

Chapter 4

Legislation and Guidelines

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Learning Objectives

After studying this chapter, you will:

- ◆ Appreciate what are the essentials of various legislation, Acts and guidelines enacted by Bank Negara Malaysia;
- ◆ Be aware of the main regulatory requirements and guidelines governing transactions and conduct of business in a banking environment;
- ◆ Know certain key provisions of the Banking and Financial Institutions Act 1989, the Anti-Money Laundering and Anti-Terrorism Financing Act 2001, BNM General Guidelines for Financial Institutions and Exchange Control Regulations; and
- ◆ Know provisions from other relevant Acts such as the National Land Code 1965, Hire-Purchase Act 1967, Bill of Exchange Act 1949, Companies Act 1965, Unclaimed Moneys Act 1965 and Bankruptcy Act 1967, which may have an impact in certain transactions of an institution.

1. INTRODUCTION

The regulatory and supervisory framework for the Malaysian banking sector has evolved significantly over the years. The main thrust of banking policies has always been to preserve the soundness and stability of the financial system whilst ensuring that the intermediation process continues to support economic growth. For effective supervision and regulation of financial institutions, Bank Negara Malaysia has executed various legislation, Acts and guidelines to ensure the orderly development of financial institutions. This is aimed at preserving and maintaining a sound and stable financial system in the country.

2. LEGISLATION, ACTS AND GUIDELINES

In carrying out an audit, internal auditors should evaluate whether their financial institution complies with the applicable laws and regulations, including BNM's guidelines and directives as well as the rules and regulations imposed by the Securities Commission and Bursa Malaysia Securities Berhad. The various legislation and Acts for financial institutions are listed below:

- a. Central Bank of Malaysia Act 1958 (Revised 1994)
- b. Islamic Banking Act 1983
- c. Banking and Financial Institutions Act 1989 (BAFIA)
- d. Essential (Protection of Deposits) Regulation 1986
- e. Insurance Act 1996
- f. Takaful Act 1984
- g. Anti-Money Laundering and Anti-Terrorism Financing Act 2001**
- h. Bills of Exchange Act 1949
- i. Hire-Purchase Act 1967.

BNM, as agent of the Government on exchange control regulations, also administers the Exchange Control Act 1953 with the Governor as the Controller of Foreign Exchange. Furthermore, effective 1 May 1988, the Governor also became the Director-General of Insurance and the Director-General of Takaful. Arising from the appointments, BNM was made responsible for the supervision, regulation and development of the insurance industry. In addition, the Development Financial Institutions Act, enacted in 2002, immediately brought the country's six development financial institutions under the jurisdiction of BNM.

3. CENTRAL BANK OF MALAYSIA ACT 1958 (REVISED 1994)

Bank Negara Malaysia (the Central Bank of Malaysia) was established on 26 January 1959 as a statutory body under the Central Bank of Malaya Ordinance 1958 (CBO). Concomitantly, the Banking Ordinance 1958, which provided for the licensing and regulation of banking business in the then Federation of Malaya also came into force. The CBO was revised in 1994 and is now known as the Central Bank of Malaysia Act 1958 (Revised 1994). The Central Bank is entrusted with the responsibility of ensuring the orderly development of the financial system by introducing monetary policies to achieve Malaysia's economic objectives.

- ii) For interim reporting, the condensed financial reports must include the information and disclosure requirements as set out in Appendix C of the BNM/GP8 Guidelines and any other information as may be required by Bank Negara Malaysia.

5.8 UPW/GP1: Standard Guidelines on Anti-Money Laundering and Counter Financing of Terrorism (Replaces BNM/GP9: Guidelines on Money Laundering and “Know Your Customer Policy”)

The Guidelines are issued pursuant to certain provisions of the **Anti-Money Laundering and Anti-Terrorism Financing Act 2001** (AMLA). The Guidelines are established and formulated to address the requirements that must be complied with by the reporting financial institutions under the AMLA to effectively combat money laundering and financing of terrorism activities.

