

Chapter 4

Legislation and Guidelines

Contents

	Page
1. Introduction	2
2. Legislation, Acts and Guidelines	2
3. Central Bank of Malaysia Act 1958 (Revised 1994)	2
4. Banking and Financial Institutions Act 1989.....	3
5. BNM General Guidelines for Financial Institutions	5
6. Exchange Control Act 1953	16
7. Anti-Money Laundering and Anti-Terrorism Financing Act 2001	19
8. National Land Code 1965	19
9. Hire-Purchase Act 1967	21
10. Bills of Exchange Act 1949.....	22
11. Companies Act 1965	24
12. Unclaimed Moneys Act 1965 (Amended 2002)	25
13. Bankruptcy Act 1967.....	26
14. Cyberlaws.....	26
15. Basel Capital Accord II.....	27
16. Conclusion	29

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.

BNM's principal objectives are as follows:

- a. Issue currency and keep reserves to safeguard the value of the currency;
- b. Act as banker and financial advisor to the government;
- c. Promote monetary stability and a sound financial structure; and
- d. Influence the credit situation to Malaysia's advantage.

BNM's objectives are inter-related and complementary. For example, because of its ability to issue currency, BNM has the primary responsibility of ensuring that domestic prices remain stable so that the benefits of economic growth are not eroded. Monetary stability, in turn, is dependent on the existence of a sound and stable financial system. Of equal importance is the need for smooth functioning of the intermediation process among the financial institutions so that domestic savings are mobilised and transmitted to investors, thereby contributing to the overall growth in investment and output.

STUDENT PRACTICE 1

1. What are the objectives of Bank Negara Malaysia? (para 3)
2. What is the intermediation process facilitated by Bank Negara Malaysia? (para 3)

4. BANKING AND FINANCIAL INSTITUTIONS ACT 1989

The regulatory and supervisory framework of the Malaysian banking system was revised in the early 1980s in order to ensure its relevance in the light of structural changes in the domestic economy and external environment. Prior to 1969, banking legislation was tailored specifically to regulate particular types of institutions. It used to be fragmented, with different laws and regulations governing the activities of commercial banks, finance companies and merchant banks (now known as investment banks). Furthermore, the various legislation did not provide BNM with effective regulatory and supervisory powers over the activities of non-bank institutions, e.g. cooperatives and development financial institutions, operating at the fringe of the highly regulated banking sector. A conscious effort was made to review the various banking legislation in the aftermath of the 1985-86 recession. The change was also prompted by the blurring of lines between the activities of different financial institutions, such as commercial banks, merchant banks (now known as investment banks) and finance companies as well as the inadequacy of BNM's powers to deal effectively with the problems that arose during the "Deposit-taking Co-operatives" crisis in the mid-1980s. This review led to the introduction of the Banking and Financial Institutions Act 1989 (BAFIA) in October 1989.

The BAFIA is aimed at providing a framework for an integrated supervision of the Malaysian financial system and enhancing BNM's regulatory and supervisory powers. However, it was recognised that there was no specific regulation governing the activities of other financial institutions such as development finance institutions, specialised credit institutions, credit firms and cooperatives. As such, there was a need to have a cohesive regime covering all deposit-taking activities in order to protect the interests of depositors and to maintain the integrity and stability of the financial system as a whole.

The BAFIA empowers BNM to grant and revoke banking licences and to take prompt corrective action to effectively deal with “ailing” financial institutions, including assumption of management control. It also enhances the powers and duties of the auditors of licensed institutions, and makes a director, officer or controller liable to indemnify the financial institution in full for any loss or damage in any form arising from or caused by an offence committed by any person. These powers, among others, include the removal of directors, appointment of directors and advisors, suspension of lending activities, appointment of receivers and the reduction of capital.

Besides the licensed financial institutions, the BAFIA can, under specific circumstances, regulate “scheduled” and “non-scheduled” institutions. The “scheduled” institutions include credit and charge card companies, building societies, factoring and leasing companies, and development financial institutions as well as the representative offices of foreign banks. On the other hand, “non-scheduled” institutions refers to “any statutory body or any person being an individual or a body or organisation, not being a statutory body, whether corporate or unincorporated, whether or not licensed, registered or authorised under any written law who or which is neither liable to be licensed under the BAFIA”. The important provisions of the BAFIA are elaborated below:

- Section 7 : Revocation of licence – The Minister of Finance may revoke a licence granted to a financial institution, on BNM’s recommendation.
- Section 41 : Submission of financial statements to BNM
- Section 45 : Acquisition or disposal of an aggregate of 5% shareholdings needs prior approval from BNM
- Section 46 : Maximum permissible holdings in shares of licensed local financial institutions. In the case of an individual, 10% and in the case of a person other than an individual, 20%
- Section 47 : Prohibit holding of shares by other licensed local financial institutions
- Section 56 : Disqualifications of a director or CEO of a financial institution
- Section 59 : Advance against security of own shares or shares of holding company is prohibited
- Section 60 : Granting of secured and unsecured credit facilities
- Section 61 : Restriction of credit to single customer up to certain limit
- Section 62 : Prohibition of credit facilities to directors and officers of a financial institution
- Section 65 : Directors or officers of financial institutions shall not give any credit facility in excess of the limit or outside terms and conditions imposed by the financial institution
- Section 97 : Banking secrecy – The duty of a banker is not only confined to information about the state of a customer’s account but extends to all information derived from the account
- Section 103 : Offences and penalties as specified in the Fourth Schedule
- Section 105 : Offences in relation to entries in books, documents and so on

