

Chartered Financial Analyst (CFA®) Program

BNM's Pandemic Relief Measures: A Welcomed Move to the Malaysian Banking Industry?



Speakers Today



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Disclaimer

Information in this presentation is intended to provide only a general outline of the subjects covered.

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Agenda

a) APAC Regional Overview: Responses from various national regulators

b) Malaysia Overview: BNM's Pandemic Relief Measures

c) C-A-M-E-L-S Framework:

- **Capital**
- **Asset Quality**
- **Earnings**
- **Liquidity**
- **Sensitivity to Market Risk**

The discussion broadly covers across various topics, e.g. Financial Reporting Analysis, Economics, Equity, Fixed Income across 3 levels.

Example: CFA Level II Reading 16: Analysis of Financial Institutions

- a) describe how financial institutions differ from other companies;
- b) describe key aspects of financial regulations of financial institutions;
- c) explain the CAMELS (capital adequacy, asset quality, management, earnings, liquidity, and sensitivity) approach to analyzing a bank, including key ratios and its limitations;
- d) describe other factors to consider in analyzing a bank;
- e) analyze a bank based on financial statements and other factors;
- f) describe key ratios and other factors to consider in analyzing an insurance company.

Updates on regulatory and supervisory responses in Asia Pacific

Legend:

- Loans, NPL, Provisioning
- Capital and Liquidity
- Others

HONG KONG



Some AIs have *informed HKMA* and they plan to roll out temporary relief measures to help their customers

The *counter-cyclical capital buffer* from 2.0% to 1.0% with immediate effect.

The SFC reiterated the obligations to properly manage the *liquidity of funds* and ensure *fair treatment of investors*

Japan



The JFSA requested FIs to support the cash flow of corporate clients in light of the COVID-19 outbreak

The JFSA affirmed that the banks *ay use their capital buffers* so as to absorb losses and maintain necessary funding to the economy under the stressed situation.

Banks also may use *liquidity buffers* so as to absorb the liquidity shock under the stressed market environment

SINGAPORE



MAS *welcomes measures* by financial institutions to support customers facing the impact of COVID-19

FIs are reminded to adopt *BCPs* and appropriate control measures and guard against *cyber threats* in this uncertain environment.

AUSTRALIA



APRA *announced temporary changes on capital*, noting that banks may be required to draw down on capital to the minimum CET1 ratio of 10.5% in order to support the economy in light of the impact of COVID-19.

APRA *suspended the majority of its 2020 policy* and supervision priorities in order to free up capacity for regulated entities and APRA to focus on managing the impact of COVID-19 on customers and operations

Overview of BNM Policy Changes

22nd Jan 2020 – Announcement of 0.25% overnight policy rate cut to 2.75% as a pre-emptive measure to secure improving growth trajectory amid dissipation of trade tensions. With Covid-19 cases in China on the rise and slowing domestic economic activities, capital market is pricing in another round of policy rate cut.

3rd Mar 2020 – As expected by capital market, BNM delivered another round of 0.25% policy cut citing weakening global economic conditions. Since May 2019, Overnight Policy Rate was lowered by 0.75% to just 2.50%, a level not seen since Global Financial Crisis in 2008. Banks are increasingly facing profit margin compression from lower lending rates.

19th Mar 2020 – With foreigners being net seller of MYR fixed income and equity assets, BNM slashed Statutory Reserve Requirement ratio from 3% to 2%. This move is expected to release approximately RM30bil worth of financial institutions liquidity into the banking system, aiming to support domestic financial assets prices.

24th Mar 2020 – BNM again made a few announcements to support the domestic banking system, notably the automatic 6-month loan moratorium to SMEs and consumer loans excluding credit card balances starting 1st April. This move is likely to assist banks to continue to accrue interests on loan (i.e. to continue to report earnings) and keeping asset quality healthy. However this moratorium will still affect bank's cash flow. As such, Bank Negara allows banks to run at a liquidity coverage ratio of below 100% (with lower boundary at 80%) up to end of September next year. Banks can also draw down on its capital conservation buffer of 2.5% - so the minimum required CET-1 ratio will be 4.5% instead of 7% up to end of 2020.

What are key prudential ratios for banks?

3 + 3 + 2 + 1

3 CAPITAL ADEQUACY RATIOS

CET 1 Ratio	Tier 1 Ratio	Capital Ratio
4.5%	6.0%	8.0%
$\frac{\text{Capital}}{\text{Risk Weighted Assets}}$		

2 LIQUIDITY RATIOS

- 1) Liquid Coverage Ratio (LCR) $\geq 100\%$
- 2) Net Stable Funding Ratio (NSFR) $\geq 100\%$

3 CAPITAL BUFFERS

- 1) Conservation buffers (2.5%)
- 2) Countercyclical buffers (0-2.5%)
- 3) D-SIBs buffers (0.5% - 2%)

1 LEVERAGE RATIOS

- 1) Leverage Ratio $\geq 3\%$

$$\frac{\text{Tier 1 Capital}}{\text{Total Assets}}$$

(1) Capital Adequacy

1. “Capital adequacy,” described in terms of the proportion of the bank’s assets that is funded with capital, indicates that a bank has enough capital to absorb potential losses without severely damaging its financial position.

