

2015

REGULATORY AND SUPERVISORY FRAMEWORK

- 81 Strengthening the Prudential Framework
- 87 Safeguarding Financial System Integrity
- 89 Enforcement Activities
- 91 *Box Article: Enforcement and Penalty Framework*

REGULATORY AND SUPERVISORY FRAMEWORK

The Bank continued to strengthen the pillars of a sound prudential framework in 2015. Regulatory and supervisory activities were guided by a domestic focus on ensuring strong governance and appropriate risk-taking by financial institutions in an environment of heightened risks. These included the intensification of stress tests conducted by both the Bank and financial institutions. In addition, the Bank's policy priorities took into consideration progress made on global regulatory reforms.

On 31 January 2016, amendments to the Development Financial Institutions Act 2002 (DFIA) were brought into force to further strengthen the regulatory framework for development financial institutions (DFIs). The amendments aim to better support the DFIs' specific mandates in a sustainable manner, and reflect the evolving role of DFIs in supporting Malaysia's socio-economic development and inclusive growth.

Efforts to strengthen safeguards against threats of money laundering and terrorism financing (ML/TF) continued to be a key priority for the Bank. In September 2015, the Financial Action Task Force (FATF) published a report on the Mutual Evaluation (ME) of Malaysia's anti-money laundering and countering the financing of terrorism (AML/CFT) framework. The report acknowledged Malaysia's well-developed legal and regulatory arrangements, and strong inter-agency coordination for the supervision of ML/TF. Drawing in part on the recommendations of the ME Report, the National Coordination Committee to Counter Money Laundering (NCC) has formulated a five-year National AML/CFT Strategic Plan (NSP) to promote and protect the integrity of Malaysia's financial system over the long term and contribute towards reducing the level of crime in the country. Based on the commitment demonstrated by Malaysia's action plan and the continuing progress in efforts to improve its AML/CFT programme, Malaysia was granted full membership of the FATF in February 2016.

On the international front, the Bank signed the International Association of Insurance Supervisors (IAIS) Multilateral Memorandum of Understanding

(MMoU) in May 2015. The MMoU provides a global framework for supervisory co-operation and information exchange to support the effective supervision of insurers that operate in multiple jurisdictions. As at 31 December 2015, the MMoU has been signed by 54 other supervisory authorities which collectively account for more than 65% of insurance premiums globally.

STRENGTHENING THE PRUDENTIAL FRAMEWORK

Liquidity standards for banking institutions

In March 2015, the Bank issued the final Liquidity Coverage Ratio (LCR) standards for banking institutions as part of the implementation of the Basel III reform package in Malaysia. The rules, which require banking institutions to maintain sufficient liquidity buffers to withstand severe short-term liquidity shocks over a 30-day horizon, came into effect on 1 June 2015. As expected, banking institutions transitioned smoothly to the new liquidity requirements with all banking institutions meeting the 60% minimum requirement. As at 31 December 2015, the average LCR of the banking sector stood at 127% with 39 out of 54 banking institutions already reporting LCR levels above the 100% requirement which only comes into effect in 2019 under the transitioning arrangements. Since August 2015, the Bank has started to publish the aggregate LCR position for the banking system to supplement the loan-to-deposit ratio as a more reflective indicator of liquidity risks.

Banking institutions transitioned smoothly to the new liquidity requirements with all banking institutions meeting the 60% minimum requirement

The Bank continues to monitor banking institutions' positions against the Net Stable Funding Ratio (NSFR) rules set out by the Basel Committee on

Banking Supervision (Basel Committee). The NSFR complements the LCR by reducing a banking institution's funding risk over a longer-term horizon. This is achieved through a requirement for banking institutions to fund their activities with sufficiently stable sources of funding. During the year, the Bank updated the NSFR reporting template to capture the Basel Committee's final NSFR rules which were issued in October 2014. The changes incorporate revised factors for measuring available stable funding and required stable funding as well as more granular reporting of derivatives and short-term exposures. Owing to the more favourable treatment of retail deposits and performing loans, the changes are likely to improve compliance with the NSFR by banking institutions in Malaysia.

Data gathered during the observation period will serve as input to inform the Bank's approach to the implementation of the NSFR in Malaysia. The Bank expects to consult on the proposed rules for banking institutions in the second half of 2016. As with other global standards, the Bank will address issues arising from the application of the rules in the context of the domestic financial system.

Corporate governance

Financial institutions in Malaysia have demonstrated continued improvements in corporate governance over the past few years. In particular, progress was observed among larger financial institutions in strengthening the collective expertise of the board and senior management to navigate a more complex regulatory and operating environment. The Bank has reviewed its corporate governance standards for financial institutions to reflect these developments as well as evolving global standards. The revised corporate governance standards also incorporate changes to existing rules to take into consideration the more diverse range of practices among various financial institutions in the financial system. The revised

standards will be issued for industry consultation in the first quarter of 2016.

