Nor Shamsiah Mohd Yunus: Re-envisioning financial stability - the path forward

Opening remarks by Ms Nor Shamsiah Mohd Yunus, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Central Bank of Malaysia's Financial Stability Conference "Re-envisioning Financial Stability – The Path Forward", Kuala Lumpur, 23 October 2018.

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Let me begin by extending a very warm welcome to the distinguished speakers, policymakers and participants who have joined us this morning at Bank Negara Malaysia's Financial Stability Conference. This is the first time that the Bank is organising this conference and we are honoured to have among us individuals with deep experience and insights to share their perspectives on the important topic of financial stability.

Over the next one and a half days, we will take a closer look at financial stability in a post-crisis world – how far we have come, what we have learned and the considerations moving forward. In my remarks, I hope to set out what I see as priorities for financial stability authorities, anchored on what we have learned from the crisis and our own experiences in implementing financial stability reforms. Many of these ideas are not new. But in order for us to move forward, it is also important to take stock of what we've achieved so far, while critically re-examining the lessons that we have drawn in recent years. For this, it is useful to start from the global financial crisis.

Ten years have passed since the global financial crisis of 2008. In the words of the famed American economist, Paul Samuelson, "*what we know about the global financial crisis is that we don't know very much*". And so, policymakers around the world continue to direct their energies towards searching for signs of the next crisis, and preparing themselves to deal with it when it comes.

But as you can imagine, when there is much that we still do not fully understand, this is far from straightforward.

The conundrum here is that the next crisis will likely come from where we least expect it. Our understanding of the sources, drivers and transmission channels of systemic risk remains incomplete. While many had warned of pressures building in the subprime mortgages industry before the crisis hit, few, if any, had imagined the scale and impact of the blow up on the global financial system or economy.

Our challenge isn't just a question about where, but *when* a crisis is going to strike and how it will spread. And therefore *when, how and with what instrument* policymakers should act.

The permutations presented by these questions alone in any single economy are almost boundless. Add to that, financial systems that have become far more complex and the relentless pace of technological advancements, and one quickly gets a sense of the daunting challenges facing authorities who are tasked to maintain financial stability. Or even engender some sympathy from those who believe that there should be much less regulation.

With that in mind, I would like to suggest four strategic priorities for financial stability authorities as we navigate an uncertain future.

First, authorities need to remain vigilant. While the global financial system is now on a stronger footing, the IMF reminded us that near-term risks to global financial stability have risen modestly, while medium term risks remain elevated. Emerging economies face mounting pressures that continue to see more volatile capital flows. Tightening financial conditions may also expose financial fragilities that have been created over an extended period of easy monetary conditions.

In addition, structural changes in the financial system are giving rise to new risks, including those presented by a growing shadow banking system and fintech players which might not fall within the regulatory net. Roboadvisors, algorithmic trading and other automated trading platforms powered by AI also have the potential to induce highly disruptive procyclical market behaviour, notwithstanding their substantial benefits in reducing transaction costs and increasing market liquidity. And of course, there are cyberthreats with the global cost of cybercrime projected to reach $2 trillion in 2019.

Both the tools and coverage of surveillance activities to support financial stability have evolved significantly in the post-crisis period. It is imperative that authorities continue to build on this to capture current and future emerging risks. The good news is that with the rise of big data and new technologies, authorities have the capacity to achieve what was not possible before to keep a pulse on developments affecting the financial system.

Second, authorities must continue to develop and deepen their understanding of risk transmission. Approaches to quantify the immediate, direct impact on institutional resilience are now reasonably well developed. However, further work remains in mapping out the second and higher order effects on the broader financial system and economy. Authorities need to continue pushing the envelope to advance the development of more holistic approaches to systemic risk assessments. This needs to be able to capture propagation channels and feedback loops not just among entities within the financial system, but also across the domestic and global economy. An understanding of structural changes driving such interlinkages will become increasingly critical.

Third, authorities must have a broad policy toolkit for responding to financial stability risks. In recent years, central banks and other authorities responsible for financial stability have had their mandates clarified and powers strengthened for this purpose. This is however by no means assured in many other countries where financial stability authorities continue to face significant limitations in their ability to act, in particular, during a crisis.

In Malaysia, the enactment of new central bank legislation in 2009 accorded Bank Negara Malaysia with strengthened surveillance powers, along with broad powers to implement measures to avert risks to financial stability. This included powers to resolve non-viable financial institutions and powers to direct specific institutions running systemic risks to take measures to reduce those risks. These powers are in addition to the Bank's regulatory and supervisory powers over banks and insurers.

