

Box Article

Medium-term priorities for the prudential framework and anti-money laundering and countering financing of terrorism (AML/CFT)

The recent pandemic has underscored the importance of prudent risk-taking and building up buffers in good times – so that the financial system can cushion unexpected shocks during a crisis and be an effective countercyclical force to support economic recovery. We will continue to ensure the continued effectiveness of Bank Negara Malaysia's prudential framework for financial institutions, with the focus areas outlined below for the next five years.

Basel III capital requirements

Introduced in the wake of the 2008 Global Financial Crisis, the Basel III reforms have been integral in promoting the resilience of the global banking system. Over the years, Malaysia has implemented most of the key elements of this reform package – particularly the minimum capital requirements, leverage ratio, and liquidity standards.

Our priority ahead will be to review and implement Basel III reforms related to the computation of risk-weighted assets – with a focus on credit risk, operational risk, counterparty credit risk, securitisation, and exposures to central counterparties. We will also review the Single Counterparty Exposure Limit (SCEL) policy to take into account developments in international standards on large exposures where relevant. This will include potential refinements to the limit, scope of eligible collateral, and treatment of specific exposures (e.g. to sovereigns, central counterparties and intragroup entities).

As with existing practice, in the adoption of international standards, we will carefully consider relevant applications in the Malaysian context, as well as the expanding footprint of Malaysian financial institutions abroad. Where relevant, we will also continue to ensure that regulatory standards are proportionate to the risks at hand, while taking into account the industry's operational readiness and the need for transition arrangements.



Risk-Based Capital Framework for Insurers and Takaful Operators (RBC/T)

Since the implementation of the RBC/T in 2009 for insurers and 2014 for takaful operators, market conditions have evolved alongside greater product innovation and the introduction of new takaful models and Shariah contracts. New global regulatory measures such as the Risk-based Global Insurance Capital Standards (ICS) developed by the IAIS have also paved the way for greater convergence on international capital adequacy standards.

In line with these developments, we have commenced a holistic review of the RBC/T to ensure its continued effectiveness to respond to new and emerging risks, as well as to align measurement practices across the insurance and takaful industry. This should enable the insurers and takaful operators (ITOs) to align their business strategies and remain competitive. We intend to broadly align our RBC/T with the ICS, both in terms of the framework design and timeline. In the years ahead, we will also seek to build upon the industry feedback on proposed enhancements to the RBC/T, particularly on the appropriateness of broad design elements to the different business models.

The review will also consider Shariah principles to facilitate greater fungibility of capital between takaful funds, which is currently restricted to reflect different ownership of individual funds. These considerations will include *ta'awun* (mutual assistance) for surpluses in a particular takaful fund – in excess of capital requirements at the fund level – to be used to support another takaful fund.

AML/CFT measures

As the competent authority under the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA), we remain committed to drive a robust national AML/CFT regime. In doing so, we have led efforts to establish the necessary mechanisms and initiatives for effective prevention, investigation, and prosecution of financial crimes, in collaboration with the domestic law enforcement agencies (LEAs), reporting institutions, foreign financial intelligence units, regional and international groups, as well as other relevant stakeholders.

In this regard, our medium-term priorities for preserving the integrity of the financial system will continue to build on the established collaboration mechanisms, while targeting mitigation of the ML/TF risks identified in the recently concluded National Risk Assessment 2020 (NRA 2020)¹. Overall, our strategies will be anchored on three key thrusts.

First, we will explore integrated efforts to improve coordination to better prevent, detect, disrupt and dismantle financial crimes at the earliest opportunity, prioritising highest-risk crime, namely fraud and crimes with elements of organised criminal syndicates. This includes the development of an information sharing platform between participating financial institutions and relevant LEAs to minimise the dissipation of scammed funds and leveraging on the National Anti-Financial Crime Centre (NFCC) to conduct joint intelligence and investigation focusing on organised criminal groups.

¹ The NRA 2020 had identified that the banking system, remittance services and designated payment instruments continue to be abused to facilitate top five high risk crimes – fraud, corruption, smuggling, illicit drug trafficking and organised crimes. This is further aggravated by increasing digitalisation in the financial sector and the swift nature of domestic and cross-border transactions.

Second, we will continue to further our understanding of the emerging and higher ML/TF risk areas, involving financial and non-financial sectors, to provide responsive mitigating policies and guidance to reporting institutions. Among others, we will focus on assessing the key ML/TF risk drivers identified in the NRA 2020, such as the growing use of virtual assets and technology to facilitate financial crimes and the exposure emanating from digitalisation of financial services or digital banking. Emphasis will also be placed on other high-risk areas, such as the abuse of shell and shelf companies, or professional services.