1

$$\frac{\text{CET 1 Capital}}{\text{Total Risk Weighted Assets}} = \text{CET 1 Capital Ratio}$$

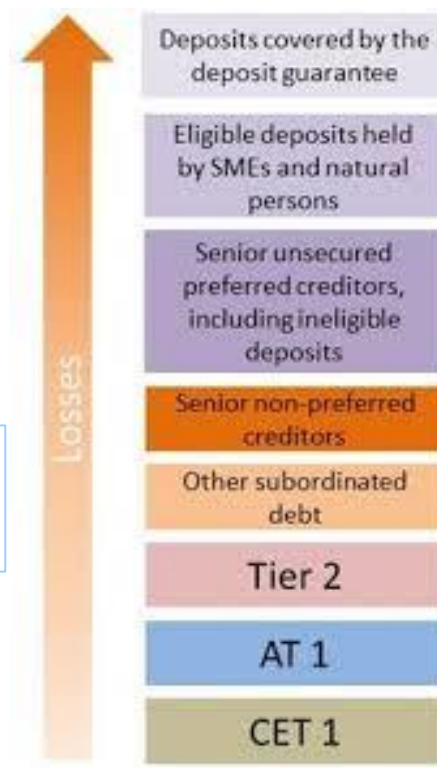
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$$\frac{\text{Tier 1 Capital}}{\text{Total Risk Weighted Assets}} = \text{Tier 1 Capital Ratio}$$

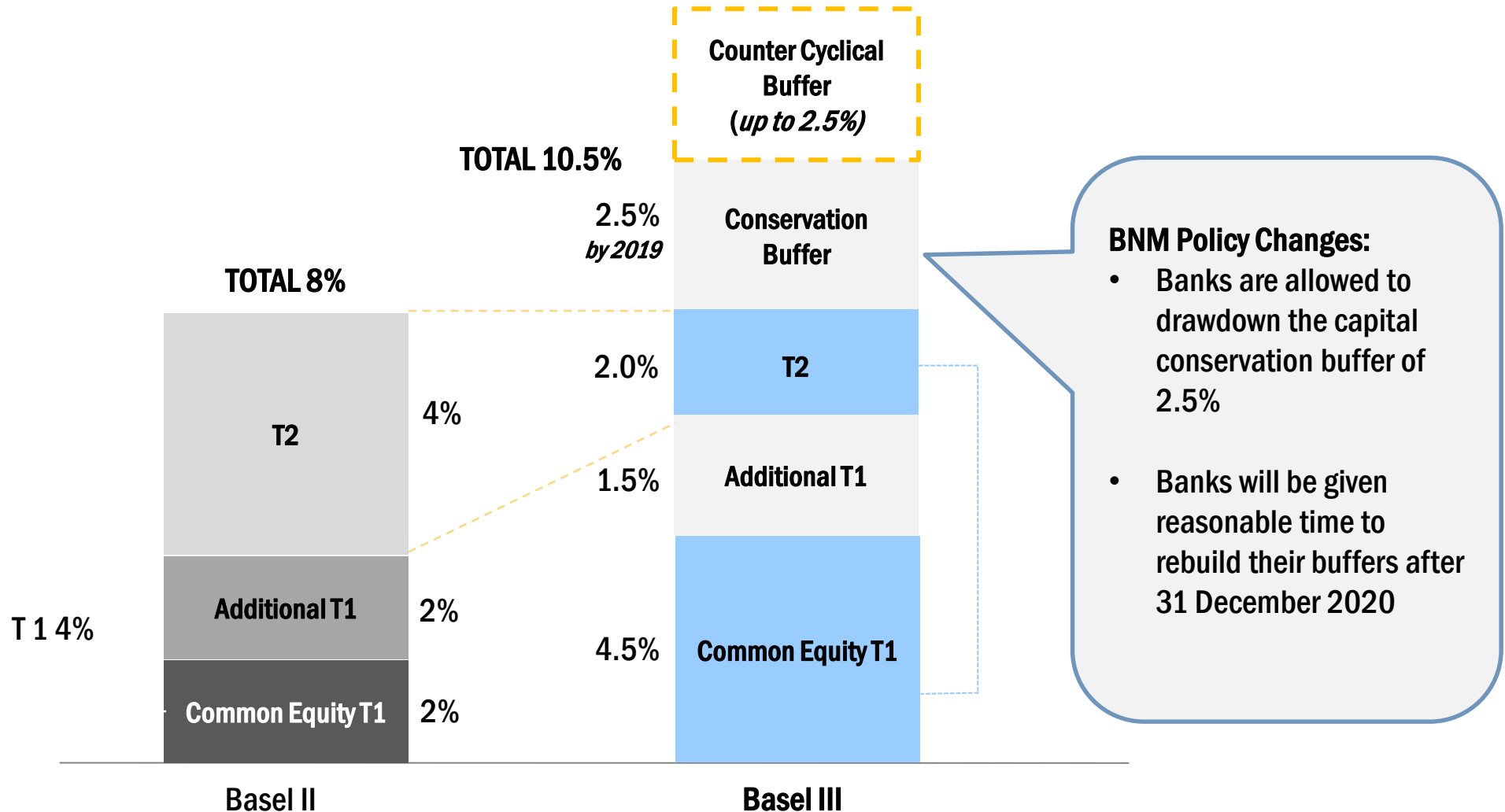
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$$\frac{\text{Total Regulatory Capital}}{\text{Total Risk Weighted Assets}} = \text{Total Capital Ratio}$$

