

## The Legal Framework for Financial Stability

The enactment of the Financial Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA), which were approved by Parliament in December 2012, marks another important milestone in modernising Malaysia's financial sector laws. These new laws are the culmination of more than six years of work which started concurrently with the review of the Central Bank of Malaysia Act 1958, and involved a wide-ranging review of the various laws for the regulation and supervision of the financial sector, particularly taking into account important changes that were occurring across the domestic and global financial landscapes. The review and modernisation of Malaysia's financial sector laws ensure that these laws continue to be relevant and effective in preserving financial stability and supporting the growth of the Malaysian financial system and the real economy.

Over the decade, the focus of and the approach to financial sector regulation and supervision has evolved substantially, not just in Malaysia but also internationally. As the financial system has become more diverse, more sophisticated and more interconnected, financial regulation has correspondingly evolved from detailed and prescriptive rules to a principles-based approach that combines greater supervisory judgment and intensity with high-level principles of sound practice that can be applied to institutions according to the nature, scale and complexity of their activities. There has also been a fundamental re-orientation of the focus of financial supervision to take into account system-wide developments and risks, in addition to the traditional focus on individual financial institutions. This has involved a widening of the scope of oversight to include the supervision of financial groups and non-bank financial institutions that engage in financial intermediation activities. Beyond prudential regulation, the other aspects of financial sector regulation such as business conduct regulation that focuses on consumer protection and financial inclusion have also become more prominent, driven by changing demographics, the increasing complexity of financial products and public policy goals to alleviate poverty, improve equity and enhance growth. Another important feature in the development of Malaysia's financial system has been the growing significance and role of Islamic finance. The development of a comprehensive legislation for Islamic finance has further extended the frontier of financial regulation in Malaysia. These developments have had a significant role in shaping the key statutes which were introduced over the decade and which form part of the legal framework for the financial sector, including the Development Financial Institutions Act 2002 (DFIA), Payment Systems Act 2003 (PSA) and the Malaysia Deposit Insurance Corporation Act 2011 (MDICA). The enactment of the new central bank legislation in 2009, the Central Bank of Malaysia Act 2009 (CBA), and the FSA and IFSA in 2013 capped off the series of comprehensive legislative reforms that have been undertaken.

In the post 9/11 era, global efforts to combat money laundering and terrorism financing have intensified in response to new political realities and increasingly sophisticated money laundering techniques and methods. Preserving the integrity of the financial system and preventing its abuse for criminal and terrorism purposes became an important agenda of the Government. While Malaysia already had in place a rigorous legislation for these purposes in 2001, the scope of reporting institutions under the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLATFA) has now been extended to include non-financial institutions to more effectively address money laundering risks in activities that fall outside the financial sector. The AMLATFA also supports more effective collaboration between the Bank, financial institutions and law enforcement agencies in the areas of crime prevention and national security. Recognising that certain sectors, such as money-changing and remittance services, can be particularly vulnerable to the flow of illicit funds, the Money Services Business Act 2011 (MSBA) and supporting regulatory and supervisory frameworks were put in place to strengthen the Bank's oversight of these sectors.

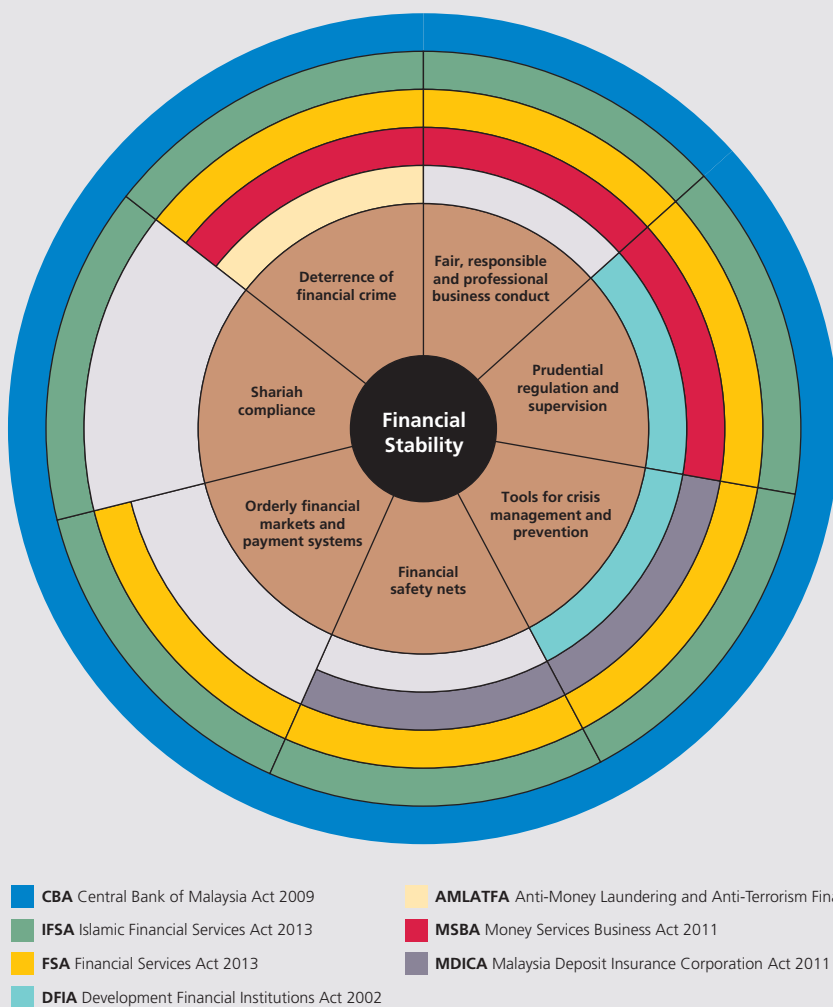
Taken together, the modernisation of Malaysia's financial sector laws serves to promote greater resilience and efficiency of the financial sector and its continued growth, strengthen the regulatory and supervisory environment, provide greater protection for consumers, and preserve a high level of confidence in the financial system. These are supported by enhanced arrangements for inter-agency