Among the key changes proposed are: (i) requirements for boards of financial institutions to comprise a majority of independent directors; (ii) heightened expectations on the board and senior management to foster a corporate culture that promotes ethical, prudent and professional behaviour; and (iii) expanded requirements on compensation structures to ensure that employees' incentives are aligned with prudent risk-taking. Financial groups are also required to provide effective group-wide oversight over risks arising from activities within the group and across jurisdictions where the group has operations. The Bank further proposes to reduce interlocking board representations across licensed institutions within a financial group to address potential conflicts that can arise between group and entity-specific interests.

Key changes in the revised corporate governance standards include expanded requirements on compensation structures to align incentives with prudent risk-taking

The Bank is cognisant that sourcing for top quality board members remains a challenge for many financial institutions and is therefore proposing to phase in the strengthened requirements on board composition over three to five years. Concurrently, work to develop a Directors Register is being advanced by the Financial Institutions Directors' Education Programme (FIDE) Forum. FIDE Forum aims to launch the Directors Register in April 2016,

Components of the Net Stable Funding Ratio (NSFR)

The measurement of the NSFR is represented in the formula below:

$$\text{NSFR} = \frac{\text{Available Stable Funding (ASF)}}{\text{Required Stable Funding (RSF)}} \geq 100\%$$

ASF factors are weighted according to the stability of various funding sources while RSF factors reflect the amount of stable funding needed for the banking institution's assets and other exposures.

along with a process to admit qualified individuals to the Register on an ongoing basis to meet the growing demand of financial institutions for new directors.

Credit risk management in banking institutions

Under the more challenging business conditions that prevailed during the year, banking institutions have continued to strengthen their credit risk monitoring and measurement approaches to identify and actively manage potential losses from borrowers that are more exposed to financial stress. With higher exposures of banking institutions to large corporates which are interconnected across economic sectors, and a growing share of foreign currency denominated loans, the Bank has also increased its scrutiny of practices in the industry to account for concentration, country and transfer risks.

In line with these developments, the Bank undertook a comprehensive review of the existing regulatory framework for credit risk management to ensure that the prudential standards continue to remain relevant. A key focus of the review is on improving the sophistication of credit risk measurement methods that are employed across the industry. The Bank proposes to strengthen requirements on credit rating frameworks, including requiring all banking institutions to develop, test and implement loss estimation

models that capture internal estimates of the probability of default, loss given default and exposure at default. The proposals will also further clarify the role of the board in credit decisions to reflect the board's primary responsibility for approving the credit risk management strategy (including the risk appetite) and significant credit policies, rather than individual loans. The Bank expects to issue the revised standards for industry consultation in the first half of 2016.

Insurance and takaful

Following the implementation of the revised standards on the role of the appointed actuary which came into effect on 1 January 2015, the Bank completed revisions to four related standards for insurers and takaful operators during the year (Table 3.1). Taken together, these changes support a strong and independent role for the appointed actuary in promoting the sound management of insurance/takaful and financial risks. They also reinforce a more active role of the board in overseeing an insurer/takaful operator's financial affairs.

The independence of an appointed actuary is an important element in promoting sound risk management

Table 3.1

Revised Standards for Insurers and Takaful Operators

Standards	Salient revisions
Introduction of New Products by Insurers and Takaful Operators	<ul style="list-style-type: none"> • Making the Chief Executive Officer (CEO) clearly responsible to ensure that new products offered are consistent with the risk-bearing capacity of the institution and the interests of the customers
Management of Participating Life Business	<ul style="list-style-type: none"> • Strengthened responsibility of the appointed actuary to recommend the surplus distribution based on an annual bonus supportability study • Enhanced accountability of the CEO and board in relation to the principles for treating customers fairly
Financial Condition Report (FCR)	<ul style="list-style-type: none"> • Closer alignment of the FCR prepared by the appointed actuary with an insurer's business planning cycle, including strategy setting, in line with its intended use as a capital and risk management tool by the board and senior management
Stress Testing	<ul style="list-style-type: none"> • Expanded principles and guidance on the conduct of stress tests for the purpose of informing the appointed actuary's assessments in the FCR. This must include: <ul style="list-style-type: none"> - forward-looking multi-period stress tests (over a medium- to long-term horizon) - scenarios prescribed by the Bank in addition to internally-developed scenarios

Source: Bank Negara Malaysia

Islamic finance

During the year, the Islamic banks completed the migration of their existing customer accounts to either Islamic deposits or investment accounts, as required under the Islamic Financial Services Act 2013 (IFSA). To comply with the IFSA, Islamic banks can either migrate all existing customer accounts to IFSA-compliant deposit products, or offer customers a choice of placing their monies in IFSA-compliant deposits or investment accounts. As at end of 2015, eight Islamic banks have opted to offer the choice of Islamic deposits or investment accounts to their customers. These Islamic banks have continued to strengthen governance and risk management arrangements in respect of Islamic investment accounts, including arrangements to ensure the proper segregation and management of funds governed under investment account mandates. The remaining Islamic banks, meanwhile, have migrated all their existing customers to IFSA-compliant deposit products which will continue to be principal-guaranteed and insured by Perbadanan Insurans Deposit Malaysia (PIDM).