	CET 1 Ratio	Tier 1 Ratio	Capital Ratio
Basel III	4.5%	6.0%	8.0%



(1) Capital Adequacy



(2) Asset Quality

2. “Asset quality” includes the concept of quality of the bank’s assets—credit quality and diversification—and the concept of overall sound risk management.

1. **Loans** typically constitute the largest portion of a bank’s assets. Asset quality for loans reported on the balance sheet depends on the creditworthiness of the borrowers and the corresponding adequacy of adjustments for expected loan losses. Loans are measured at amortized cost and are shown on the balance sheet net of allowances for loan losses.
2. **Investments in securities** issued by other entities, often another significant portion of a bank’s assets, are measured differently, depending on how the security is categorized.
3. Specifically, under International Financial Reporting Standards (IFRS), financial assets are classified in one of three categories, depending on the company’s business model for managing the asset and on the contractual cash flows of the asset.
 - The financial asset’s category specifies how it is subsequently measured (either amortized cost or fair value) and, for those measured based on fair value, how any changes in value are reported – either through other comprehensive income (OCI) or through profit and loss (PL). The three categories for financial assets are (1) measured at amortized cost, (2) measured at fair value through other comprehensive income (FVOCI), and (3) measured at fair value through profit and loss (FVTPL).

(2) Asset Quality

IFRS 9 ECL Impairment Requirements

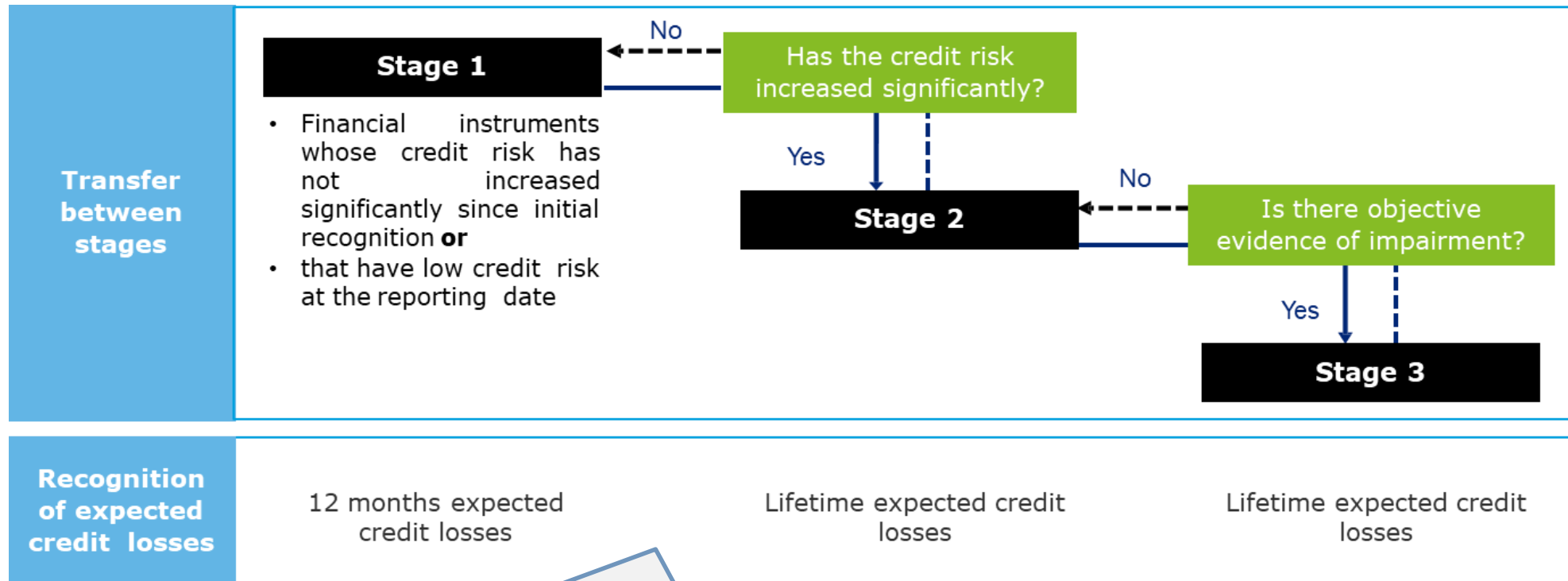
- | | |
|--|---|
| 1. 12-month ECL models required | 6. Lifetime ECL models required |
| 2. Sensitive to economic cycle | 7. Discounting incorporated |
| 3. Macroeconomic forecasting element | 8. Assess credit deterioration from origination |
| 4. Determine 'significant increase in credit risk' | 9. Default must be defined |
| 5. Define product lifetime | |

10. Forward looking loss estimate

BNM Policy Changes:

Banks are to incorporate impacts of COVID-19 and government economic measures, in their forward-looking loss estimate. The impacts should be reasonable and well-supportable.

