

# Regulatory and Supervisory Framework

In 2018, the Bank's regulatory and supervisory activities continued to focus on ensuring that the financial system remains resilient against emerging risks amid a more challenging environment. Further progress was made in the implementation of the Basel III reforms package. This continued to be supported by a sustained focus on strengthening risk management practices in the banking and insurance sectors, particularly in response to risks associated with the rapid pace of technological change and increasing reliance on third party arrangements. A stronger focus on culture has also been an increasingly important part of the Bank's regulatory and supervisory approach in efforts to drive behaviour that is consistent with the responsible management of financial institutions and society's expectations.

Malaysia's efforts to preserve the integrity of the financial system and combat money laundering (ML) and terrorism financing (TF) risks have resulted in the Financial Action Task Force (FATF) Plenary upgrading Malaysia's technical compliance ratings of its Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) framework. This places Malaysia among jurisdictions that are highly rated for their technical compliance with FATF Recommendations. The National Coordination Committee to Counter Money Laundering (NCC) has also endorsed the results of the National Risk Assessment (NRA), which will provide important inputs for the NCC to review the National AML/CFT Strategic Plan in 2019 to further enhance the identification of, and safeguards against, ML/TF threats and vulnerabilities at the national level.

## REGULATORY DEVELOPMENTS

### Implementation of Basel III standards and other global reforms

Domestic implementation of the Basel III reforms continued to be a focus of the Bank's regulatory activities in 2018 to ensure that Malaysia's banking system remains strong and resilient. Since the implementation of the Liquidity Coverage Ratio (LCR) in 2015, banking institutions had transitioned smoothly to fully comply with the phased-in minimum requirements in accordance with global timelines. The LCR promotes short-term resilience to liquidity shocks by requiring banking institutions to hold adequate liquidity buffers to withstand a 30-day liquidity stress scenario. As at January 2019, all banking institutions reported LCR levels of above the 100% minimum ratio (refer to 'Liquidity and Funding Risk' in the Chapter on 'Risk Developments and Assessment of Financial Stability in 2018').

### ***Extension of the Net Stable Funding Ratio (NSFR) observation period***

In October 2018, the Bank announced the extension of the NSFR observation period to 31 December 2019. The NSFR complements the LCR by promoting long-term resilience of banking institutions' liquidity risk profiles. The requirements incentivise banking institutions to fund their activities with sufficient stable funding on an ongoing basis. As at end-2018, the average NSFR for the banking industry stood at 109.3%, with 83% of banking institutions reporting NSFR levels of at least 100% (2017: 107.6%; 76% of banking institutions). While most banking institutions are expected to be well-positioned to meet the NSFR minimum requirement of 100%, the Bank is conducting

further work on the liquidity risk management practices of banking institutions as additional input to the finalisation of the NSFR requirements. Although progress in the implementation of NSFR globally remains uneven, the Bank remains committed to its implementation in Malaysia and aims to finalise the NSFR requirements in the first half of 2019.

#### **Enhancements to Pillar 3 disclosures**

As part of efforts to strengthen market discipline through the provision of meaningful and comparable information on the risk profiles of banking institutions, the Bank published an exposure draft on revised requirements for financial institutions to disclose key information relating to regulatory capital and risk exposures (“Pillar 3” requirements) in June 2018.

### The Pillar 3 exposure draft aims to provide clear, comprehensive and consistent disclosures of key information relating to a financial institution’s regulatory capital and risk exposures

Building on the existing Pillar 3 disclosure requirements issued in 2010, the key proposals are broadly aligned with the requirements set by the Basel Committee on Banking Supervision (BCBS) and aim to provide clear, comprehensive and consistent disclosures to users. Common templates were introduced to improve consistency of disclosures and ease comparability of banking institutions’ risk profiles within and across jurisdictions. The proposed revisions also complement financial reporting by providing more granular data on regulatory metrics, supported by additional qualitative information. This seeks to enable more meaningful assessments by market participants. The Bank also took the opportunity to consolidate all existing regulatory disclosures, including those on capital, credit risk-weighted assets, Leverage Ratio, LCR and remuneration practices, into a single document for easier reference.