STUDENT PRACTICE 2

1. Why there is a need for the Banking and Financial Institutions Act 1989? (para 4)
2. What are the scheduled institutions under the BAFIA? (para 4)

5. BNM GENERAL GUIDELINES FOR FINANCIAL INSTITUTIONS

Bank Negara Malaysia issues “Garis Panduan-Garis Panduan Untuk Institusi-Institusi Kewangan” or General Guidelines (GPs) for Financial Institutions from time to time. The 11 BNM/GPs, namely BNM/GP1 to BNM/GP11, are briefly summarised below:

5.1 BNM/GP1 (Revised): Guidelines on Corporate Governance for Licensed Institutions

The primary objective of the Revised BNM/GP1 is to promote the adoption of effective and high standards of corporate governance practices by licensed institutions and bank/financial holding companies. The Revised BNM/GP1 sets out the broad principles and minimum standards as well as specific requirements, based on the fundamental concepts of **responsibility, accountability and transparency**. The purpose of adopting sound corporate governance standards and practices is to ensure that licensed institutions are managed safely and soundly where risk taking activities and business prudence are appropriately balanced to maximise shareholders’ returns and protect the interests of all stakeholders.

Corporate governance is defined as the process and structure used to direct and manage the business and affairs of the institution towards enhancing business prosperity and corporate accountability with ultimate objective of realising long-term shareholder value, whilst taking into account the interests of other stakeholders.

The Revised BNM/GP1 spells out the main principles governing the roles, responsibilities, structure and obligations of the board of directors, legal obligations and conduct of directors, chief executive officers and senior bank officers, where there must not be a conflict of interest situation. It also sets out the need for a formal and transparent process for the appointment of directors and chief executive officers and in fixing their remuneration packages. In addition, it sets out that there should be a formal and ongoing assessment of the board as a whole, the directors and chief executive officer. The need for robust auditing requirements is also clearly set out, with the role of internal auditors clearly defined so as to ensure they could perform their functions unimpeded and independently. In addition, financial institutions are also required to establish different board committees to facilitate sound and good corporate governance practices. The committees are:

- i). *Nominating committee* – to provide a formal and transparent procedure for the appointment and assessment of effectiveness/performance of directors, chief executive officer and key senior management officers.
- ii). *Remuneration committee* - to provide a formal and transparent procedure for developing a competitive remuneration policy for directors, chief executive officer and key senior management officers, consistent with the institution’s culture, objectives and strategy.

- iii) *Risk management committee* – to oversee senior management’s activities in managing credit, market, liquidity, operational, legal and other risks and to ensure that the risk management process is in place and functioning.
- iv) *Audit committee* – to provide independent oversight of the institution’s financial reporting and internal control system, ensuring checks and balances within the institution. The audit committee is also to review the performance and findings of its internal auditors, and to recommend appropriate remedial action regularly, meeting at least once every quarter.

The Guidelines on Submission of Annual Accounts (BNM/GP2) has been superseded by **BNM GP/8 (Revised): Guidelines on Financial Reporting for Licensed Institutions.**

5.2 **BNM/GP3: Guidelines on the Suspension of Interest on Non-Performing Loans and Provision for Bad and Doubtful Debts**

BNM/GP3 was introduced in 1985 against the backdrop of the mid-80s bank crisis which revealed that the absence of a sound and efficient credit risk management process, coupled with imprudent lending practices and mismanagement adversely affected the asset quality of loans.

BNM/GP3 was introduced to establish uniformity in income recognition and loan loss provisions. The Guidelines also set out the minimum standards on the treatment of interest on non-performing loans and the provisions for the financial institutions’ bad and doubtful debts. This involves policies on suspension of interest as well as setting of provisions, i.e. general and specific provisions for bad and doubtful debts. Essentially, a loan is classified as non-performing when the principal or interest is due and unpaid for six months or more from the first day of default. The institution has to stop recognising interest income thereon. Furthermore, non-performing loans are to be classified and provisions made accordingly, as follows:

Period of Default	Classification	Specific Provision on the shortfall in security value over the amount outstanding, net of unearned interest and interest suspended
6 months < 9 months	Substandard, unless there is evidence to support a worse-off classification	20% provisioning unless overall loan loss provisions are adequate.
9 months < 12 months	Doubtful, unless there is evidence to support a worse-off classification.	50%
12 months and above	Bad	100%

BNM/GP3 allows for the early identification and recognition of potential deterioration in the quality of assets and setting aside adequate provisions to absorb the potential losses on these assets.

5.3 BNM/GP4: Guidelines on Staff Training Fund

In an attempt to discourage “staff pinching” among financial institutions and to promote industry-wide training and manpower development, the Guidelines on Staff Training Fund (STF) was established in 1985. As a deterrent against recruiting experienced personnel from another financial institution, the hiring institution is required to contribute a maximum of 6 months of the personnel’s new gross salary to the STF. The STF is applicable if the recruitment is made within 6 months of the staff’s resignation and whose previous salary exceeds RM2,000 per month. In 1993, rules pertaining to “staff pinching” were liberalised where “staff pinching” was redefined to refer to the recruitment of new staff who were not approved for release by the previous employer. All the contributions to the STF are channelled to support training courses for banking personnel, in collaboration with Institut Bank-Bank Malaysia (IBBM).

5.4 BNM/GP5: Guidelines on the Credit Limit to a Single Customer

In 1986, BNM/GP5 was issued to limit over concentration of credit facilities on a single customer and its related corporations as the business failure of a large borrower could have direct adverse implications on the respective institution’s financial position. The percentage is determined by BNM in relation to the financial institution’s capital funds or a foreign bank’s net working funds unimpaired by losses or otherwise. The guidelines aim to diversify risks among financial institutions vis-à-vis their exposure to a single customer. BNM/GP5 also imposes an overall limit on granting of “large” loans, which are set at 50% of the total credit facilities.