(2) Asset Quality



BNM Policy Changes:

Moratoriums provided to borrowers should not automatically result in stage transfer under MFRS 9

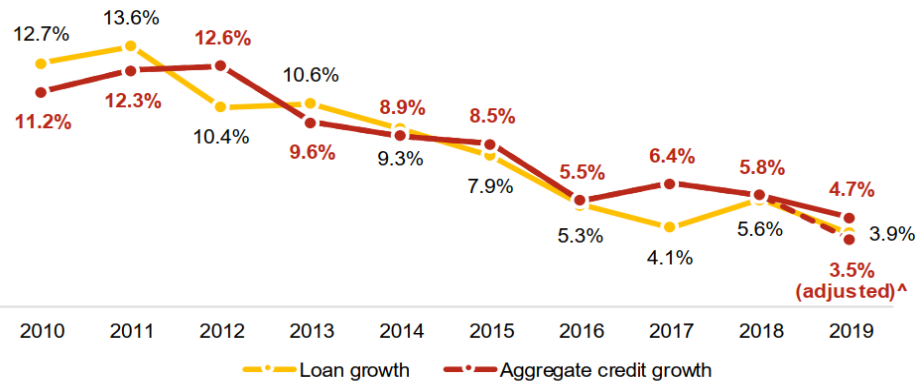
(3) Earnings

4. “Earnings” refers to the bank’s return on capital relative to cost of capital and also includes the concept of earnings quality.

1. For banks, one important area involving significant estimates is loan impairment allowances. In estimating losses on the loan portfolio collectively, statistical analysis of historical loan losses can provide a basis for an estimation, but statistical analysis based on past data must be supplemented with management judgement about the potential for deviation in future. In estimating losses on individual loans, assessments are required concerning the likelihood of the borrower’s default or bankruptcy and the value of any collateral.
2. Banks also must use estimates in valuing some financial assets and liabilities that must be measured at fair value. When fair value of an investment is based on observable market prices, valuation requires little judgment. However, when fair values cannot be based on observable market prices, judgment is required.

Malaysian Banks' earnings indicators have been a downtrend since 2015...

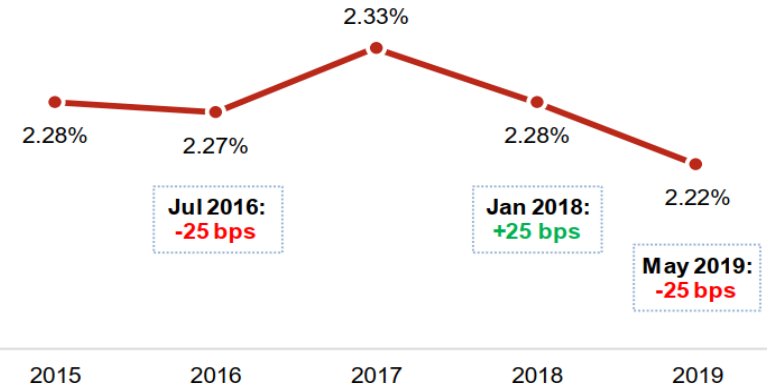
Loan and aggregate credit expansion



Source: BNM

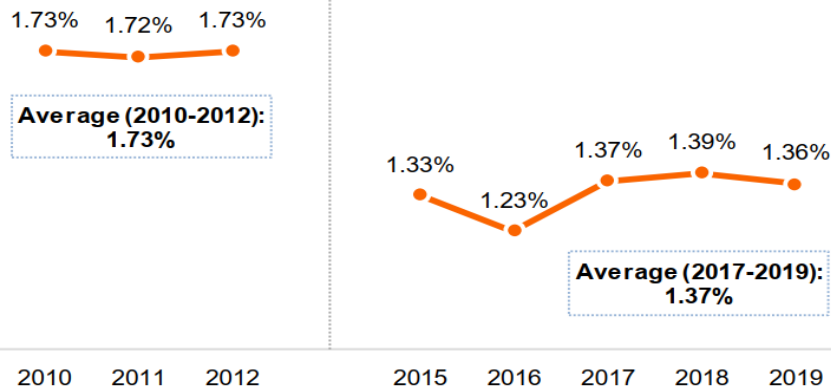
^ Adjusted to exclude Urusharta Jamaah's extraordinary issuance.

