INTERNATIONAL MONETARY FUND

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# MALAYSIA

## FINANCIAL SECTOR ASSESSMENT PROGRAM

April 2014

## BANKING SYSTEM SPILLOVERS—TECHNICAL NOTE

This Technical Note on Banking System Spillovers on Malaysia was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in February 2013.

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# FINANCIAL SECTOR ASSESSMENT PROGRAM

# MALAYSIA

## BANKING SYSTEM SPILLOVERS

# TECHNICAL NOTE

FEBRUARY 2013

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

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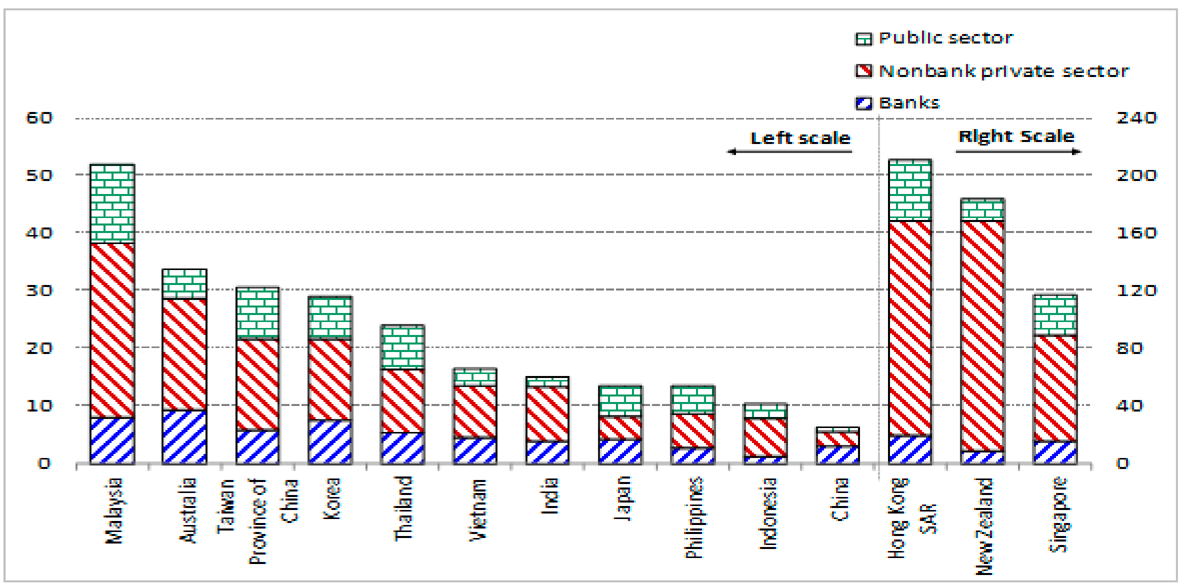
# I. INTRODUCTION[1]

1. **This note looks at inward spillovers on the Malaysian financial system**. It focuses on two channels: (a) the presence of foreign banks and the potential for problems in other jurisdictions to spillover to Malaysia; and (b) the overseas operations of Malaysian banks, which make their performance and solvency more exposed to economic and political developments abroad.

2. **A key facet of the current crisis is serious problems in advanced economy banks, suggesting a role for spillovers from their claims on Malaysia.** In particular, as many of these banks have become international banks, their potential need to deleverage could lead to a marked disruption in credit provision in countries other than their home jurisdiction. And such concerns have historical precedent given the deleveraging of U.S. banks from emerging markets in general following the Latin American debt crisis and the deleveraging of Japanese banks from south east Asia following the Japanese financial crisis in the 1990s (IMF 2009). Moreover, in Malaysia, BIS-reported foreign bank claims are over 50 percent of GDP (Figure 1), significantly higher than for other countries in the region except New Zealand (and excluding the financial centers of Hong Kong and Singapore).

**Figure 1. Total Foreign Bank Claims by Country[1]**




[1/] Claims are on an ultimate risk basis. The sum of quarterly GDP in U.S. dollars between 2011:Q3 and 2012:Q2 is used in the denominator.
Sources: BIS-reported and consolidated bank claims; CEIC Data Company Ltd.; Haver Analytics; and IMF staff calculations.

[1] Prepared by Ravi Balakrishnan in the context of the 2013 Malaysia FSAP, with research assistance provided by Sanjeeda Munmun Haque. (http://www.imf.org/external/pubs/ft/scr/2013/cr1352.pdf)

3. **Over the last decade, Malaysian banks have also expanded significantly abroad, pointing to spillovers from developments overseas to the health of Malaysian banks**. The expansion abroad (through acquisitions and establishing subsidiaries and branches) has been part of a diversification strategy given the already high degree of banking penetration in Malaysia and increasing economic and trade linkages. Member states of ASEAN have been particular targets, especially Indonesia and Singapore, suggesting that Malaysian banks performance is now more exposed to economic and political developments in the region.

4. **The note is structured as follows**. The next section looks at the history of foreign banks' exposures to Malaysia over the last 30 years and how material a concern advanced economy bank deleveraging is. The third section then turns to analyzing Malaysian banks' regionalization, drawing lessons from what we have seen happen when banks in other jurisdictions have expanded abroad. The final section draws together the findings for the stability of the Malaysian financial system.

5. **The main findings are**: despite relatively large foreign bank claims on Malaysia, deleveraging pressures associated with eurozone troubles do not appear to be as big a vulnerability as for other countries given experience with past crises, large local-currency content, and the importance of UK and Singapore banks. However, it would be prudent to continue monitoring developments closely, especially any ratings downgrades of UK banks with a systemic presence in Malaysia. Regarding the expansion of Malaysian banks overseas, exposures appear manageable by international standards, at around 30 percent of both GDP and of operating income currently. However, these are likely to grow given ASEAN Economic Integration and opportunities to expand further as European banks continue to deleverage. International experience suggests that rapid bank expansion in new markets can pose challenges if bank risk management and supervisory monitoring fail to keep pace. Uneven supervisory quality in host markets can also contribute to masking of vulnerabilities. Bank Negara Malaysia (BNM) should continue to monitor overseas operations closely (especially rising loan-to-deposit ratios) and enhance coordination with host supervisors.

## II. FOREIGN BANKS' EXPOSURE TO MALAYSIA

6. **Foreign banks have been in Malaysia for over a century and all commercial banks have to be locally incorporated**. The longest established banks are the U.K. ones, HSBC and Standard Chartered. The UK banks have extensive branch networks as do the two Singaporean banks, OCBC and UOB. Citibank is the other foreign commercial bank with a significant presence, but it has a more limited branch network than the U.K. or Singaporean banks. Instead, Citibank is one of the leading issuers of credit cards and also a leading participant in the foreign-exchange market.[2] Local incorporation became mandatory under the 1989 Banking and Financial Institutions Act. Foreign parents were allowed to keep

[2] For further details, see EIU 2012.

100 percent of the equity. Overall, foreign banks hold around 20 percent of the assets and deposits of the banking system (see section II.B).

7. **Since late 2009, BNM has taken steps to liberalize the entry of foreign banks, leading to seven new entrants joining the existing 14 foreign banks.** In the wake of bilateral treaties with India and China, Industrial and Commercial Bank of China (ICBC) and the consortium of Bank of Baroda, Indian Overseas Bank, and Andhra Bank (which jointly established the Malaysian subsidiary Indian International Bank (M) Bhd) were awarded commercial bank licenses in November 2009 and April 2010, respectively. These banks are permitted to take retail deposits, but are expected to focus more on corporate banking. In mid-2010, five other foreign bank institutions were issued licenses. These included two Japanese banks (Mizuho Corporate Bank and Sumitomo Mitsui Banking Corp) and BNP Paribas, with BNM saying the banks had been chosen based on their "financial strength, track record, expertise, business plan and potential contribution towards the development of the financial sector in Malaysia." With new flexibility introduced to the branch-distribution requirement in 2011, all foreign banks were allowed to open up to eight new branches.

## A. Helicopter View of Exposures Over Last Three Decades

8. **Notwithstanding the Asian Financial Crisis (AFC), foreign claims of BIS reporting banks on Malaysia have generally been on an increasing trend since the early 1990s**. Up until the mid-1980s, Japanese banks expanded significantly their claims on Malaysia, reaching a peak of around 20 percent of GDP.[3] This was associated with some major Japanese FDI in Malaysia in the early-mid 1980s. However, Japanese bank exposures to Malaysia started falling soon after as Thailand and Indonesia became more popular FDI destinations in ASEAN—in other words their influence was already diminishing well before the Japanese financial crisis became systemic. From the early 1990s, Eurozone banks and U.S. banks helped fuel the boom until the AFC, as they expanded credit provision relative to GDP (Figure 2).[4] After the AFC, the exposure of Eurozone and U.S. banks has generally diminished, with the Singaporean and UK retaining preeminence in the 2000s.[5] Since 2000, total foreign claims have hovered above 50 percent of GDP, with those of the U.K. at around

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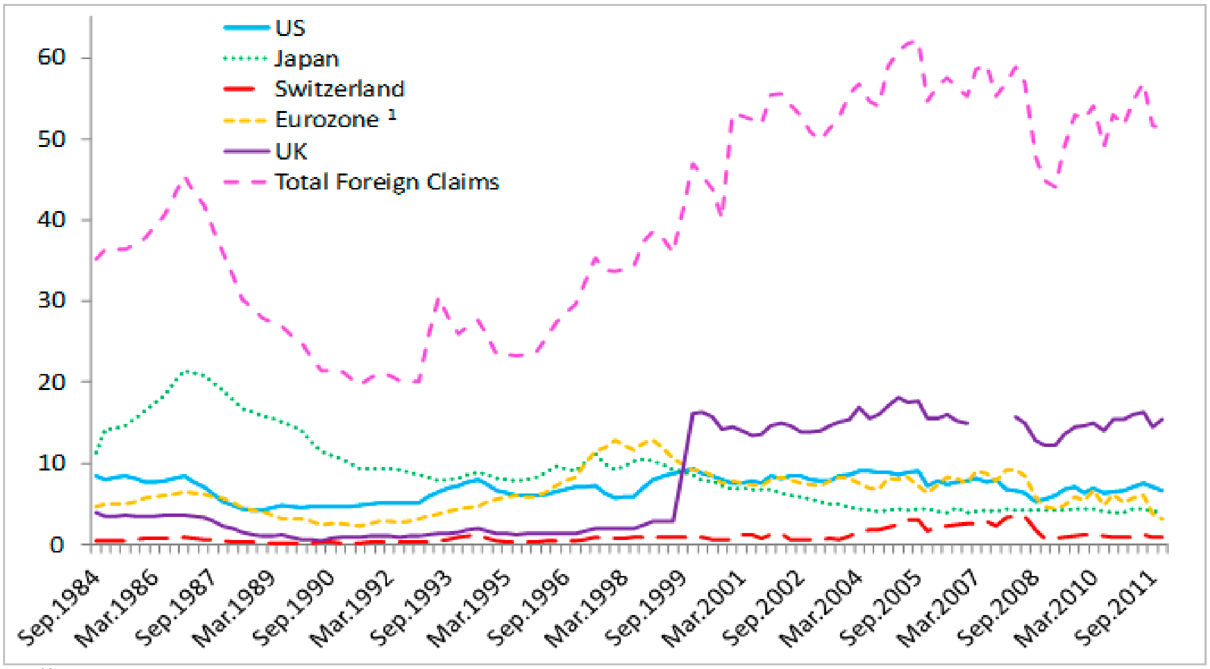
[3] As there was only one Japanese subsidiary in Malaysia then (Bank of Tokyo-Mitsubishi) with a small asset base, the vast majority of these claims were likely cross border loans to Japanese corporates.