5.5 Guidelines on Credit Transactions and Exposures with Connected Parties (replaced BNM/GP6: Guidelines on Prohibition of Loans to Directors, Staff and their Interested Corporations)

BNM/GP6 was introduced to prevent abuses, conflicts of interest and irregular practices by bank officers. It was to ensure that credit facilities granted to directors and staff of financial institutions did not have undue advantage over that of other customers and were subject to the same test of creditworthiness as for all customers in obtaining financing and advances.

BNM/GP6 seeks to extend credit and make investments in the ordinary course of business to/in connected parties that are of good credit standing. Terms and conditions of the credit transactions must be appropriate, based on sound credit risk management practices. Connected parties refer to the following person(s) and his close relatives: directors, controlling shareholder, executive officers and officer responsible for/power to appraise/approve the credit transactions, of the institutions. This is extended to cover firms, partnerships, companies or any legal entities which control, or are controlled by the person mentioned in the preceding sentence.

5.6 **BNM/GP7: Guidelines on the Code of Conduct of Directors, Officers and Employees in the Banking Industry**

The Guidelines on the code of conduct of directors, officers and employees in the banking industry were issued in 1998. As the custodian of public funds, the management of financial institutions should exhibit impeccable integrity and a high level of professionalism in their conduct to promote public confidence in the safety of the public's deposits. This integrity and credibility of financial institutions must be safeguarded by the following six principles:

- a. To avoid conflict of interest;
- b. To avoid misuse of position;
- c. To prevent misuse of information gathered through the banking institution's operations;
- d. To ensure completeness and accuracy of relevant records;
- e. To ensure confidentiality of communication and transactions between the banking institution and its customers; and
- f. To ensure fair and equitable treatment of all customers.

In April 1994, BNM/GP7 was expanded to incorporate broad guidelines prohibiting the participation of bank staff in share-trading activities and their involvement in schemes pertaining to the misuse of *bumiputera* names in public share issues.

5.7 **BNM/GP8 (Revised): Guidelines on Financial Reporting for Licensed Institutions**

The BNM/GP8 guidelines were issued in 1988, revised in 1994 and subsequently revised in 2004. The guidelines encompassed minimum standards of disclosure that should be followed by financial institutions in their publication of financial statements and revised accounting policies to bring them closer to international standards. The disclosure requirements were further tightened in 1997 and 1998 when financial institutions were required to publish information on the capital adequacy ratio, non-performing loans, general provision and interest-in-suspense as well as sectoral credit exposure according to economic sectors. Financial institutions are also required to disclose in their annual financial statements, a breakdown of the off-balance sheet items.

Reporting institutions must ensure that their financial reports fulfil the following:

- i) Must be prepared in accordance with the provisions of the Companies Act 1965 and approved accounting standards issued by the Malaysia Accounting Standards Board (MASB).
- ii) For listed reporting institutions, the financial reports must comply with the disclosure requirements of Bursa Malaysia Securities Berhad.
- iii) Must include the information and disclosure requirements set out in Appendix A of the BNM/GP8 Guidelines and any other information as may be required by Bank Negara Malaysia.

- iv) 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,

- c. stored value card terminals,
- d. cash dispensing machines,
- e. cash deposit machines,
- f. telephonic instruments, or
- g. debit cards.

A financial institution providing any type of electronic fund transfers shall have standard terms and conditions in writing on the carrying out of such electronic fund transfers. They include the following:

- a. The customer's liability for any unauthorised electronic fund transfers and duty to report to the financial institution promptly any loss, misuse, theft or unauthorised use of access code or a card;
- b. The telephone number and address of the department in charge of electronic fund transfers so that the financial institution can be notified in the event a customer believes that an unauthorised electronic fund transfer has been or may have been effected;
- c. The customer's right to stop payment of a pre-authorised electronic fund transfer and the conditions and procedures to initiate such a stop payment order;
- d. Information relating to lodgement of complaints, investigation and resolution procedures;
- e. The customer's right to receive relevant documents in relation to electronic fund transfers; and
- f. The circumstances in which the financial institution may, in the ordinary course of business, disclose information in relation to a customer's account to a third person.

5.10.1 Guidelines on Management of IT Environment (GPIS 1)

In addition to the above guidelines on consumer protection on electronic fund transfers, Bank Negara Malaysia has also issued another set of guidelines on the management of the IT environment. This is in view of the high reliance on and usage of IT in the current banking system and related risks thereon. The Guidelines outline the minimum responsibilities and requirements for planning and managing, as well as establishing preventive and detective measures that should be implemented by institutions to mitigate the risks pertaining to an IT environment.

The Guidelines outline the main areas of IT governance:

i) Board and Management Oversight

For proper IT governance, the board of directors is responsible to ensure adequate steps, measures and procedures are in place to comply with the Guidelines. Similarly, senior management oversight should be established in

governing the day-to-day IT activities. There should also be an IT Steering Committee whose main duties include overseeing the development and maintenance of the IT strategic plan.

ii) System Security

System security failures can be very costly and disruptive to an institution's business. Minimum standards should be implemented to ensure that logical access controls are one of the primary safeguards. In addition, there should be well documented and designed policy, procedures and awareness programmes. Authentication management and password controls are the other key areas. These in turn must be supported by proper log-in controls, logical access, activity monitoring, data and database controls and application controls

iii) System Development

There should be minimum standards in place to ensure that system development activities are sufficiently controlled to ascertain the integrity of data and system. Poor management and controls over system development could result in the following:

- Inadequate specifications,
- System design error,
- Lack of controls in programme change management,
- System not adequately tested,
- Incomplete and inadequate documentation, and
- Frequent data and system integrity problems.

