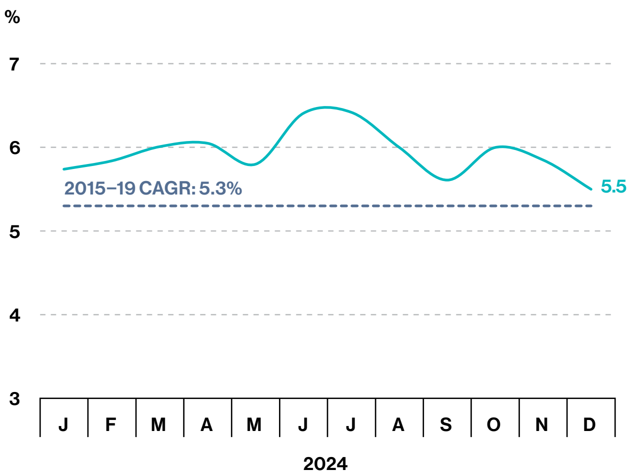
[4] The year-on-year change in the weighted average 3-month conventional retail fixed deposit rates is -17 basis points (bps).

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



Source: Bank Negara Malaysia

Chart 2.6: Banking System – Annual Loan Growth

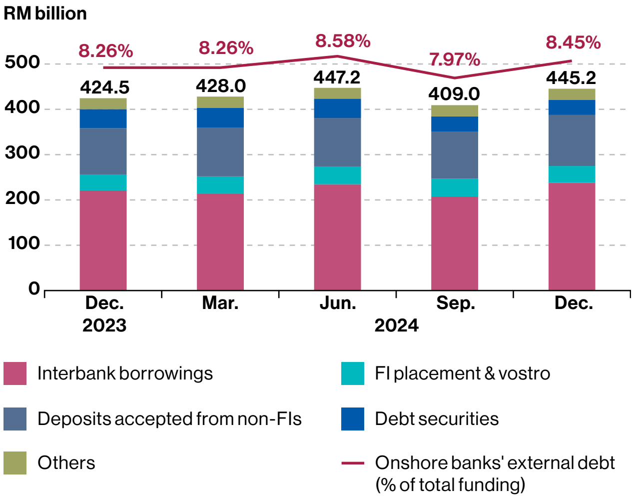


Source: Bank Negara Malaysia

Contagion risks from banks' exposures to external counterparties remained manageable

Banks' external debt remained broadly stable at RM445.2 billion in the second half of 2024 (June 2024: RM447.2 billion) (Chart 2.7). Interbank borrowings continued to make up the bulk of banks' external debt, with more than half being intra-group exposures. These exposures were mainly by locally incorporated foreign banks (LIFBs) sourcing funds from parent companies located abroad and by banks located in the Labuan International Business and Financial Centre (LIBFC) to facilitate transactions arranged and managed by foreign head offices. Additionally, some banks continued to utilise FCY swap arrangements for cheaper ringgit funding as effective cost of funds remained lower than KLIBOR. However, this accounted for only around 3.1% of total banks' funding and is not expected to grow significantly amid expectations of further Fed rate cuts in 2025.

Chart 2.7: Banks' External Debt – by Instrument



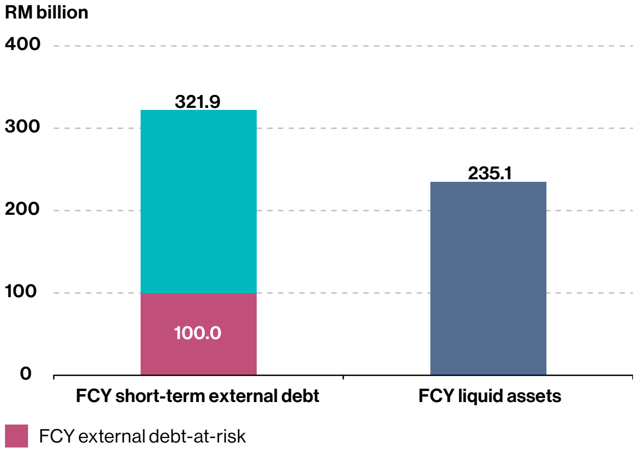
Note: Banks' external debt in this context refers to external debt of DBGs, LIFBs and banks in the Labuan International Business and Financial Centre (LIBFC).

Source: Bank Negara Malaysia

Risks from banks' external debt continued to be limited as their reliance on external counterparties for domestic funding needs remained low. The bulk of banks' external exposures continued to be with related counterparties or in the form of long-term stable[5] debt (76.9%; June 2024: 78.4% of total banks' external debt), minimising rollover and withdrawal risks. Meanwhile, short-term external debt with unrelated counterparties is adequately buffered as banks continued to hold sufficient FCY liquid assets to cover up to 2.4 times (June 2024: 2.5 times) of total FCY external debt-at-risk[5] (Chart 2.8).

Banks also continued to be resilient against foreign exchange (FX) risk. Given increased market volatility in the second half of 2024, banks actively managed their exposures by reducing their FX net open position (FX NOP) (Chart 2.9), which stood lower at 3.9% of total capital (June 2024: 5.2%; 2020–22 average: 4.2%).

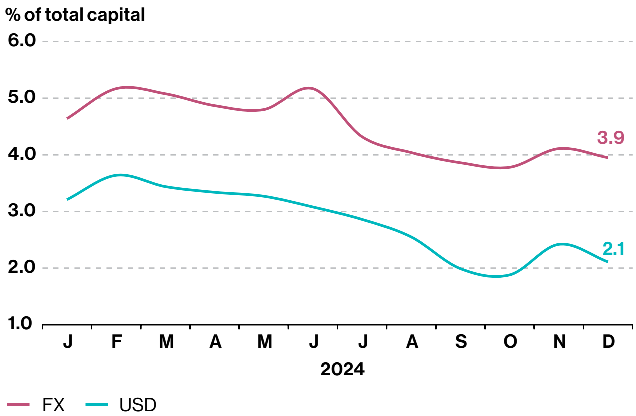
Chart 2.8: Banking System – FCY External Debt-at-Risk and Liquid Assets



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

Source: Bank Negara Malaysia

Chart 2.9: Banking System – FX and USD Net Open Positions



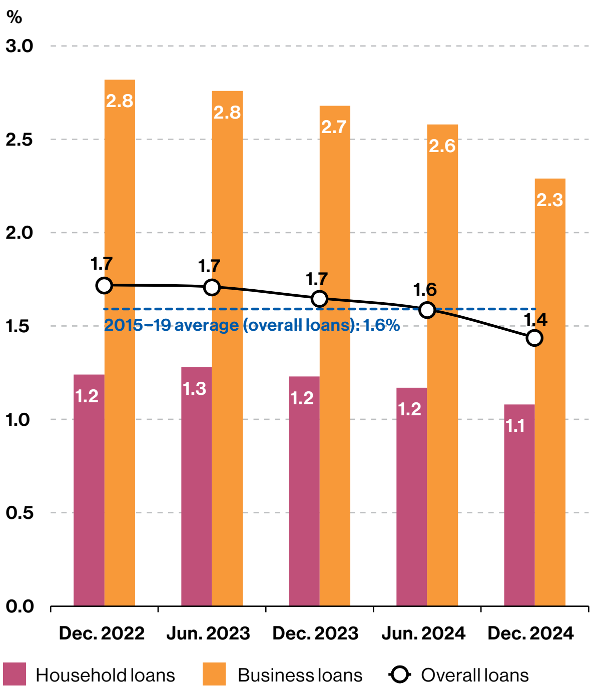
Source: Bank Negara Malaysia

[5] Banks' external debt-at-risk or less stable debt comprises financial institutions' deposits, interbank borrowings and short-term loans from unrelated non-resident counterparties maturing within a year, which are considered to be more susceptible to sudden withdrawal shocks.

Banks' asset quality broadly improved

Banks' asset quality remained sound as most borrowers continued to show improvements in their debt-servicing ability. The gross impaired loans ratio declined to 1.4% in the second half of 2024 (June 2024: 1.6%) (Chart 2.10). The outlook for asset quality also improved, with the share of loans classified as Stage 2 declining further below the pre-pandemic average to 6.6% of banking system loans (June 2024: 7%; 2018–20 average: 8%) (Chart 2.11). Consistent with this, loans under repayment assistance programmes[6] declined to 1.7% of total banking system loans (June 2024: 2%), while newly rescheduled and restructured loans of borrowers facing financial strains remained small at 0.08% of banks' total loans (June 2024: 0.09%). Nonetheless, banks continue to closely monitor pockets of vulnerable borrowers impacted by continued cost pressures particularly from lower-income households and businesses in the manufacturing, wholesale and retail, as well as hotels and restaurants sectors.

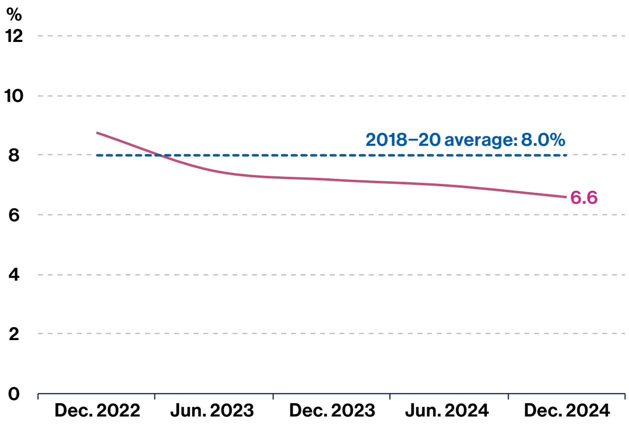
Chart 2.10: Banking System – Gross Impaired Loans Ratio



Source: Bank Negara Malaysia

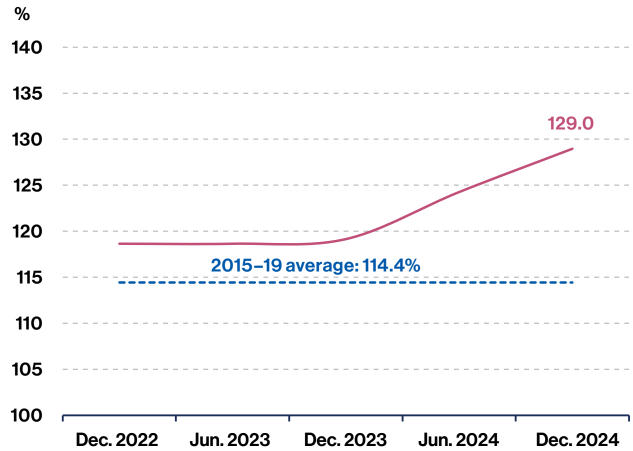
In the second half of 2024, the banking system loan loss coverage ratio (including regulatory reserves) increased to 129% from 124.3% seen in June 2024 (Chart 2.12). This reflects the increase in collective impairments held by banks on the back of continued robust loan growth in 2024. At the same time, banks maintained prudent provisions for higher-risk borrower segments amid uncertainties in the operating environment particularly from the impact of persistent cost challenges. While banks have been writing back pandemic-related management overlays[7] (MO), this was offset at the aggregate level by MO allocated for specific borrowers.

Chart 2.11: Banking System – Stage 2 Loans Ratio



Source: Bank Negara Malaysia

Chart 2.12: Banking System – Loan Loss Coverage Ratio (Including Regulatory Reserves)



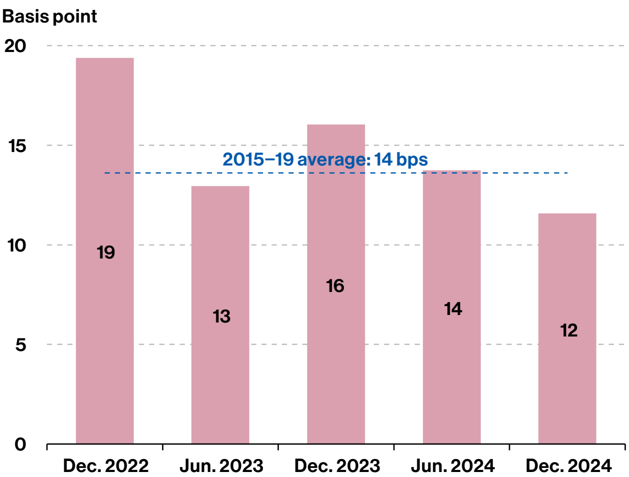
Source: Bank Negara Malaysia

[6] Refers to all types of repayment assistance programmes including remaining loans under assistance extended under COVID-19, banks' bespoke packages, and restructuring and rescheduling (R&R).