Industry feedback received during the consultation period was largely focused on the operational cost of compliance. In this regard, the Bank is considering options to preserve the intended objectives of the proposed revisions, while minimising undue operational burdens on banking institutions. The Bank expects to finalise the requirements earliest in 2020.

#### **Framework on domestic systemically important banking institutions (D-SIBs)**

In light of the increasing size, complexity and regional footprint of some domestic banking groups, their failure is more likely to cause market-wide disruptions that could threaten financial stability. It is therefore crucial to hold these banking groups to higher prudential standards to ensure their continued resilience and reduce the moral hazard associated with expectations of publicly-funded bail-outs.

### The D-SIBs framework will establish enhanced regulatory requirements and policy measures for D-SIBs to reduce the probability and impact of their distress or disorderly failure on the financial sector and the economy

In the first half of 2019, the Bank will issue an exposure draft that sets out the assessment methodology to identify D-SIBs and the corresponding applicable regulatory requirements. The D-SIBs framework is developed in line with the principles outlined by the BCBS framework on global systemically important banks (G-SIBs). The framework will establish enhanced regulatory requirements and policy measures for D-SIBs to reduce the probability and impact of their distress or disorderly failure on the financial sector and the economy. This will include requiring additional capital buffers in the form of Common Equity Tier 1 (CET1) to be maintained by D-SIBs. The exposure draft will also impose supplementary reporting requirements to facilitate the Bank’s identification and assessment of D-SIBs.

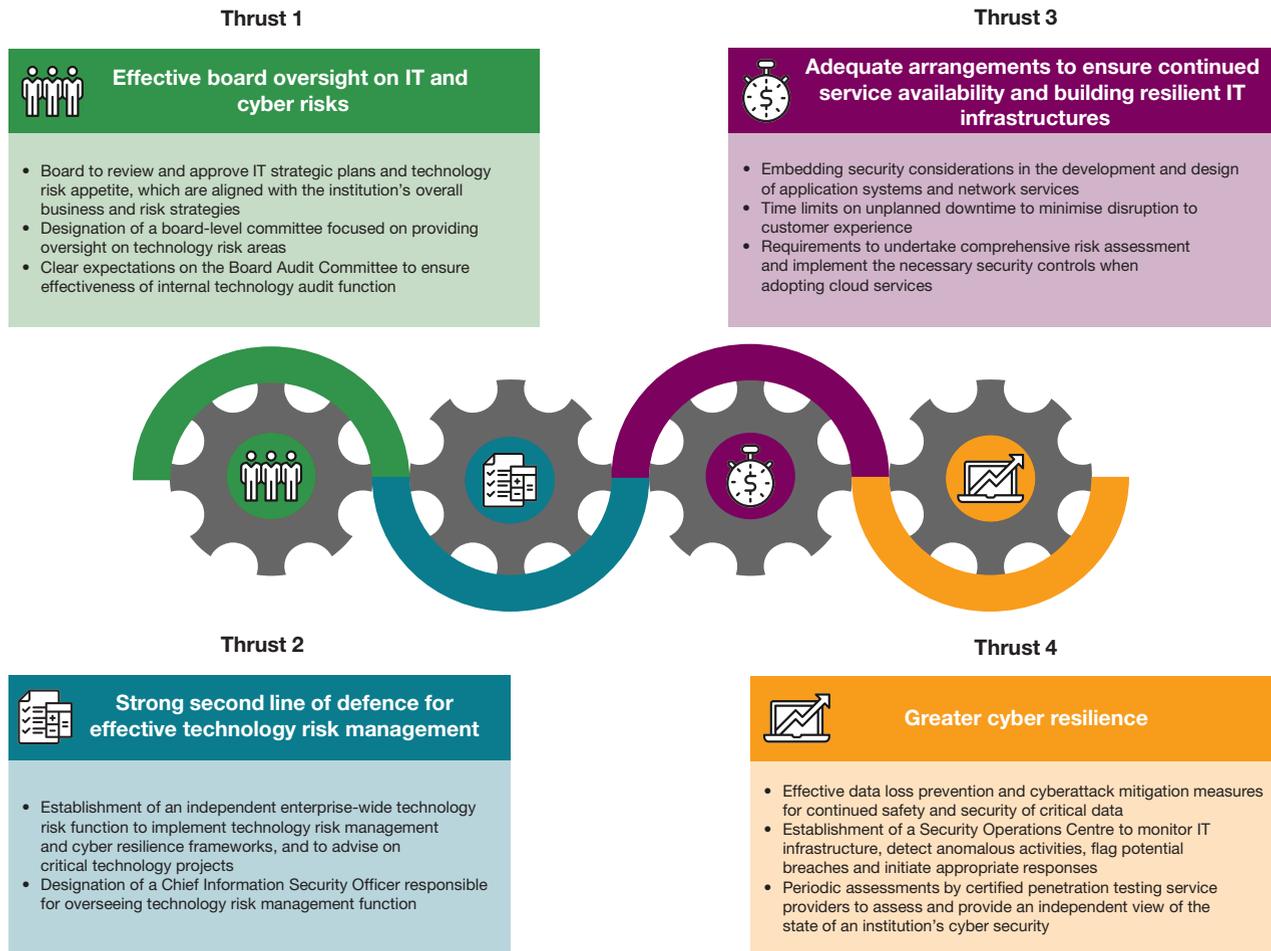
### Strengthening conduct, culture and risk management in the financial industry