Continued contraction in NIMs



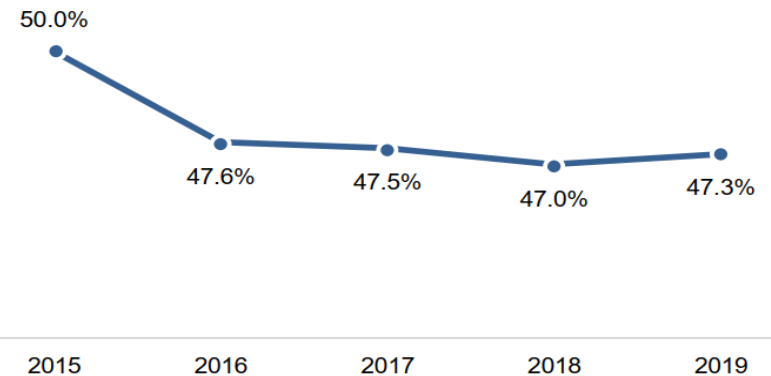
Sources: Banks' financial statements

Weaker average pre-tax ROA



Sources: Banks' financial statements

Cost-to-income ratio held steady



Sources: Banks' financial statements

Higher non-interest income helped Malaysian Banks in 2019, but it is unlikely to happen again in 2020...

Summary of eight anchor banks' financial performance (excluding exceptional or non-recurring items)

Calendar year	2018 (RM bil)	2019 (RM bil)	y-o-y change	Remarks
Net interest income^	51.1	52.3	+3%	Loan growth was 3.9% y-o-y, with slight NIM compression (-6 bps) partially offsetting the upside.
Non-interest income^	18.8	20.7	+10%	The improvement was supported by stronger trading and investment income amid lower bond yields. ⁷⁷
Operating income	69.9	73.1	+5%	
Operating expenses	33.0	35.1	+6%	The higher expenditure is mostly attributable to CIMB's incremental costs from its <i>Forward23</i> programme.
Pre-provision operating profit	36.9	38.0	+3%	
Impairment charges on loans	(3.6)	(4.6)	+26%	The elevated credit costs mainly stemmed from two major players' overseas exposures.
Impairment charges on non-loan assets	(0.2)	(0.4)	+142%	The increase mostly relates to CIMB's writing off of intangible assets.
Share of profits of associates and joint ventures	0.7	0.8	+12%	
Core pre-tax profit	33.8	33.8	+0.1%	On the whole, core pre-tax profit was flat y-o-y due to higher impairment losses.

Sources: Banks' financial statements

(4) Liquidity

5. “**Liquidity**” refers to the amount of liquid assets held by the bank relative to its near- term expected cash flows. Under Basel III, liquidity also refers to the stability of the bank’s funding sources.

The **Liquidity Coverage Ratio (LCR)** is expressed as the minimum percentage of a bank’s expected cash outflows that must be held in highly liquid assets. For this ratio, the expected cash outflows (the denominator) are the bank’s anticipated one-month liquidity needs in a stress scenario, and the highly liquid assets (the numerator) include only those that are easily convertible into cash. The standards set a target minimum of 100%.

- Must hold a stock of **unencumbered high-quality liquid assets (“HQLA”)** which are liquid in markets in times of stress
- Assets are subject to operational requirements
- HQLA are categorised into Level 1 & Level 2
- 3 alternative treatments for jurisdictions with insufficient liquid assets

LCR

At a minimum, the stock of liquid assets should enable the bank to survive until Day 30 of the stress scenario

STOCK OF HQLA

TOTAL NET CASH
OUTFLOWS OVER THE
NEXT 30 CALENDAR DAYS

1

≥ 100%

2

- = Outflows – Min (inflows; 75% of outflows)
- Categorisation and run-off rates of cash outflows

BNM Policy Changes:

- Banks are allowed to operate below the minimum LCR of 100%

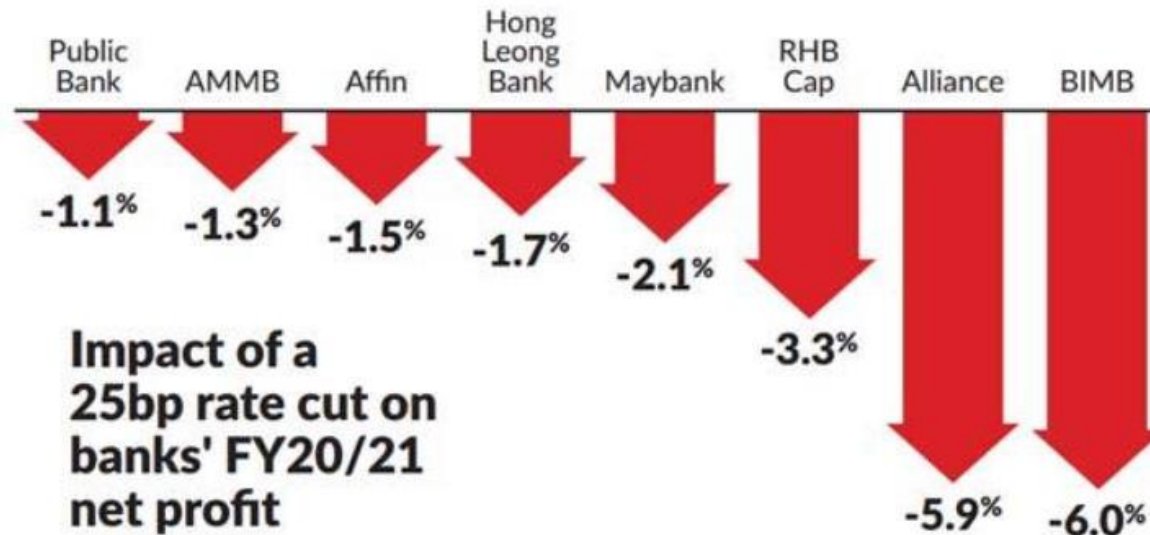
(5) Sensitivity to Market Risk

6. **“Sensitivity to market risk”** pertains to how adverse changes in markets (including interest rate, exchange rate, equity, and commodity markets) could affect the bank’s earnings and capital position.