[7] Management overlays are additional provisions set aside on top of provisions derived from expected credit loss (ECL) models. They reflect adjustments to account for data deficiencies or uncertainties not adequately captured by the ECL models.

This has resulted in MO remaining stable at around 25% of banks' total ECL provisions for loans. These buffers are expected to be sufficient to absorb potential losses. The sustained level of provision has also led to stable annualised credit costs (Chart 2.13).

Chart 2.13: Banking System – Annualised Credit Cost Ratio



Source: Bank Negara Malaysia

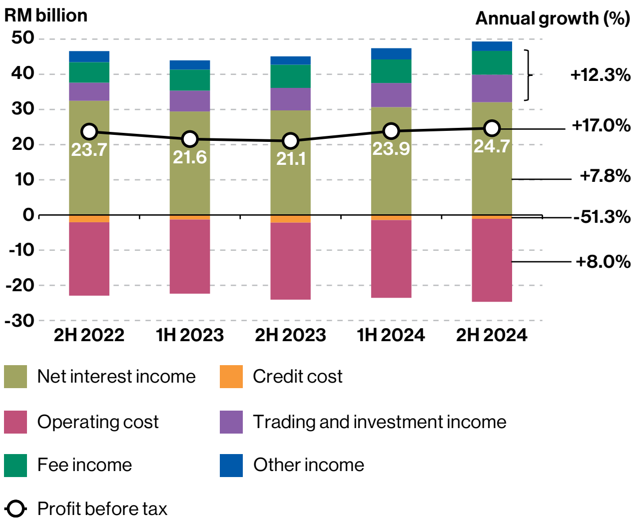
Banks' earnings improved, supported by higher interest income

Banks' profitability in the second half of 2024 continued to be supported by interest income (Chart 2.14) amid robust overall loan growth. The higher interest income and a slower growth in interest expense contributed to the improvement of net interest margins (December 2024: 2%; June 2024: 1.96%; 2015–19 average: 2.11%). Meanwhile, the cost-to-income (CTI) ratio[8] increased slightly to 47.9% (June 2024: 46.6%), mainly driven by an increase in employee expenses.

Trading and investment income (2H 2024: RM7.8 billion; 1H 2024: RM6.8 billion) provided additional support to banks' earnings. This was mainly driven by the substantial FX revaluation gains recorded in the third quarter of 2024 amid the strengthening of the ringgit. Despite the sizeable holdings of government bonds (10.1% of total banking system assets; June 2024: 10.6%), banks' exposure to interest rate risk in the banking book remained manageable.[9] This has been supported by active strategies to reduce the duration of government bond holdings, especially in the last quarter of 2024 amid market expectations of high-for-longer interest rate in the US as well as uncertainties surrounding US trade policies from the new administration.

Consistent with higher earnings in the second half of 2024, returns on asset and equity of the banking system rose slightly to 1.4% and 12.2% respectively (June 2024: 1.3% and 12.1% respectively). This, in turn, supported the market valuations of listed banks, as measured by the price-to-book (P/B) and price-to-earnings (P/E) ratios (Chart 2.15). Looking ahead, the positive growth outlook for the economy will provide sustained support for banks' profitability.

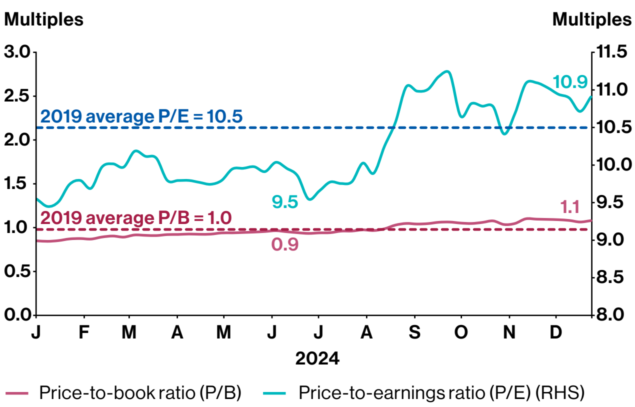
Chart 2.14: Banking System – Income, Cost and Profit before Tax



Note: 1. Annual growth computed based on figures for 2H 2023 and 2H 2024.
2. Figures may not add up due to rounding.

Source: Bank Negara Malaysia

Chart 2.15: Banking System – Price-to-Book and Price-to-Earnings Ratios of Publicly Listed Banks in Malaysia



Note: Refers to the median ratio of domestic banking groups in Malaysia.

Source: Bloomberg

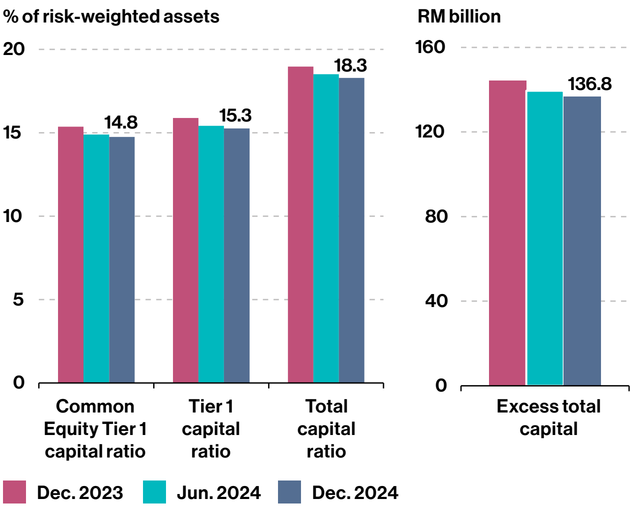
[8] CTI ratio refers to the costs of running operations (i.e. operating costs), over banks' total income.

[9] 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 (December 2024: 6.7%; June 2024: 6.7%).

Banking system remained well-capitalised

The banking system total capital ratio remained healthy at 18.3% of total risk-weighted assets (June 2024: 18.5%), with capital buffers of RM136.8 billion (June 2024: RM139.5 billion) (Chart 2.16). These buffers continue to preserve banks' capacity to supply credit to the economy, as well as absorb unexpected losses. Banks' capital buffers were further supported by revaluation gains from bond holdings in the banking book, driven by a slight decline in domestic bond yields across all tenures between June to December 2024.

Chart 2.16: Banking System – Capitalisation



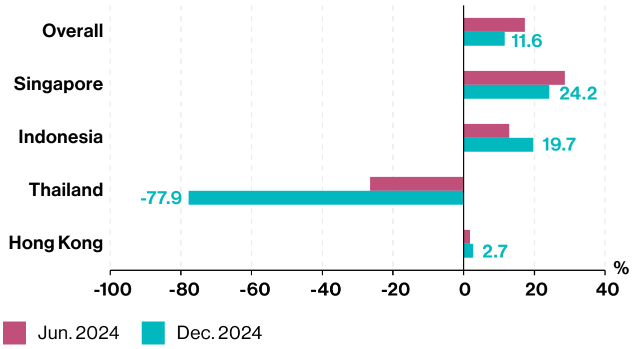
Note: Excess total capital refers to total capital above the regulatory minimum, which includes the capital conservation buffer requirement of 2.5% and bank-specific higher minimum requirements.

Source: Bank Negara Malaysia

Contagion risk from DBGs' overseas operations remained limited

Overall overseas operations[10] of domestic banking groups (DBGs) remained profitable (Chart 2.17). This was mainly driven by operations in Singapore (representing 56% of overseas operations' assets) (Chart 2.18) which recorded sustained net interest and non-interest incomes. Operations in Thailand continued to record losses due to the high credit costs for selected non-retail borrowers amid ongoing economic headwinds. Notwithstanding this, spillover risks to parent banks in Malaysia remain limited, as total operations in Thailand contributed less than 2% of DBGs' total consolidated assets.

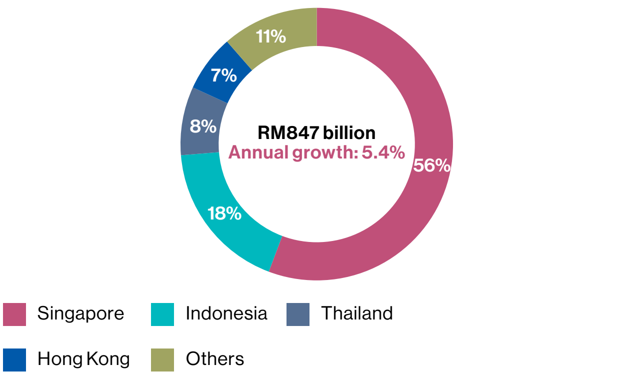
Chart 2.17: Banking System – Return on Equity of Overseas Operations by Jurisdiction



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.
3. The negative ROE for Thailand is a function of a small equity base associated with a small operation contributing only about 0.1% of DBGs' total consolidated assets.

Source: Bank Negara Malaysia

Chart 2.18: Banking System – Asset Profile of Major Overseas Operations



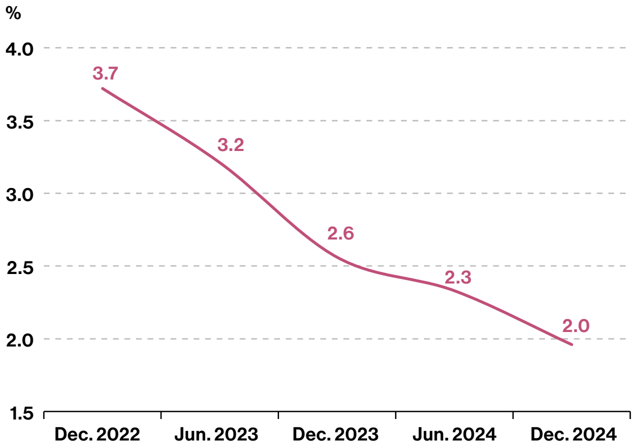
Note: Figures may not add up due to rounding.

Source: Bank Negara Malaysia

Similar to Malaysia, asset quality of overseas operations continued to improve (Chart 2.19). The share of loans under repayment assistance programmes continued to decline (0.8% of total overseas operations' loans; June 2024: 0.9%). Liquidity and funding risks posed by DBGs' overseas operations remained limited as major overseas operations continued to be primarily funded by stable customer deposits (Chart 2.20). DBGs' overseas operations also continue to be supported by strong capital buffers (average total capital ratio as at December 2024: 19.9%, June 2024: 20.6%).

[10] Overseas operations data from 2023 onwards shown in this publication may be different from data cited in earlier publications due to updated statistical reporting requirements and methodology.

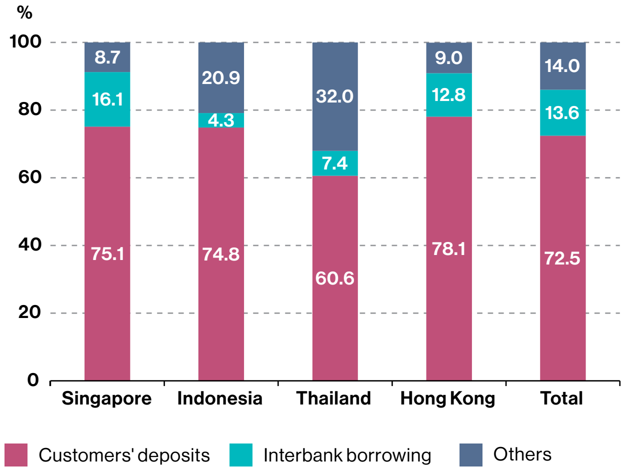
Chart 2.19: Banking System – Gross Impaired Loans Ratio of Overseas Operations



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

Source: Bank Negara Malaysia

Chart 2.20: Banking System – Funding Profile of Major Overseas Operations



Note: Figures may not add up due to rounding.