#### **Enhancements to requirements on risk management in technology**

The digitalisation of financial institutions’ business operations has spurred the offering of more diverse, efficient and innovative financial services. However, this poses new dimensions of risk that must be managed appropriately, in particular from increased exposures to cyber threats and compromised access to confidential data. In September 2018, the Bank issued the exposure draft on Risk Management in Technology (RMIT) to enhance and streamline existing policies on technology

Diagram 3.1

### Key Thrusts of the Risk Management in Technology Framework



Source: Bank Negara Malaysia

risk management. The proposed requirements raise regulatory and supervisory expectations (Diagram 3.1) for financial institutions to ensure: (i) effective board oversight over information technology (IT) and cyber risks; (ii) a strong second line of defence for effective technology risk management; (iii) adequate and sufficiently tested arrangements to ensure continued service availability and resilient IT infrastructure; and (iv) strengthened monitoring and independent assurance to promote greater resilience to cyberattacks. Industry feedback mainly sought further clarity on the use of cloud services and parameters applied to define critical services and systems which are subject to heightened regulatory requirements. These will be addressed in the finalisation of the RMIT policy in 2019.

#### **Finalisation of revised outsourcing standards**

Following extensive engagements with the industry and further progress made towards the implementation

of recovery plans for financial institutions, the Bank issued the revised standards on the management of outsourcing risks in December 2018. The finalisation of the standards has sought to balance the benefits that outsourcing can bring to financial institutions in terms of increasing efficiency and visibility to risks across the financial group, with the potential costs of over-reliance on third parties, reduced supervisory oversight and added complexity to business operations and their recovery. Over the longer term, the hollowing out of internal capacity within financial institutions to manage key risks was also an important consideration that informed the final standards. In achieving this balance, the final standards require financial institutions to clearly identify material outsourcing arrangements and maintain adequate safeguards over outsourcing arrangements that must include senior management accountability for outsourced activities, audit access

to service providers and business continuity plans that are commensurate with the nature and risk of the outsourcing arrangements. Financial institutions must also maintain complete information on all outsourcing arrangements for the purpose of ongoing supervisory and risk assessments. The standards have been in effect since 1 January 2019, with a six-month transition period for institutions to complete an internal register of all outsourcing arrangements, perform a gap analysis of existing arrangements against the enhanced requirements and develop an action plan to address identified gaps. All existing outsourcing arrangements entered into by financial institutions are expected to fully comply with the standards by 1 July 2022.