[4] Given breaks in the BIS data, eurozone banks are limited to those from Belgium, France, Germany, Spain, and the Netherlands.

[5] While there appears a steep change in U.K. bank claims on Malaysia in 1999, this is unlikely to be the case, with claims under-reported pre-1999. This is because as a result of changes in U.K. statistical publications and reporting methodology to the BIS, coupled with changes in confidentiality rules, some claims previously reported by U.K. banks as 'residual' or 'unallocated' were able to be reported against the underlying country from 1999. There is also some missing data for U.K. banks from 2006–2008 (which also affects other countries in Asia and thus Figure 3).

15 percent of GDP. While Singaporean bank claims are not published by the BIS, their claims on Malaysia are included in the total, and are about 20 percent of GDP.

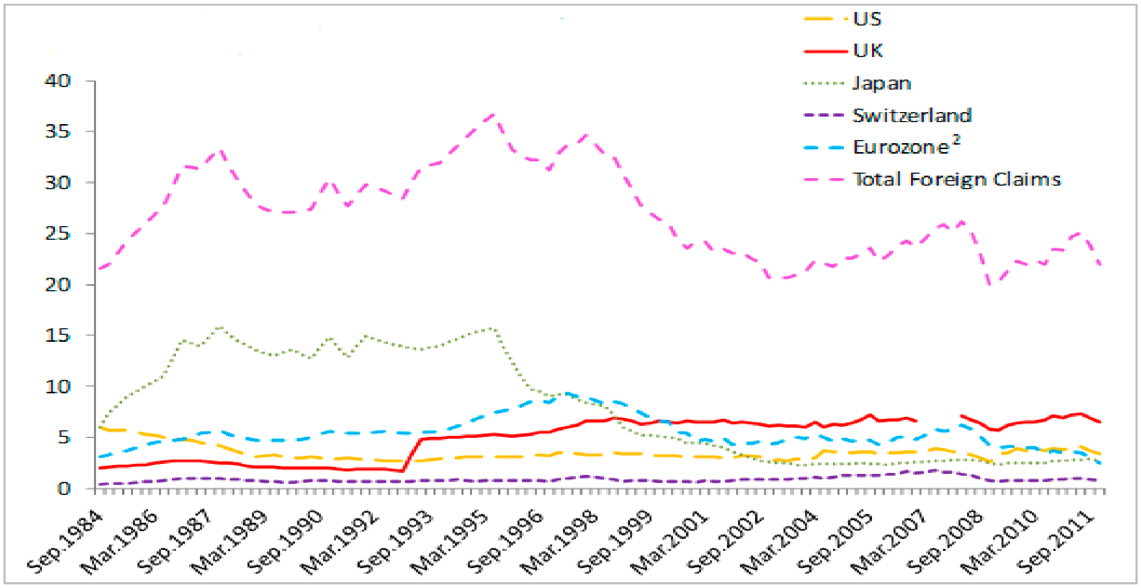
**Figure 2. Total Foreign Bank Claims on Malaysia**
**(in percent of Malaysian GDP)**




[1/] Eurozone includes Belgium, Germany, France, Spain, and The Netherlands
Sources: BIS-reported consolidated bank claims on immediate borrower basis; and Haver Analytics.

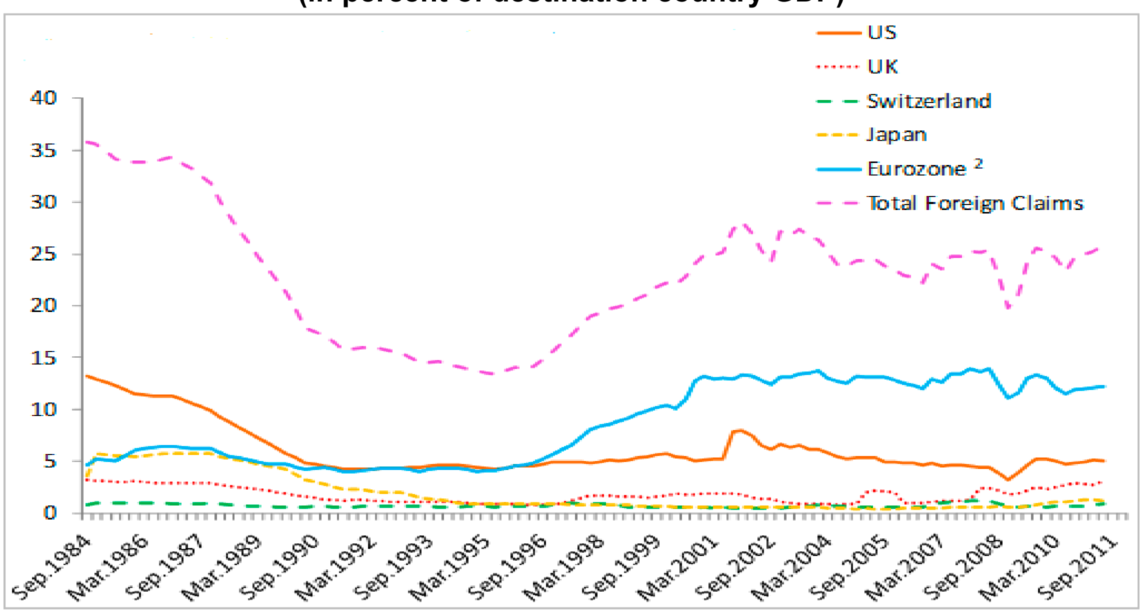
9. **Trends in Emerging Asia and Latin America as a whole are quite different** (Figures 3 and 4). For Emerging Asia, foreign banks claims have been on a secular decline since the mid-1990s. Essentially, the withdrawal of Japanese banks from the region (Japanese claims on emerging Asia reached nearly 16 percent of destination country GDP in 1995) was not offset by an expansion by Eurozone banks up to the AFC or U.K. banks in general since the 1990s. In Latin America, foreign bank claims halved after the Latin American debt crisis, reaching a trough of below 15 percent of destination country GDP in the mid-1990s. Since then, claims have gone up significantly, as Eurozone banks (particularly Spanish ones) have expanded in the region, although foreign exposure still remains below the peaks of the late 1970s/early1980s (IMF 2009). Overall, foreign bank claims on Emerging Asia and Latin America in terms of destination country GDP are around half of those on Malaysia.

**Figure 3. Total Foreign Bank Claims on Asia[1]**
**(in percent of destination country GDP)**




[1/] Asia includes Hong Kong, Singapore, China, Taiwan, India, Indonesia, Malaysia, Philippines, South Korea, and Thailand.
[2/] Eurozone includes Belgium, Germany, France, Spain, and The Netherlands.
Sources: BIS-reported consolidated bank claims on an immediate borrower basis; Haver Analytics; and Global Data Source.

**Figure 4. Total Foreign Bank Claims on Latin America[1]**
**(in percent of destination country GDP)**

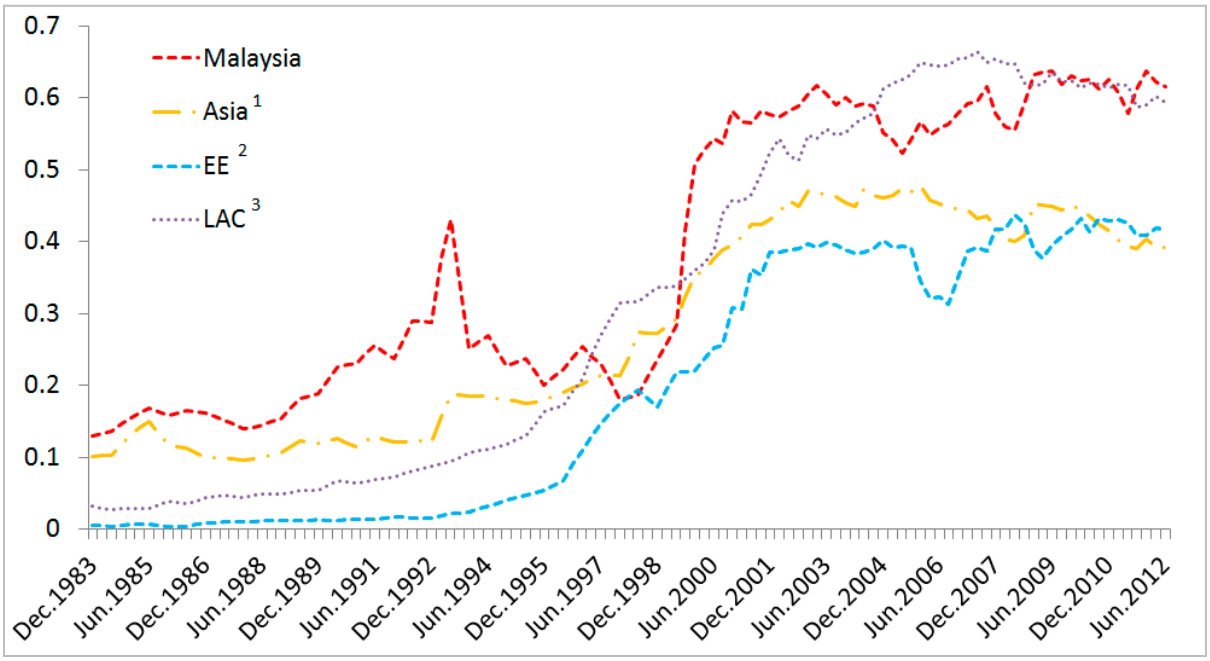



[1/] Latin America includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay, and Venezuela.
[2/] Eurozone includes Belgium, Germany, France, Spain, and The Netherlands.
Sources: BIS-reported consolidated bank claims on an immediate borrower basis; Haver Analytics; and Global Data Source.