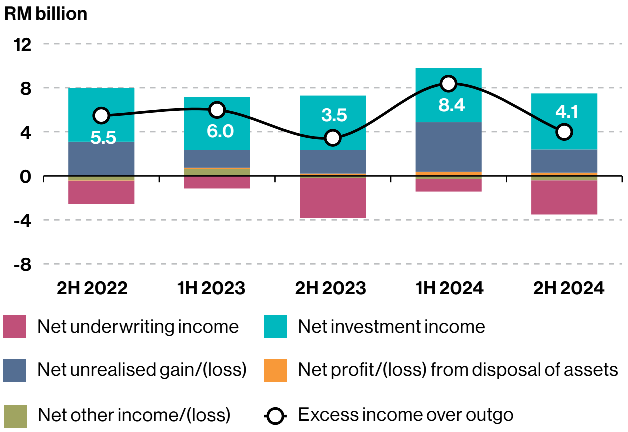
Source: Bank Negara Malaysia

THE INSURANCE AND TAKAFUL SECTOR

Overall profitability of insurance and takaful funds declined on weaker investment performance and larger net underwriting losses

The overall profitability of life insurance and family takaful funds, as measured by excess income over outgo (EIOO),[11] declined in the second half of 2024 (RM4.1 billion; 1H 2024: RM8.4 billion) (Chart 2.21). The decline was mainly driven by lower net unrealised gains from investment portfolios following some paring back in the performance of equities and higher bond yields. Nevertheless, the EIOO for the full year of 2024 improved from the previous year to RM12.4 billion (2023: RM9.4 billion), supported by the stronger performance of the equity market for the year.

Chart 2.21: 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

Life insurers and family takaful operators (life and family ITOs) recorded higher net underwriting losses in the second half of 2024. Net underwriting income was weighed down by higher medical payouts of RM6.2 billion (1H 2024: RM5.3 billion; 2H 2023: RM5.3 billion), mainly driven by increased overall average cost and utilisation rate for medical treatment, particularly from chronic and acute cases. This led to premiums for medical and health insurance/takaful (MHIT) policies/certificates being adjusted upward to ensure sustainability of long-term coverage. Interim measures have been put in place by the insurance and takaful industry to assist individuals who are affected by the premium[12] revisions to their MHIT policies/certificates. One such measure is the spreading of premium adjustments due to medical claims inflation over a minimum period of three years. This measure applies to repricing exercises that take place between 2024 and 2026. The impact of the interim measures to stagger the repricing of MHIT products, increase in benefit payouts from medical claims and ongoing shrinkage of participating life insurance business could further weigh on net underwriting income of life and family ITOs going forward. In this regard, structural reforms addressing the root cause of rising medical costs are crucial in ensuring the sustainability of MHIT business.[13]

New business premium growth for life and family ITOs expanded by 6.4% in the second half of 2024 (2H 2023: 6.8%; 2019–23 half-yearly average: 9.1%) (Chart 2.22), mainly sustained by the growth in new business premium for investment-linked products. The participating life insurance segment[14] continued its decline amid shifts in consumers' preference for broader coverage against life uncertainties such as medical and health coverages which are not typically covered by participating life insurance policies. Investment-linked products, which are perceived to be more flexible, are expected to remain as a key driver of overall new business premium growth.

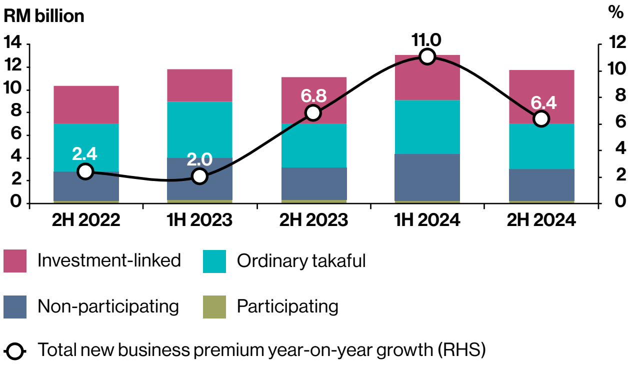
[11] The EIOO does not take into account changes in reserves required to be set aside by insurers and takaful operators to cover future insurance/takaful claims.

[12] Refers to both insurance premium and takaful contribution, unless stated otherwise.

[13] Refer to the section on 'Securing Sustainable Access to Medical and Health Insurance/Takaful Protection' in BNM's Annual Report 2024 for more details.

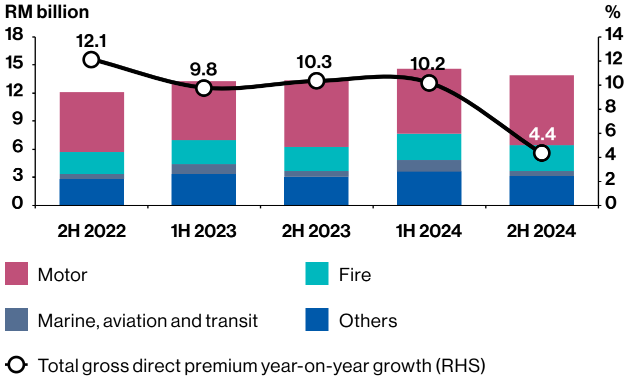
[14] Refer to the Box Article on 'Participating Life Insurance Business in Malaysia' from the Financial Stability Review for First Half 2024 for more details.

Chart 2.22: Life Insurance and Family Takaful Sector – New Business Premium Growth and Product Composition



Source: Bank Negara Malaysia

Chart 2.24: General Insurance and Takaful Sector – Gross Direct Premium Growth and Product Composition

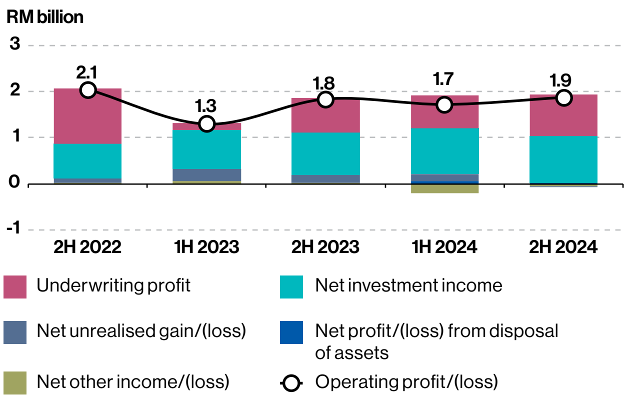


Source: Bank Negara Malaysia

In the general insurance and takaful sector, operating profits increased to RM1.9 billion in the second half of 2024, supported by underwriting profit (1H 2024: RM1.7 billion; 2H 2023: RM1.8 billion) (Chart 2.23). Underwriting performance was driven by the growth in the motor segment (Chart 2.24), which reflected stronger demand for motor vehicles. Lower claims from fire events also contributed to the improvement in underwriting profit of general ITOs. While seasonal flood events at the end of 2024 and early 2025 may pose a drag to the underwriting profit of general ITOs, claims from these events are expected to be less severe than that experienced in 2021.[15]

Gradual adjustments to the premium for Comprehensive, and Third Party, Fire and Theft motor insurance and takaful products continued during the second half of 2024. This is in line with the increased pricing flexibility introduced under Phase 2A[16] of the ongoing motor and fire tariffs liberalisation process. Under the transition, both premium increases and decreases have been observed. These indicate a more granular and differentiated pricing for various insured motorist segments to better reflect their respective risk profiles. The net claims incurred ratio[17] for the motor line of business stabilised in the second half of 2024 (69%; 1H 2024: 69%), after normalising from low levels during the pandemic and is slightly below the pre-pandemic average of 71%.

Chart 2.23: General Insurance and Takaful Fund – Composition of Operating Profits



Source: Bank Negara Malaysia

The insurance and takaful sector remained resilient, further supported by strong capital and liquidity positions. The aggregate capital adequacy ratio (CAR) for the industry remained healthy at 224% in the second half of 2024 (June 2024: 227%), well above the regulatory minimum of 130% (Chart 2.25). In addition, aggregate capital buffers in excess of regulatory requirements also remained ample at RM41.1 billion (June 2024: RM37.4 billion).

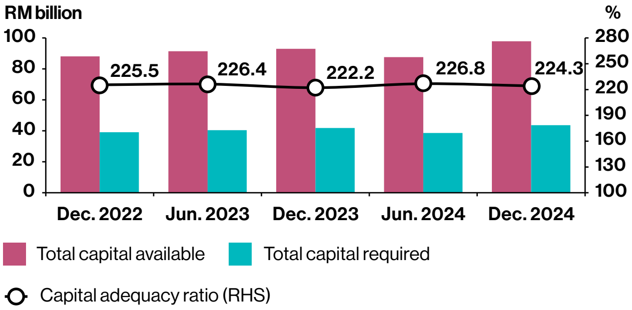
Looking ahead, investment performance of ITOs continues to be susceptible to financial market conditions given the sizeable investment holdings of ITOs in bonds and equities, as well as climate-related risks as increased physical and transition risks could translate into financial risks. ITOs are required to assess their exposure to climate-related risks in the inaugural

[15] Losses from the flood events in 2021 were more extensive as it involved major economic centres, such as Kuala Lumpur and Shah Alam.

[16] ITOs that commit to reforms to improve the motor claims ecosystem (encompassing prudential and market conduct conditions and a commitment to digitalise the motor claims process for greater control and efficiency) will gradually receive greater pricing flexibility for motor and fire insurance/takaful products. This will happen in two stages: Phase 2A and then Phase 2B.

[17] Net claims incurred ratio refers to the ratio of net claims incurred to earned premium income.

Chart 2.25: Insurance and Takaful Sector – Capital Adequacy Ratio



Source: Bank Negara Malaysia

Climate Risk Stress Testing[18] exercise in 2025. ITOs could also face constraints in growing new MHIT businesses due to concerns on medical cost pressures, making the current pricing structures unsustainable. The measures taken by ITOs to provide short-term relief to policyholders/participants from the repricing of MHIT premiums are also expected to weigh on the financial performance of the industry. Despite these potential headwinds, ITOs are expected to remain solvent with capital buffers above the regulatory minimum.[19]

[18] Under the Climate Risk Stress Testing Methodology Paper, financial institutions are required to submit the results of their exercise to BNM either by 30 June 2025 (Cohort 1) or 31 December 2025 (Cohort 2).

[19] Refer to the section on 'Assessing the Resilience of Financial Institutions' for more details.

ASSESSING THE RESILIENCE OF FINANCIAL INSTITUTIONS

Stress testing is an integral part of BNM's financial stability surveillance framework. Every year, BNM performs a multi-year, top-down macro solvency stress test to assess the potential impact of prolonged adverse macroeconomic conditions on individual banks and insurers, as well as to the broader financial system. In this macro solvency stress test, two adverse scenarios were applied to simulate the impact of different paths of economic contraction or slowdown on the resilience of financial institutions over a three-year horizon from 2025 up to the end of 2027. These scenarios are not indicative of BNM's actual economic forecasts but have been developed to assess the resilience of financial institutions to extreme shocks.

The first adverse scenario (AS1) is designed to test financial institutions' resilience to a sharp but temporary shock in the operating environment. AS1 assumes a deep recession in the domestic economy in 2025. This is followed by a sharp economic recovery in 2026, whereby GDP growth makes a strong V-shaped recovery and normalises thereafter. The second adverse scenario (AS2) tests financial institutions' resilience to a less severe but more prolonged economic contraction. It assumes a more persistent recessionary environment spilling over into 2026 with a sluggish L-shaped economic recovery. For both scenarios, the GDP growth shock was calibrated to levels similar to that observed during the Asian Financial Crisis and the COVID-19 pandemic episode. Selected key assumptions and shock parameters applied in AS1 and AS2 are as outlined in Table 2.1.

