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BNM'S CREDIT RISK DISCLOSURE ITS ROLE IN STRENGTHENING MALAYSIA'S BANKING STABILITY



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In recent years, Bank Negara Malaysia (BNM) has placed greater attention on improving transparency in the banking industry, particularly through clearer credit risk disclosure. These disclosures require banks to provide detailed information about their lending activities, the quality of their loans, and how they manage potential losses. The main goal is to build trust, promote sound risk management, and maintain financial stability in Malaysia's banking system.

BNM's regulatory framework encourages banks to be open about their credit exposure, capital strength, and risk management practices. Through the Pillar 3 disclosure requirements under the Basel framework, banks must regularly publish data on loan portfolios, non-performing loans (NPLs), provisions, and capital adequacy ratios. This allows investors, regulators, and the public to understand how much risk each bank carries and how well it can absorb potential shocks. (Aris et al, 2019)

In addition, BNM has introduced newer expectations related to climate-related financial risks. Banks are now required to assess how environmental and transition risks may affect their borrowers, particularly those in sensitive sectors like energy, agriculture, and property development. This means credit risk disclosure has evolved from simply reporting past numbers to including forward-looking analysis and scenario-based assessments.

WHY BETTER DISCLOSURE MATTERS?

Firstly, transparent disclosure helps to detect risks early. When banks publish timely and accurate information about loan quality and exposure, supervisors can identify sectors that show early signs of distress. This helps prevent small issues from growing into systemic problems. For example, if a particular industry faces declining repayment ability, BNM and banks can act quickly by imposing tighter lending standards or providing focused support.

Second, greater disclosure improves market discipline. When more information is available, investors and analysts can assess the health of each bank more accurately. This encourages responsible behaviour, as banks that manage risks poorly may face higher funding costs or weaker investor confidence. In this way, transparency rewards prudence and discourages excessive risk-taking. (Nahar and Jahan, 2021)

Third, it helps build resilience against future uncertainties. By requiring banks to conduct climate-related stress tests and scenario analysis, BNM ensures that the financial sector considers how extreme weather events or energy transitions might affect loan repayment. The results of these exercises are shared through disclosures, giving both the market and policymakers a clearer view of the system's preparedness for long-term risks.



HOW ARE MALAYSIAN BANKS ADAPTING?

Most local banks have taken positive steps to improve the quality and scope of their credit risk reports. Many have enhanced their data systems, upgraded credit modelling tools, and introduced expected credit loss (ECL) models to comply with international standards. Their annual and sustainability reports now include detailed explanations of how loans are classified, what assumptions are used in provisioning, and how exposures are distributed across sectors.

Some banks also include summaries of climate risk initiatives, linking their strategies to BNM's guidelines. This shows that the industry is slowly shifting from a backward-looking approach to a more forward-looking risk culture, where banks actively assess what could happen in the future rather than just reporting what has already occurred.

However, challenges remain. Habit et. al (2025) said that smaller financial institutions may find it difficult to produce detailed disclosures or perform complex scenario analyses due to limited resources and expertise. Differences in how data is presented can also make it harder to compare banks. To address this, BNM continues to provide standardized guidance and industry-wide exercises, which help align practices across the sector.

Striking a balance between transparency and practicality remains crucial for Malaysia's banking sector. While detailed disclosures enhance accountability and investor confidence, they may also lead to misinterpretation. For instance, a temporary increase in loan provisions could be mistaken for financial weakness rather than prudent risk management. Additionally, the cost and complexity of implementing advanced data and reporting systems pose challenges, particularly for smaller banks. Through its phased approach and capacity-building initiatives, Bank Negara Malaysia (BNM) helps financial institutions navigate these challenges effectively.

In conclusion, Bank Negara Malaysia's efforts to improve credit risk disclosure are key to keeping the country's banking system stable and strong. By making sure banks share clear and timely information about their risks and financial health, the central bank helps build trust and transparency in the market. Including climate-related risks in these reports is also an important step toward preparing the financial system for future challenges.

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