10. **There has been a dramatic increase in the local currency share of foreign claims on Malaysia over the last two decades, with a similar but weaker trend seen in other emerging markets (Figure 5).** Since the AFC, the share of local currency claims in foreign bank exposures to Malaysia has increased from around 20 percent to over 60 percent. While we have seen similar trends to de-dollarization of foreign bank lending in other emerging markets, particularly Latin America, Malaysia now has a much higher share of local currency lending by foreign banks than is the norm in Asia or Emerging Europe (where the share is around 40 percent). This probably reflects the increasing role played by local subsidiaries in local currency lending given sizable Ringgit deposit bases, which has replaced cross border lending in U.S. dollars.

**Figure 5. Share of Foreign Bank Claims in Local Currency**

(Local currency claims on residents as a share of foreign claims on an immediate borrower basis)



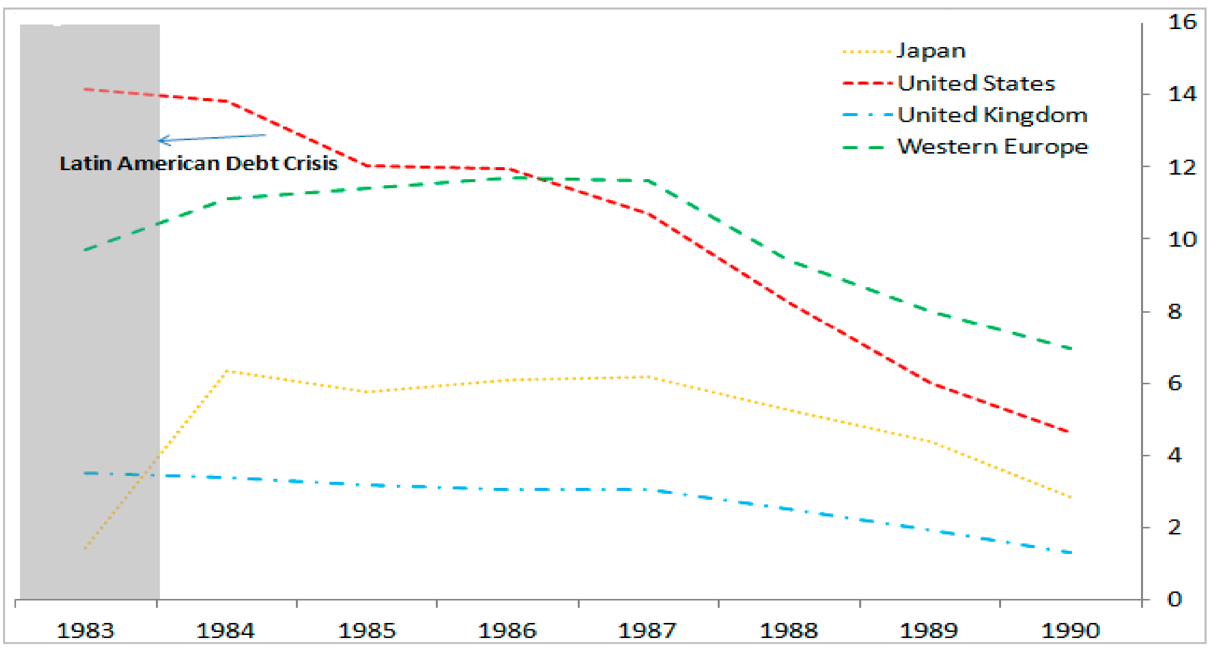

1/ Asia includes Hong Kong, Singapore, China, Taiwan, India, Indonesia, Malaysia, Philippines, South Korea and Thailand.
2/ Emerging Europe includes Bulgaria, Hungary, Poland and Turkey.
3/ Latin America includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay and Venezuela.
Source: BIS-reported Consolidated Bank Claims on an Immediate Borrower Basis.

### B. How Likely And Disruptive Would Foreign Bank Deleveraging Be For The Financial System?

11. **As mentioned earlier, previous systemic crises in advanced economy banking systems have presaged dramatic withdrawals from lending in emerging markets** (IMF 2009). The Latin American debt crisis was associated with severe stress in U.S. banks. By the end of the 1978, syndicated loan exposures to the region accounted for twice the capital

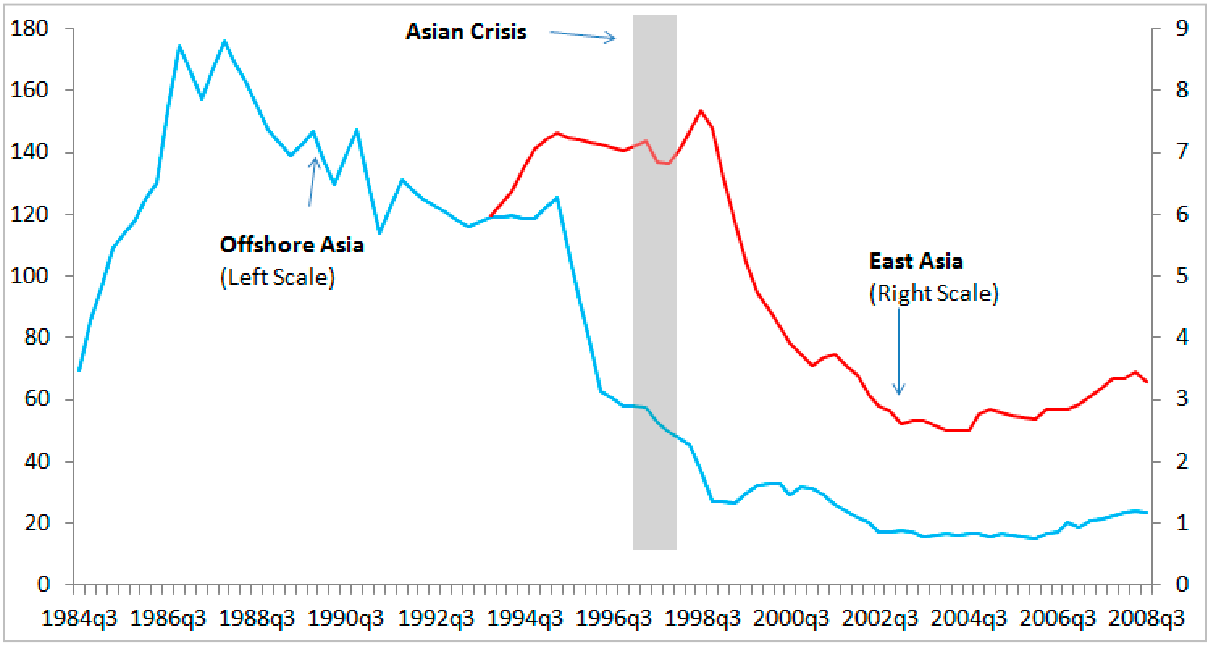
and reserves of major U.S. banks. Perhaps unsurprisingly then, the crisis was followed by a period of significant U.S. bank retrenchment from Latin America. U.S. bank claims fell from around 15 percent of Latin American GDP at the peak in 1983 to less than 5 percent of GDP by 1990 (Figure 6). But the deleveraging was not contained to Latin America, as U.S. banks also reduced exposures to emerging economies more generally in the second half of the 1980s. Another period of dramatic retrenchment followed the Japanese systemic banking crisis during the 1990s. At the time, Japanese banks had large overseas exposures, especially in Asia. Japanese banking claims on the financial centers of Hong Kong and Singapore fell precipitously from the late 1980s but they continued to rise on East Asian countries until 1997, when the AFC erupted (Figure 7). Around the same time, the financial crisis in Japan became systemic as the Japanese economy weakened. A dramatic withdrawal from East Asia followed and even today claims (including on Hong Kong and Singapore) remain well below the peaks of the 1980–90s.

**Figure 6. Impact of Debt Crisis on Bank Lending to Latin America[1]**
**(percent of destination region's GDP)**




[1/] Latin America includes Argentina, Brazil, Chile, Mexico, and Venezuela.
Source: BIS-reported consolidated bank claims on an immediate borrower basis.

**Figure 7. Impact of the Japanese Banking Crisis on Bank Lending to Asia (percent of destination region's GDP)**

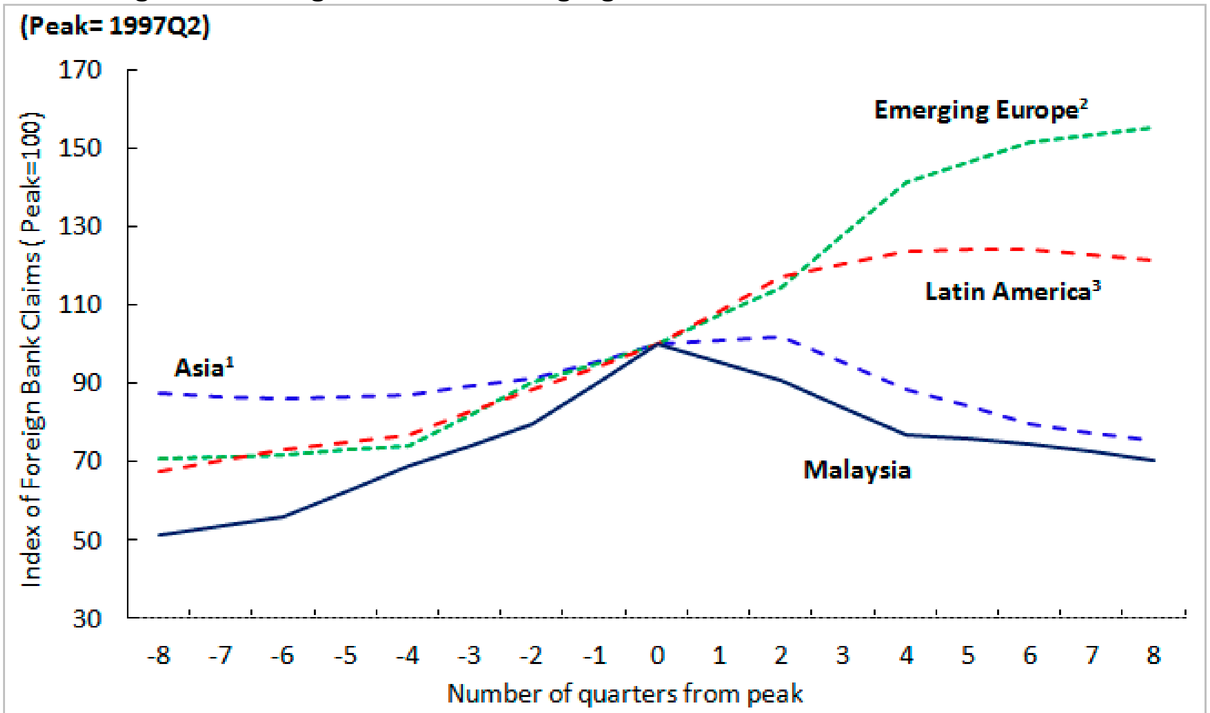



Source: BIS-reported consolidated bank claims on an immediate borrower basis.