As a means to counteract the possible lapses, there should be a formal project management team setting out proper standards and procedures, and proper change management. There should be proper and sufficient level of testing and post implementation review. Other measures include a secured library for programs pending migration to the production environment and proper procedures and process for source codes conversion and maintenance.

iv) Operations

The computer operations activity involves the operation and maintenance of computer and telecommunications equipment. Adequate operating standards are necessary to ensure that the information produced by the computer system is accurate, reliable and safeguarded against errors, fraudulent manipulation and accidental destruction of records.

Accordingly, there must be proper standards and procedures covering computer operation functions, complemented by proper maintenance of the computer centre. There should be in place a system of monitoring of operational activities and a set of emergency procedures.

v) Communication Network

Communication conveys information and provides a channel of access to information systems. A breach in the integrity of the network can be extremely costly and is a reputational risk.

The following should be in place:

- Standards and procedures,
- Network design,
- Network operations,
- Access controls, and
- Activity monitoring.

vi) Business Continuity Management

Business continuity management (BCM) entails enterprise-wide planning and arrangements of key resources and procedures that enable the institution to respond and continue to operate critical business functions across a broad spectrum of interruptions to the business, arising from internal or external events. BNM has issued the “Guidelines on Business Continuity Management” which supersedes ‘GPIS1 – Guidelines on Management of IT Environment’ issued in May 2004. The Guidelines essentially aim to ensure that financial institutions:

- have in place a comprehensive BCM framework, which includes a business continuity policy
- establish a comprehensive BCM programme to formulate, implement and test the business continuity plan (BCP) and disaster recovery plan (DRP)
- review and update the BCP and DRP continuously to reflect changes in the operating environment
- provide sufficient information to the Board of Directors to enable it to discharge its responsibilities as stated in the Guidelines.

The BCM encompasses disaster recovery for IT systems, crisis management and contingency planning. Hence, the FI is required to ensure that internal linkages with crisis management and emergency response procedures as well as external dependencies on key service providers/vendors are adequately considered during business continuity planning. Safeguard measures should also be undertaken for human life and business assets/premises.

The BCM life cycle comprises the following:

- a. analysing the FI's business functions and their criticality through risk assessment and business impact analysis,
- b. formulating appropriate and workable BCM recovery strategies based on the risk assessment and business impact analysis;
- c. developing and implementing the BCP and the DRP,
- d. Testing the plans,
- e. Reviewing and maintaining the plans,
- f. Auditing the plans, and
- g. Conducting ongoing awareness programmes and communication, training and education on BCM.

5.11 Other Significant BNM Guidelines and/or Circulars

Bank Negara Malaysia has, from time to time, issued new guidelines and/or circulars to streamline certain practices or to enhance certain operating/control features and measures, in view of new developments and the changing landscape in the banking environment. Some of the more significant guidelines are on:

i) Outsourcing

Main criteria for outsourcing are:

- Processes which are not integral to the core business, do not take away the banking institution's decision-making function and do not threaten its strategic flexibility and process control,
- Outsourcing would not impair the image, integrity and credibility of the institution, and
- Lower cost for the institution to outsource, rather than developing the necessary infrastructure and expertise.

The following functions can be outsourced to external parties, subject to the banking institution giving an undertaking to Bank Negara Malaysia that the stipulated safeguards Bank Negara Malaysia requires are fully complied with.

- Information systems internal audit,
- Credit card receivables collection, and
- Non-core operational functions.

Banking institutions are required to comply with the following conditions (safeguards) before being allowed to outsource their functions:

- a. There must be a due diligence review performed to evaluate and ascertain the capabilities and expertise of the vendor prior to selection;
- b. Approval from the institution's Board of Directors must be obtained and documented;
- c. The outsourcing vendor must provide a written undertaking to the institution concerned to comply with the secrecy provision pursuant to Section 97 of the BAFIA;
- d. There must be a service agreement drawn up between the outsourcing vendor and the institution with a clause on professional ethics and conduct. The service agreement should also clearly define the roles and responsibilities of the outsourcing vendor;
- e. The service agreement should clearly state the institution reserves the right to terminate the services of the outsourcing vendor if it fails to comply with the stipulated terms and conditions;
- f. There must be proper reporting and monitoring mechanisms in place to track the integrity and quality of work/services performed;
- g. There should be regular testing and review of work/services performed by the outsourcing vendor;
- h. Auditors, both external and internal, must be able to review the outsourcing vendor's books and internal controls;
- i. The institution must have a contingency plan to continue the work/services being provided by the outsourcing vendor in the event the vendor is unable to continue. The contingency plan must be reviewed regularly to ensure the plan is current and relevant.

STUDENT PRACTICE 3

1. What is the subject matter in BNM/GP3? (para 5.2 – BNM/GP3)
2. What are the six principles outlined in BNM/GP7 on the conduct of directors, officers and employees of financial institutions? (para 5.6 – BNM/GP7)
3. What are the objectives of the guidelines on Anti-Money Laundering and Counter Financing of Terrorism? (para 5.8 – UPW/GP1)
4. What are the criteria for outsourcing? (para 5.11)
5. What are the conditions banking institutions must comply with in respect of outsourcing? (para 5.11)

6. EXCHANGE CONTROL ACT 1953

BNM administers the country's exchange control system in accordance with the provisions of the Exchange Control Act 1953. Moving in tandem with the changing economic and investment climate, the foreign exchange administration rules have been amended to cater to the changing environment. The most recent amendment was effected on 1 April 2007. The purposes of the amendments are to:

- i) liberalise and provide greater flexibility so as to create a more conducive financial and investment climate to enhance the country's competitiveness,
- ii) increase efficiency on the regulatory delivery system, and
- iii) encourage effective risk management activities while safeguarding economic and financial stability.

