Chapter 7
Operational Restructuring

According to Bank Negara Malaysia, the banking sector here was in a better position (compared to other affected countries) to withstand the economic crisis due to its past efforts to strengthen the banking sector. These efforts included (Bank Negara Malaysia, 1997a):

- In September 1994, lending secured by shares was limited to 15% of outstanding loans for commercial banks and finance companies and 30% for merchant banks to reduce bank exposure to the more volatile sectors.

- In April 1997, a 20% limit on lending to the broad property sector was introduced and commercial banks' and finance companies' exposure to the stock market was limited to 15% of total loans.

- Minimum capital adequacy ratios for finance companies was raised from 8% to 10% and minimum capital funds increased from RM 5million to RM 600million to be achieved by the end of 2000. This was combined with heightened supervision of the operations of the banking institutions, including monthly stress tests on individual institutions.

7.1 Measures in 1997

When the crisis arose in July 1997, Bank Negara Malaysia first placed a limit of US$2 million on non-commercial related swap transactions¹ on 4 August 1997 to

¹ Banks are required to observe a limit of USD2 million on outstanding non-commercial related ringgit offer side swap transactions with each foreign customer on a group basis. Banks which have exceeded the limit will not be allowed to transact in any further non-commercial related ringgit offer side swaps with such foreign customers until the outstanding amount has been reduced to below the limit. Hedging requirements of foreigners for trade related and genuine portfolio and direct investments in Malaysia are not affected by this measure.
maintain stability in the domestic money market and allow domestic interest rates to be more reflective of domestic conditions (Bank Negara Malaysia, 1997e).

In October 1997, Bank Negara Malaysia introduced measures to bring confidence back to the sector including higher disclosure standards, forcing greater transparency in financial reporting with details on NPLs, sector exposure and movements in provision. Minimum level of general provisions for bad and doubtful debts was raised from 1.0% to 1.5% of total loans (net of specific provision and interest-in-suspense) effective from 1 January 1998, (Bank Negara Malaysia, 1997f). These measures were expected to assist the banking sector to identify and monitor problem loans at an early stage and bring the current practice closer to international standards.

The central bank raised the minimum risk-weighted capital adequacy ratio (RWCR) of the banking sector from 8% to 9% by the end of 1998, and to 10% by the end of 1999 (Bank Negara Malaysia, 1997a). Also, banks needed to comply with the consolidated RWCR on a quarterly basis instead of annually, to ensure that they were adequately isolated against credit risks.

The new credit plan was implemented to slow down credit growth and reduce the leverage of the economy as well as curb inflationary pressures. Banks were required to submit their credit plans for remaining quarter of 1997 and for the year 1998 (Bank Negara Malaysia, 1997a). The annual loan growth of the banking sector was expected to fall to 25% by the end of year 1997 and 20% by the end of year 1998. However, the credit facilities extended to productive and exported related manufacturing activities were encouraged as priority.

On 20 October 1997, the margin of financing for hire-purchase loan of non-commercial passenger vehicles was reduced from 75% to 70% of the purchase
price of vehicles with repayment period of not more than five years (Bank Negara Malaysia, 1997f).

In December 1997, banks were directed not to grant new credit to property projects where construction had not started. For projects already being implemented, those projects' viability had to be re-examined based on the changed economic conditions to ensure that loans would be used to expand productive capacity (Bank Negara Malaysia, 1997a). The Malaysian government also set up a special RM1 billion fund to provide financing to the small-and medium-scale industries (SMIs) in order to ensure that credit would be available for productive activities.

7.2 Measures in 1998

On 6 February 1998, Bank Negara Malaysia announced new measures to streamline the interest rate structure. The 3-month intervention rate rose by 100 basis points to 11.0% from 10.0% as a result of tight liquidity in the financial system. To ease the liquidity condition, the central bank reduced the Statutory Reserve Requirement (SRR) to 10% from 13.5% of the banking institutions' eligible liabilities on 16 February 1998 (Bank Negara Malaysia, 1998c).

On 1 May 1998, the band for the permissible daily variation in the average balances required to meet the SRR was widened to ± 2% of the prescribed SRR rate from the previous band of ± 0.5%. This measure was expected to provide the banking sector greater flexibility in managing its daily liquidity operations and help reduce the operation costs (Bank Negara Malaysia, 1998a).