The Bank also made further progress on the development of a comprehensive Shariah contract-based regulatory framework that addresses Shariah parameters and operational requirements. The Bank's Shariah Advisory Council has approved the Shariah parameters for an additional five contracts, bringing the total number of approved Shariah parameters to date to 13. During the year, operational standards for four other contracts were finalised while standards for five new contracts were issued for consultation. A compendium of Shariah contract-based standards developed and issued to date is provided in Table 3.2.

To complement the Risk-Based Capital Framework for Takaful Operators (RBCT), the Bank outlined proposals for the implementation of the Internal Capital Adequacy Assessment Process (ICAAP) by takaful operators in a concept paper issued for industry feedback in August 2015. The ICAAP aims to promote a more rigorous process for capital management which is aligned with the risk profile of each takaful operator, including under a stressed scenario. Similar to the ICAAP for insurers, takaful operators are required to set and observe individual target capital levels which reflect risks beyond those covered

Table 3.2

Compendium of Shariah Contract-based Standards

	Shariah parameters	Operational requirements
<i>Murabahah</i>	✓	✓
<i>Musarakah</i>	✓	✓
<i>Mudarabah</i>	✓	✓
<i>Tawarruq</i>	✓	✓
<i>Istisna`</i>	✓	✓
<i>Qard</i>	✓	✓*
<i>Hibah</i>	✓	✓*
<i>Wakalah</i>	✓	✓*
<i>Wad`iah</i>	✓	✓*
<i>Kafalah</i>	✓	✓*
<i>Ijarah</i>	✓	✓*
<i>Bai` inah</i>	✓	–
<i>Wa`d</i>	✓	–
<i>Rahn</i>	✓*	–
<i>Bai` al-sarf</i>	✓*	–

* Issued for consultation

Source: Bank Negara Malaysia

in the RBCT. In addition, takaful operators must specifically assess the need to allocate *qard* for the purpose of addressing a potential deficit in the Participants' Risk Fund. The Bank expects to finalise the requirements in 2016 for implementation in 2017.

Amendments to the DFIA

Amendments to the DFIA, which came into effect on 31 January 2016, marked another important development in the Bank's continuing efforts to ensure an effective legal framework for financial services in Malaysia. The DFIA supports the effective regulation and supervision of DFIs to ensure that the specific mandates entrusted to DFIs are achieved in a financially sustainable manner. Six DFIs¹ are currently regulated and supervised by the Bank pursuant to the DFIA.

¹ Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat), Bank Pembangunan Malaysia Berhad (Bank Pembangunan), Bank Pertanian Malaysia Berhad (Agrobank), Bank Simpanan Nasional (BSN), Export-Import Bank of Malaysia Berhad (EXIM Bank) and Small Medium Enterprise Development Bank Malaysia Berhad (SME Bank).

The amendments aim to ensure sound financial management, and improve the operational efficiency and resilience of DFIs. To this end, existing provisions in the DFIA on corporate governance, business activities and the scope of the Bank's regulatory oversight have been enhanced. In addition, the amended Act incorporates new provisions for the regulation of Shariah governance and consumer protection, with expanded enforcement tools to ensure compliance (Diagram 3.1).

The amendments to the Development Financial Institutions Act 2002 are expected to further strengthen the ability of DFIs to support Malaysia's socio-economic development and promote inclusive growth

As Malaysia progresses towards becoming a high value-added economy, these amendments are expected to further support the important role of DFIs in promoting inclusive growth, building on achievements over the past decade (Diagram 3.2). Importantly, the strengthened legislation will ensure that DFIs are financially sound and sustainable, and well managed in order to effectively contribute to Malaysia's socio-economic development and promote financial stability.

International developments

In the banking sector, the Basel Committee is currently reviewing the overall architecture of the risk-based capital requirements. The review aims to make the requirements simpler, more comparable across jurisdictions and more risk-sensitive. The Basel Committee will be conducting a quantitative impact assessment on the proposed requirements in 2016 with an aim to not significantly increase the overall capital requirements. The expected impact for Malaysian banking institutions will be most significant in the areas of review relating to capital requirements for credit and market risks.