The following are some of the rules affecting foreign exchange transactions:

6.1 Current Account Transactions

a. Payments for Imports of Goods and Services

There is no restriction on payments to non-residents for imports of goods and services. Such payments must be made in foreign currency.

b. Proceeds Arising from Export of Goods

All export proceeds are required to be repatriated back to Malaysia in accordance with the payment schedule as specified in the sales contract, which should not exceed 6 months from the date of export.

6.2 Capital Account Transactions

a. Foreign Direct Investment

There is no restriction on repatriation of capital, profits, dividends, interest and rental income by foreign direct investors.

b. Investment Abroad by Residents

- i) Residents, without domestic borrowings are free to invest abroad in foreign currencies to be funded from their internal foreign currency account or from conversion of ringgit funds.
- ii) Corporations with domestic credit facilities are also free to use their foreign currency funds or convert ringgit up to RM50 million per annum for investment in foreign currency assets. These corporations must have a minimum shareholders' fund of RM100,000 and must be operating for at least 1 year.
- iii) Individuals with domestic credit facilities may invest abroad any amount of their own foreign currency funds or convert ringgit up to RM1 million per annum.

For investment abroad in excess of RM50 million for companies, prior registration is required and submission of quarterly report continues.

c. Foreign Currency Credit Facilities Obtained by Residents

- i) Resident company is free to obtain:
 - Foreign currency trade finance facilities of any amount and tenor from licensed onshore banks; and
 - Foreign currency credit facilities up to an equivalent of RM100 million in aggregate, on a corporate group basis, from licensed onshore banks and non-residents. The limit includes the raising of funds through the issuance of foreign currency bonds onshore or offshore.
- ii) An individual resident is allowed to obtain credit facilities in foreign currencies up to the equivalent of RM10 million in aggregate from licensed banks and non-residents.
- iii) Where the aggregate amount of credit facilities is more than RM50 million equivalent, the resident borrower is required to provide the Controller with information on the foreign currency credit facilities within 7 working days prior to obtaining the credit facilities as follows:
 - i. individuals – no registration requirement, and
 - ii. companies – exceeding RM50 million in aggregate.
- iv) Residents are free to prepay foreign currency borrowings subject to registration (at least 7 days prior to remittance by completing Form SSC 10C) where the prepayment amounts to RM50 million equivalent and above. In such cases, a Registration ID will be issued. There is no reporting requirement for prepayments.
- v) Credit facilities in foreign currencies, other than permitted as mentioned above, require prior approval from the Controller.

Residents may obtain credit facilities in foreign currencies up to equivalent of RM5 million in aggregate from onshore licensed bankers, licensed merchant banks and non-residents. Any amount exceeding the permitted limit will require the prior permission of the Controller. Where the aggregate amount exceeds the equivalent of RM1 million, the resident is required to provide the Controller with information on the credit facilities

d. Portfolio Investments

There is no restriction on non-resident portfolio investors to repatriate their principal sum and profits out of the country at any time.

6.3 Ringgit Credit Facilities

- i) Residents (banks or non-banks) are allowed to extend ringgit credit facilities to non-residents to finance or refinance the purchase or construction of residences or commercial properties in Malaysia (excluding financing for purchase of land only).
- The property financed by loans obtained may not be for non-residents' own use.
 - There is no limit on the number or amount for such loans.
 - All purchases are subject to the guideline issued by the Foreign Investment Committee (FIC). (FIC guidelines can be found at <http://www.epu.jpm.my>).
- ii) Lending by Banking Institutions to Foreign Stockbroking Companies and Foreign Custodians

No limit to overdraft facilities to non-resident stockbrokers and non-resident global custodian banks.

Condition:

Only to be used to finance funding gaps due to unforeseen or inadvertent technical or administration errors or time zone delays in relation to settlements of ringgit instruments through the Real Time Electronic Transfer of Funds and Securities System (RENTAS) and Bursa Malaysia.

- Resident stockbroking companies are allowed to extend margin financing facilities of any amount to non-resident clients for the purchase of shares listed on the Bursa Malaysia, subject to compliance with the rules on margin financing imposed by the Bursa Malaysia.
- iii) Various lending limits are to be consolidated by licensed onshore banks to non-residents up to an aggregate of RM10 million for any purpose for use in Malaysia, except for purchase or construction of immovable property in Malaysia.
- iv) Other non-bank residents are allowed to lend in ringgit up to RM10,000 to a non-resident.

STUDENT PRACTICE 4

1. What is the purpose of the recent amendments to the Exchange Control Act 1953? (para 6)
2. Can a non-resident have a ringgit credit facility? (para 6.3)

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.

All charges created by companies must be registered with the Company Commission of Malaysia within 30 days after their creation; otherwise the charges will be void against the liquidator and other creditors of the company. A floating charge is usually in the form of a debenture securing debt by charging all the company's assets. If the company goes into liquidation, all floating charges automatically crystallise. When a floating charge crystallises, it is treated as a fixed charge.