On 31 July 1998, a new framework of liquidity measurement was announced to ensure better utilisation of funds, effective January 1999. This framework is expected to enhance higher returns for the banking institutions. Banks have to
project the maturity profile of their assets, liabilities and off-balance sheet commitments based on the ability of an institution to match its liquidity requirement arising from maturing obligations with maturing assets. Banks also have to maintain adequate liquidity surplus to meet expected obligations, and at the same time, to sustain unexpected heavy withdrawal for at least one month (Bank Negara Malaysia, 1998j).

To facilitate the transition to this new liquidity framework, a specified amount of liquid assets, amounting to at least 17% of banks’ eligible liabilities for commercial banks and 10% for finance companies and merchant banks (12.5% if they issue negotiable instruments of deposit), would be reduced in stages. Banks who manage their liquidity prudently and efficiently would no longer have to hold significant amounts of liquid assets. The SRR was further cut from 8%, to 6% and then to 4% in July and September 1998 respectively (Bank Negara Malaysia, 1998e; 1998k; 1998m).

In August 1998, Bank Negara Malaysia eased its monetary policy. The 3-month intervention rate was reduced by 350 basis points in August, September and October 1998 (Table 7.2.1).

| Table 7.2.1: Change in BNM's 3-month Intervention Rate |
|-------------|------------------|
| 3-Aug-98    | -50 basis points to 10.5% |
| 11-Aug-98   | -50 basis points to 10.0% |
| 28-Aug-98   | -50 basis points to 9.5% |
| 3-Sep-98    | -150 basis points to 8.0% |
| 5-Oct-98    | -50 basis points to 7.5% |

Source: Rashid Hussain Research Institute (1998)

On 1 September 1998, capital control and exchange control were implemented by the Malaysian government to regain monetary independence and to insulate its economy from the risks and vulnerabilities emerging in the regional and global financial markets (Bank Negara Malaysia, 1998n). The controls focused on: (1) limiting the contagion effects of external developments on the Malaysian
economy, (2) preserving the recent gains made in terms of the policy measures to stabilise the domestic economy, and (3) ensuring stability in domestic prices and the ringgit exchange rate and creating an environment that is conducive for a revival in investors' and consumers' confidence to facilitate economic recovery.

The central bank also revised the BLR framework to allow a faster transmission of changes in the monetary policy on interest rate levels. The calculation of the BLR would now be based on the 3-month intervention rate (instead of the KLIBOR) and administrative margins of financial institutions in the BLR computation was reduced by 25 basis points to 2.25% (Bank Negara Malaysia, 1998i and Appendix B, pp. C).

The Liquid Asset Ratio (LAR) of commercial banks was cut from 17.0% to 15.0% of eligible liabilities effective from 16 September to improve liquidity in the banking sector (Bank Negara Malaysia, 1998i; 1998j).

On 23 September 1998, Bank Negara Malaysia increased the default period for NPLs from three to six months. NPLs could be reclassified as performing loans when the repayments under the rescheduled terms were complied for a continuous period of 6 months (instead of continuous payment of 12 months). Also, a 20% specific provision on sub-standard loans was removed. Instead, the amount of provisioning would be based on the adequacy of the banking institutions' loan loss coverage. These measures (effective beginning 1 January 1998) were to promote lending activities in order to quickly revive the Malaysian economy (Bank Negara Malaysia, 1998o).

The central bank also raised the limit on loans by commercial banks and finance companies for the purchase of shares and unit trusts from 15% to 20%. The limit for merchant banks remained at 30%. Besides, the banking institutions were advised not to withdraw credit facilities from their customers based solely on
problems that the latter have with other banks. Bank Negara Malaysia also provided an additional RM 3.9 billion for greater accessibility and efficiency of two special funds - funds for small and medium scale industries and special scheme for low and medium cost houses - to promote bank lending at lower cost for economic revival.

Generally, the monetary policy was tightened in year 1997 until July 1998 to contain inflationary pressures. Many measures were implemented during that period to improve liquidity in the banking sector. Bank Negara Malaysia then eased its monetary policy in July 1998, with some selected controls to lower cost of funds and boost economic activities as part of economic recovery.