### **Enhanced accountability through responsibility mapping**

In April 2018, the Bank concluded preliminary consultations with the industry on the Responsibility Mapping discussion paper. The paper provides an overview of the Bank's proposed approach to strengthen the accountability framework of senior managers in financial institutions. This complements existing expectations for senior management of financial institutions to promote prudent and ethical conduct by clarifying accountabilities at an individual level, and ensuring that a material failure by senior managers to discharge their responsibilities is met with appropriate consequences. Preliminary ideas were shared on areas covering interactions between entity-level and group-wide senior roles, basic duties of senior managers, 'double hatting' and joint responsibility roles, and collective decision-making. Further engagements with the industry will be carried out over the course of 2019 to better understand how the proposed approach to responsibility mapping can be implemented in a way that meaningfully strengthens accountability frameworks and drives culture improvements.

### **Proportionate regulatory approach for development financial institutions (DFIs)**

As Malaysia's economic landscape and structure continue to evolve, the Bank will be reviewing the mandates of DFIs to ensure that their developmental objectives are aligned with the nation's economic strategies. In line with this initiative, the Bank is undertaking a holistic review of the existing regulatory framework for DFIs to better align the role of DFIs in supporting the wider objectives, including growth and financial inclusion. This review builds on the Bank's existing approach in implementing differentiated prudential requirements between DFIs and banking institutions, as well as progress being made to

significantly strengthen performance measurement and accountability frameworks for DFIs (refer to 'Banking' in the Chapter on 'Development of the Financial Sector'). The latter is also particularly important to minimise market distortions and ensure that the prudential framework remains appropriate to the specific risk profiles of individual DFIs. The Bank's regulatory and supervisory approach aims to provide greater differentiation at the individual institution level reflecting the nature, size, complexity and specific roles and mandates of each DFI. This is expected to enable DFIs to increase their developmental impact and to achieve this in a sustainable manner. Over the coming year, the Bank plans to consult on proposed revisions to 10 core prudential standards applicable to DFIs as part of the review.

### **Policy enhancements to investment-linked (IL) business for insurers and takaful operators**

As part of the phased implementation of the Life Insurance and Family Takaful Framework (LIFE Framework) to support the long-term development of the insurance and takaful industry, the Bank conducted a review of standards applicable to the conduct of IL business during the year, with the revised standards issued in January 2019. The standards strengthen requirements to ensure that the rapid growth of IL business in recent years is not achieved at the expense of the responsibility of insurers and takaful operators to ensure the fair treatment and appropriate protection of policy owners and takaful participants.

Key requirements in the revised IL business standards include:

- (i) the introduction of the Minimum Allocation Rate (MAR) to protect customer account values in tandem with the removal of commission limits which will take effect in July 2019 (for life insurers) and July 2020 (for family takaful operators), respectively. The MAR will also result in commissions being spread over a longer term, which incentivises better sales and servicing practices as well as persistency management for long-term IL policies/takaful certificates;
- (ii) strengthened expectations for insurers and takaful operators to conduct more robust sustainability tests to ensure an IL policy/takaful certificate can sustain its coverage until the end of its contractual term; and
- (iii) improved disclosures in IL product illustrations to help customers better understand the key risks and benefits of IL policies/takaful certificates, thereby facilitating more informed decisions.

### Regulatory framework for Islamic finance

The growing complexity in the Islamic financial business observed in recent years stemmed from the increasing demand for Islamic financial solutions to be more differentiated and targeted. This has resulted in the development of more sophisticated and complex bespoke Islamic financial solutions to navigate the changing environment of Islamic finance. To ensure that the regulatory framework for Islamic finance remains responsive to the changing environment, increased focus was directed by the Bank to:

- (i) promote effective integration of Shariah governance and risk management within the operations and processes of Islamic financial institutions (IFIs);
- (ii) strengthen compliance with Shariah standards in the operationalisation of Shariah contracts; and
- (iii) encourage innovation, particularly in the takaful industry, by clarifying the application of a wider range of Shariah contracts for takaful product offerings.