Money laundering is defined as a process by which proceeds derived from criminal or illegal activities are converted to legitimate funds. It embodies all transactions which disguise, conceal or impede the establishment of the illegal origins, location or ownership of the funds. Financing of terrorism generally refers to carrying out transactions involving funds that may or may not be owned by terrorist, or that have been, or are intended to be, used to assist the commission of terrorism.

The Guidelines require that every reporting institution:

- i) Develop a customer acceptance policy and procedures to address the establishment of business relationship with the customer, and perform a risk profiling of the customers.
- ii) Conduct customer due diligence and obtain satisfactory evidence in its records, the identity and legal evidence thereon.
- iii) Keep all records and documents of transactions, in particular, those obtained during customer due diligence procedures, for at least 6 years and to ensure the retained documents are able to create an audit trail.
- iv) Shall conduct on-going customer due diligence to examine and clarify the economic background and purpose of any transaction. Any unusual findings, such as doubts on its economic purpose or legality must be documented and made available to Bank Negara Malaysia and any relevant authority upon request.
- v) Have in place an adequate management information system to complement its customer due diligence.
- vi) Establishes internal criteria known as “red flags” to detect suspicious transactions. May be guided by examples from Bank Negara Malaysia or other international organisations, such as the Bank for International Surveillance (BIS), International Association of Insurance Supervisors (IAIS) or International Organisation of Securities Commissions (IOSCO).

- vii) Promptly submit a suspicious transaction report to the Financial Intelligence Unit in Bank Negara Malaysia when any of its employees suspect that a transaction or attempted transaction involves proceeds from an unlawful activity or the customer is involved in money laundering or financing of terrorism.
- viii) Appoint one or more officers at the senior management level to be the compliance officer responsible for the submission of suspicious transaction reports to the Financial Intelligence Unit in Bank Negara Malaysia. This is similarly extended to branch and subsidiary level.
- ix) Implement a AML/CFT compliance programme, starting from the board of directors and senior management who must be aware of the money laundering and financing of terrorism risks associated with all its business products and services, and understand the AML/CFT measures required by the law.
- x) Provides training and guidance to staff in the operation of procedures and controls relating to anti-money laundering;

5.9 GP10: Guidelines on Minimum Audit Standards for Internal Auditors of Financial Institutions

As part of the move to enhance the corporate governance process and the quality and effectiveness of the internal audit function in the banking system, BNM issued BNM/GP10 in 1997. The guidelines require internal auditors of financial institutions to carry out the minimum standards on internal audit, which include a comprehensive assessment of the risk management system as part of their audit scope. BNM envisages that the quality and effectiveness of the internal audit function in financial institutions will be enhanced with the implementation of these guidelines. BNM/GP10 was issued to meet the following objectives:

- a. To improve the quality and effectiveness of the internal audit function;
- b. To re-emphasise the role, duties and responsibilities of internal auditors to the board of directors (board), all levels of management and the external auditors; and
- c. To provide a uniform practice guide on internal auditing which will serve as a basis for guidance and measurement of the performance of the internal audit function.

A more detailed discussion of BNM/GP10 is given in Chapter 6.

5.10 BNM/GP11: Guidelines on Consumer Protection on Electronic Fund Transfers

GP11 was issued in 1998, pursuant to sections 119 and 126 of the BAFIA, to provide financial institutions with minimum guidelines on electronic fund transfers. The purpose is to provide a basic framework to establish the rights, liabilities and responsibilities of customers and financial institutions relating to electronic fund transfers. For purposes of these guidelines, electronic fund transfers mean fund transfers carried out through or by means of:

- a. telegraphic transfers,
- b. point-of-sale terminals,

7. ANTI-MONEY LAUNDERING AND ANTI-TERRORISM FINANCING ACT 2001

The three stages of money laundering are as follows:

- a. Placement – the physical disposal of cash proceeds derived from illegal activities;
- b. Layering – separating illicit proceeds from their source through transactions that disguise the audit trail and provide anonymity; and
- c. Integration - place laundered proceeds into the economy as normal business funds.

The **Anti-Money Laundering and Anti-Terrorism Financing Act 2001** (Revised 2003) was enacted in order to provide for:

- a. the definition of money laundering;
- b. the offences under money laundering activities;
- c. the measures to be taken for the prevention of money laundering;
- d. the forfeiture of property derived from, or involved in money laundering; and
- e. the requirements of record-keeping and reporting of suspicious transactions by reporting institutions.