A floating charge is ambulatory and shifting in nature, hovering over and floating with the property which it is to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp. For example, if a floating charge is given over a company's inventory, the company can continue to dispose of its inventory as if the charge did not exist. However, as soon as the charge crystallises, the charge will fix upon whatever specific assets exist in the company's inventory at the moment of crystallisation. A floating charge will crystallise on default of the credit facility. Such defaults can be a failure to pay some moneys due under the debenture or some other defaults, e.g. when the debenture-holder appoints a receiver or when the company ceases business or winding-up commences.

STUDENT PRACTICE 5

1. Explain the effect of a caveat. (para 8)
2. What is a floating charge? (para 8)

9. HIRE-PURCHASE ACT 1967

In Malaysia, hire purchase (HP) is mainly provided by finance companies, credit companies and dealers in consumer goods. It was originally introduced as a marketing tool by some merchants to stimulate sales. It has since undergone significant development over the years. Nowadays, HP is mainly a form of consumer credit for acquisition of fixed or durable assets such as motor vehicles and consumer goods, e.g. refrigerators, air-conditioners and machinery. The essence of the Hire-Purchase Act 1967 is that the title of the goods does not pass to the hirer (borrower) unless the hirer fully repays the HP loan. In other words, under the HP agreement the hirer possesses the asset while the financial institution is the legal owner.

The Act also stipulates the form and content of the HP agreement. It defines the HP agreement as a hiring agreement with the option to purchase and the title of the goods does not pass to hirer until the last payment. The Act also spells out the method of calculating HP charges and rebates if there is an early settlement by the hirer. It also limits the maximum interest rate chargeable and highlights the rights and obligations of the hirers and owners with respect to repossession of the goods financed under the Act.

In accordance with the HP Act, it is vital that section 4 (1) be complied with. Section 4 (1) states that before any HP agreement is entered into, the owner or any person acting on his behalf, shall serve on the hirer a written statement duly completed and signed by him in accordance with the form set out in Part I of the Second Schedule. The written statement must be served personally on the intending hirer or his agent who will acknowledge receipt of it. The financial institution must be familiar with Schedules 1 to 7

of the Act (with the exception of Schedule 3 which has been deleted) for financing all consumer goods and motor vehicles. The Schedules are summarised below:

- Schedule 1 Highlights the list of goods available for financing under the HP Act.
- Schedule 2 Summarises the borrower's financial obligations under the HP agreement, such as payment of instalments. The duty remains even after the goods has been destroyed.
- Schedule 3 (Deleted)
- Schedule 4 This is the notice of the owner's intention to repossess the good under section 16 of the HP Act. The owner shall not exercise any power to repossess the goods unless:
- i) there have been two successive defaults of payments;
 - ii) the owner has served a written notice on the hirer in the form set out in the Fourth Schedule;
 - iii) the period fixed by the notice has expired;
 - iii) the intention to take possession of the goods is not less than 21 days after the service of the Fourth Schedule.
- Schedule 5 This is the notice to the hirer and guarantor(s) under section 16 stating that the goods hired have been repossessed and that the hirer is entitled to get them back. If there is no response from the hirer within 21 days from the service of the Fifth Schedule, the owner may dispose of the goods.
- Schedule 6 On the calculation of term charges as per the formula under the HP Act.
- Schedule 7 On the calculation of the annual percentage rate using a formula.

STUDENT PRACTICE 6

1. Specify the purposes of Schedules 1 to 5 of the Hire-Purchase Act 1967. (para 9)

10. BILLS OF EXCHANGE ACT 1949

A bill of exchange is defined under the Bills of Exchange Act 1949 as “an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of, a specified person, or to the bearer”. An example is a cheque which is an unconditional order in writing addressed by the drawer to another who has to be a banker, requiring the bank to pay on demand, i.e. on presentation, a sum certain in money to or to the order of a specified person or to the bearer.

Example: Susan Lim draws an MBB cheque dated 30 June 2004 for RM1,500 to KJ Electrical Shop to buy a television set. Susan is the drawer, MBB is the drawee and KJ Electric shop is the payee. The transaction satisfies the following conditions:

- a. Unconditional order in writing;
- b. Addressed by one person to another (Susan to KJ Electrical Shop);
- c. Signed by the person giving it (Susan);
- d. Requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time (30 June 2004); and
- e. A sum certain in money (RM1,500).

10.1 Negotiability of Instruments

Cheques and bills of exchange are negotiable instruments. There are three conditions that must be met for an instrument to be negotiable:

- a. Transfer of bill by mere delivery or by indorsement. The instrument can be transferred by giving it to another person or by signing on the back of the instrument. The holder of the instrument does not have to give notice to the person who issues the instrument or the person who transferred the instrument earlier to him.
- b. The holder of the instrument can acquire absolute legal title by taking the instrument:
 - i) in good faith,
 - ii) for value, and
 - iii) without notice of defect in title.
- c. The transferee gains full title and can sue in his own name, i.e. the transferee gains full rights to the bills and can take legal action in his own name.

The parties to a bill can be the drawer, drawee, acceptor, indorser, indorsee, transferor, holder, holder for value and holder in due course. The holder is the payee or indorsee or the bearer who is in possession of the bill of exchange. Where value has been given for a bill then the holder is regarded as a holder for value. Value can be a simple contract or a past debt.

Example: Peter draws a bill in favour of Ben, who then indorses it in favour of Alice. Alice then exchanges the bill with Henry for RM100. Henry becomes a holder for value and can enforce the bill against Peter, Ben and Alice.

Besides holder and holder for value, there is also a holder in due course.

10.1.1 Holder in Due Course

A holder in due course is a person who has taken a bill complete and regular on the face of it under the following conditions:

- a. He became the holder before it was overdue and without notice of any previous dishonour; or
- b. He took the bill in good faith and for value, without any notice of any defect in the title of the person who negotiated it.

