EVALUATION OF CAPITAL ADEQUACY RATIO OF COMMERCIAL BANK IN MALAYSIA BASED ON BASEL II ACCORD

A thesis submitted to the Graduate School in Partial fulfillment of the requirements for the degree Master of Science (Banking), Universiti Utara Malaysia

by

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ABSTRAK

Kajian ini menyelidik tentang perhubungan di antara nisbah modal terkumpul bank-bank perdagangan di Malaysia berdasarkan Basel II Accord. Faktor-faktor tersebut mewakili tujuh angkubah tidak bersandar, iaitu risiko pasaran, risiko operasi, risiko kredit, pinjaman, keluaran dalam negara kasar(KDNK), pinjaman tidak berbayar dan saiz. Angkubah bersandar ialah nisbah modal terkumpul. Tujuan kajian ini adalah untuk menyediakan dokumen mengenai konsep nisbah modal terkumpul di bank-bank perdagangan berdasarkan Basel II Accord dan menilai kesan setiap factor-faktor penentu ke atas nisbah modal terkumpul. Kerangka kajian dan satu hypothesis telah dibentuk. Hipotesis kajian telah diuji dengan menggunakan analisis regrresi linear. Ia digunakan untuk mengenalpasti penentu-penentu yang mempengaruhi nisbah modal terkumpul bank-bank perdagangan di Malaysia. Daripada tujuh pembolehubah yang dipilh khusus untuk kajian ini, dua pembolehubah didapati tidak signifikan, iaitu risiko kredit dan keluaran negara kasar. Lima lagi pembolehubah yang signifikan pada paras 5% dalam kajian ini ialah risiko pasaran, risiko opearsi, saiz, pinjaman tidak berbayar dan pinjaman.

ABSTRACT

This study investigates the evaluation of capital adequacy ratio of commercial banks in Malaysia based on Basel II Accord. Capital adequacy ratio is represented by seven independent variables namely: market risk, operational risk, credit risk, loans, loan loss provision, size and gross domestic product (GDP). The objective this study is to identify the problem of not complying with Basel II Accord, to find out the level of Capital Adequacy Ratio of commercial bank and lastly to identify of component risk consist of credit risk, market risk and operational risk in commercial banks. A research framework and a hypothesis are developed. The hypothesis of this study is tested using linear regression analysis. This analysis is used to investigate the evaluation of capital adequacy ratio in commercial banks base Basel II Accord. From seven independent variables in this study, two independent variable are not statistically significant; thy are credit risk and gross domestic product. The other five variables are statistically significant. They are market risk, operational risk, LOANS, loan loss provision and LNTA. In conclusion, this study offered insights to understanding the evaluation of capital adequacy ratio in commercial banks base Basel II Accord for the first time in Malaysia. The main determinants of capital adequacy ratio in Malaysia have been examined empirically. Hopefully this contribution will interest for future in-depth study considering that capital adequacy ratio is one of the most important in commercial banks.

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LIST OF ABBREVIATIONS

CAR	:	Capital Adequacy Ratio
OR	:	Operational risk
CR	:	Credit risk
MR	:	Market risk
SIZE	:	Nature log of total asset (LNTA)
LLP	:	Loan loss provision
LOANS	:	The percentage of total asset tied up in loans.
GDP	:	Gross domestic product

CHAPTER 1

INTRODUCTION

1.1 Background of Study

Commercial banks are the main players in the banking system. They are the largest and most significant providers of fund in the banking system. Commercial banks were initially brought under supervisory control of BNM in 1959. Prior to the inception of BNM, the commercial banks had only to comply to the Companies' Ordinance 1948. The Banking Act 1973 was subsequently replaced in 1989 with the Banking and Financial Institution Act 1989 (BAFIA), which combines the Banking Act 1973 and the Finance Companies Act 1969 under a single legislation (BNM, 1999).

The main function of commercial banks is to provide retail-banking services such as the acceptance of deposit, granting of loans and advances and financial guarantees. Apart from that, commercial banks provide trade-financing facilities such as trust receipts, Banker's Acceptance, shipping guarantee and letter of credit. Commercial banks are also authorized. Risks are usually defined as the adverse impact on profitability of several distinct sources of uncertainty. While the types and degree of risks an organization may be exposed, depend upon a number of factors such as its size, complexity business activities, volume, it is believed that generally the banks face Credit, Market, Liquidity, Operational, Compliance, legal, regulatory and reputation risks. Since there are many

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