12. **Following the AFC and the GFC, foreign banks (including eurozone and U.K. banks) delevered more from Malaysia than from many other emerging markets**. Following the AFC, BIS-reported bank claims on Latin America and Emerging Europe continued to rise. In Asia, unsurprisingly they fell, and the decline in Malaysia was larger than in the region as a whole (as a share of peak claims in U.S. dollars or in terms of destination GDP—Figures 8 and 9). Perhaps more surprisingly, this is also true of the GFC, during which the deleveraging from Malaysia was particularly evident amongst eurozone banks (Figures 10 and 11). Most of the eurozone bank claims are likely holdings of government bonds and BNM bills, as: (i) only one eurozone bank has had a subsidiary in Malaysia historically speaking and this did not include a significant presence in the local loan or deposit market; and (ii) cross-border direct lending to corporates is perceived to be small.[6] Substantial holdings of official fixed-income paper would also be consistent with the nonresident share of such instruments having increased significantly over the 2000s.

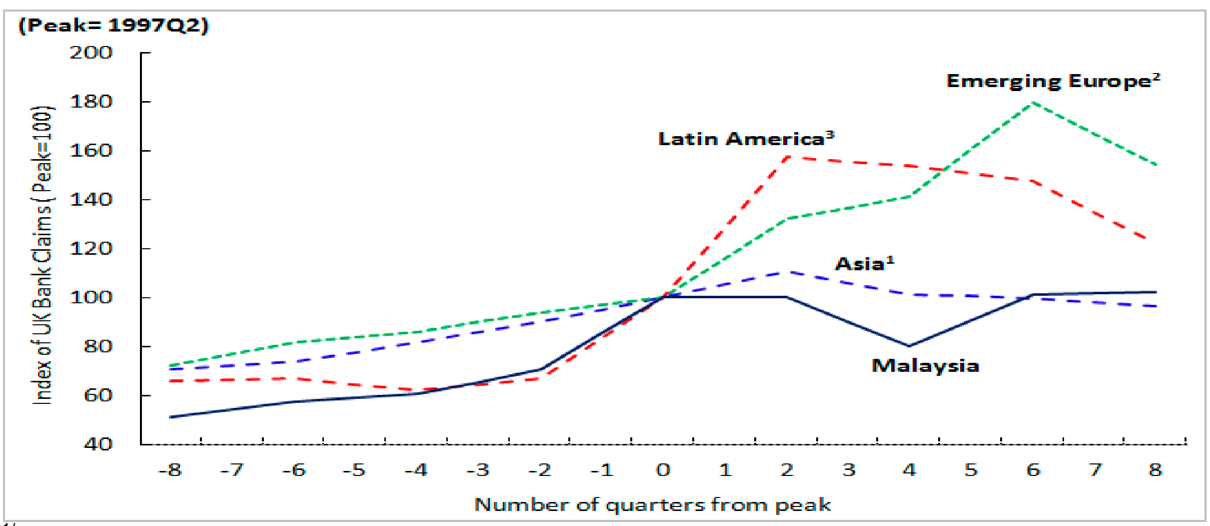
[6] BNP Paribas only received a license in 2010.

**Figure 8. Foreign Bank Deleveraging Around the Asian Financial Crisis**



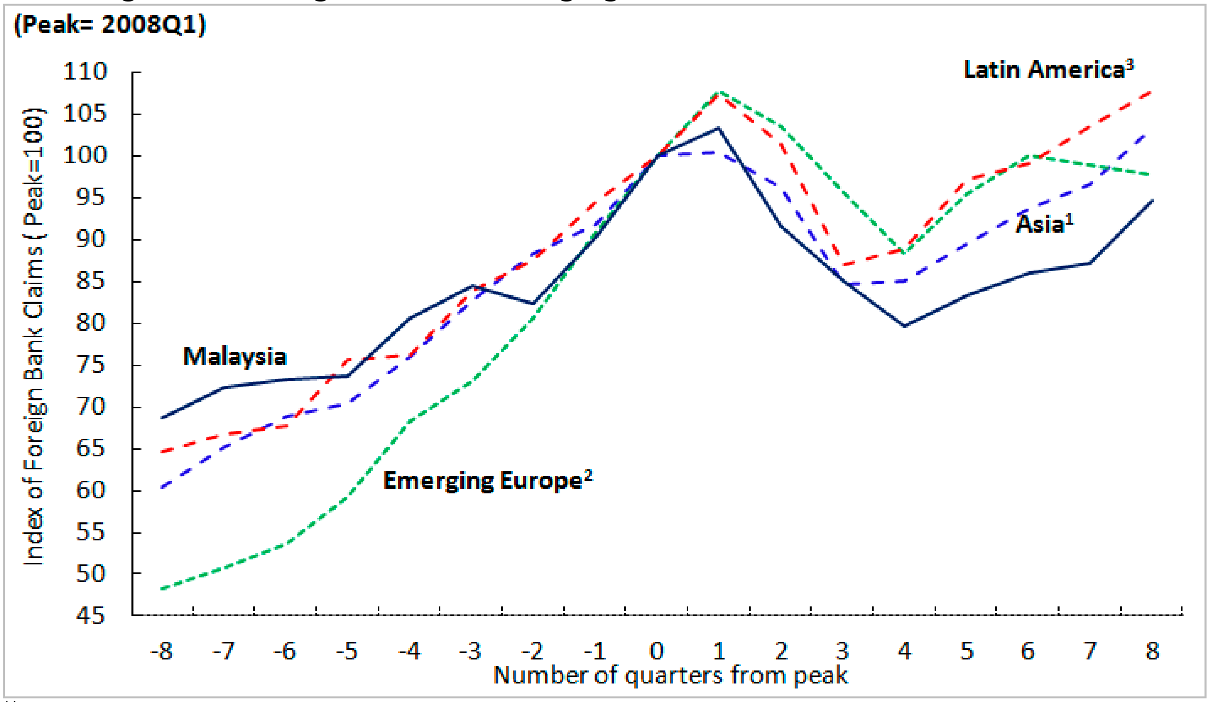

[1/]Asia includes Hong Kong, Singapore, China, Taiwan, India, Indonesia, Malaysia, Philippines, South Korea and Thailand.
[2/]Emerging Europe includes Bulgaria, Hungary, Poland and Turkey.
[3/]Latin America includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay and Venezuela.
Source: BIS-reported Consolidated Bank Claims on an Immediate Borrower Basis.

**Figure 9. U.K. Bank Deleveraging Around the Asian Financial Crisis**



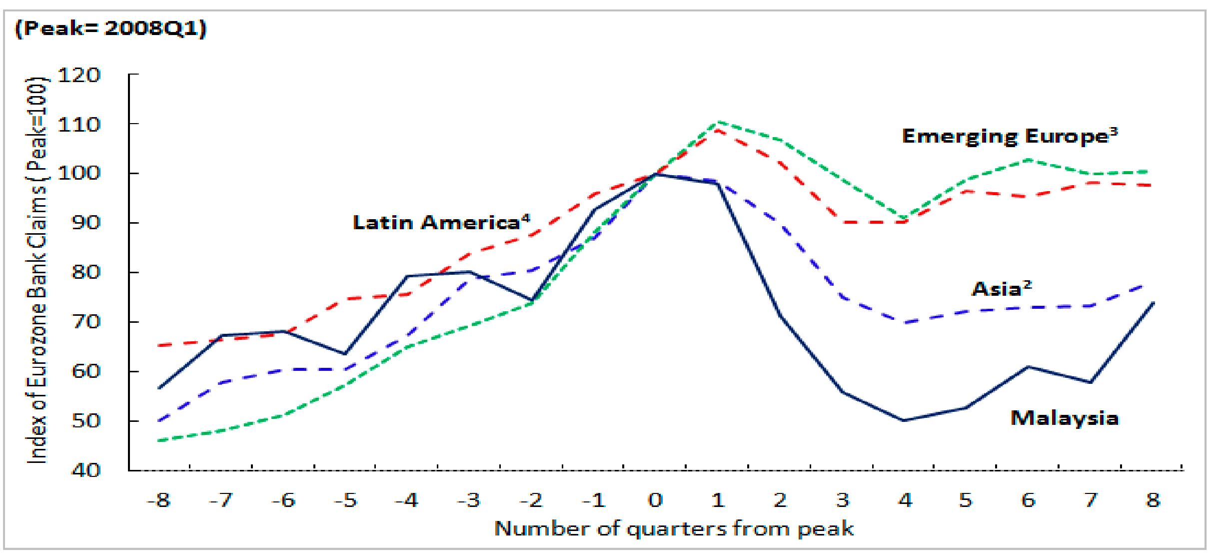

[1/]Asia includes Hong Kong, Singapore, China, Taiwan, India, Indonesia, Malaysia, Philippines, South Korea and Thailand.
[2/]Emerging Europe includes Bulgaria, Hungary, Poland and Turkey.
[3/]Latin America includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay and Venezuela.
Source: BIS -reported Consolidated Bank Claims on an Immediate Borrower Basis.