Having such powers is useful in a crisis. But the ability to operationalise them can be a whole different matter that requires greater attention to forethought and scenario-planning.

Fourth, authorities need to increase policy agility. Every crisis or financial stability issue is different, and each requires a different policy response. The pressure will be on authorities to be able to respond to an infinite variety of problems, which are very rarely understood clearly at the onset, and which often evolve rapidly.

Going forward, long-standing policy frameworks are likely to come under increasing pressure, simply because they are not built to respond to the intensity and pace of change taking place in the financial system. I believe the solution lies *not* in building new frameworks, but in strengthening institutional *foundations* which allow for more nimble frameworks to emerge. Such foundations include clear decision authorities, credible analysis to support decision-making, effective policy feedback loops and strong monitoring and accountability frameworks. Equally important is the ability to react to unplanned events given the inherent difficulties in predicting market behaviour, especially further out in time.

Managing financial stability will ultimately require authorities to walk a fine balance.

The need for surveillance to extend beyond traditional boundaries of financial services can make it harder for authorities to “stay within their lanes”. This can be further complicated when the primary responsibility for financial stability is not always clearly defined.

More authorities today have acquired expanded powers to access information and respond to financial stability risks. Even where there is a single authority charged with the mandate for financial stability, such powers will tend to rely on a system of regulation and supervision over different actors in the financial system that is often discharged by different authorities, using different instruments and approaches.

Ensuring effective coordination across such a system depends on a number of factors. Institutional set ups such as inter-agency arrangements – of which there are many good examples – are important and clearly even necessary. But they are not a sufficient condition for effective coordination. The most important factors for effective coordination are more likely to be *internal* ones – the submission of institutional agendas to a higher collective goal, an internal resolve to overcome inherent conflicts, and the organisational flexibility to move in a common direction with others.

In increasing their agility to shift gears where required, authorities must also find ways to do so while preserving the credibility and predictability of policy. Shorter policy cycles and more frequent adjustments in response to developing risks can make this significantly more challenging.

Communicating financial stability policies effectively will be key. This is incredibly difficult to do, particularly to a broad and diverse audience who are more likely than before to be affected by policies that are directed at managing financial stability risks. The challenges are further compounded by the reality that the vast majority of the public prefer to receive information not through traditional channels but through secondary sources, including social media.

Authorities are responding in a number of different ways. Some have increased the frequency of published financial stability reviews, while making them more readable and easy to understand. Others have taken their message directly to the masses by supplementing official financial stability communications with multi-faceted media campaigns. Authorities have also strengthened industry and inter-agency platforms for communicating information on financial stability developments.

What is clear is that communications has become an integral part of the management of financial stability. And it goes beyond increasing the effectiveness of a particular policy response to emerging risks. It is essential to the integrity of financial stability policies *over time*, and to public confidence in the institutions that are responsible for implementing them.

In a more globalised financial system, authorities also face increasing pressures to conform to global standards, many of which were not designed with institutions that have no or limited activities beyond their domestic borders in mind. Global standards are also often ill-equipped to respond to specific conditions in domestic financial systems that differ significantly in their stage of development and vulnerabilities to risks. The more inclusive process to global standard setting is therefore very much welcomed and needs to be further enhanced through continued open dialogue and support for implementation approaches that are more responsive to unintended consequences at a jurisdictional level.

Today, the Bank will communicate its intention to extend the observation period for the Net Stable Funding Ratio, or NSFR, in Malaysia for another year to 2020. This takes into account the Bank’s intention to conduct further on-site assessments to validate the maturity and robustness of the liquidity and funding practices of banks, and uneven progress in implementation at the global level.

The Bank remains committed to implementing the NSFR requirements as part of overall liquidity standards applicable to licensed banks in Malaysia. At present, all banks maintain adequate liquidity buffers against short term liquidity stress, and the vast majority of banks already report NSFR levels above the minimum 100% based on observation data.

Let me now draw my remarks to a close. The task of financial stability authorities is to prepare for the worst, and work for the best. There are rarely easy fixes to the issues that we face, but also no shortage of diverse experiences to draw from and to guide our path. It is my hope that this conference will serve to generate useful discussions that will help inform our own preparations to confront any eventuality, and strengthen our conviction that being prepared is better than being right.

On that note, I look forward to the discussion and insights that will emerge over the coming days.