Diagram 3.1

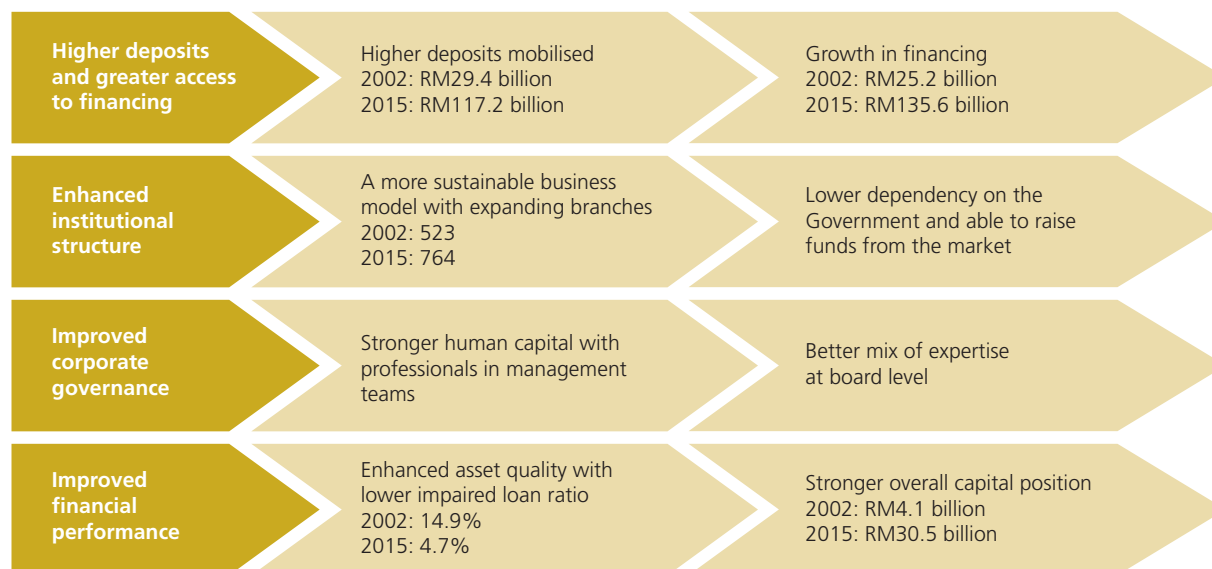
Amendments to the DFIA



Source: Bank Negara Malaysia

Diagram 3.2

Accomplishments by DFIs



Source: Bank Negara Malaysia

With respect to credit risk, the majority of banking institutions in Malaysia currently adopt the standardised approach which sets out rules for quantifying capital required based on external ratings of credit exposures. The Basel Committee has proposed changes to the standardised approach with the aim of reducing the mechanistic reliance by banking institutions on credit ratings in determining regulatory capital requirements. Changes to the prescribed risk weights for each exposure class are also being proposed to increase their risk-sensitivity and better reflect inherent risks of the exposures.

The market risk framework is also similarly being reassessed. The fundamental review of the trading book addresses the boundaries between the banking and trading books of banking institutions to limit arbitrage opportunities arising from the large differences in capital treatment. The review also introduces changes to the calculation of capital requirements for market risk to better capture tail risk events, with additional constraints proposed for the use of the internal model approach. Based on results of an interim impact analysis published by the Basel Committee in November 2015, substantially higher market risk capital requirements were reported among the sampled banking institutions regardless of whether they adopted the standardised or internal model approach.

In the insurance sector, the introduction of a global capital standard for insurers continued to be a key focus of global regulatory reforms. This is being progressed under two main work streams led by the IAIS. The first is the development of a capital framework for Global Systemically Important Insurers (G-SIIs). The framework will be applied from January 2019 and will comprise basic capital requirements (BCR) as well as higher loss absorbency requirements (HLA). The BCR is the baseline measure and will serve as a comparable foundation for the calculation of HLA, which has been added to appropriately reflect the systemic importance of G-SIIs. In parallel, the IAIS is also developing a risk-based and group-wide insurance capital standard (ICS) that will be applicable to all internationally-active insurance groups (IAIGs). The ICS is aimed at establishing a common methodology for supervisors to assess capital adequacy in IAIGs across different jurisdictions. When implemented at the end of 2019, the ICS is expected to replace the BCR as the baseline capital measure for HLA.

In the area of financial reporting, the development of a single measurement framework for insurance contracts (IFRS 4 Phase II) by the International Accounting Standards Board (IASB) is at an advanced stage and a final standard is expected to be issued in 2016. As the IASB intends to allow a three-year implementation period after

the publication of the final insurance contracts standard, the earliest mandatory effective date will be after the implementation date of IFRS 9 Financial Instruments. In response to concerns on the potential increase in profit and loss volatility reported by insurance entities arising from the different implementation dates of IFRS 9 and IFRS 4 Phase II, the IASB is consulting on proposals to allow insurers to either remove from profit and loss any accounting mismatches and temporary volatility arising from the IFRS 9 implementation (overlay approach), or opt for a temporary exemption from applying IFRS 9 (deferral approach). This is a welcome development given Malaysia's convergence with IFRS.

The Bank is monitoring these international developments closely, including through its participation in the global standard setting process. The Bank is also an active member of various regional central banking and supervisory fora which regularly engage with the standard setting bodies to ensure that proposed standards appropriately consider relevant characteristics that may be prevalent in national financial systems. This work is supported by the Bank's specialist units which are tasked to undertake, in coordination with domestic financial institutions, specific reviews and analyses of the impact of global standards on financial intermediation activities in Malaysia.

SAFEGUARDING FINANCIAL SYSTEM INTEGRITY

National level assessment and collaboration

Malaysia continues to make positive strides in detecting and deterring criminal ML/TF activities. In September 2015, the FATF published a report on the ME of Malaysia's AML/CFT framework, an exercise that commenced in 2014. The ME is an independent assessment of a jurisdiction's compliance with the International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation. To date, 12 countries, including Malaysia, have been assessed against the updated standards that were adopted by the FATF in 2012. The ME Report on Malaysia acknowledged a 'high degree' of technical compliance and a 'substantial to moderate' level of effectiveness in the implementation of the international standards. The ME Report also confirmed that the findings from Malaysia's own National Risk Assessment (NRA), which was conducted by the NCC in 2013, are 'reasonable and sound'.