**Figure 10. Foreign Bank Deleveraging Around the Global Financial Crisis**




1/Asia includes Hong Kong, Singapore, China, Taiwan, India, Indonesia, Malaysia, Philippines, South Korea and Thailand.
2/Emerging Europe includes Bulgaria, Hungary, Poland and Turkey.
3/Latin America includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay and Venezuela.
Source: BIS-reported Consolidated Bank Claims on an Immediate Borrower Basis.

**Figure 11. Eurozone Bank Deleveraging around the Global Financial Crisis[1]**




1/Eurozone includes Belgium, Germany, France, Spain and the Netherlands.
2/Asia includes Hong Kong, Singapore, China, Taiwan, India, Indonesia, Malaysia, Philippines, South Korea and Thailand.
3/Emerging Europe includes Bulgaria, Hungary, Poland and Turkey.
4/Latin America includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay and Venezuela.
Sources: BIS -reported Consolidated Bank Claims on an Immediate Borrower Basis.

13. **While eurozone banks do not have particularly large claims on Asia or Malaysia relative to other regions, troubles in the eurozone could spillover to U.K and U.S. banks, although direct deleveraging pressures on Malaysia will likely be contained**. Fund staff analysis of bank interconnectedness suggests strong spillovers from eurozone G-SIBs to U.K. and U.S. G-SIBs, with limited spillovers to Asian G-SIBs (IMF 2012a). As noted earlier and discussed in more detail later in this section, the Singaporean and U.K. banks have by far the biggest claims on Malaysia (U.K. banks hold around ¾ of the European bank claims). While acknowledging the spillover risks to U.K. banks in general, the individual banks that have a systemic presence in Malaysia are likely less exposed as both HSBC and Standard Chartered have the lion's share of their assets outside of Europe, the U.K, and the U.S.[7] And the Singaporean banks are well capitalized, with core tier 1 capital adequacy ratios of around 11-12 percent at end-2011—among the highest levels for banks rated in the "AA" category (Fitch 2012).

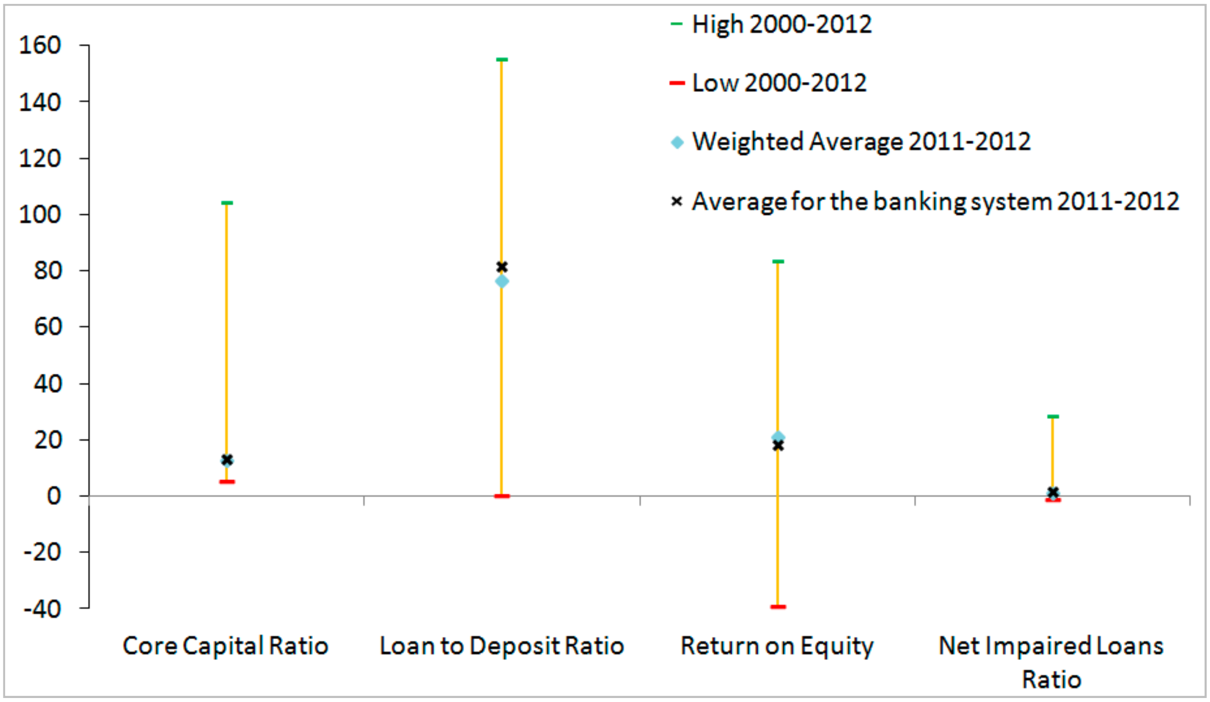
14. **Strong performance of foreign commercial bank subsidiaries, the increasing importance of Asia, and a large share of foreign claims in local currency will also help mitigate deleveraging pressures.** Foreign banks in general have a relatively high return on equity and strong soundness indicators (Figure 12).[8] But from a host nation perspective, with the exception of the Singaporean banks, assets and profits of the Malaysian subsidiaries make up significantly less than 10 percent of the consolidated group figures for the five banks with an important presence in Malaysia (Figure 13).[9] Many analysts also argue that Asia will continue to remain a profit center for many banks given its share of the global population and GDP, suggesting that banks will be loathe to deleverage significantly from the region. Moreover, as shown in Figure 5, Malaysia has one of the highest shares amongst emerging economies of foreign bank claims in local currency (around 60 percent). All these factors should work against pressures for banks to deleverage from Malaysia.

[7] As of end-2010, over 90 percent of Standard Chartered's assets and around 70 percent of HSBC's assets were outside of these three zones.

[8] The analysis excludes banks which have insignificant market shares (defined in this note as below 2 percent of total foreign bank assets) to avoid the problem of outliers.

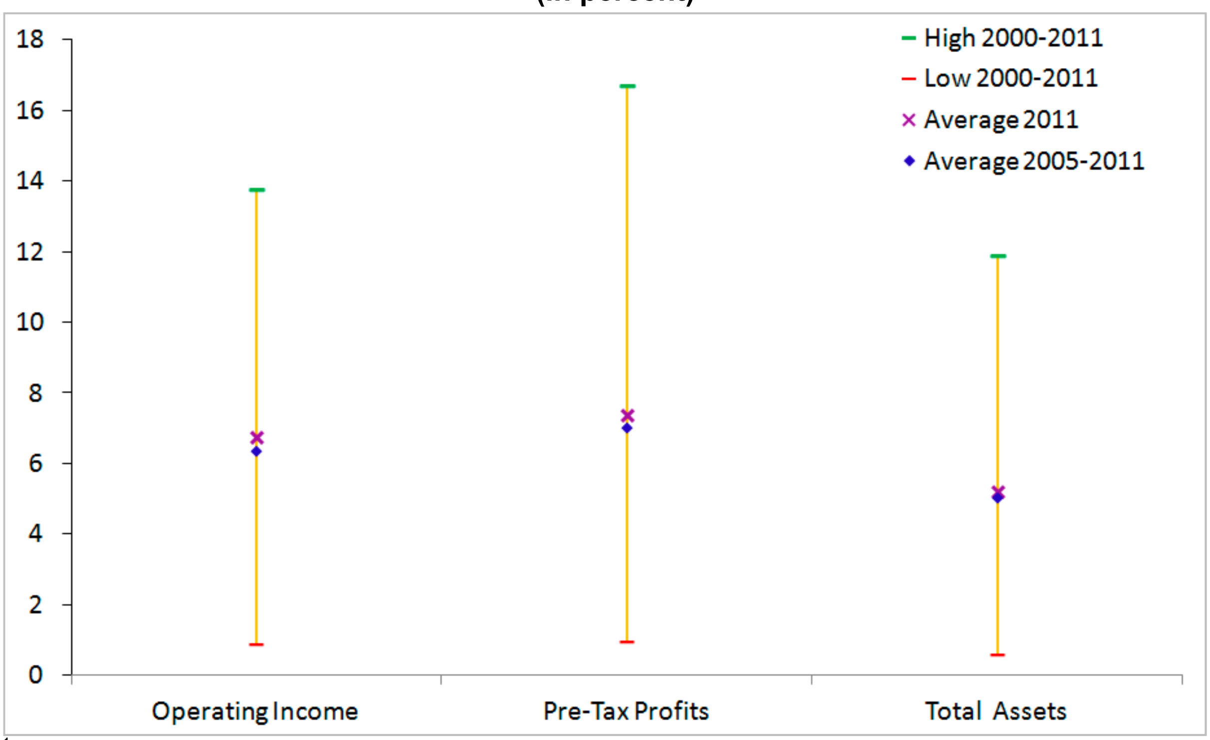
[9] Regarding the Singaporean banks, as they are so well capitalized and given Singapore's strong cultural, historical, and political connections with Malaysia, their presence in Malaysia appears well anchored.

**Figure 12. Key Financial Soundness Indicators of Foreign Banks [1]**
**(in percent)**




[1/] Banks with a share of total foreign banks' assets of less than 2 percent are excluded. The weighted average is calculated using the share of assets as weights. The sample includes Islamic banks.
Sources: BNM FSAP Data; and Fund Staff Calculations.