These macroeconomic and financial shocks are broadly similar to the previous exercise in 2024,[20] with revisions made to some of the parameters to reflect updated macroeconomic conditions. The severity of AS1 and AS2 parameters reflects heightened global risk aversion from a potential escalation of tariffs and trade wars, coupled with heightened geopolitical tensions, resulting in higher portfolio outflows from emerging economies. Financial markets are assumed to be more volatile, with domestic bond yields increasing considerably. The upward trend is more prolonged under AS2, attributed to persistently tight global financial conditions. The FBM KLCI performance worsens and subsequently rebounds sharply under AS1, whereas recovery under AS2 is more sluggish. The ringgit trends weaker to levels beyond historical lows against the US dollar amid greater uncertainty in the global financial environment, with sharper adjustments in 2025 under AS1.

The stress test exercise emphasises conservatism over strict macro-coherence in its input assumptions. This enables the stress test to factor in potential additional downside risks, ensuring that the Malaysian financial system can withstand even unlikely combinations of risk. For instance, the OPR is assumed to rise even within a recessionary environment driven by supply-side inflationary shocks. Policy rate hikes are assumed to impact the debt-servicing capacity of borrowers and

Table 2.1: Macro Stress Test – Key Assumptions and Shock Parameters Applied Under Assumed Adverse Scenarios

Key Assumptions	AS1	AS2
Annual domestic real GDP growth	Up to -6.0%	Up to -3.5%
Annual unemployment rate	Up to 5.4%	Up to 6.0%
Market risk shocks - Increase in 10Y MGS yield - Increase in 10Y AAA corporate bond yield - Decline in FBM KLCI	 Up to 300 basis points Up to 420 basis points Up to 30%	 Up to 270 basis points Up to 370 basis points Up to 30%
OPR hike[1]	Up to 100 basis points	Up to 100 basis points
MYR depreciation against USD	Up to 30%	Up to 20%
Quarterly headline inflation[2]	Up to 9.3%	Up to 7.3%

1 The assumption of an OPR hike may not, in certain circumtances, be consistent with the broader macroeconomic scenarios but is assumed by design to account for potential downside risks.
2 The assumption for the quarterly headline inflation reflects stressed impact from global shocks such as trade tensions and geopolitical conflicts putting pressure on energy prices and ringgit.

Source: Bank Negara Malaysia

20 Refer to the section on 'Assessing the Resilience of Financial Institutions' in BNM's Financial Stability Review for Second Half 2023 for more details.

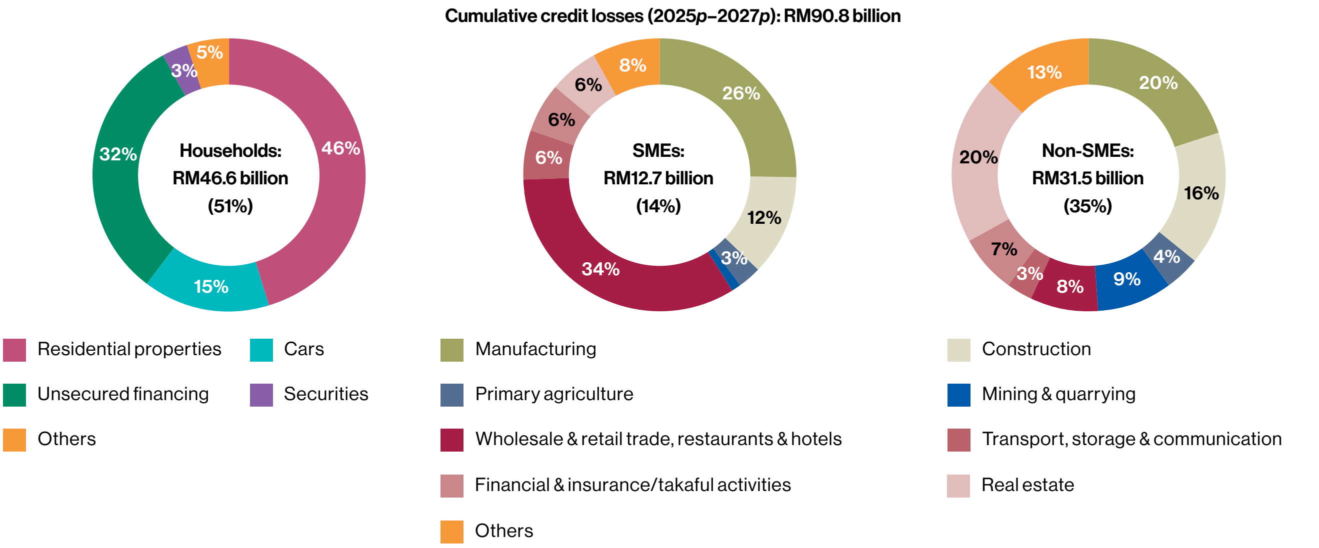
banks' interest expense, but do not increase banks' interest income. Meanwhile, banks facing persistent financial weakness during the stress horizon are also subjected to additional liquidity shocks in the form of adverse deposit outflows to simulate a loss of depositor confidence. Non-SME borrowers that fail the simulation are assumed to trigger cross-defaults across their entire business group, despite other subsidiaries being financially viable. Similar assumptions on cross-defaults are also applied to household borrowers who default on their loans. It is also assumed that there are no subsequent cures or reversal in loan staging even if there are improvements in the defaulted borrowers' debt-servicing capacity later in the stress horizon. Additionally, no policy intervention or support measures to distressed borrowers or financial institutions is assumed.

The financial system remains resilient even under severe simulated shocks.

Under the severe macroeconomic environment assumed in the scenarios, the Malaysian banking system is expected to remain resilient. Credit losses are expected to drive the bulk of projected losses. Overall, projected cumulative credit losses over the 3-year horizon are estimated to be RM77 billion and RM90.8 billion under AS1 and AS2 respectively (or equivalent to 58% and 63% of total losses respectively). In particular, banks are projected to face higher defaults post-shock from household borrowers contending with the higher inflationary shocks. Meanwhile, a few large corporate borrowers are projected to default given their pre-existing weak financials while prolonged weakness in the economy will continue to impact SMEs (Chart 2.26). Losses from interest rate risk in the banking book, driven by higher bond yields, are the second largest source of projected losses. Revaluation losses on banks' securities held at fair value through other comprehensive income (FVOCI) are expected to erode banks' capital buffers by RM52.3 billion and RM50.3 billion under AS1 and AS2 respectively (AS1: 39%; AS2: 35% of total losses). Conversely, trading book losses which are mainly driven by bonds, equity and FX movements are not significant under both scenarios (AS1: 3.2%; AS2: 2.3% of total losses) (Chart 2.27). Losses from domestic banking groups' (DBGs) overseas operations are also not expected to pose a significant risk to overall resilience, accounting for only 11% of cumulative credit losses and stemming primarily from defaults of large corporates.

By the end of the stress horizon in 2027, overall impairments are projected to increase to 8% and 9% of total banking system loans under AS1 and AS2 respectively,

Chart 2.26: Macro Stress Test: Banking System – Drivers of Cumulative Credit Losses Under Adverse Scenario 2



p Projected

Note: 1. (...) refers to % of overall cumulative credit costs.
2. Figures may not add up due to rounding.

Source: Bank Negara Malaysia

Chart 2.27: Macro Stress Test: Banking System – Key Loss Drivers under Adverse Scenario 2

Note: Market risk includes revaluation losses on bonds held in the fair value through other comprehensive income (FVOCI) portfolio.

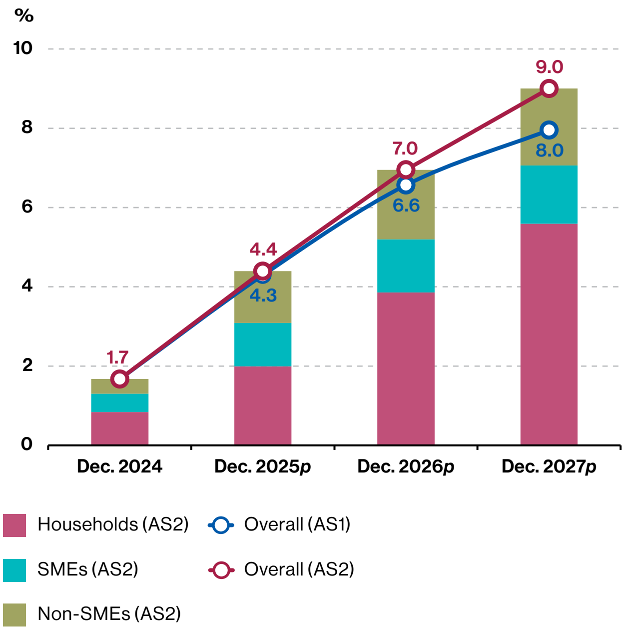
Source: Bank Negara Malaysia

driven mainly by household borrowers (Chart 2.28). Household borrowers at risk of defaulting continue to largely comprise those earning less than RM5,000 per month (62%) given their lower financial buffers relative to other income segments (Chart 2.29). Nevertheless, these borrowers account for a lower share (36%) of new impairments by value due to the smaller size of exposures. In comparison, borrowers earning between RM5,000 and RM10,000 a month form a larger share (45%) of new impaired debt by value. The stress test also indicates that highly indebted borrowers[21] are less resilient when severe shocks materialise, with defaults rising more rapidly for borrowers with DSRs beyond 60%. This group accounts for more than 75% of defaulting household borrowers. For businesses, non-SMEs make up the bulk of the projected increase in impaired business loans under AS2 (64%), commensurate with their larger outstanding loan sizes and the conservative cross-default assumption. SMEs make up the remaining 36% of business impairments with projected defaults notably higher under AS2 (1.5%; AS1: 1% of total banking system loans). This is to be expected given the limited and smaller cash buffers of SMEs under the extended stress horizon.

Overall banking system profitability is expected to decline sharply in the initial year of stress mainly from higher credit costs. While net interest income would also decline sharply amid elevated funding costs, this is expected to gradually recover in the subsequent years, leading to a recovery in profits and capital buffers. Expected losses incurred from overseas operations are notable for some large DBGs but the impact is mitigated by the healthy capital buffers held by the respective overseas entities.

The aggregate capital ratios of the banking system remain above the regulatory minima under both scenarios

Chart 2.28: Macro Stress Test: Banking System – Impaired Loans Ratio Under Adverse Scenarios 1 and 2

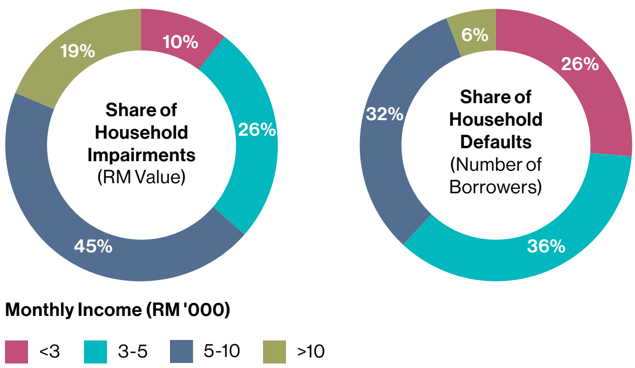


p Projected

Note: Impairment figures are inclusive of exposures from selected DBGs' overseas operations.

Source: Bank Negara Malaysia

Chart 2.29: Macro Stress Test: Household Sector – Impairment Profile Under Adverse Scenario 2



Note: Figures may not add up due to rounding.

Source: Bank Negara Malaysia

[21] Refers to borrowers with high debt service ratio of more than 60%.