In addition, the ME Report identified several priority areas for attention to further strengthen Malaysia's defences against threats and vulnerabilities at the national level. Among others, the report highlighted a need to deepen the assessment of money laundering risks from foreign-sourced threats. Malaysia was also encouraged to increase the number of investigations, prosecutions and confiscations in connection with suspected ML/TF offences. Improvement was also recommended in the implementation of risk-based AML/CFT safeguards by designated non-financial businesses and professions (DNFBPs). These include casinos, real estate agents, lawyers and notaries, trust companies, company secretaries, and dealers in precious metals and stones. The full FATF ME Report on Malaysia can be found at the Bank's website (amlcft.bnm.gov.my).

In September 2015, the NCC finalised a comprehensive NSP which draws upon the recommendations of the ME Report and findings from the NCC's own risk assessments. The five-year NSP supersedes the interim plan developed by the NCC in 2014 and sets out to deliver on ten strategic outcomes, including through improvements to legal frameworks, more effective international co-operation and more aggressive training and awareness initiatives. The formulation of the NSP represents a more sustained programme, with a strong emphasis on strengthening inter-agency coordination, to promote and protect the integrity of Malaysia's financial system over the long term. To ensure the effective implementation of the NSP within the agreed timeline, the NCC has established six working groups to monitor the performance of each of the 16 member agencies, with regular reporting to the NCC.

AML/CFT assessments of reporting entities

As the competent authority under the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA), the Bank disseminates financial intelligence received from reporting entities to the law enforcement agencies tasked to investigate ML/TF offences. The bulk of such intelligence processed by the Bank during the year related to suspected fraud, corruption and illegal deposit taking activities. The Bank also increased its engagements with relevant law enforcement agencies throughout the year. This included providing to these agencies both proactive and reactive disclosures, particularly

to support investigations on crimes which the NRA identified as posing the highest money laundering threat, namely smuggling, tax evasion, corruption, fraud and drug trafficking.

Observations from the Bank's review of AML/CFT frameworks implemented by reporting entities during the year are provided below.

Banking institutions

The Bank has observed a continued emphasis on strengthening AML/CFT controls and practices among banking institutions. This has been evident in increased resources allocated to, and investments in, screening and transaction monitoring systems. The Bank has also noted improved practices in the conduct of customer due diligence (CDD). Further enhancements in governance and control measures were identified to improve processes for identifying transactions designed to evade tax and for assessing risks associated with politically exposed persons. The Bank will continue to monitor the rectification measures undertaken by banking institutions in these areas.

During the year, the Bank also progressed its internal initiatives to better integrate financial intelligence with its prudential supervision of banking institutions. This involves developing a structured process to incorporate, in a consistent way, results from annual AML/CFT assessments and analyses of trends and patterns in the Bank's risk-based supervisory framework. Such an integrated approach aims to leverage on the Bank's supervisory activities more effectively to support timely interventions by the Bank to pre-emptively address AML/CFT weaknesses identified in banking institutions. As an expected outcome of this work, banking institutions with weak AML/CFT systems will be subjected to closer and more intensive supervision and enforcement action by the Bank.

DNFBPs and other financial institutions

The Bank adopts a risk-based approach in monitoring compliance with AML/CFT requirements by DNFBPs and other financial institutions. Under this approach, supervisory resources are allocated to the sub-sectors and individual entities that have been identified as posing greater risk. Examinations carried out during the year found that most DNFBPs and other financial institutions had in place internal processes for conducting basic CDD assessments.

However, the full implementation of beneficial ownership and client risk profiling requirements remains a challenge for these entities. Further efforts will also be required among DNFBPs and other financial institutions to establish appropriate internal controls to ensure a more comprehensive assessment of ML/TF risk. Apart from conducting on-site and off-site examinations and surveillance, the Bank regularly engages with licensing authorities and self-regulatory organisations to assess emerging risks and developments relating to AML/CFT.

While DNFBPs and other financial institutions are currently assessed to pose a medium or low ML/TF risk, the NSP has accorded a specific focus on improving the understanding of AML/CFT issues among such entities. To this end, the NCC elevated the DNFBP Taskforce into a permanent DNFBP Working Group in 2015. The Bank is the Chair and Secretariat to this working group, which is expected to further strengthen inter-agency co-operation in undertaking risk assessments and promoting stronger safeguards against ML/TF risks among DNFBPs. The Bank also plans to increase resources allocated to the assessment of DNFBPs to provide broader coverage of such institutions in its ongoing supervisory activities. This includes carrying out joint assessments with other members of the DNFBP Working Group.

Money services business

Money changing, wholesale currency and remittance services represent an important area of focus for the Bank in reducing vulnerabilities to ML/TF risks. Transactions in these money services business (MSB) sub-sectors continued to expand in 2015 and were supported by improvements observed in operational and compliance standards.