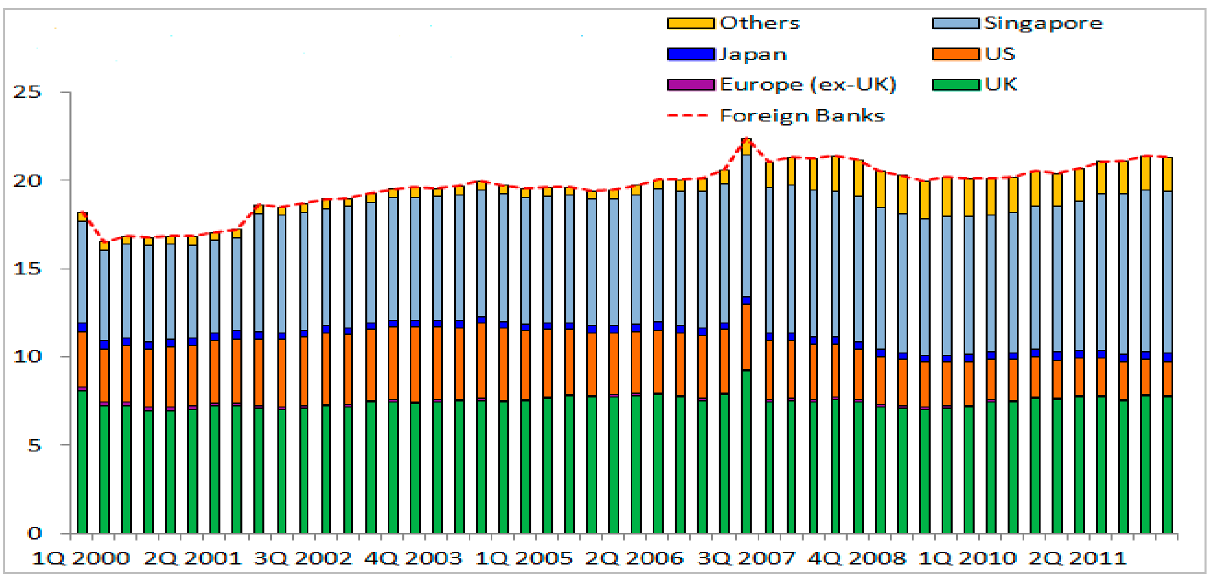
**Figure 13. Revenue and Asset Contributions of Five Biggest Foreign Banks to Parent Group[1]**
**(in percent)**




[1]/2007 Pre-tax profits for Citibank have been excluded because of an exceptional contribution that year.
Sources: BankScope and Fund Staff Calculations.

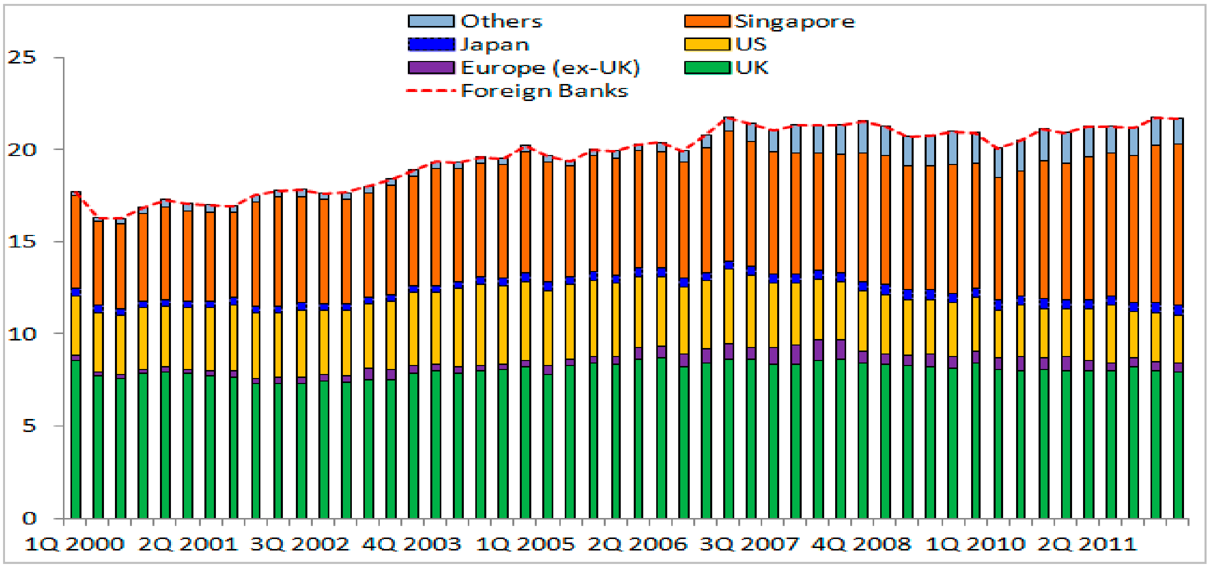
15. **From a banking system perspective, foreign banks' share of domestic assets and liabilities appears manageable, especially when comparing internationally**. Over the last decade, the foreign bank share of banking system deposits and loans has increased marginally to just above 20 percent, and around ¾ of these are with the U.K. and Singaporean banks (Figures 14 and 15). By contrast, in Central, Eastern and Southeastern Europe (CESE), foreign banks, largely from Western Europe, control on average 64 percent of domestic banking system assets in the region (around 35 percent in Russia, Turkey, and Slovenia, and greater than 80 percent in Bosnia, the Czech Republic, Croatia, and Slovakia—see IMF 2012b). To allow a more complete international comparison, Figure 16 looks at the ratio of foreign liabilities of deposit taking banks to domestic claims, as reported in the IFS. This tries to capture the extent to which domestic credit provision is financed from abroad (i.e., the importance of cross-border lending to local banks and foreign bank branches and subsidiaries). In Malaysia, this ratio has always been lower than 12 percent, even during the pre-AFC years. It is also much lower than the ratios seen in Emerging Europe and the Middle East and North Africa (MENA).

**Figure 14. Foreign Bank Share of Loans**
**(as a percent of banking system total loans)**



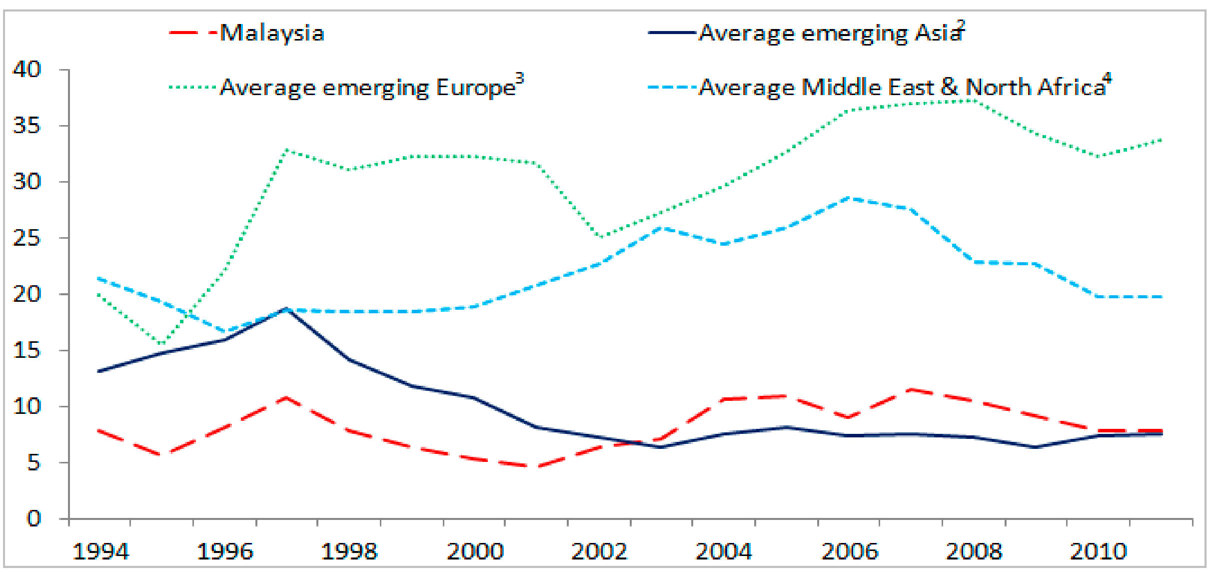

Source: BNM FSAP Data.

**Figure 15. Foreign Bank Share of Deposits**
**(as percent of banking system total deposits)**




Source: BNM FSAP Data.

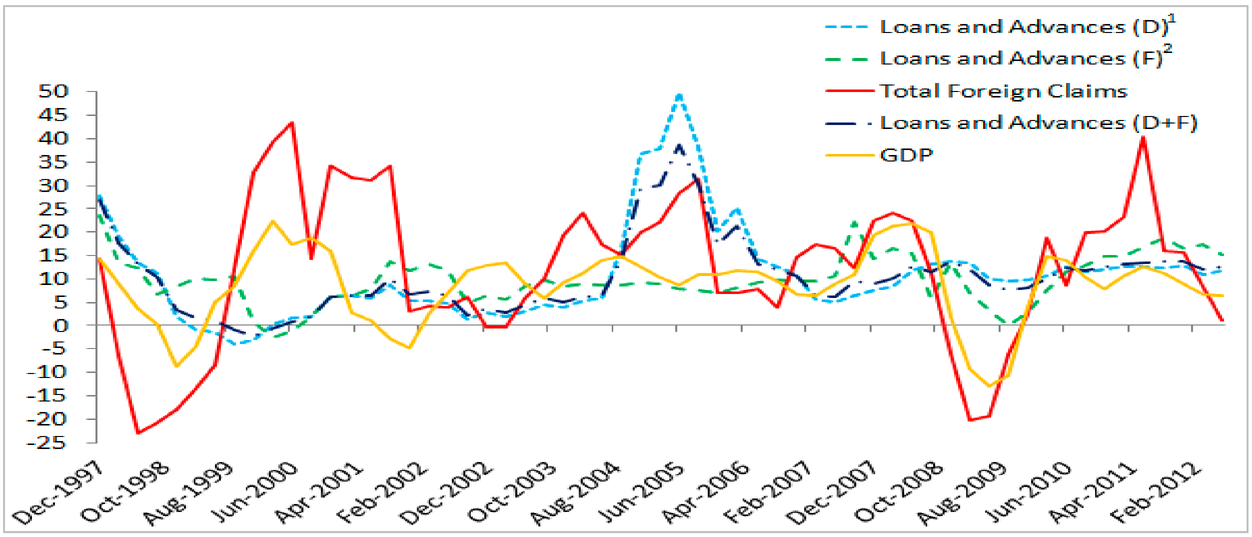
**Figure 16. Foreign Liability Vulnerability Indicator[1]**
**(as percent of domestic credit)**




[1/] Defined as foreign liabilities of deposit taking banks/domestic claims.
[2/] Emerging Asia includes China, India, Indonesia, Malaysia, Philippines, Sri Lanka, Thailand and Vietnam.
[3/] Emerging Europe includes Albania, Bosnia and Herzegovina, Belarus, Bulgaria, Croatia, Hungary, Latvia, Lithuania, Macedonia, Poland, and Romania, Russia, Serbia, Turkey, and Ukraine.
[4/] Middle East& North Africa includes Algeria, Armenia, Egypt, Georgia, Jordan, Kazakhstan, Lebanon, Morocco, Pakistan, and Tunisia.
Source: IMF *International Financial Statistics Database.*

16. **Based on previous periods of foreign bank deleveraging, it would take a sizable and protracted retrenchment to materially affect domestic credit provision**. Figure 17 shows the relationship between year-on-year growth in foreign claims and banking system loan growth.[10] There were two periods when the growth rate of foreign claims went significantly negative, during the AFC and the GFC. While during the AFC the growth rate of banking system loans also turned negative, during the GFC it stayed significantly above 5 percent, as while the growth rate of loans by foreign banks fell significantly that of domestic banks remained robust—and this was despite a larger output drop in the GFC. This likely reflects the much stronger fundamentals of the Malaysian banks heading into the GFC relative to the AFC.