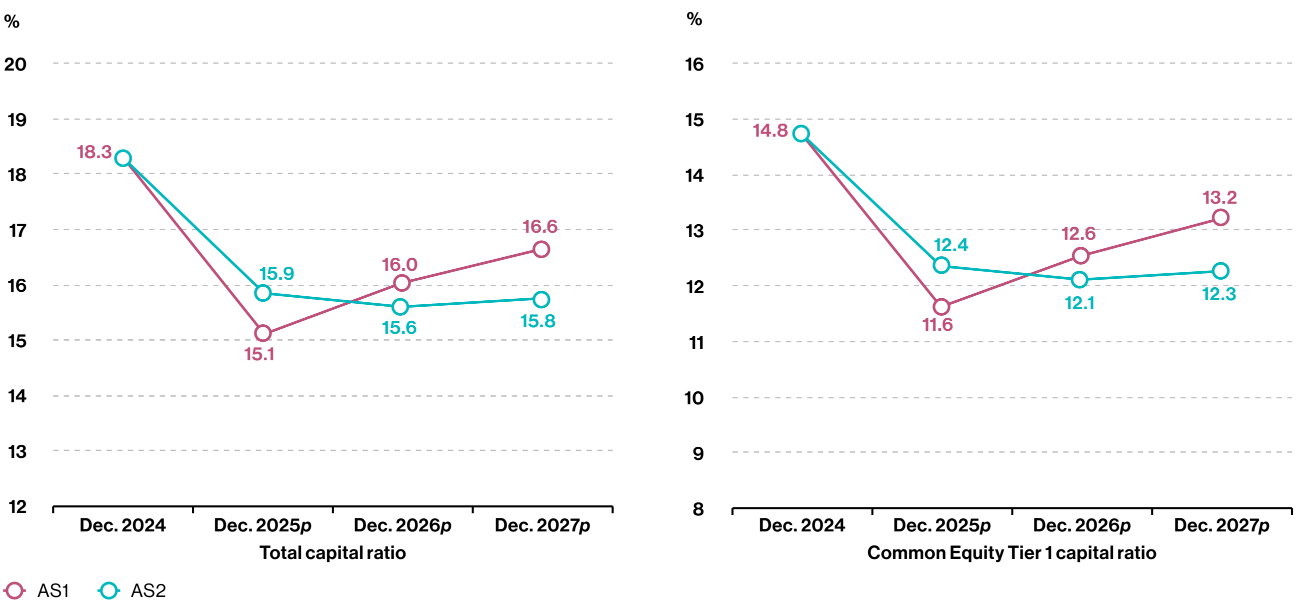
(Chart 2.30). However, the impact on individual banks varies depending on their risk profiles. Three banks,[22] accounting for only 2% of total banking system assets, are projected to breach minimum regulatory capital requirements across both adverse scenarios. These banks exhibit common characteristics of higher leverage levels and weaker profitability, coupled with a higher share of FVOCI bonds exposed to revaluation losses (Chart 2.31). Under AS2, an additional ten banks could require additional capital to maintain their internal capital targets. However, they would be able to continue meeting the minimum regulatory capital requirements.

Banks facing persistent financial weaknesses[23] or whose capital ratios dipped below regulatory minima are also assumed to experience an additional liquidity shock[24] in the form of adverse deposit outflows. Under this scenario, nine banks would see their LCR[25] levels drop below 100% but all banks maintain sufficient stock of unencumbered HQLA to meet the heightened cashflow demands. This reflects the strong starting liquidity position of banks with the banking system LCR currently at 171% as of December 2024.

The solvency stress test exercise along with the additional liquidity stress test continue to affirm that banks remain highly resilient in the face of severe macroeconomic, financial and liquidity shocks. The banking system is expected to have sufficient capacity to maintain lending to the economy, even during downturns.

The macro solvency stress test for insurers incorporates additional insurance-specific assumptions. These assumptions are largely similar to those applied in the 2024 exercise.[26] Overall, the insurance sector's aggregate CAR is assessed to remain above the regulatory minimum (Chart 2.32). Market risk remains the key driver of losses for both life and general insurers due to their significant holdings of bond and equity investments (Chart 2.33). Increased bond yields coupled with the weak equity market performance under both scenarios continued to affect the investment performance of insurers. Life insurers are expected to experience sustained net underwriting losses throughout the stress horizon under AS2 due to the impact from assumed benefit payouts, including those for medical claims and

Chart 2.30: Macro Stress Test: Banking System – Capital Ratios Under Adverse Scenarios 1 and 2

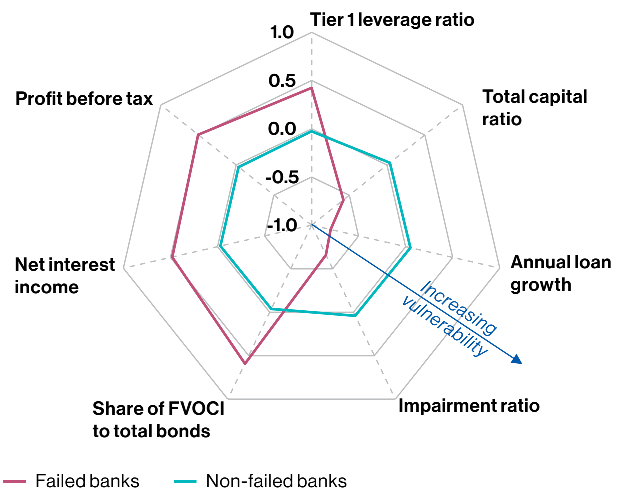


p Projected

Source: Bank Negara Malaysia

[22] Refers to the banking group or standalone bank if it does not belong to a larger banking group, as the case may be.
[23] Refers to banks that incurred at least two consecutive quarters of losses, or a minimum two years of annual losses.
[24] Stressed outflows applied on the deposits of each bank is assumed to be at least 16% based on benchmarking of recent global distressed banks' experience.
[25] LCR applied in the stress test refers to only Malaysian ringgit position.
[26] Refer to Table 2.2 in the section on 'Assessing the Resilience of Financial Institutions' in BNM's Financial Stability Review for Second Half 2023 for more details.

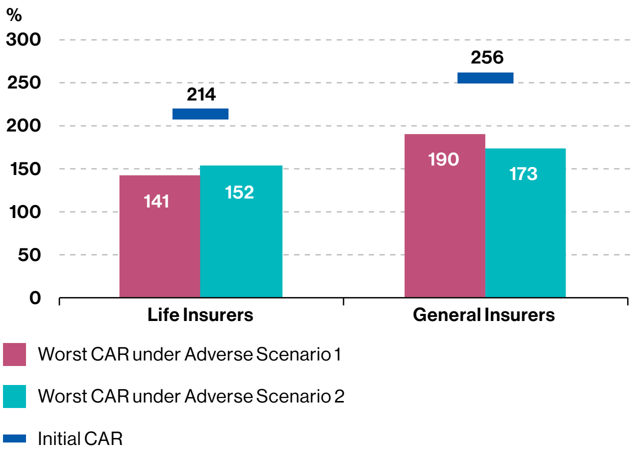
Chart 2.31: Macro Stress Test: Banking System – Common Characteristics of Failed Banks' Pre-stress Position (2024)



Note: 1. Failed banks refer to banks which would breach the minimum regulatory capital requirements under stress test scenario.
2. Chart values are standardised using z-score, where larger values along a given axis signify more risks along that characteristic.
3. 'Tier 1 leverage ratio' refers to Tier 1 capital divided by total assets.

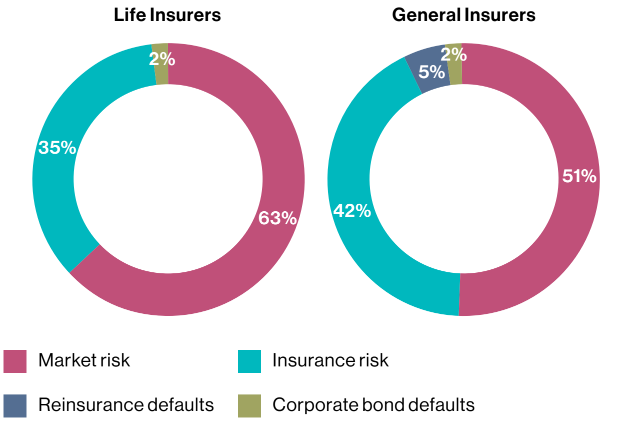
Source: Bank Negara Malaysia

Chart 2.32: Macro Stress Test: Insurance Sector – Capital Adequacy Ratio (CAR) Under Adverse Scenarios 1 and 2



Source: Bank Negara Malaysia

Chart 2.33: Macro Stress Test: Insurance Sector – Loss Drivers Under Adverse Scenario 1



Source: Bank Negara Malaysia

surrenders. Nonetheless, the downward revaluation of liabilities due to the increase in bond yields is expected to partly cushion the impact on their CAR.

Under AS1, two life insurers, accounting for less than 8% of total insurance assets, are projected to breach the regulatory minimum of 130% post-shock. Another ten insurers (making a total of 12 insurers) would also fall below their individual target capital levels (ITCL).[27] In the current stress test exercise, an assessment was also made on the potential impact from constraints on the ability of insurers to reprice existing medical insurance premiums throughout the stress horizon.[28] Such a shock is expected to increase the number of life insurers that are expected to fall below the ITCL over the stress horizon, relative to the baseline shock assumption. This includes a number of larger insurers that will incur medical losses that more than offset the improvements to their capital position from the economic recovery assumed in AS1. The capital shortfall to restore ITCL for all affected life insurers is estimated to be RM8.8 billion.[29] The ability to reprice improves the resilience of life insurers to stress, as it allows the revenue of life insurers to keep up with the cost of medical claims. Long-term reforms to contain medical cost inflation are therefore critical to ensure the sustainability of the medical insurance business.

[27] ITCL is the supervisory intervention level at which insurers are expected to activate their capital management plan to conserve and restore capital. This first intervention level is higher than the regulatory minimum.

[28] The additional shock applied is more severe than the December 2024 interim measures. Refer to BNM's press release dated 20 December 2024 on 'Interim measures to assist policyholders and to promote the continued access to suitable medical and health insurance/takaful products' for more details.

[29] The estimated total capital shortfall reflects the impact from severe macroeconomic conditions as well, and not specifically from medical-related shocks.

For general insurers, lower premiums from pricing competition in the motor and fire segments as well as higher claims due to more expensive motor repair costs and increased fraud incidents will continue to weigh on their CAR. Four general insurers accounting for less than 5% of total insurance assets are projected to breach the regulatory minimum CAR post-shock. The insurance macro solvency stress test also takes into account insurers' ability to meet short-term liquidity needs under stressed conditions. This is complemented by a liquidity assessment on insurers' ability to meet obligations such as higher policy benefit payouts for medical and surrenders, as well as flood claims. The liquidity assessment affirms that insurers have sufficient liquid assets and are able to fulfil these obligations.

Guiding *Hajah* and *Darurah* Application in Islamic Finance

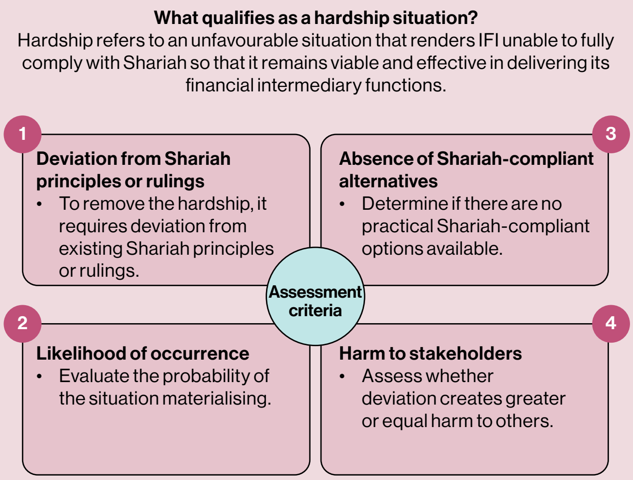
Concept of *hajah* and *darurah*

Islamic finance is premised on the core obligation for its participants to fully comply with Shariah. This entails Islamic financial institutions (IFIs) entering into transactions or engaging in practices which are fully compliant with Shariah requirements. Nevertheless, in practice, there will be situations where achieving full Shariah compliance, has its challenges as our Islamic financial system operates within the broader domestic and international ecosystem that includes, conventional finance that practices elements which may be in conflict with Shariah requirements such as usury or excessive uncertainty.