collaboration and coordination to better cope with the increasing interconnectedness across industries and national boundaries. The financial sector laws are also intended to keep pace with changes in the financial landscape in a way which will allow financial institutions to tap new opportunities and better manage future challenges, while preserving strong conditions for financial stability. Diagram 1 illustrates the key aspects of a strong regulatory and supervisory system in Malaysia which the statutes address.

The remainder of this article describes the key pieces of legislation that make up the legal framework for the financial sector in Malaysia, including highlights of the main legislative changes that were introduced.

**Diagram 1**

**Comprehensive Laws for Financial Stability**



**Central Bank of Malaysia Act 2009**

A high point of the legislative changes was the enactment of the CBA, coinciding with the Bank’s 50<sup>th</sup> anniversary. The CBA replaced the former Central Bank of Malaysia Act 1958 following a comprehensive two-year review on the role, powers and responsibilities of a modern central bank, providing clarity to the Bank’s mandates on promoting monetary stability and financial stability. With respect to its financial stability mandate, the Bank’s statutory responsibilities are clearly set out in

the CBA, namely to regulate and supervise financial institutions, provide oversight over the money and foreign exchange markets, exercise oversight over payment systems, and to develop a sound, progressive and inclusive financial system. It is upon these responsibilities that the regulatory laws administered by the Bank are founded.

Taking into account a more developed and mature domestic financial sector as well as the challenges presented by the more integrated and globalised economic and financial environment, the CBA vests in the Bank expanded macroprudential powers and instruments to safeguard financial stability. These include wider powers for the Bank to obtain information for purposes of monitoring risks to financial stability and strengthened conditions and powers to take early action to avert and manage crises. It also includes specific powers to resolve systemically-important financial institutions that are not regulated by the Bank, where necessary, to preserve financial stability. In addition, the law enables the Bank to effectively coordinate with other regulatory authorities across sectors and borders, reflecting the greater overlaps in financial services and products offered by different financial institutions, and the wider geographical footprint of financial institutions. These enhanced powers are complemented by a strengthened framework for governance, transparency and accountability for the financial stability mandate. It also includes the establishment of the Financial Stability Executive Committee to provide additional oversight over major financial stability decisions such as the provision of capital support to financial institutions and orders to avert or reduce risk to financial stability for entities not regulated by the Bank.

### **Financial Services Act 2013 and Islamic Financial Services Act 2013**

The FSA and IFSA build upon the foundations of the Bank's financial stability mandate in the CBA and provide the Bank with the necessary powers to effectively perform its regulatory and supervisory roles. They reflect an increased focus by the Bank on early interventions to address emerging problems in financial institutions, and the more risk-focused and integrated approach to the regulation and supervision of financial institutions under the Bank's purview in response to the rapid changes taking place in the financial sector, including the emergence of financial groups that offer a broader range of financial services and products. The FSA and IFSA have respectively combined six pre-existing statutes, namely the Banking and Financial Institutions Act 1989, Insurance Act 1996, PSA and Exchange Control Act 1953 (ECA), and the Islamic Banking Act 1983 and Takaful Act 1984. The new legislation provides a more cohesive and integrated legal framework that delivers a consistent and comprehensive treatment of similar risks, thus minimising the prospect for regulatory arbitrage and gaps, while substantially easing the process of review and update going forward. Key features of the new legislation include:

- Greater transparency and accountability of the Bank in carrying out its principal object to safeguard financial stability;
- Differentiated intensity of regulation and supervision applied to institutions and markets under the Bank's purview, commensurate with the nature of activities and levels of risk posed by such institutions and markets to the overall financial system;
- Transparent assessment criteria for authorising institutions to carry on regulated financial business, and for shareholder suitability;
- New provisions for the oversight of financial holding companies and non-regulated entities to take account of systemic risks that can emerge from the interaction between regulated and unregulated institutions, activities and markets;
- Strengthened business conduct and consumer protection requirements to promote consumer confidence in the use of financial services and products;
- Specific provisions to support the Bank's role in the oversight of the money and foreign exchange markets in cooperation with Securities Commission Malaysia, where relevant;
- Strengthened provisions for effective enforcement and supervisory intervention, including the ability for the Bank to issue directions of compliance or accept legally enforceable undertakings that commit financial institutions to take specific actions to address identified risks, and higher penalties to act as a credible deterrent. The legislation further provides *locus standi* for the Bank to initiate civil actions in court against financial institutions; and

- A clear focus on Shariah compliance and governance in the Islamic financial sector. In particular, the IFSA provides a comprehensive legal framework that is fully consistent with Shariah in all aspects of regulation and supervision, from licensing to the winding-up of an institution.

### **Development Financial Institutions Act 2002**

Six development financial institutions (DFIs) are regulated and supervised by the Bank pursuant to the DFIA to ensure that their development mandates can be achieved in a financially sustainable manner, while contributing to the overall stability of the financial system. The DFIA supports the effective regulation and supervision of DFIs to ensure sound financial management, and strengthens the accountability of DFIs in the performance of their mandated roles. This in turn contributes towards the development of a sound, progressive and inclusive financial sector in Malaysia. As part of the ongoing programme by the Bank to regularly review and update the legal framework for the financial sector, amendments to the DFIA are being proposed to further enhance the regulatory and supervisory framework for DFIs. Proposals will focus on reforms to further improve governance practices within DFIs, strengthen their mandates in filling gaps in the financial system, and promote greater operational efficiencies.

### **Anti-Money Laundering and Anti-Terrorism Financing Act 2001**

The AMLATFA, previously known as the Anti-Money Laundering Act 2001 (AMLA), provides a legal framework to counter the laundering of money from the proceeds of crime, thus preserving the integrity of and confidence in the financial system. Under the AMLA, the Bank was appointed and continues to carry out the functions of the competent authority which include the responsibility to ensure the implementation of reporting obligations by the reporting institutions, and the gathering and dissemination of financial intelligence. In 2003, the Government of Malaysia enacted amendments to five different pieces of legislation, including the AMLA, to enable accession to the International Convention for the Suppression of the Financing of Terrorism. With the coming into force of the Anti-Money Laundering (Amendment) Act 2003 on 6 March 2007, the AMLA was renamed and extended to provide a comprehensive framework of measures for the prevention of money laundering and terrorism financing, and for the forfeiture of terrorist property and property involved in money laundering.

### **Money Services Business Act 2011**

The AMLATFA is also complemented by the MSBA which aims to modernise and elevate the status of the money-changing and remittance businesses into a more dynamic, competitive and professional industry, while strengthening safeguards against the threats of money laundering, terrorist financing and other illegal activities. The MSBA came into effect from 1 December 2011 following the consolidation of the Money-Changing Act 1998 and parts of both the PSA and ECA. Licensed money-changers, approved remittance service providers and approved wholesale currency providers are now regulated and supervised under one law. Under the MSBA, the Bank's surveillance capabilities and powers of examination and investigation have been further strengthened. At the same time, broader enforcement powers, including administrative penalties and civil actions, have further enhanced the Bank's ability to effectively address weaknesses in the industry that could give rise to the risk of abuse for money laundering and financial crimes.

### **Malaysia Deposit Insurance Corporation Act 2011**

The Malaysia Deposit Insurance Corporation Act 2005 established the deposit insurance system in Malaysia to protect deposits placed with licensed commercial and Islamic banking institutions. This law also established the Malaysia Deposit Insurance Corporation (Perbadanan Insurans Deposit Malaysia, PIDM) to administer the deposit insurance system, provide strong incentives for sound risk management through differential deposit insurance premiums and act as a resolution agency. In 2011,

the law was replaced by the MDICA. Key changes that were made to provide for a wider financial safety net also include a takaful and insurance benefit protection system and powers for the Minister to extend insurance or protection coverage beyond the scope of the normal protection for deposits as well as takaful and insurance benefits, for purposes of protecting the stability of the financial system. This legislation complements the Bank's regulatory laws, in promoting sound risk management in financial institutions and maintaining public confidence in the financial system, particularly during times of financial stress.