MSBs' compliance with AML/CFT requirements continued to improve during the year. Further progress was made by larger MSBs in implementing a risk-based approach to managing and mitigating ML/TF risk, while the Bank continued to work closely with the industry to support smaller players in incorporating risk-based approaches in their management of ML/TF risks. This included a specific focus on strengthening the competence of compliance officers employed in the industry.

With this in view, the Malaysian Association of Money Services Business has established a Group of Compliance Officers (GOCO) to coordinate and drive capacity building initiatives for compliance officers in the industry. The GOCO also acts as a

Key Developments in the Money Services Business (MSB) Industry

During the year, MSB transactions conducted through formal channels continued to grow.

- Outward remittances expanded strongly by 23.2%, increasing to RM34.8 billion from RM28.2 billion in 2014.
- The retail money changing segment turned around to record a growth of 16.4% from a marginal drop in 2014 to RM60.6 billion. This increase reflects the greater demand for common currencies including the Singapore Dollar, US Dollar and Indonesian Rupiah mainly from inbound and outbound tourists.
- Turnover of the domestic wholesale currency services increased further to RM7.7 billion, representing an increase of 17.2% over the RM6.6 billion registered in 2014.

The industry also continued to consolidate, with the number of licensed entities reducing further from 414 in 2013 to 380 in 2015. Despite the lower number of licensees, public access to money services remained widely distributed given the broader branch and agent networks established by qualified industry players. The number of approved MSB agents rose from 290 in 2014 to 349 in 2015, of which about 273 are agents conducting remittance business.

During the year, rules regulating the conduct of MSB were extended to banking institutions that carry on MSB but which are not subject to the Money Services Business Act 2011 (MSBA). This is particularly relevant in the context of banking institutions that carry on MSB through agents. Such agents and bank outlets providing money services to the public must now comply with relevant operational requirements on a consistent basis with those applied to MSBs. The rules for banking institutions came into effect in July 2015.

In November 2015, efforts to promote the wider use of formal remittance channels were advanced under a collaborative project between the Bank and the World Bank to establish Johor Bahru as Asia's first Greenback champion city. The Greenback 2.0 project will mobilise and channel resources towards targeted educational programmes and initiatives over a two-year period to make formal remittance channels more competitive, convenient and inclusive.

reference point for the industry on compliance matters affecting MSB players. An immediate priority of the GOCO is to develop structured training modules on AML/CFT matters. In addition, the GOCO is working on plans to accredit compliance officers working within the industry to assure a minimum standard of competence. These initiatives will support the industry in meeting the minimum standards for compliance officers which will be issued by the Bank in March 2016.

ENFORCEMENT ACTIVITIES

Enforcement actions by the Bank, including criminal, civil and administrative actions, have an

important role in providing a credible deterrence against non-compliance with rules and regulations, which can undermine confidence in and the integrity of the financial system. A summary of enforcement actions taken by the Bank in 2015 is provided in Table 3.3. The Bank successfully prosecuted 182 criminal offences and obtained six court orders requiring entities and/or individuals to cease operating illegal activities. In addition, RM69.5 million in fines were imposed on licensees for regulatory breaches relating to over 240 offences identified under the laws administered by the Bank. The Bank also opened 26 new investigations during the year into suspected illegal activities and regulatory breaches.

Table 3.3

Enforcement Actions Taken in 2015

Illegal deposit taking	<ul style="list-style-type: none"> Two individuals convicted for two charges under section 25 of the Banking and Financial Institutions Act 1989
Money laundering	<ul style="list-style-type: none"> Two individuals convicted for 28 charges under section 4 of AMLA
Unauthorised provision of money services	<ul style="list-style-type: none"> Two charges pursued against one entity and two individuals for unauthorised provision of money changing services under section 4 of MSBA 179 charges pursued against three entities and eight individuals for unauthorised provision of money remittance services under section 4 of MSBA Two entities and 12 individuals convicted for 20 charges of unauthorised provision of money changing services under section 4 and section 23 of MSBA, resulting in fines amounting to RM910,000 One entity and eight individuals convicted for nine charges of unauthorised provision of money remittance services under section 4 of MSBA, resulting in fines amounting to RM650,000 Six court orders obtained against entities and/or individuals conducting money services business without a licence
Non-compliance with AML/CFT policies	<ul style="list-style-type: none"> Compounds amounting to RM1.05 million against two Islamic banks for failure to comply with AMLA Orders under section 48 and section 50 of AMLA Compound of RM530,000 against one insurance company for failures relating to its reporting obligations and compliance programme under section 14(1)(b) and section 19(1) of AMLA Compounds amounting to RM82,500 against three MSB operators for failures relating to their compliance programmes under section 19(1) of AMLA Administrative monetary penalties amounting to RM57.6 million against three banking institutions for failure to comply with standards prescribed by the Bank under section 48(1) of FSA and section 58(1) of IFSA
Non-compliance with prudential requirements	<ul style="list-style-type: none"> Compound of RM210,000 against one insurance company for failure to properly maintain a register of policies and claims under section 47(3) of the Insurance Act 1996 Administrative monetary penalty of RM550,000 against one takaful operator for failure to comply with standards prescribed by the Bank and for submitting misleading or inaccurate information under section 58(1) and section 155(3) of IFSA respectively
Non-compliance with foreign exchange administration rules	<ul style="list-style-type: none"> Compounds amounting to RM8.78 million against six banking institutions and RM30,000 against one banking institution for facilitating foreign exchange transactions without the Bank's prior written approval under section 214 of FSA and Exchange Control Act 1953 respectively
Non-compliance with prudential requirements for MSBs	<ul style="list-style-type: none"> Compounds amounting to RM305,000 against 13 MSB operators for failure to issue receipts in the manner prescribed by the Bank and three MSB operators for failure to maintain proper records under section 27 and section 28 of MSBA respectively Compounds amounting to RM205,000 against four MSB operators for failure to obtain the Bank's prior written approval under section 30 or section 32(2) of MSBA Administrative monetary penalties amounting to RM17,000 against 11 MSB operators for failure to maintain minimum capital funds under section 22 of MSBA Administrative monetary penalties amounting to RM114,000 against 74 MSB operators for failure to submit their audit reports within the specified period under section 31(9) of MSBA