Third, consistent with regional and global developments, we will encourage industry-led collaborative initiatives to drive more efficient practices and strengthen the compliance culture in the industry. These initiatives include the issuance of sector-driven AML/CFT guidance or best practices to streamline the implementation of specific measures, development of professionally qualified or certified subject matter experts through accreditation or train-the-trainer programmes, as well as development of shared infrastructure or solutions for effective monitoring and information sharing on ML/TF risks.

Responsibility mapping

We will finalise the Responsibility Mapping Framework, which was proposed at end-2019 before the onset of the pandemic. Reflecting the importance of the tone-from-the-top, the framework aims to ensure that responsibilities for key functions, including those prescribed by laws and regulations, are clearly allocated to individuals at senior levels.

By enabling greater clarity and transparency in the governance and accountability of individuals in the financial institutions, the framework supports several important outcomes. These include facilitating meaningful regulatory engagements with the board of directors of financial institutions on the operations and decision-making process of the financial institution, driving better decisions through strengthened incentives for good conduct and culture, and allowing institutions to address barriers that may prevent key individuals from carrying out their duties effectively. In the longer term, these internal transformations will be key to bolster the industry's long-term financial soundness – and in turn, their continued ability to fulfil their obligations and meet the customers' needs.



Risk Management in Technology (RMiT)

The rapid pace of change in the digital landscape means that regulatory expectations must evolve in tandem to remain effective. We will prioritise fine-tuning the RMiT policy, which is a central piece of the regulatory framework for technology risk management. Efforts on the RMiT in particular will be guided by four thrusts.

First, we will ensure greater supervisory focus on how financial institutions manage risks from TPSPs. Our supervisory activities will focus on financial institutions' overall governance, due diligence, continuous monitoring, and data protection – and whether safeguards are commensurate with the scope of services provided and criticality of information being processed by TPSPs. The goal will be to ensure that TPSPs do not become the 'weakest link' in the supply chain. Complementing this, we will also explore supporting broader initiatives to develop common standards for TPSPs in relation to governance and risk management, in line with the interest among TPSPs to bolster confidence on the robustness of their services. This may entail leveraging the RMiT as a baseline for TPSPs to develop such standards.

Importantly, heightened supervisory focus in this area complements the broader digitalisation strategies in the Blueprint – particularly on regulatory oversight and cyber security (refer to the chapter "Advancing digitalisation of the financial sector"), which emphasise the need to consider the broadening perimeter of risks, including those arising from greater partnerships with TPSPs.

Second, we will enhance our guidance to the industry on cloud service management. We will consider various possible models for future oversight arrangements, with the desired outcome of establishing assurance that cloud service providers (CSPs) are mitigating risks effectively. To this end, it will be important for industry players to strengthen their capacity in understanding these operations, particularly the resultant risks to financial institutions – rather than solely relying on the CSPs or appointed TPSPs for knowledge and expertise on cloud-related arrangements. We will look to financial institutions to have a clear roadmap in building internal capabilities in this regard.

Third, we will heighten our scrutiny on the implementation of 'high availability' infrastructures. Such infrastructures include online financial services, for which there is a reasonable expectation for minimal disruptions or continued service availability by customers and counterparties. Maintaining a high level of uptime is therefore crucial, particularly to preserve confidence in the financial sector. As industry players are making encouraging progress in this regard, we will remain open to different approaches by respective financial institutions to build greater operational resilience into their 'high availability' infrastructures.

Fourth, the Bank will explore allowing financial institutions to rely on their internal risk function in conducting risk assessment, as the industry's infrastructure and practices mature. Currently, the use of external service providers for independent assessment is required in the RMiT. We expect financial institutions to leverage these external assurance arrangements to build internal capacity for technology risk management.

Recovery and resolution planning

In recent years, we have collaborated with Malaysia Deposit Insurance Corporation (PIDM) to establish a policy framework to implement recovery and resolution planning (RRP) for financial institutions in Malaysia – guided by the Financial Stability Board's (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions. This framework serves to ensure continued resilience of the financial system in times of distress and avert episodes of financial institution failure that could threaten financial stability.

With the release of the Recovery Planning policy in July 2021, the recovery plans in Malaysia will be implemented on a phased approach. Our immediate focus will be on financial institutions under the first phase of the roll-out plan, with first submissions from banks on their recovery plans expected in 2023. These recovery plans will serve as an important starting point to support PIDM's resolvability assessments and resolution plans.