

Banks to come up with recovery plans to prevent failures and bailouts

BY ADELINE PAUL RAJ

Bank Negara Malaysia's upcoming requirement for banks to draw a detailed "recovery plan" — identifying what could potentially bring them to their knees and action plans to avert such crises — is timely given the particularly strong headwinds buffeting the industry.

Apart from a slowing global economy, the Covid-19 outbreak — now declared a pandemic by the World Health Organization — and political uncertainties at home are taking a toll on the industry.

"Bank failures are real ... hence it is timely that Bank Negara issued the exposure draft on recovery planning for Malaysian financial institutions (FIs) to better prepare for the unexpected," Ting Choo Wai, PwC Malaysia's risk assurance services partner, tells *The Edge*.

The central bank issued the exposure draft on Jan 17 and the industry has been given until end-March to provide feedback. If all goes well, a final policy guidance will likely be out by end-June, industry observers say.

"Under the proposed framework, each FI will be required to identify and plan for the execution of a suite of recovery options to restore its long-term viability under a range of idiosyncratic and system-wide stress events," Bank Negara says.

Once the final policy is out, it is understood that FIs — for now, that excludes development FIs and insurers — will have 12 months

to prepare and submit their recovery plan.

This is all part of Bank Negara's recovery and resolution planning (RRP), which is ultimately aimed at preventing the need for government bailouts and the use of taxpayers' money in the event banks fail.

While banks will be made to draw up a recovery plan, Malaysia Deposit Insurance Corp (PIDM) will have to come up with a "resolution plan". The resolution plan is to ensure that, if any bank does eventually fail, it will be resolved in an orderly manner without putting severe stress on the financial system.

PIDM, the body that provides protection for bank deposits, is considered the "resolution authority" in Malaysia, says Ting.

"Resolution planning is ... aimed at heightening the financial system's resilience. [It] involves, for example, obtaining information from member institutions and identifying where member institutions have functions that are critical to the financial markets and the real economy. This way, PIDM and other safety net players would be in a better position to address how they would respond during a crisis. Continuous engagements are being carried out to prepare PIDM's member banks for the phased resolution plan roll-out, expected to commence after 2022," PIDM's CEO Rafiz Azuan Abdullah says in stating its plans for 2020 to 2022.

What RRP entails

RRP was introduced by central banks around the world in the

wake of the 2008/09 global financial crisis. European and American banks were the first to be subject to them.

"It is something in addition to Basel III rules, and the whole world is moving towards it. Singapore, Indonesia and Hong Kong already have their own guidelines. Bank Negara took some time [to come up with its own] as it wanted to understand what the other countries were doing and the lessons learnt," Ting explains.

He says Bank Negara's requirements for recovery planning are quite onerous compared with other jurisdictions in the sense that it requires the banks to submit more details.

It comes at a time when banks are already struggling with myriad and complex compliance rules.

"This is actually quite a big thing that is coming for banks. But it is quite clear from the central bank that this is not meant to be just a compliance exercise [for the banks]. Recovery planning is an extension of a bank's risk management practices. It requires a change in the bank's processes and a change in certain behaviours as well. The way the bank manages the business needs to be different — you not only factor in business-as-usual, you also have to factor in near-default situations and how you are going to prepare for them. It will be different from bank to bank," Ting says.

Glenda Eng, PwC's risk assurance services senior manager,

says banks will have to dig deep and ask themselves some tough questions.

"For example, they will have to ask which parts of their business are strategic and could be systemic to the financial system? Does their current governance structure need to be enhanced to provide oversight in such [near-default] situations? What are the appropriate triggers and indicators signalling early signs of distress? What are the options available as self-remedies, for example, what businesses would they be willing to sell first to salvage the overall bank?" she adds.

Banks will have to think about scenarios that could put them in a "near-default" situation.

An example, Eng says, would be "if there's a run on one of the banks because someone withdrew a whole chunk of money that results in insufficient liquidity for the bank. Or, with Covid-19, let's say one of the banks has very heavy exposure to tourism and transport-related loans, which could result in heavy non-performing loans. Those are some of the scenarios that could be tested as they affect the bank's capital."

Banks will have to come up with a group recovery plan, which means they will need to include their overseas subsidiaries. This could get complex for regional banks such as Malayan Banking Bhd and CIMB Group Holdings Bhd, which have major operations in Indonesia and Singapore, as their recovery plan will also have to be

in keeping with the requirements of those countries.

According to Ting, Bank Negara had actually developed the guidelines much earlier and tested it on three banks in the country — two local and one foreign — about a year and a half ago.

"So the current guidelines (in the draft exposure) are a slightly tweaked version of the earlier guidelines. One of the three banks submitted a recovery plan that was almost 1,000 pages. So, banks should not underestimate the requirements and the effort needed to develop this recovery plan as it is not something that can be done in isolation [from] one department. It requires the bank as a whole, including the board of directors, to be involved as there are certain sensitive decisions that factor in, such as, if the bank is in dire straits and needs to dispose of one of the business arms, which arm will you dispose of first? This plan requires you to think about it now," he says.

RRP measures are important given that there were bank failures in Malaysia during the 1997 Asian financial crisis. Danamodal Nasional Bhd, a government agency that was set up to recapitalise and restructure the banking system, injected RM6.4 billion into the 10 banking groups that emerged from an industry-wide consolidation in the late 1990s. Separately, Pengurusan Danaharta Nasional Bhd was created to purchase NPLs from banks. It acquired about 31.8% of the total NPLs in the banking system. **E**