Money laundering refers to all activities and procedures to change the identity of illegally obtained money (e.g. drug production and trafficking, and smuggling activities) so that it appears to have originated from a legitimate source. Under the present circumstances, it is a moral and ethical obligation on the part of financial institutions to not facilitate money laundering activities that can be derived from drug trafficking, terrorism, corruption, arms smuggling, illegal deposit-taking, gambling and other offences.

Please refer to the earlier discussion on UPW/GPI for an elaboration on the risk profile of customers and reporting of suspicious transactions.

8. NATIONAL LAND CODE 1965

The National Land Code 1965 defines “land” to include the surface and the subsurface of the earth, the substance forming the earth, all vegetation and other natural products on and below its surface, as well as all things (building, etc) attached to the earth including water and water courses (such as rivers, streams, river banks, riverbeds, lakes, sea beds and seashores). Dealings relating to land or real properties in Malaysia are governed by several sets of land laws. For Peninsular Malaysia, the major land law is the National Land Code 1965 (NLC) whereas for East Malaysia, the land laws are the Sabah Land Ordinance 1968 and the Sarawak Land Code 1958 for the states of Sabah and Sarawak respectively. Despite the use of different legislation, the principles adopted are generally similar.

Land matters in Malaysia are administered under the Torrens System which is a system of title and interest by registration, i.e. until a transaction is registered, it is not effective in law. The proprietary interest in the surface of the land is known as “estate”. The duration of an estate is denoted by the term “freehold” or “leasehold”. The conclusive ownership to an estate is an entry in the relevant register of land titles, known as the title’s register document.

Once registered, the title deed relating to the particular plot of land will be stamped with a memorial of registration indicating the following:

- a. the nature of the transaction such as a transfer, a charge or discharge,
- b. the interested parties, and
- c. the date and time of presentation.

8.1 Lien-holder's Caveat and Private Caveat

The relevant land authority may present a "caveat" which has the effect of prohibiting any dealing with the land in which an interest is claimed by the government or any party for various reasons. Such a caveat shall take priority over any memorandum presented but registration of which has not been completed. Essentially, a caveat is aimed at preserving the status quo of the parties pending the resolution of disputes by a court of law. Its main function is to restrain against dealings in land.

There are four types of caveats but the more popular ones are the lien-holder's caveat and the private caveat. A lien-holder's caveat refers to any proprietor who may deposit his issued document of title with any person, as security for a loan. Upon the entry of such a caveat, the lender becomes entitled to a lien over the land. A lien-holder's caveat may be withdrawn at any time by a notice in writing to the Registrar of Titles by the person entitled to the lien's benefit. On the other hand, a private caveat is aimed at protecting the interests of any person who claims to have any title or any registrable interest in the land of the registered proprietor or the caveatee. A private caveat can be entered on the following grounds under section 323 (1) of the NLC:

- a. Any person or body claiming title to, or any registrable interest in any alienated land or any right to such title or interest;
- b. Any person or body claiming to be beneficially entitled under any trust affecting such land or interest; and
- c. The guardian or next of kin of any minor claiming to be entitled as mentioned in (b). In law, a private caveat can remain in force continuously for 6 years before it expires. In reality, its duration may be shorter if it is withdrawn by the caveator under section 325. Alternatively, it may be removed by the Registrar under section 326 or by order of the court (section 327) upon a successful application by the caveatee or any other aggrieved person.

8.2 Fixed and Floating Charges

Charges represent the most common form of security taken by financial institutions for credit facilities extended. A charge is the creation of rights or claims on fixed assets to secure debts. There are generally two types of charges, namely a fixed charge and a floating charge. Under the NLC, a charge is a security transaction where the proprietor of the alienated land, pledges it as security for repayment of a credit facility. The formality requires the execution of a memorandum of charge by the chargor (the proprietor of the land) and the title deed and the deposit of the title deed with the chargee. Section 241 requires all lands to be charged in whole. Hence, where proprietary interests are shared, all the joint proprietors must sign in concert to create a charge.