Source: Bank Negara Malaysia

Enforcement and Penalty Framework

The Bank, under the laws it administers, has the authority to take formal enforcement actions against authorised financial institutions or other persons who fail to comply with regulatory standards and other requirements issued pursuant to these laws. Such actions are important to promote good conduct in the financial industry that is aligned with sound financial and business practices, the legitimate interests of consumers and the prevention of crime. Following wider enforcement powers provided under the laws administered by the Bank, the Bank reviewed and strengthened its internal enforcement procedures. These procedures are set out in the Enforcement and Penalty Framework which governs the Bank's decision-making process and its approach in deciding on enforcement actions.

The framework aligns the Bank's enforcement efforts, activities and resources to achieve the Bank's statutory objectives while ensuring that enforcement actions are commensurate with the severity of the wrongdoing and are applied consistently across entities/persons in similar circumstances.

Enforcement Committee

Enforcement matters are decided by the Enforcement Committee (EC). The EC is chaired by the Governor, and its members consist of two Deputy Governors and five Assistant Governors with responsibilities in the areas of regulation, supervision, legal and enforcement. The EC oversees the implementation of the Bank's enforcement policies and decides on enforcement actions to be pursued in specific cases, which may be administrative, civil and criminal in nature. Under the law, the consent of the Public Prosecutor must be obtained to pursue criminal enforcement actions, that is to prosecute criminals and to compound offences. The EC may delegate its authority to decide on enforcement actions within clearly defined parameters to heads of departments within the Bank that are responsible for administering certain statutory functions of the Bank. In practice, such delegation has been limited to the issuance of warnings and meting out administrative penalties for failures to comply with routine reporting requirements. The vast majority of enforcement decisions were accordingly escalated to the EC for decision.

Laws currently administered by the Bank:

- Financial Services Act 2013 (FSA)
- Islamic Financial Services Act 2013 (IFSA)
- Money Services Business Act 2011
- Central Bank of Malaysia Act 2009
- Development Financial Institutions Act 2002
- Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA)¹

An important outcome of enforcement actions is to encourage a strong compliance culture among market participants by providing an effective deterrent against future non-compliance. In taking an enforcement action, the EC will consider the likelihood that an enforcement action will achieve this outcome that may also strengthen market discipline, while ensuring that the action is proportionate to the seriousness of the non-compliance. The severity of an action to be taken will be based on a careful examination by the EC of the facts and circumstances of each case, including the seriousness and impact of the non-compliance, the degree of culpability of the financial service providers (FSPs), past record of non-compliances, the effectiveness of remedial measures taken to rectify the non-compliance and the strength of governance arrangements and risk management control functions within an FSP to prevent a recurrence. The EC, having deliberated each case, may recommend action that is supervisory in nature, instead of pursuing an enforcement action. In some circumstances, both

¹ AMLA is jointly enforced with other law enforcement agencies in Malaysia.

supervisory and enforcement actions are taken. Supervisory actions would form part of the Bank's ongoing prudential and conduct supervision of FSPs and may involve supervisory directions issued to an FSP to take certain actions to improve compliance and oversight functions. Such actions must also be monitored by the FSP's board and management, and reported to the Bank.

Range of supervisory and enforcement actions

Supervisory and enforcement actions are broadly categorised under the Enforcement Framework as actions that are protective or corrective, and actions that are punitive (Table 1).

Table 1

Nature and Type of Actions

Nature of actions	Type of actions
Protective/corrective	<ul style="list-style-type: none"> • Supervisory letter • Enforceable undertaking • Direction of compliance • Assumption of control • Power to appoint manager • Order to transfer of business, asset and liability • Administrative - order to do or not to do • Administrative - private reprimand • Administrative - order to mitigate • Removal of directors/key responsible persons • Revocation
Punitive	<ul style="list-style-type: none"> • Administrative - monetary penalty • Administrative - public reprimand • Administrative - remedy/restitution • Civil action • Criminal - prosecution (court) • Criminal - compound

Source: Bank Negara Malaysia

Protective or corrective actions include actions that aim to encourage prompt remedial measures by FSPs and are generally applied where an errant conduct is determined to be isolated in nature and not representative of broader, systemic compliance or governance failures in an FSP. In these circumstances, the Bank may intervene by requiring the FSP to improve its risk management control functions or issuing a private reprimand as a formal record. A more severe or punitive action might be taken should the non-compliance recur. In more serious cases of non-compliance where an FSP's ability to carry on its business in a sustainable manner is affected, the Bank may take more severe corrective actions including the appointment of a manager to manage the FSP's business, removal of directors or key responsible persons, or the assumption of control by the Bank. These actions generally aim to restore the institution to a sound financial position and ensure its proper management, or support its orderly resolution.