10.2 Cheques crossings

The crossing of cheques is done to prevent unauthorised persons from encashing a cheque. A crossing is basically an instruction to the paying banker that the cheque will be paid for the credit of an account within the bank or with any other bank.

With the introduction of the Cheque Truncation and Conversion System (CTCS) in June 2007, all cheques are preprinted with the crossing, "A/C Payee Only". This is to ensure payment will be made into the account of the named payee. This is further strengthened by the practice of not allowing cash withdrawals by third parties, unless duly authorised by the cheque signatory.

STUDENT PRACTICE 7

1. What are the three conditions whereby a holder of an instrument has absolute legal title? (para 10.1)
2. What is a holder in due course? (para 10.1.1)

11. COMPANIES ACT 1965

The Companies Act 1965 is of particular importance in lending activities, as reflected under Part IV of the Act covering shares, debentures and charges. Part V, especially Division 2 covering directors and officers, is also important. Due attention should be given to the following sections:

Section 108 Deals with the registration of charges. Lending institutions must ensure that when a company creates a charge, it is required to be registered with the Registrar within 30 days after the creation of the charge. Auditors should confirm the required registration by sighting Form 40.

Section 133 Deals with prohibition of loans to directors of companies, while **section 133A** prohibits the granting of loans to any persons connected with a director of the company or its holding company; or to enter into any guarantee or provide any security in connection with a loan made to such a person by any other person. However, a loan can be given to a director who is engaged in the full-time employment of the company or its holding company in order for him to purchase a house. This is subject to the company being given the approval at a general meeting for a scheme to

give loans to its employees, and that the loans given are in accordance with that scheme.

Section 176 Concerns the power to compromise with creditors and members. Companies usually resort to this section to frustrate any attempts for winding-up by creditors. This is only a temporary measure as once the sanctioned timeframe has lapsed, the lending party can proceed with its actions to wind up the borrowing company.

Section 294 Deals with the effect of a floating charge. A floating charge of the company created within 6 months of the commencement of winding-up shall be invalid; unless it is proven that, the company was solvent immediately after creating the charge.

12. UNCLAIMED MONEYS ACT 1965 (AMENDED 2002)

Section 8 of the Unclaimed Moneys Act 1965 defines “unclaimed moneys” is as follows:

- a. All principal and interest and all dividends, bonuses, and profits and all salaries, wages and commissions and all fixed and other deposits and all sums of money whatsoever which are legally payable to the owner and have remained unpaid not less than 12 months after they have become payable. Examples are stale banker’s cheques or local remittances that have not been presented for payment for more than 1 year or matured fixed deposits (not under automatic renewals) exceeding 1 year.
- b. Any moneys, including any interest whenever paid thereon, to the credit of an account that not been operated by the owner either by deposit or withdrawal for a period of not less than 7 years. For example, current and savings accounts which are dormant for more than 7 years
- c. Any moneys to the credit of a trade account that has not been operated by any transaction for a period of not less than 2 years. For example, moneys due to a trade creditor, e.g. a supplier of office stationery, which are reflected in the sundry creditor’s account.

It is normal for branches of financial institutions to identify all unclaimed moneys as defined above at end-December of each calendar year. The declared “unclaimed moneys” are separately reported to the head office, which will then consolidate and remit all declared unclaimed moneys to the Registrar of Unclaimed Moneys before 31 March of the following calendar year.

Each financial institution has its own procedure to handle claims by owners of unclaimed moneys under the following scenarios:

- a. Before remitting the “unclaimed moneys” to the Registrar of Unclaimed Moneys (i.e. after 31 December but before 31 March the following year); and
- b. After remitting the “unclaimed moneys” to the Registrar of Unclaimed Moneys (i.e. after 31 March of the following calendar year).

13. **BANKRUPTCY ACT 1967**

Under the Bankruptcy Act 1967, a creditor shall not be entitled to present a bankruptcy petition against a debtor unless:

- a. the debt owing by the debtor to the petitioning creditor, or if two or more creditors join in the petition the aggregate amount of debts owing to the several petitioning creditors, amounts to RM30,000; and
- b. the debt is a liquidated sum payable either immediately or at some certain future time; and
- c. the act of bankruptcy on which the petition is grounded has occurred within 6 months before the presentation of the petition; and
- d. the debtor is domiciled in Malaysia or within 1 year before the date of the presentation of the petition, has ordinarily resided and had a dwelling house or place of business in Malaysia, or has carried on business in Malaysia personally or by means of an agent.

Section 3 (1) of the Act further spells out various conditions where a debtor commits an act of bankruptcy. When a person is adjudged a bankrupt, all the moneys owned to him by financial institutions should be frozen. After informing the affected customer, the customer's assets including accounts with credit balances will have to be closed and such balances transferred to the Official Assignee in accordance with section 55 (5). The transfer of the credit balances to the Official Assignee is effected by way of a banker's cheque.

14. **CYBERLAWS**

Cyberlaws are growing in importance in Malaysia. The country has passed six cyberlaws, namely:

- a. Digital Signature Act,
- b. Computer Crimes Act,
- c. Telemedicine Act,
- d. Communications and Multimedia Act 1998,
- e. Optical Disk Act 2000, and
- f. Copyright (Amendment) Act 2000.

The Digital Signature Act 1997 is relevant in the audit of e-commerce, especially business to business such as Electronic Data Interchange (EDI) where the security requirements of key public infrastructure should be adhered to.