The nature of banks’ operations generally makes sensitivity of earnings to market risks a particularly important consideration for analysts. Mismatches in the maturity, repricing frequency, reference rates, or currency of banks’ loans and deposits create exposure to market movements.

Further, exposure to risk arises not only from loans and deposits on a bank’s balance sheet but also from off- balance sheet exposures, including, for example, guarantees or derivatives positions linked to interest rates, exchange rates, equities, or commodities. It is important to understand how an adverse change in any of these markets would affect a bank’s earnings. It is also important to evaluate the strength of a bank’s ability to manage market risks.

Sensitivity of interest rate change on Malaysian Banks' interest income



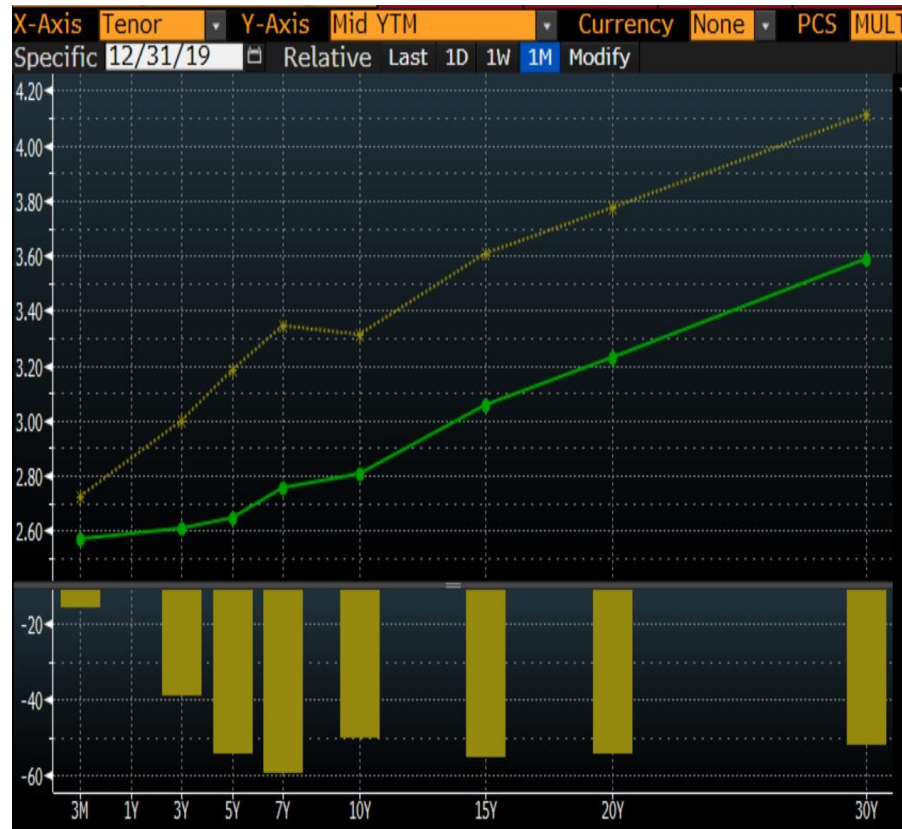
Source: CIMB Research

Even in a purely hypothetical situation of a bank with assets and liabilities that are identical in terms of interest rates, maturity, and frequency of repricing, an decrease in interest rates would cause the bank's net interest income to decrease. This would occur simply because banks have more assets than liabilities.