The Bank will generally pursue punitive enforcement actions in cases where errant conduct is the result of a deliberate or reckless disregard of regulatory requirements which is compounded by weak controls and governance, or where criminal elements are present. Such actions will also be pursued to provide a credible deterrent where the wrongdoing has wider adverse consequences for public interests. Punitive enforcement actions, which include imposition of monetary penalties, civil or criminal actions, signal the Bank's intolerance of serious non-compliances, particularly those that can undermine the stability of or confidence in the financial system, or the integrity of the financial markets. The law also empowers the Bank to pursue administrative restitution that involves issuing an order to FSPs to compensate depositors and policyholders for their losses.

The Bank takes a strong stance against unlawful conduct or unauthorised or illegal activities. In cases of suspected unauthorised or illegal activity, the Bank will pursue either criminal sanctions or civil actions, or both. Civil proceedings can serve to secure, among other things, compensation for pecuniary gain or loss avoided as a result of the contravention. The Bank may also seek a court order to prevent errant parties from continuing unauthorised activities.

In the enforcement process, FSPs are accorded with an opportunity to provide explanations or highlight mitigating factors which will be considered by the EC in reaching its decision.

Monetary penalties

In imposing monetary penalties for non-compliances with regulatory requirements, the Bank is guided by a structured penalty framework. This framework details out parameters for the computation of initial monetary penalties, and the principles and factors that the EC must have regard to in deciding the final amount of penalty to be imposed for a particular non-compliance.

The amount of initial penalty derived under the penalty framework accounts for aggravating and mitigating factors. This is based on scaling factors applied to a standard starting penalty amount that relates to the maximum fines provided under the laws for a particular non-compliance. Aggravating and mitigating factors include the intent of the offender, history of previous non-compliances, financial gains or losses avoided from the non-compliance and any adverse impact of the non-compliance on the FSP and its customers or on public confidence in the financial system. An FSP's post-conduct behaviour is also factored in the initial determination of the penalty amount. This may include whether an FSP voluntarily reported and provided complete information on the circumstances surrounding the non-compliance to the Bank, and proactively took measures to hold those responsible for the non-compliance to account and prevent similar non-compliances from recurring in future.

The EC may increase or decrease the amount of penalty initially derived from the penalty framework, having regard to additional factors including a consideration of whether the penalty will have a deterrent effect, the extent of its impact on the financial position of the offender and the appropriateness of the penalty in relation to precedents set by the Bank in similar circumstances. Deliberations and decisions of the EC are formally documented and confirmed, and may be reviewed by the Monetary Penalty Review Committee in the event of an appeal against the Bank's decisions in respect of administrative monetary penalties imposed by the Bank. All monetary penalties imposed by the Bank are paid into the Federal Consolidated Fund.

Monetary Penalty Review Committee

As required under the FSA and IFSA, the Bank has established the Monetary Penalty Review Committee (MPRC) whose members are independent of the Bank's executives, to consider appeals relating to the quantum of administrative monetary penalties and pecuniary remedies enforced by the Bank. A person aggrieved by the Bank's decision may file an appeal to the MPRC within 21 days after being notified of the Bank's decision. The MPRC will consider the appeal and it may decide either to confirm the Bank's decision or require the Bank to reconsider the decision in accordance with the findings of the MPRC. More information on MPRC, including its present members, is available on the Bank's website.

Transparency of enforcement actions

The law provides for the Bank, where it thinks necessary, to publish information in relation to any enforcement actions taken. Aggregated information on enforcement actions by the Bank is currently provided in the Bank's annual Financial Stability and Payment Systems Reports. Moving forward, it is recognised that an appropriate degree of transparency around enforcement actions by the Bank beyond what is currently provided, can be helpful to reinforce the deterrent effect of enforcement actions, promote confidence in the financial system and provide information on how the Bank has discharged its responsibilities on a matter of public interest. With these objectives in mind, the Bank will in each case of enforcement actions taken against a firm or individual, specifically consider

whether it is also appropriate to publish information on the actions taken in a particular case. Such information will identify the parties against whom actions have been taken, provide a brief description of the circumstances of the non-compliance and outline the specific actions taken, including any material considerations of the EC in reaching its decision. The Bank generally expects to publish information on enforcement actions taken except where the Bank has reason to believe that the publication would be prejudicial to financial stability, the soundness of an FSP or the interests of depositors and policyholders. This in turn is expected to enhance the efficacy of enforcement actions as a tool to promote financial stability.