As an example, to offer multi-currency products and services, an IFI in Malaysia needs to open nostro accounts with correspondent banks in other countries. However, it may not be possible to open Shariah compliant nostro accounts in places where Islamic finance is absent or limited. In this case, full compliance with Shariah will make it impossible for the IFI to offer such services. This, in turn, will affect their financial intermediation role, as they are unable to serve their customers and meet the needs of the economy. Thus, the concept of *hajah* and *darurah* provide guidance on circumstances where exceptions from Shariah rulings may apply, within defined parameters. In this regard, Shariah recognises that such difficulties and operational constraints may be present and provides a pragmatic way forward.[1]

Hajah refers to a situation where hardship arise due to unavoidable circumstances, which requires partial compliance or temporary relaxation of specific rulings (Diagram 1). This is intended to minimise harm (*mafsadah*) and maximise benefits (*maslahah*). For example, a takaful operator may transfer certain specialised risks to a reinsurance company where there is insufficient retakaful capacity to absorb the risks.

Diagram 1: Assessment Criteria to Determine What Qualifies as a 'Hardship Situation'



Source: Bank Negara Malaysia

Meanwhile, *darurah* refers to extreme situations risking a financial institution's solvency or liquidity, which allows for tolerance of actions usually prohibited by Shariah. This is in view that Shariah recognises life and wealth preservation in specific circumstances over strict adherence to Shariah prohibitions. For example, an IFI may seek funding from conventional sources during a resolution process, when Shariah compliant funding is not available.

[1] As stated in the Quran, *'Allah intends ease for you, not hardship'*. (Surah Al-Baqarah, 2:185).

Application of *hajah* and *darurah* in Islamic finance

As part of BNM's efforts to promote a sound and progressive Islamic finance sector through the prudent application of exemptions to Shariah rulings, BNM issued the *Hajah* and *Darurah* Policy Document (HD PD). The HD PD aims to provide clearer guidance on applying *hajah* and *darurah*, in line with the fundamental Shariah principles. It also intends to streamline industry practices to effectively mitigate Shariah non-compliance risks. Furthermore, the HD PD facilitates regulatory oversight through standardised *hajah* and *darurah* parameters (Diagram 2) which enable consistent interpretation and informed decision-making by Shariah Committee (SC) of IFIs.

Diagram 2: Key Elements in *Hajah* and *Darurah* Applications

Key elements to ensure relevancy and rigour in *hajah* and *darurah* applications

Preconditions for hardship evaluation

- Ensure certainty of the hardship.
- Require deviation from Shariah principle or ruling.
- Absence or impracticality of Shariah compliant alternatives.
- Does not cause greater or equal harm to stakeholders.

Categorisation and its parameters

- ***Hajah* type 1:** Customary commercial practice & general needs.
- ***Hajah* type 2:** Not customary commercial practice & for IFI specific needs.
- ***Darurah*:** For IFI specific needs & triggered by recovery or resolutions actions.

Operational enhancement

- **Governance:** Specify heightened oversight expectation by the Board.
- **Decision-making process:** Deliberation by all Shariah Committee (SC) members and reporting to BNM within 14 working days after approval by the Board and SC.

Source: Bank Negara Malaysia

In applying *hajah* and *darurah*, IFIs must carefully evaluate multiple factors in respect of its categorisation (Diagram 3). This is to ensure that any exception to Shariah compliance is recognised by the IFIs' SC and the Shariah Advisory Council (SAC) thereby preserving the integrity and credibility of the Islamic finance sector.

Diagram 3: The Three Categories of *Hajah* and *Darurah*

1

***Hajah* type 1**
- Experienced by many IFIs.
- Allowed by SAC without restrictions.

Example: Using conventional nostro accounts.

2

***Hajah* type 2**
- Experienced by certain IFIs.
- Allowed by SAC with some restrictions.
- Temporary basis and proportionate to the severity of hardship.

Example: Ceding out a certain percentage of its takaful risk by takaful operators to reinsurers instead of fully retaining the risk due to higher costs or lack of specific capacity.

3

Darurah
- Triggered by resolution action.
- Allowed by SAC with certain restrictions.
- Temporary basis and proportionate to the severity of hardship.

Example: Taking conventional loan during resolution of IFI to settle the liabilities.

Source: Bank Negara Malaysia

A key aspect of this evaluation is understanding the extent and impact of the hardship involved, including whether the hardship affects a wide segment of the community or specific to certain IFIs. Proportionality ensures the exception matches the severity of the hardship, preventing unnecessary departures from Shariah principles. It is also crucial to assess whether the hardship needs any remedial actions, thereby requiring specific temporary exceptions to Shariah compliance. The application of SAC rulings concerning *hajah* and *darurah* is inherently temporary to the specific hardship at hand. This underscores the commitment to return to full Shariah compliance once the hardship is alleviated. This careful balance considers the need for flexibility weighed against the overarching objectives of Shariah to ensure that the responses are appropriately scaled to the severity and scope of the hardship.

Conclusion

In the pursuit of growth and sustainable innovation, the HD PD is integral to ensure IFIs continue to operate within Shariah-compliant boundaries while navigating hardships guided by a robust governance framework. IFIs' adherence to these boundaries will result in more consistent and rigorous applications of *hajah* and *darurah* and further foster trust and credibility in the practices of IFIs. As a pioneering initiative, the HD PD could serve as reference for the global Islamic finance community, promoting best practices and enhancing resilience of the broader ecosystem.

Implementation of the Standardised Approach for Credit Risk: Key Revisions under Basel III and the Impact on Banks

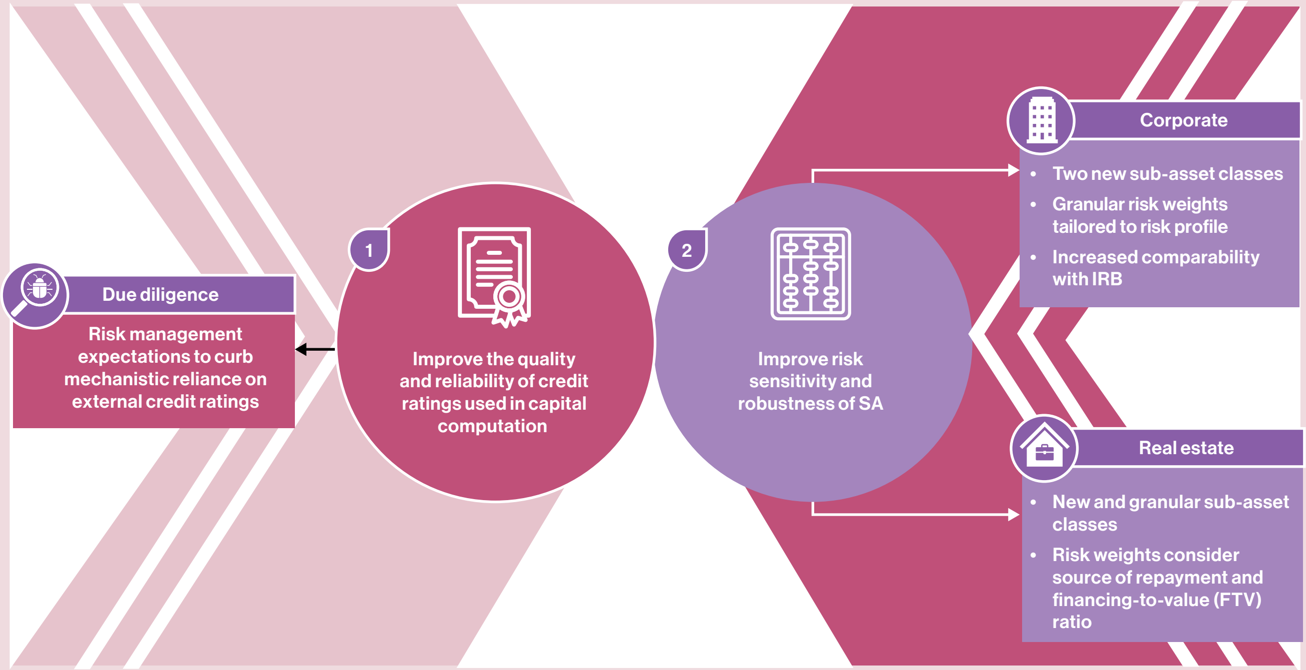
In 2017, the Basel Committee on Banking Supervision (BCBS) finalised key components of the revised capital framework for banks i.e. Basel III. The revisions in the framework were aimed at addressing the weaknesses identified from the 2008 global financial crisis. A key component of the revision is the computation of the risk-weighted assets (RWAs) for credit, market and operational risks to better reflect the inherent risk of these exposures.

BNM is committed to aligning the domestic capital framework with Basel III. This aims to enhance the resilience of our banking system against any potential shocks while ensuring that banks continue to support Malaysia's financing needs. In line with this commitment, BNM issued a revised capital framework for credit risk under the standardised approach (Standardised Approach for Credit Risk (SA)) in November 2024. The SA strengthens the capital buffers that banks hold against shocks in two ways (Diagram 1):

i. Improve the quality and reliability of credit ratings used in capital computation by requiring banks to independently conduct due diligence of borrowers, instead of relying solely on their external credit ratings.
ii. Improve the risk sensitivity and robustness of the standardised approach in computing capital.

These enhancements would also bring the SA more in alignment with the Internal Ratings-based approach for Credit Risk (IRB).

Diagram 1: Summary of the SA Revisions



Source: Bank Negara Malaysia

Due diligence requirement

Under Basel II, banks can use external credit ratings by rating agencies to determine the risk weights of corporate credit risk exposures. The due diligence requirement introduced in Basel III ensures that banks have a thorough understanding of the underlying risks of their exposures and do not mechanistically rely on external credit ratings. If banks observe the external credit ratings do not fully account for the underlying risks, they must revise the credit ratings and increase the regulatory risk weights for those exposures.

In Malaysia, under BNM's credit risk management expectations, banks are already required to perform credit risk assessments[1] on the borrower, where they must consider all relevant factors including macroeconomic, transaction, counterparty and country-risks when deriving a credit rating. In addition, when using external credit ratings, banks must demonstrate that they have sound understanding of the assessment methodology adopted by the rating agency. Therefore, the due diligence requirements under Basel III will better align credit ratings used for internal risk management and capital computation purposes. Banks operating in Malaysia are therefore well-placed to adopt the due diligence requirements under Basel III. The sophistication of the due diligence practices will depend on the size and complexity of the bank's financing activities.

Recalibration of risk weights for key asset classes

Under Basel II, certain asset classes are assigned flat risk weights or limited categories of risk weights. As a result, the risk weights prescribed under Basel II are not sufficiently granular to distinguish between different risk profiles of exposures and are less sensitive to changes in risk profiles compared to that observed under the IRB approach.

In line with Basel III, a number of new asset classes with more granular risk weights were introduced under the SA to improve the sensitivity of the risk weights and enhance comparability with IRB. These recalibrations mainly affected risk weights for financing to: (i) corporate exposures, and (ii) real estate exposures.

i. **Corporate exposures**
   Under Basel III, corporate exposures are broken down into three categories i.e. general corporate, corporate SMEs and specialised financing (Diagram 2) to better reflect the underlying characteristic and risk profile of the various types of corporate exposures.

Diagram 2: Corporate Exposures under Basel II and Basel III

	Basel II	Basel III	Exposure as % of total financing*
1 Corporate	**Corporate** *(5 risk weight buckets, range from 20%–150%)*	**General corporate** *(6 risk weight buckets, range from 20%–150%)*	~13%
		+ **Corporate SMEs** *(85% risk weight)*	~6%
		+ **Specialised financing** *Rated:* • *5 risk weight buckets, range from 20%–150%* *Unrated:* • *Commodity finance (100% risk weight)* • *Object finance (100% risk weight)* • *Project finance (depending on the stage of project development) i.e.* *Pre-operational project finance* 130% *Operational project finance* 100% *High-quality operational project finance* 80%	~1%

+ **New sub-asset classes introduced under Basel III**

* Total financing provided by banks, based on banks' submission to the Quantitative Impact Study for the position as at 31 December 2023.

Source: Bank Negara Malaysia

[1] Requirement stipulated in Credit Risk policy document.