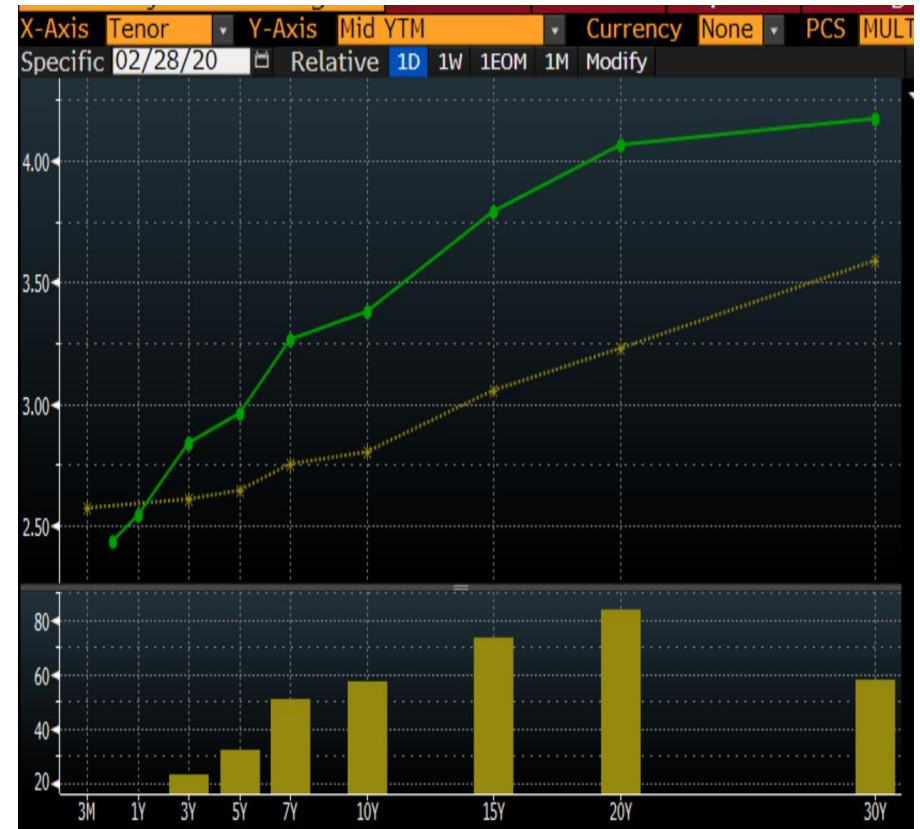
Given BNM has slashed OPR by 50bps in 1Q2020 (with high likelihood of further interest rate cutting in 2H2020), banks bottom line is facing a serious challenge.

Sensitivity of interest rate change on Malaysian Banks' non-interest income

MGS yields flattened circa 40bps in end Feb-2020 after two rounds of OPR cut....



Just to see yields steepened 60 – 80bps after the March-2020 exodus of foreign flows amid covid-19






















Leading up to March 2020, the MGS yield curve bullish flattened on expectation of OPR cut. However, as covid-19 cases started to increase outside China, financial market saw a great shift to safe heave asset which caused the Emerging Market local currency government (MGS included) bonds yield to spike. Given MGS yields are higher than beginning of the year, it is hard to be optimistic on Malaysian banks non-interest income.

Despite nearly 5% depreciation, Malaysian Banks are unlikely to have severe impact on loan book



While MYR depreciated nearly 5% against USD, Malaysian banks are unlikely to have severe impact on its earnings due to the stringent BNM Foreign Exchange Administration rules. These rules have prevented banks to have mismatch in currency between assets and liabilities.

KLCI return in USD denomination is at bear market territory

Asia/Pacific	2Day	Future	%MisPx	Value	Net Chg	%Chg	Time	%Ytd	%YtdCur
1) TOPIX		1427.00 d	-0.855%	1439.67 d	+4.13	+0.29%	10:30	-16.36%	-16.24%
2) NIKKEI 225		19070.00 d	-0.834%	19233.50 d	+148.53	+0.78%	10:35	-18.70%	-18.58%
3) JPX Nikkei 400		12780.00 d	-0.894%	12898.05 d	+35.54	+0.28%	10:30	-16.12%	-15.99%
4) HANG SENG		23366.00 d	-0.199%	23376.21 d	+201.10	+0.87%	11:16	-17.08%	-16.68%
5) CSI 300		3672.00 d	-0.603%	3690.91 d	+16.79	+0.46%	11:16	-9.90%	-11.52%
6) Shanghai Comp				2755.89 d	+8.68	+0.32%	11:16	-9.65%	-11.26%
7) Shenzhen Comp				1669.14 d	+11.60	+0.70%	11:16	-3.12%	-4.86%
8) HS China Ent		9503.00 d	-0.134%	9498.71 d	+96.54	+1.03%	11:16	-14.95%	-14.54%
9) Taiwan TAIEX		9589.00 d	-1.331%	9719.83 d	+90.40	+0.94%	11:11	-18.98%	-19.65%
10) KOSPI				1749.09	+31.97	+1.86%	11:31	-20.41%	-24.68%
11) KOSDAQ				563.54	+21.43	+3.95%	11:31	-15.87%	-20.38%
12) S&P/ASX 200		5198.00 d	-0.316%	5214.30	+32.92	+0.64%	11:31	-21.99%	-31.30%
13) Nifty 50		8290.15 d	-0.286%	8281.10 d	-379.15	-4.38%	03/30 c	-31.95%	-35.74%
14) S&P BSE SENSEX 30		29000.00 d	+1.586%	28440.32 d	-1375.27	-4.61%	03/30 c	-31.06%	-34.90%
15) MCX-SX		17293.85 d	-0.074%	17238.18 d	+0.00	+0.00%	03/30 c	-28.73%	-32.70%
16) FTSE Straits Tim		2507.00 d	+2.084%	2462.96 d	+46.72	+1.93%	11:16	-23.58%	-27.81%
17) FTSE Malay KLCI		1341.00 d	+0.121%	1339.38 d	+10.50	+0.79%	11:16	-15.70%	-19.90%
18) SE THAI				1107.25 d	+19.43	+1.79%	11:16	-29.91%	-36.17%
19) Jakarta Comp				4502.75	+88.25	+2.00%	11:31	-28.52%	-39.27%

Given a weak equity market, investment banks revenue is also under threat with fewer corporate finance activities.