The Computer Crimes Act 1997 should also preferably be communicated to all staff so as to elicit their awareness and commitment in securing the organisation's system against abuse and sabotage. Under section 3 (1) of the Act, a person shall be guilty of an offence if:

- a. he causes a computer to perform any function with intent to secure access to any program, or data held in any computer;
- b. the access he intends to secure is unauthorised; and
- c. he knows that that is the case at the time when he causes the computer to perform the function.

A person who is found guilty of an offence under this section shall be liable to a fine not exceeding RM50,000 or to imprisonment for a term not exceeding 5 years, or both. A person shall be guilty of an offence under section 4 if he commits an offence involving fraud or dishonesty or which causes injury whether by himself or by any other person. On conviction, he is liable to a fine not exceeding RM150,000 or to imprisonment for a term not exceeding 10 years, or both.

Several new cyberlaws will soon be introduced, namely:

- a. The Electronic Government Activities Act seeks to establish common protocols for electronic interaction between the government and the public;
- b. The Electronic Transactions Act is primarily targeted at boosting e-commerce by providing legal recognition of electronic transactions including e-commerce transactions; and
- c. The Personal Data Protection Act will regulate the collection, possession, processing and use of security, piracy and handling of personal information.

STUDENT PRACTICE 8

1. What constitutes unclaimed moneys? (para 12)
2. Under what conditions may a creditor present a bankruptcy petition against a debtor? (para 13)

15. BASEL CAPITAL ACCORD II

The Basel Committee on Banking Supervision is a committee established by the Bank of International Settlements consisting of representatives from the national banking regulators of the G-10 countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Its permanent Secretariat is located at the Bank for International Settlements in Basel.

a. Main Highlights of Basel II

The Basel Capital Accord defines a standard methodology for calculating the capital to assets ratio. Basel II is the second of the [Basel Accords](#) and is more than just a definition of capital to assets ratio. The purpose of Basel II, which was initially published in June 2004, is to create an international standard that banking regulators can use when creating regulations about how much capital banks need to put aside to guard against the types of financial and operational risks they face. Basel II attempts to accomplish this by setting up rigorous risk and capital management requirements designed to ensure that a bank holds capital reserves appropriate to the risk it exposes itself to through its lending and investment practices. Essentially, this translates to mean the amount of capital the bank needs to hold to safeguard its solvency and overall economic stability has to be in tandem with its exposure risk.

Basel II incorporates two additional components to the earlier Basel Accord, thus creating three mutually reinforcing pillars, often referred to as the “three pillars” concept:

- i) A revised methodology for calculating the capital to asset ratio:
- ii) Supervisory review standards for assuring capital adequacy; and
- iii) Market discipline through public disclosure.

The current Basel Capital Accord applies uniformly to all banks. Basel II provides three different approaches that can be used for risk weighting of assets.

- i) Revised methodology

The first pillar or concept deals with maintenance of regulatory capital. However, unlike the earlier Basel Capital Accord, it takes cognizance of three major components of risk that a bank faces: [credit risk](#), [operational risk](#) and [market risk](#). Other risks are not considered fully quantifiable at this stage. There are three approaches for calculation. Underlying the complexity of calculation and regulatory framework is the need for a robust data and information system.

- ii) Supervisory review

The second pillar or concept deals with the regulatory response to the first concept; basically residual risks from the first concept or pillar are addressed here. Increased capital should not be viewed as the only option to contend with the increased risks a bank faces. An effective risk management system, internal limits controls, ongoing reviews, etc are essential towards mitigating risks confronting a bank.

- iii) Public disclosure

The third concept or pillar greatly complements the minimum capital requirement (first pillar) and supervisory review (second pillar). This concept or pillar increases the [disclosures](#) the bank must make. This is designed to allow the [market](#) to have a better picture of the bank’s overall risk position and to allow its [counterparties](#) to price and deal appropriately.

b. Approaches used in Basel II

Basel II recommends three approaches that can be used for calculation of minimum capital:

i) Standardised approach

The standardised approach is similar to the current Accord, in that it requires fixed risk weightings to be applied to different types of assets.

ii) IRB Foundation approach

This requires the bank to utilise formulas developed by the Committee to calculate risk weightings in addition to its own assessments.

iii) IRB Advanced approach

This allows a bank more freedom to use its own systems to set risk weightings. The three key components to measure risk weighted assets are: Probability of Default (PD), Loss Given Default (LGD), and Exposure at Default (EAD). The bank runs its own PD, LGD and EAD estimates using a mathematical formula provided by the Basel Committee.

STUDENT PRACTICE 9

1. What are the three pillars in Basel II? (para 15a)
2. What is the difference between the Standardised Approach and the IRB Foundation Approach? (para 15b)

16. CONCLUSION

With the enactment of the BAFIA, BNM's supervisory powers for the regulation and control of financial institutions have been greatly enhanced. Many new banking regulations and guidelines have also been introduced to further tighten the financial system. Apart from banking legislation, there have been many changes to the exchange control regulations, especially with the further liberalisation in April 2007, which enhances business and economic conditions for better competitiveness. The introduction of Basel II will see a more complex approach towards the calculation of minimum capital and a better risk regulatory framework. BNM is expected to continue to issue other directives and circulars from time to time in line with the global best banking practices. Though some of these guidelines and directives may not have the force of law, they are sufficiently important in the regulation of financial institutions. Any breach or non-compliance with these guidelines or directives will be severely dealt with by BNM under section 116 of the BAFIA. Besides the legislation and guidelines discussed in this chapter, internal auditors must also be aware of the rules issued by The Association of Banks in Malaysia, professional bodies (such as the Institute of Internal Auditors) and other regulatory bodies in Malaysia.