In Malaysia, the predominant corporate exposures are in general corporate and corporate SMEs. Based on the Quantitative Impact Study (QIS)[2] conducted during the industry consultation process, 31% of the total corporate exposure will qualify as corporate SMEs exposure and attract a lower risk weight of 85%. Under Basel II, these SME exposures are normally unrated and would attract 100% risk weight. Specialised financing exposures are currently small, accounting for less than 1% of total financing, with the larger part being in project finance. Under Basel III, risk weights for project finance are broken down into three risk weight buckets which differentiate the risk of the project based on the project life-cycle and recognise certain features of the project which render it high-quality.

ii. Real estate exposures

Basel III introduces a more granular asset classification for real estate exposures namely residential real estate (RRE), commercial real estate (CRE), land acquisition, development, and construction (land ADC) and other real estate (Diagram 3).

RRE and CRE are further categorised into income-producing and non-income producing exposures. This is based on how the financing is expected to be repaid i.e. whether repayment is dependent on cash flows generated by the real estate collateral (income-producing) or based on the borrower's capacity to service the financing (non-income producing). In addition, the risk weights for these exposures are calibrated to be more risk-sensitive to their level of collateralisation i.e. financing-to-value (FTV).

Land ADC exposures attract a higher risk weight due to the construction performance risk as the source of repayment depends on the cash flows generated by the property under construction.

Diagram 3: Real Estate Exposures under Basel II and Basel III

2 Real estate

Basel II	Basel III	Exposure as % of total financing*
Residential real estate *(3 risk weight buckets, range from 35%–100%)* **BCBS Basel II: Flat risk weight of 35%**	**Residential real estate** *Income-producing:* • *5 risk weight buckets, range from 30%–90%* *Non-income producing:* • *5 risk weight buckets, range from 20%–90%*	~21%
Commercial real estate *(Risk weight based on counterparty and ranges from 0%–100%)* **BCBS Basel II: Flat risk weight of 100%**	**Commercial real estate** *Income-producing:* • *3 risk weight buckets, range from 70%–110%* *Non-income producing:* • *2 risk weight buckets - 60% risk weight or follow counterparty risk weight*	~8%
	+ **Land ADC** *(2 risk weight buckets - either 100% or 150%)*	~1%
	+ **Other real estate** *Income-producing:* • *150% risk weight* *Non-income producing:* • *85%, 90% or risk weight based on counterparty*	~6%

+ **New sub-asset classes introduced under Basel III**

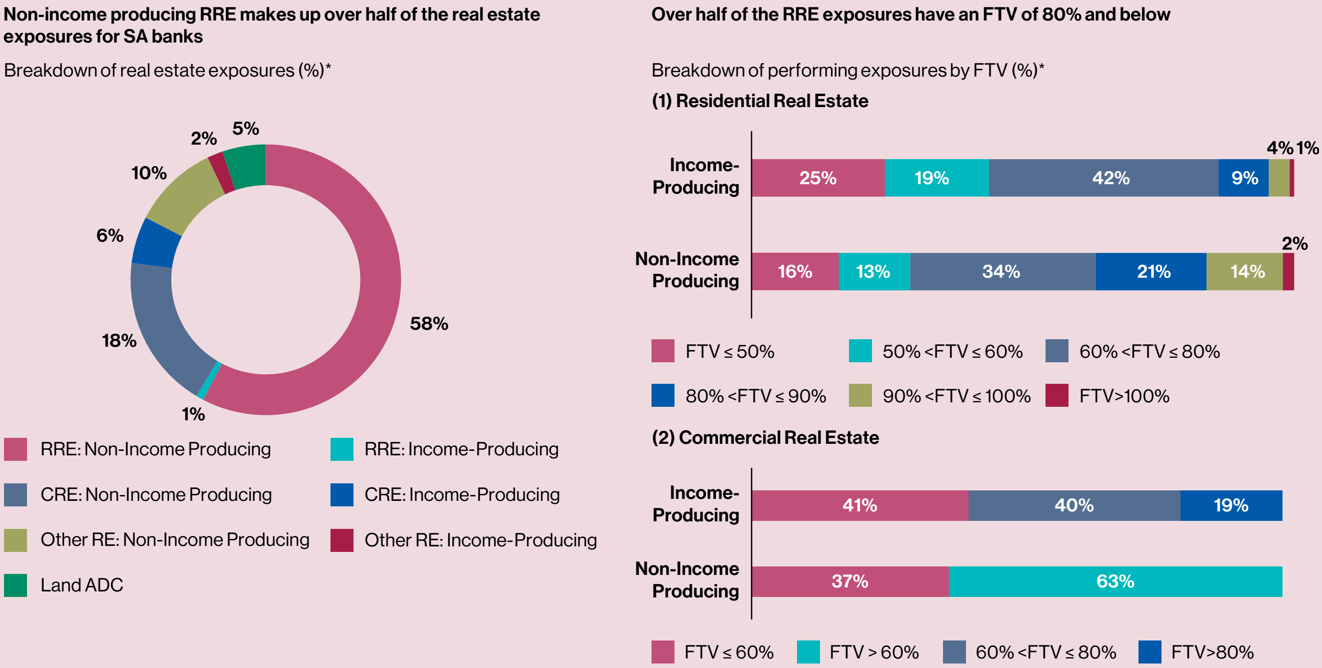
* Total financing provided by banks, based on banks' submission to the Quantitative Impact Study for the position as at 31 December 2023.

Source: Bank Negara Malaysia

[2] The QIS was issued in 2023, alongside the release of the exposure draft on the SA.

Based on QIS, around 60% of the real estate exposures of banks in Malaysia under SA are RRE. Of this, more than half of the exposures will qualify for lower risk weights based on the more granular FTV buckets (Diagram 4).

Diagram 4: Real Estate Exposures for SA Banks



* Based on banks' submission to the Quantitative Impact Study for the position as at 31 December 2023.

Source: Bank Negara Malaysia

Basel III also requires banks to compute the FTV ratio using the value of the property at the point of financing origination. This approach is intended to mitigate the impact of sharp price fluctuations during property booms or busts that could lead to excessive cyclicality in risk weights, and ultimately, capital and lending activity.

Expected impact on banks' capital

The results from the QIS carried out by BNM based on outstanding exposures as at 31 December 2023, indicate that changes to the SA are expected to have a fairly neutral capital impact on banks. At the industry level, the total capital ratio of banks adopting the SA will improve by 25 basis points. However, the impact to individual banks varies, depending on their financing portfolios and risk profiles (Diagram 5).

The SA will come into effect on 1 July 2026.

Diagram 5: Financing Portfolios

	Financing Portfolios	Impact on Capital
Real Estate	Residential properties	Reduced *
	Commercial properties	Reduced
	Land acquisition for development, and development of residential or commercial properties	Increased
Corporate	Corporate	Unchanged
	Unrated specialised finance	Increased
	Corporate SMEs	Reduced

Note:
* Assuming growth in property values remains stable.

Based on banks' submission to the Quantitative Impact Study for the position as at 31 December 2023.

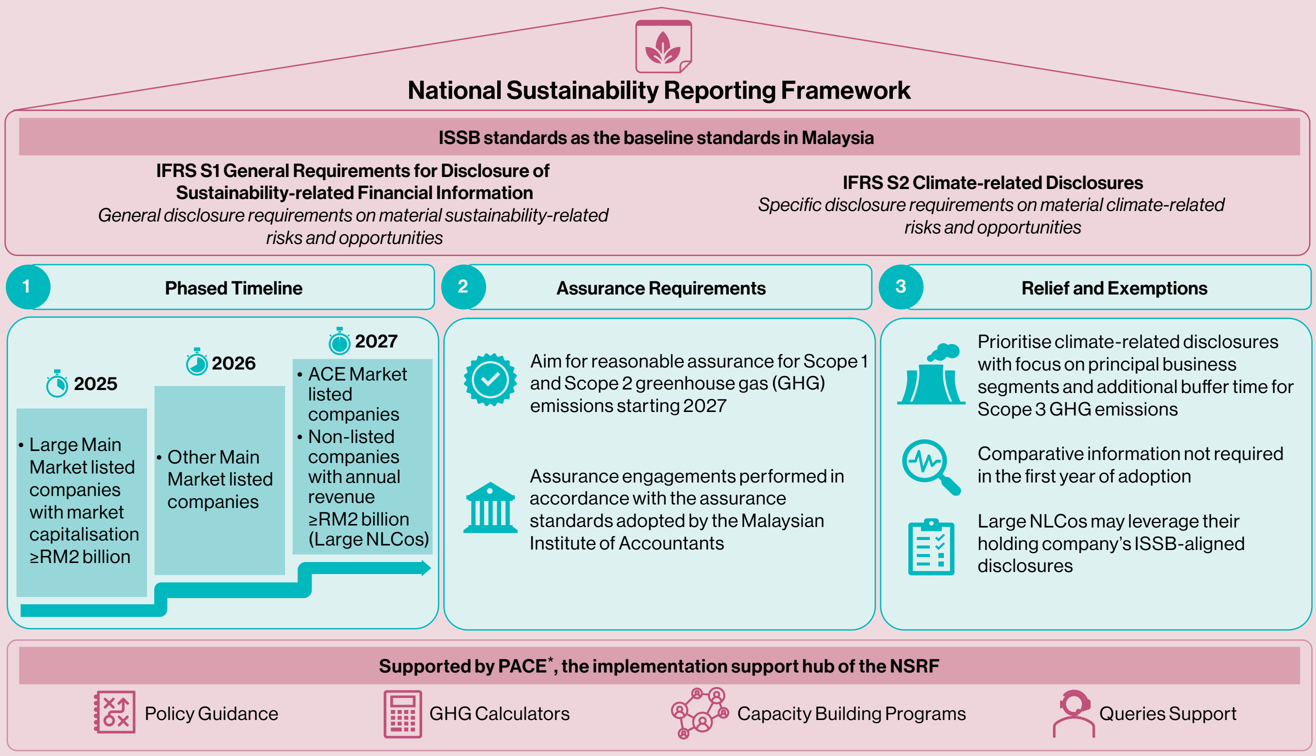
Source: Bank Negara Malaysia

Navigating the Financial Sector's Transition to the National Sustainability Reporting Framework

Following the issuance of the sustainability disclosure standards (ISSB standards) by the International Sustainability Standards Board (ISSB)[1] in June 2023, Malaysia has developed the National Sustainability Reporting Framework (NSRF), spearheaded by the Advisory Committee on Sustainability Reporting (ACSR).[2] The NSRF, published in September 2024, provides the timeline and approach on the use of ISSB standards[3] as the baseline sustainability disclosure standards in Malaysia. In essence, the NSRF requires companies to produce consistent and comparable disclosures to enhance the credibility of the reports and promote improved decision-making and stakeholder engagement.

Diagram 1 provides a snapshot of the NSRF and the support available to facilitate its adoption. This article discusses the progress of financial institutions in producing climate-related disclosures and the implications of the NSRF on them.

Diagram 1: Overview of National Sustainability Reporting Framework and Support Provided



* PACE is an initiative established to assist the adoption of the NSRF. The four key features of PACE are policy guidance (P), assumptions (A), emission calculators (C) and educational resources (E).

Source: National Sustainability Reporting Framework

Implementation of climate-related disclosures by financial institutions

As outlined in the Climate Risk Management and Scenario Analysis policy document (CRMSA PD) by BNM, financial institutions are required to produce climate-related disclosures[4] aligned to the recommendations of the Financial

1 The ISSB is a sister body to the International Accounting Standards Board (IASB) established by the International Financial Reporting Standards (IFRS) foundation in 2021 with the responsibility to develop the IFRS sustainability disclosure standards and provide a global baseline for sustainability disclosures.
2 The ACSR is a national inter-agency committee formed with the endorsement of the Ministry of Finance and chaired by the Securities Commission Malaysia (SC). Members comprised of representatives from the Audit Oversight Board of the SC, Bank Negara Malaysia (BNM), Companies Commission of Malaysia, Bursa Malaysia Berhad and the Financial Reporting Foundation.
3 Specifically, IFRS S1 on General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 on Climate-related Disclosures.
4 The CRMSA PD requires financial institutions to produce annual TCFD-aligned climate-related disclosures for financial years beginning on or after 1 January 2024. The TCFD recommendations provide a framework for companies to disclose information on their climate risks and opportunities across four core areas, namely governance, strategy, risk management, and metrics and targets, which have been incorporated into the ISSB Standards.

Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) starting 2024. To this end, some larger domestic financial institutions have started producing TCFD-aligned disclosures in their 2023 sustainability-related reports. Others are on track to produce their first TCFD-aligned disclosures alongside their 2024 financial statements. In general, notable progress has been observed in the following areas:

i. Governance policies and processes are in place to ensure the production of high-quality disclosures and mitigate the risks of greenwashing. The boards of financial institutions continue to provide robust oversight to ensure the information on climate exposures and risks in the financial statements is accurate and complete.
ii. Some banks and insurers intend to enhance the credibility of the information disclosed by obtaining third-party verification on specific details, such as Scope 1 and Scope 2 greenhouse gas (GHG) emissions. This will complement their internal verification processes and serve to prepare banks and insurers to meet the mandatory external assurance requirements which are expected to come into effect in 2027 at the earliest. The external verification providers may include both accounting and non-accounting practitioners.
iii. For financial institutions leveraging consolidated reports from their foreign group, these reports also feature material information on the Malaysian operations and provide insights into how the group policies affect local operations.

The need for reliable, high-quality data continues to be a major challenge, especially when it comes to customer and counterparty-specific data. Financial institutions have been observed to leverage:

i. The use of proxies,[5] such as sector average GHG emissions as model inputs to estimate the potential loss impacts from exposures to climate-related risks.
ii. Internally developed assessment systems, such as a flood risk assessment system built using historical data from a public agency in collaboration with external service providers or data compiled in an internal data repository to centralise access to climate data.
iii. Data and tools procured from third-party service providers to assess the potential impact of climate-related risks and opportunities.

Adoption of the NSRF for financial institutions

With steady progress in producing TCFD-aligned disclosures, the financial sector is well-placed to adopt the ISSB standards in Malaysia. BNM has revised the CRMSA PD[6] to incorporate the timelines and additional expectations set out under the NSRF for producing ISSB-aligned climate-related disclosures in phases starting in 2025. All financial institutions are expected to be ISSB-aligned by the year 2027. Diagram 2 provides an overview of the adoption timeline following the NSRF for all financial institutions.

Diagram 2: Adoption Timeline of NSRF for Financial Institutions

Applicable Entities		Timeline					
		2025	2026	2027	2028	2029	2030
Group 1	Main Market listed financial institutions with market capitalisation (excluding treasury shares) of RM2 billion and above as of 31 December 2024, or as at the date of its listing after 31 December 2024	🔴	🔴	🟢 🟠	🟢 🟠	🟢 🟠	🟢 🟠
Group 2	Main Market listed financial institutions (other than those in Group 1)		🔴	🔴	🟢 🟠	🟢 🟠	🟢 🟠
Group 3	All other financial institutions (other than Group 1 and 2)			🔴	🔴	🔴 🟠	🟢 🟠

🔴 Climate-related disclosures with relief on Scope 3 GHG emissions.
🟢 Sustainability and climate-related disclosures with mandatory Scope 3 GHG emissions.
🟠 Mandatory assurance for Scope 1 and 2 GHG emissions (subject to further consultation by the ACSR).

Source: Bank Negara Malaysia

[5] For example, the Global GHG Accounting and Reporting Standards by the Partnership for Carbon Accounting Financials (PCAF).
[6] Revised requirements issued on 17 March 2025.

Ongoing progress by financial institutions to adopt the TCFD-aligned disclosures will continue to serve as a solid foundation for financial institutions to adhere to the ISSB standards, which are developed based on the TCFD recommendations. To ease the reporting journey, financial institutions can leverage initiatives from PACE and the Joint Committee on Climate Change (JC3).[7] Diagram 3 provides an overview of the step-up requirements for financial institutions to transition from TCFD to ISSB standards.

Diagram 3: Step-up Requirements from TCFD to ISSB Standards

The ISSB standards are built on TCFD with additional disclosures and requirements for more detailed information

TCFD Recommendations

Outlines 4 foundational pillars:

- **Governance** – Disclose governance processes, controls and procedures used to monitor, manage and oversee climate-related risks and opportunities (CROs)
- **Strategy** – Disclose actual and potential impacts of CROs on businesses, strategy and financial planning
- **Risk Management** – Disclose the process to identify, assess and manage CROs
- **Metrics and Targets** – Disclose metrics and targets used to assess and manage performance of CROs

ISSB Standards

Builds on TCFD with additional expectations:

- **Disclose climate and other material sustainability information** – e.g. biodiversity and nature, water and waste management
- **Additional disclosure requirements** – e.g. use of industry-based disclosures and metrices, disclosures of opportunities in addition to risks for risk management
- **More detailed information** – for climate-related disclosures, in areas of transition plan, climate resilience assessment / scenario analysis, consolidated data for emissions, use of carbon offsets etc.

Source: Bank Negara Malaysia

The NSRF sets a clear path for the adoption of ISSB standards in Malaysia. Building on progress made, financial institutions are expected to continue to further enhance their disclosures, especially on financed emissions.[8] In this regard, financial institutions can play a meaningful role in assisting their clients to improve climate-related data collection and reporting. This will in turn enhance data capture and disclosures throughout the value chain which remains crucial to enable financial institutions to better manage climate-related risks and opportunities.

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[7] JC3 offers various capacity building program throughout the year. Refer to JC3 website for access to the upcoming events and existing resources including the Climate Data Catalogue.
[8] Financed emissions refer to GHG emissions associated with loans and investments made by financial institutions.

Annex

Table A.1

Key Financial Soundness Indicators

	As at end				
	2H 2022	1H 2023	2H 2023	1H 2024	2H 2024*p*
	% (or otherwise stated)				
Banking System					
Total Capital Ratio	19.0	18.8	19.0	18.5	18.3
Tier 1 Capital Ratio	15.8	15.7	15.9	15.4	15.3
Common Equity Tier 1 Capital Ratio	15.2	15.1	15.4	14.9	14.8
Return on Assets[1]	1.4	1.3	1.2	1.3	1.4
Return on Equity[1]	12.4	11.5	11.2	12.1	12.2
Liquidity Coverage Ratio	152.1	154.5	161.0	155.2	160.7
Net Impaired Loans Ratio[2]	1.1	1.1	1.1	1.0	0.9
Capital Charge on Interest Rate Risk in the Trading Book to Capital Base	0.9	1.0	1.0	1.3	1.3
FX Net Open Position to Capital Base	3.4	3.7	3.9	5.2	3.9
Equity Holdings to Capital Base	1.2	1.2	1.4	2.3	2.2
Insurance and Takaful Sector					
Capital Adequacy Ratio	225.5	226.4	222.2	226.8	224.3
Life Insurance and Family Takaful					
Excess Income over Outgo (RM billion)[3]	5.5	6.0	3.5	8.4	4.1
New Business Premium / Contribution (RM billion)	10.8	12.6	11.5	14.0	12.2
Capital Adequacy Ratio	216.4	217.5	211.2	219.9	215.5
General Insurance and General Takaful					
Operating Profit (RM billion)	2.1	1.3	1.8	1.7	1.9
Underwriting Profit (RM billion)	1.2	0.2	0.8	0.7	0.9
Gross Direct Premium / Contribution (RM billion)	12.1	13.3	13.3	14.6	13.9
Claims Ratio	52.0	60.7	56.7	58.5	56.6
Capital Adequacy Ratio	249.5	250.0	253.0	242.5	248.1
Household (HH) Sector					
HH Debt (RM billion)	1,451.4	1,481.8	1,534.7	1,573.5	1,625.2
HH Financial Assets (RM billion)	3,002.0	3,038.7	3,176.8	3,300.1	3,452.3
HH Debt-to-GDP Ratio	80.9	81.9	84.2	83.8	84.2
HH Financial Assets-to-Total HH Debt Ratio	206.8	205.1	207.0	209.7	212.4
HH Liquid Financial Assets-to-Total HH Debt Ratio	135.4	133.3	132.3	135.2	134.3
Impaired Loans Ratio of HH Sector (Bank+ DFI Loans)[4]	1.2	1.3	1.2	1.2	1.1
Impaired Loans Ratio of HH Sector (Non-Bank Loans)[5]	2.0	1.9	1.7	1.8	1.8
Business Sector					
Return on Assets	2.5	2.4	2.4	2.5	2.4
Return on Equity	4.6	3.8	4.0	4.2	4.4
Debt-to-Equity Ratio	22.6	20.9	20.6	20.2	21.3
Interest Coverage Ratio (times)	7.4	5.7	5.8	5.7	6.4
Operating Margin	7.0	6.6	7.0	7.0	7.5
Impaired Loans Ratio of Business Sector[4]	3.6	3.6	3.5	3.5	3.1
Development Financial Institutions[6]					
Lending to Targeted Sectors (% change)	1.3	2.4	5.9	5.3	5.6
Deposits Mobilised (% change)	3.9	1.8	-0.1	4.3	7.2
Impaired Loans Ratio	5.5	5.9	5.6	6.0	5.6
Return on Assets	1.1	1.2	1.3	1.4	1.2

1 Banking system profits are aggregated at the entity level and adjusted for dividend income received from domestic banking subsidiaries.
2 Based on Stage 3 loans under the Malaysian Financial Reporting Standard 9 (MFRS 9).
3 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.
4 Based on Stage 3 loans under the Malaysian Financial Reporting Standard 9 (MFRS 9). Data refers to banking system and development financial institution (DFI) loans.
5 Based on loans with 3 months or more in-arrears. Beginning 2H 2024, the data series has been revised to exclude DFIs, and thus, may not be directly comparable to the data reported in previous publications.
6 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 and Bank Negara Malaysia estimates

Table A.2

Key Financial Indicators: Islamic Banking and Takaful Sectors

	As at end				
	2H 2022	1H 2023	2H 2023	1H 2024	2H 2024*p*
Islamic Banking System	RM million (or otherwise stated)				
Total Assets[1]	1,316,121.5	1,343,223.8	1,398,193.1	1,440,593.4	1,516,590.2
% of total assets of entire banking system[1]	36.3	36.2	36.6	36.9	38.0
Total Financing[1]	974,383.5	993,226.8	1,049,910.7	1,083,599.8	1,133,034.6
% of total loans / financing of entire banking system[1]	44.5	44.7	45.6	45.9	46.6
Total Deposits and Investment Accounts[1]	1,058,671.8	1,075,999.2	1,121,986.4	1,148,306.9	1,197,989.6
Total Deposits[1]	926,471.6	933,153.2	968,569.3	990,501.3	1,029,031.3
Total Investment Accounts[1]	132,200.2	142,845.9	153,417.1	157,805.6	168,958.2
% of total deposits and investment accounts of entire banking system[1]	41.6	41.6	42.0	42.3	43.2
	%				
Total Capital Ratio	18.9	18.2	18.0	17.9	17.9
Tier 1 Capital Ratio	15.5	14.8	14.8	14.6	14.8
Common Equity Tier 1 Capital Ratio	14.8	14.1	14.0	13.9	14.0
Return on Assets	1.3	1.0	1.0	1.1	1.1
Net Impaired Financing Ratio	1.0	1.1	1.1	1.0	1.0
Takaful Sector	RM million (or otherwise stated)				
Takaful Fund Assets	49,864.4	52,461.9	55,631.9	59,749.8	59,681.2
Family	43,645.1	45,969.0	48,476.1	52,274.9	51,645.6
General	6,219.4	6,492.9	7,155.8	7,474.9	8,035.5
% of insurance and takaful industry	13.4	13.7	14.0	14.2	13.9
Net Contribution Income	7,715.3	8,973.5	8,310.7	9,756.8	9,239.9
Family	5,853.9	7,053.3	6,217.6	7,527.1	6,969.8
General	1,861.4	1,920.2	2,093.1	2,229.6	2,270.1
% of insurance and takaful industry	21.6	24.7	22.1	24.7	23.1
Family Takaful					
New Business Contribution	4,618.9	5,225.6	4,363.4	5,228.6	4,503.5
General Takaful					
Gross Direct Contribution	2,407.2	2,679.0	2,764.4	2,960.4	2,940.9
Claims Ratio (%)	61.0	64.3	62.2	63.6	64.3

[1] Including 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