Brent is 65% down since beginning of the year, making it one of the worst hit assets

C01 Comdty		97) Settings		Page 1/6 Comparative Returns		
Range	12/31/2019	-	03/31/2020	Period	Daily	No. of Period
Security		Currency		Price Change		Total Return
1) C01 Comdty		USD		-65.00%		-65.00%
2)						
3)						



Banks with exposure to commodity trading will also be severely impacted by the sudden price war between Saudi and Russia.

Agenda

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b) Malaysia Overview: BNM's Pandemic Relief Measures

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- **Capital**
- **Asset Quality**
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- **Liquidity**
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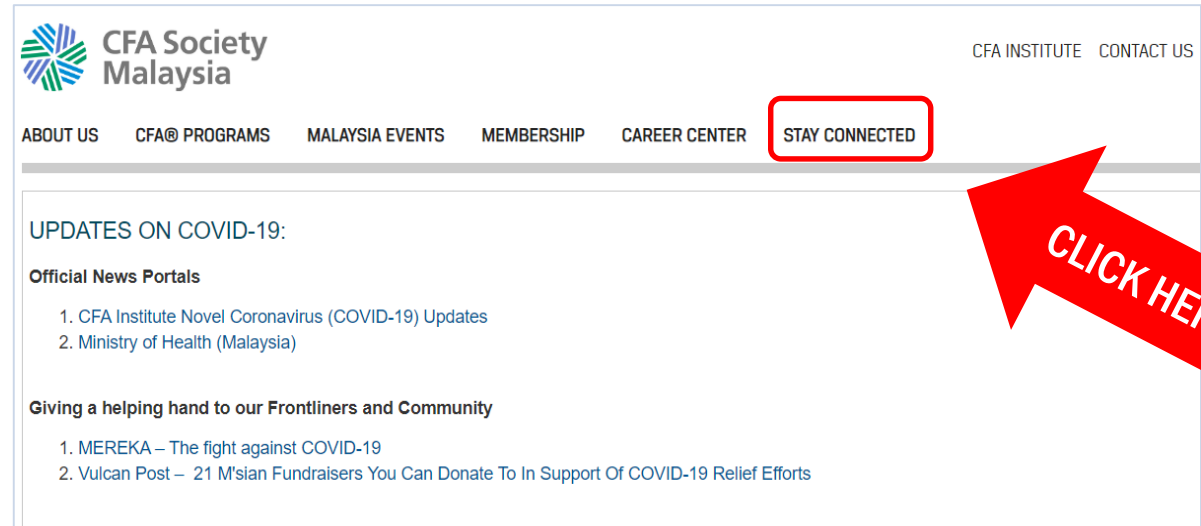


CFA Institute & CFA Society Malaysia's Up-coming Exciting Line-up of Webinars !

Date / Time	Webinar Topics	Speakers
TODAY 2 April 2020 8:30–9:30pm	BNM's Pandemic Relief Measures : A Welcomed Move to the Malaysian Banking Industry?	<ul style="list-style-type: none"> Justin Ong, CFA, President of CFA Society Malaysia Teng Yue Xiang, CFA, a Fixed Income Portfolio Manager with Principal Asset Management Bhd.
3 April 2020 6:00– 7:00pm	TGIF WFH Happy-Hour !	<ul style="list-style-type: none"> Faridq Ridzuan, CFA, Vice-President of CFA Society Malaysia Alan Lok, CFA, Director with CFA Institute.
6 April 2020 10:30-11:30am	CFA Institute Asia-Pacific Research Exchange (ARX)'s on Climate Risk & ESG Disclosures https://www.arx.cfa/en/events-webinars	<ul style="list-style-type: none"> Hosted By CFA Institute Asia-Pacific Research Exchange
10 April 2020 6:00-7:00pm	Masterclass: Career Sharing Series	<ul style="list-style-type: none"> Wong Kah Meng, CFA, Co-Founder of Funding Societies
16 April 2020 5:00-6:00pm	CFA Institute Asia-Pacific Research Exchange (ARX)'s on Natural Rubber & ESG Risk https://www.arx.cfa/en/events-webinars	<ul style="list-style-type: none"> Hosted By ZSL SPOTT, CFA Institute
17 April 2020 6:00-7:00pm	Masterclass: Career Sharing Series	<ul style="list-style-type: none"> En. Mohd Damshal Awang Amit, CFA, Chief Investment Officer, Lembaga Tabung Haji.
24 April 2020 12:30-1:30pm	CFA Institute Asia-Pacific Research Exchange (ARX)'s on Sales Inducement in Asia https://www.arx.cfa/en/events-webinars	<ul style="list-style-type: none"> Hosted By CFA Institute Asia-Pacific Research Exchange

CFA Society Malaysia's Special On-line Resource Center

<https://qrco.de/StayConnected>



Find out what you can do during the MCO period from our **Stay Connected** special resource centre where you can:

Get Current Updates on COVID-19 and how you can contribute

Access to external resource for entrepreneurs & start-ups

Attend webinars, program refresher and access research papers on COVID-19

Access to CFA Candidates Resources to upskill