**Figure 17. Relationship between Domestic Credit and Foreign Bank Claims (year-on-year growth rate)**




1/ (D) refers to banking system loans made by Malaysian banks and
2/ (F) refers to banking system loans made by foreign banks.
Sources: BNM; BIS-reported Consolidated Bank Claims on an Immediate Borrower Basis; and Fund Staff Calculations.

17. **Overall, foreign bank deleveraging pressures associated with troubles in the eurozone or elsewhere appear manageable**. While foreign bank claims are large as a share of GDP in Malaysia, they are mostly with U.K. and Singapore banks. U.K. banks in general are strongly interconnected with eurozone banks and developments but the ones with a systemic presence in Malaysia—HSBC and Standard Chartered—are much less interconnected. Singaporean banks are well capitalized and appear able to withstand major shocks, and Singapore has strong ties to Malaysia along many dimensions. When combined

[10] Foreign claims of BIS reporting banks are made up of cross-border claims and local claims of their subsidiaries and branches in local and foreign currency.

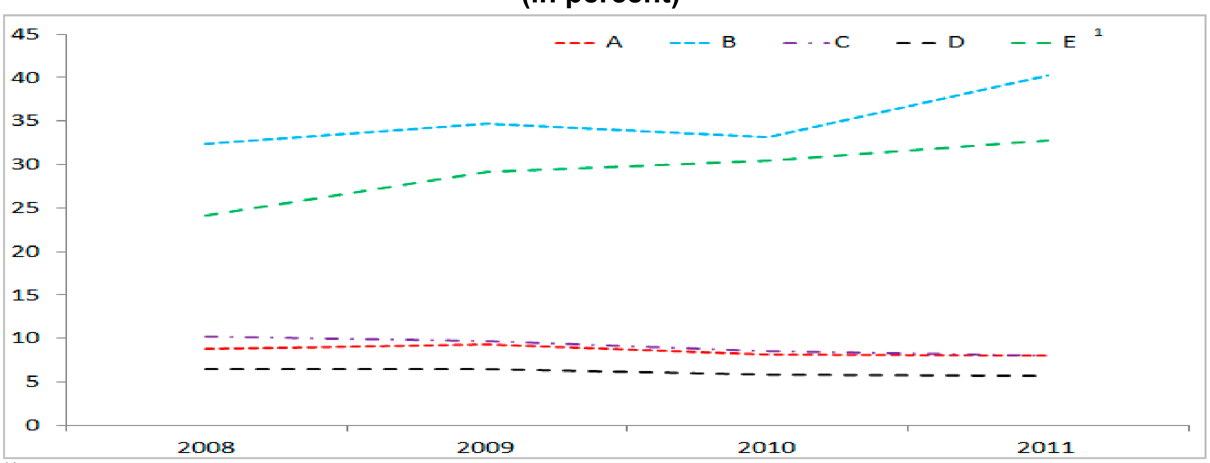
with (i) a high share of foreign bank claims being provided by local affiliates in local currency; and (ii) evidence from previous periods of foreign bank deleveraging, it appears that the Malaysian financial system should be relatively resilient to foreign bank deleveraging pressures. However, it would be prudent for BNM to continue monitoring such developments closely, especially any ratings downgrades of U.K. banks with a systemic presence in Malaysia.

## III. Overseas Operations of Malaysian Banks

### A. Expansion and Performance of Malaysian Banks

18. **Over the last decade, Malaysian banks have expanded abroad significantly, led by CIMB and Maybank**. The 6 biggest banking groups in Malaysia all have an overseas presence (Maybank, CIMB, Public Bank, Hong Leong, RHB Capital, and AmBank). Branches, subsidiaries, representative offices, and associate companies in 20 countries make up the presence depending on the jurisdiction. The biggest branches and subsidiaries are in ASEAN (Indonesia, the Philippines, Singapore, and Thailand) and Hong Kong. As of 2011, Group B had the largest share of assets abroad (around 40 percent; Figure 18A), while Group E had the largest share of profits coming from overseas (around 35 percent; Figure 18B).[11] Overall, the main overseas exposures of the top 3 Malaysian banks are just below 30 percent of GDP, overseas assets account for 19 percent of banks total assets, and operating income from abroad comprises 30 percent of total operating income.

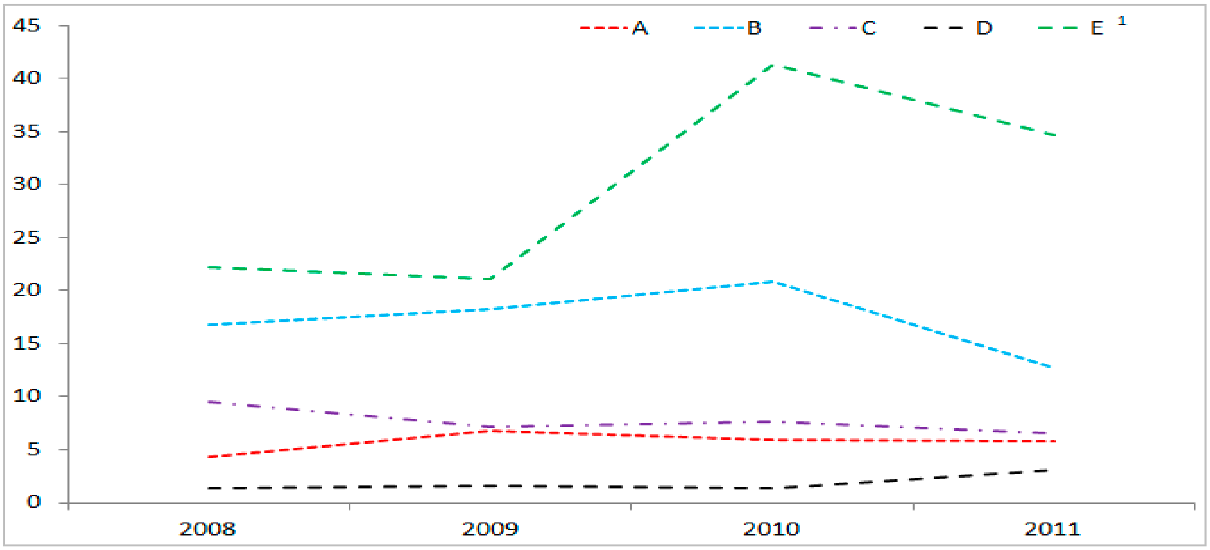
**Figure 18A. Share of Total Assets from Overseas Operations (in percent)**




1/ Main Malaysian Banking Groups with Overseas Operations.
Sources: BNM FSAP Data.

[11] For confidentiality reasons regarding certain aspects of the data, we do not name the main Malaysian banks with overseas operations in Figures 18A-B, but refer to them as Group A-E. For Group E, the large share of profits coming from overseas mainly reflects its Indonesian subsidiary, which contributes around 40 percent to the Group's net interest income.

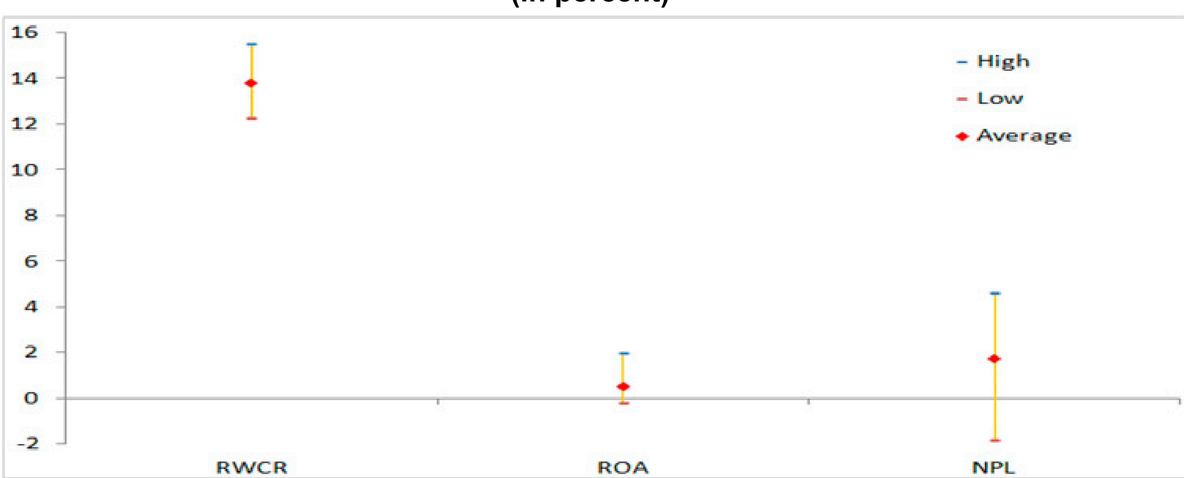
**Figure 18B: Share of Profits Before Tax from Overseas Operations (in percent)**




[1/] Main Malaysian Banking Groups with Overseas Operations.
Sources: BNM FSAP Data.

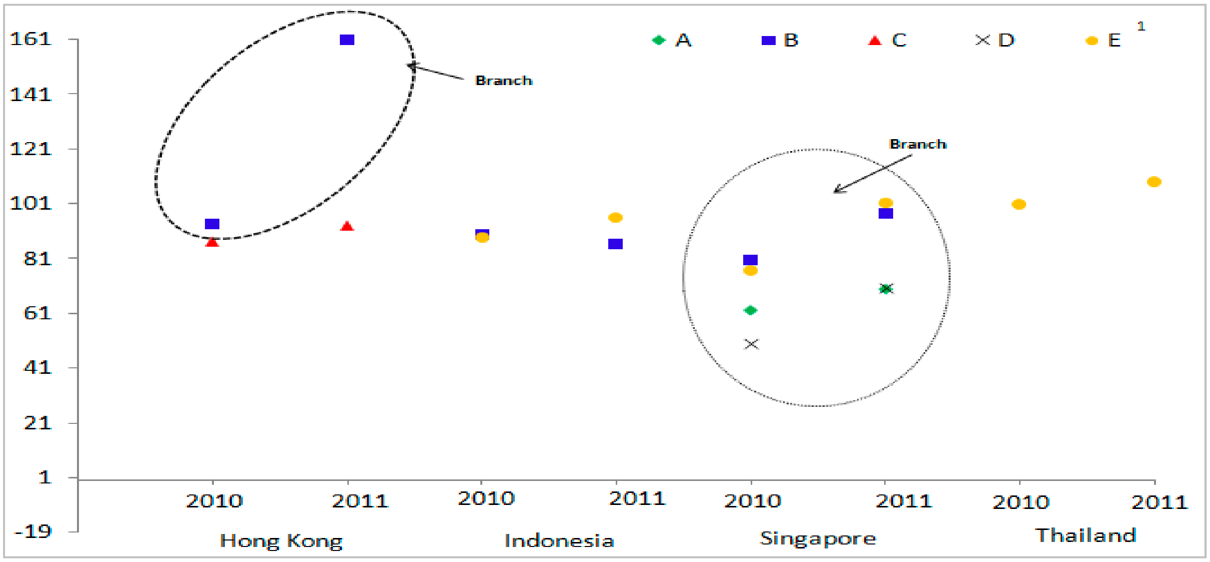
19. **Soundness indicators are solid for the overseas operations, but loan-to-deposit ratios are creeping up**. In terms of composition of assets, as noted in BNM's 2011 Financial Stability and Payment Systems Report (BNM 2011), traditional lending activities account for around ¾ of the assets of overseas operations and about 90-percent of funding comes from deposits in aggregate, although there is of course some variation across individual operations. Of the deposit base, an average of around 60 percent is retail, which is in line regional peers. Soundness ratios in general look solid (Figure 19), although NPLs in one of the Thai operations are elevated. Loan-to-deposit ratios have been also been creeping up over the last year, and are close to or above 1 for a number of overseas operations (Figure 20).

**Figure 19. Soundness Indicators for Malaysian Bank Overseas Operations (2011Q3) (in percent)**




Note: Overseas operations in Singapore, Hong Kong, Thailand, Indonesia and the Philippines are included for CIMB, May Bank, Hong Leong and RHB banks.
Source: BNM FSAP Data.

**Figure 20. Loan to Deposit Ratio for Main Overseas Operations of Malaysian Banks (in percent)**




1/ Main Malaysian Banking Groups with Overseas Operations.
Source: BNM FSAP Data.

### B. How do Malaysian Banks' Exposures Compare Internationally?

20. **Relative to other jurisdictions, Malaysian banks' expansion overseas looks relatively moderate so far**. Within the region, the Singaporean banks have a similar profile to the Malaysian banks in terms of where they have chosen to expand, although recently they have provided relatively more cross-border trade finance loans to Chinese and Indian corporates. Japanese banks obviously had a large footprint in Asia in the 1980–90s after which they retrenched dramatically. Many analysts expect them to expand again into the region, following Japanese firms, given the push factors of further elements of the supply chain being located outside of Japan and the desire to maintain profitability in the face of a declining population in Japan. Outside of the region, Austrian, Italian, Greek, U.K., and Spanish banks are examples of others who have significantly expanded overseas operations in recent times. And of course Icelandic banks are well known for having expanded beyond the ability of the home supervisor to cope. Specific comparisons with banks from some of these jurisdictions are made below:

- ***Austrian banks*** have expanded significantly into CESE since the early 1990s. It started off in Hungary and (then) Czechoslovakia and continued into virtually the whole region. In 2006, total assets of the six largest Austrian banks in the CESE region were equivalent to over 60 percent of home nation GDP (a fifth of banking assets or 3 times regulatory capital) and generated about 40 percent of bank profits (IMF 2008). Given the problems in CESE currently, this is a major vulnerability for the Austrian banks.

- ***Japanese banks*** have 60 percent of their foreign claims on the U.S., U.K., Germany, and France. No other country can generate an impairment of more than 25 percent of tier 1 capital of Japanese banks. Consistent with a renewed interest in the region, the share of foreign claims on Asia nearly doubled to 16 percent during 2004–11, with the biggest exposures to China, Australia, and Singapore (IMF 2012c).

- ***Singaporean banks*** have significantly expanded into the region since 1999 (IMF 2004). Over the last 5 years, the share of loans located outside of Singapore has increased to over 50 percent for both DBS and OCBC. For UOB, this share is about 40 percent (Fitch 2012). Given the size of the Singaporean banks, this represents a large share of home nation GDP (greater than 50 percent).

- ***Spanish banks*** have overseas exposures of around 100 percent of home nation GDP. For BBVA and BSCH (Spain's large and internationally active banks), international businesses contribute around 75 percent of profits. The U.S. and the U.K. constitute the biggest exposures, but there are also sizable assets in Latin America, especially Brazil and Mexico (IMF 2012d).

- ***U.K. banks*** make just below 50 percent of their loans outside of U.K., with around 400 percent of home nation GDP of assets held abroad. HSBC and SCB have the largest geographic footprints (greater than 80 percent of assets abroad), followed by Barclays (greater than 50 percent of assets abroad) and RBS (IMF 2011).

### C. What Lessons Can Be Taken From Other Jurisdictions?

21. **The general pros and cons of overseas operations can be described as follows**:

- *Diversification benefit*: Overseas operations can help maintain profitability when domestic markets are saturated and reduce exposure to the domestic economy.

- *Common shocks risk*: As the majority of the expansion of Malaysian banks is within the region (especially ASEAN), banks could be exposed to regional shocks. Asian countries (including those in ASEAN) are quite heterogeneous though: Malaysian banks have significant exposures in highly open financial centers (Hong Kong and Singapore), a relatively resource rich and closed economy (Indonesia), and an open emerging economy (Thailand). Given the importance of regional supply networks, however, what protection such heterogeneity provides in the face of a major global shock remains an open question.

- *Operational risk*: This could emerge from unfamiliarity with local markets, cultures and legislative-administrative processes, although given much of the expansion has been within ASEAN this risk may not be so large.

22. **Overall, comparing internationally, exposures look manageable but will need close monitoring**. BNM gets detailed monthly information on the main overseas operations and supervisory colleges have been held over last two years for three banks with significant regional exposures. BNM also conducts annual overseas inspections of key operations. However, exposures are expected to increase given the aim of ASEAN Economic Integration by 2015 (including greater mutual recognition of banks from other ASEAN countries) and the opportunity provided as European banks deleverage. Thus, continued careful monitoring will be required, especially regarding loan-to-deposit ratios of some overseas operations (including by currency) and concentration levels in big ASEAN countries. International experience also suggests a benefit in reviewing internal risk management and supervisory responses when the share of overseas assets passes around one third of total assets (e.g. given the experience with Austrian banks).

## IV. Conclusions

23. **Foreign bank claims on Malaysia are relatively large but are mainly with U.K. and Singaporean banks.** BIS-reported foreign bank claims are over 50 percent of GDP, significantly higher than for other countries in the region excluding the financial centers. Foreign banks have been in Malaysia for over a century and all commercial banks have to be locally incorporated. The longest established banks are the U.K. ones, HSBC and Standard Chartered (claims of around 15 percent of GDP currently). They have extensive branch networks as do the two Singaporean banks, OCBC and UOB (claims of around 20 percent of GDP currently).

24. **Given experience of previous advanced economy banking crises, the troubles in the eurozone will likely lead to some deleveraging but the impact appears manageable**. The pullout of U.S. banks from emerging markets following the Latin American debt crisis and the deleveraging of Japanese banks from south east Asia following the Japanese financial crisis in the 1990s are cautionary tales. And U.K. banks in general are strongly interconnected with eurozone banks and developments. However, the ones with a systemic presence in Malaysia—HSBC and Standard Chartered—are much less interconnected, with the lion's share of their assets outside of Europe, the U.K., and the US. Singaporean banks are also well capitalized and appear able to withstand major shocks. When combined with (i) a high share of the foreign bank claims residing in local affiliates and in local currency; and (ii) evidence from previous periods of foreign bank deleveraging, it appears that the Malaysian financial system is less vulnerable to foreign bank deleveraging pressures than the financial systems of many other countries. However, it would be prudent to continue monitoring developments closely, especially any ratings downgrades of U.K. banks with a systemic presence in Malaysia.

25. **Over the last decade, Malaysian banks have expanded abroad significantly.** The 6 biggest banking groups in Malaysia all have an overseas presence (Maybank, CIMB, Public Bank, Hong Leong, RHB Capital, and AmBank). Branches, subsidiaries,

representative offices, and associate companies in 20 countries make up the presence depending on the jurisdiction. The biggest branches and subsidiaries are in ASEAN (Indonesia, the Philippines, Singapore, and Thailand) and Hong Kong, where exposures of the biggest three Malaysian banks are just below 30 percent of GDP, and more than 30 percent of assets of the biggest two Malaysian banks are in overseas operations.

26. **Relative to other jurisdictions, Malaysian banks' expansion overseas so far looks moderate but will require continued careful monitoring**. Austrian, U.K., and Spanish banks also have significantly expanded overseas operations in recent times, but have much higher exposures (ranging from 60–400 percent of GDP). Soundness indicators also appear solid, although rising loan-to-deposit ratios need to be watched (including monitoring closely the ratios by currency). Looking ahead, the expansion overseas of Malaysian banks is expected to continue given the aim of ASEAN Economic Integration by 2015 and the opportunity provided as European banks deleverage. International experience suggests that rapid bank expansion in new markets can pose challenges as bank risk management and supervisory monitoring may fail to keep pace. Uneven supervisory quality in host markets can also contribute to masking of vulnerabilities. Thus, further deepening of home-host cooperation in supervision and crisis prevention—as outlined in the latest Financial Sector Blueprint—will be important going forward.

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