The Bank expects to finalise the Shariah Governance Framework in the second half of 2019, incorporating changes in response to feedback received to the exposure draft issued in 2017. The framework aims to progress IFIs from a largely compliance-based and process-driven

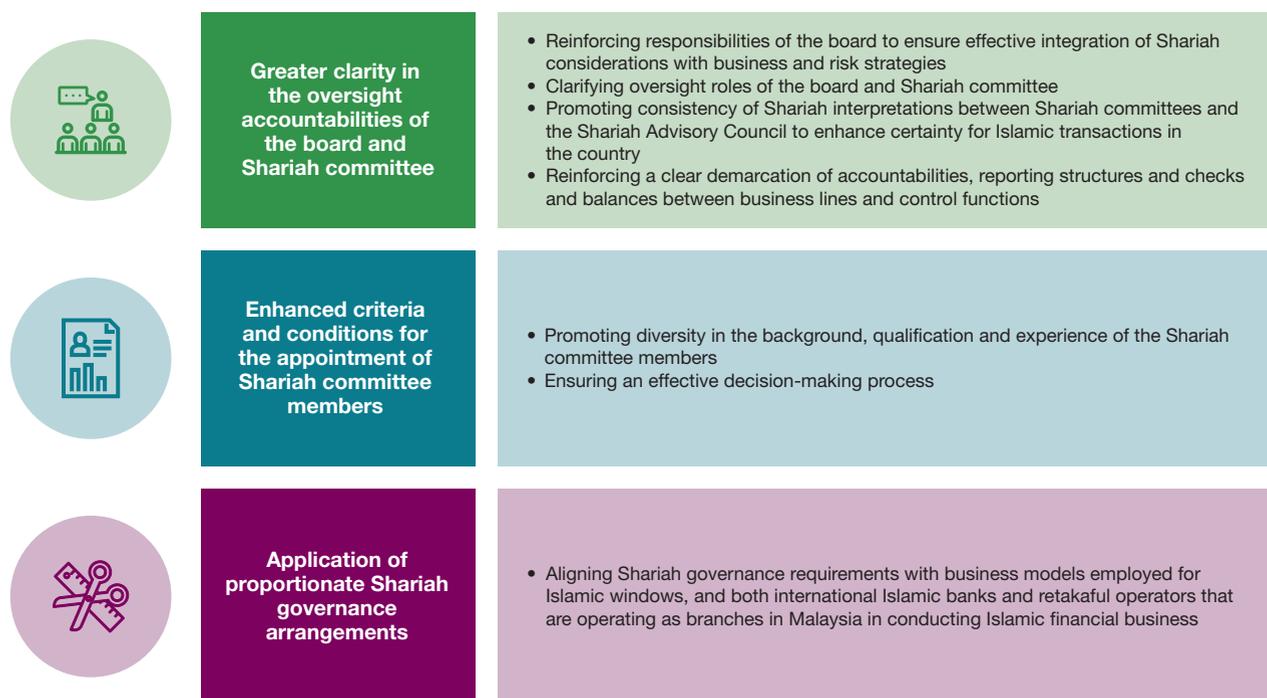
focus to a more closely integrated approach to Shariah governance that is well-embedded in the business and risk strategies of IFIs (see Diagram 3.2).

The Bank also made further progress during the year in the development of Shariah parameters and operational requirements governing the application of Shariah contracts in Islamic financial transactions. The compendium of Shariah standards was expanded to include *bai` al-sarf* (exchange of money) and *rahn* (pledge) (Table 3.1), bringing the total number of standards issued to date to 14.

The Bank additionally sought to provide greater clarity in the application of Shariah contracts to deal with the specificities of takaful business in the proposed revisions to the Takaful Operational Framework which was published for public consultation in May 2018 (Diagram 3.3). The proposed revisions accord recognition to a wider range of Shariah instruments within takaful business in line with advancements in the development of Shariah standards. The revisions are expected to encourage greater product innovation and differentiation in product offerings while strengthening takaful fund management practices, in turn increasing the diversity and growth potential of the takaful market in Malaysia. The Bank plans to issue the final standards in the first half of 2019.

Diagram 3.2

### Key Policy Considerations in Finalising the Shariah Governance Framework



Source: Bank Negara Malaysia

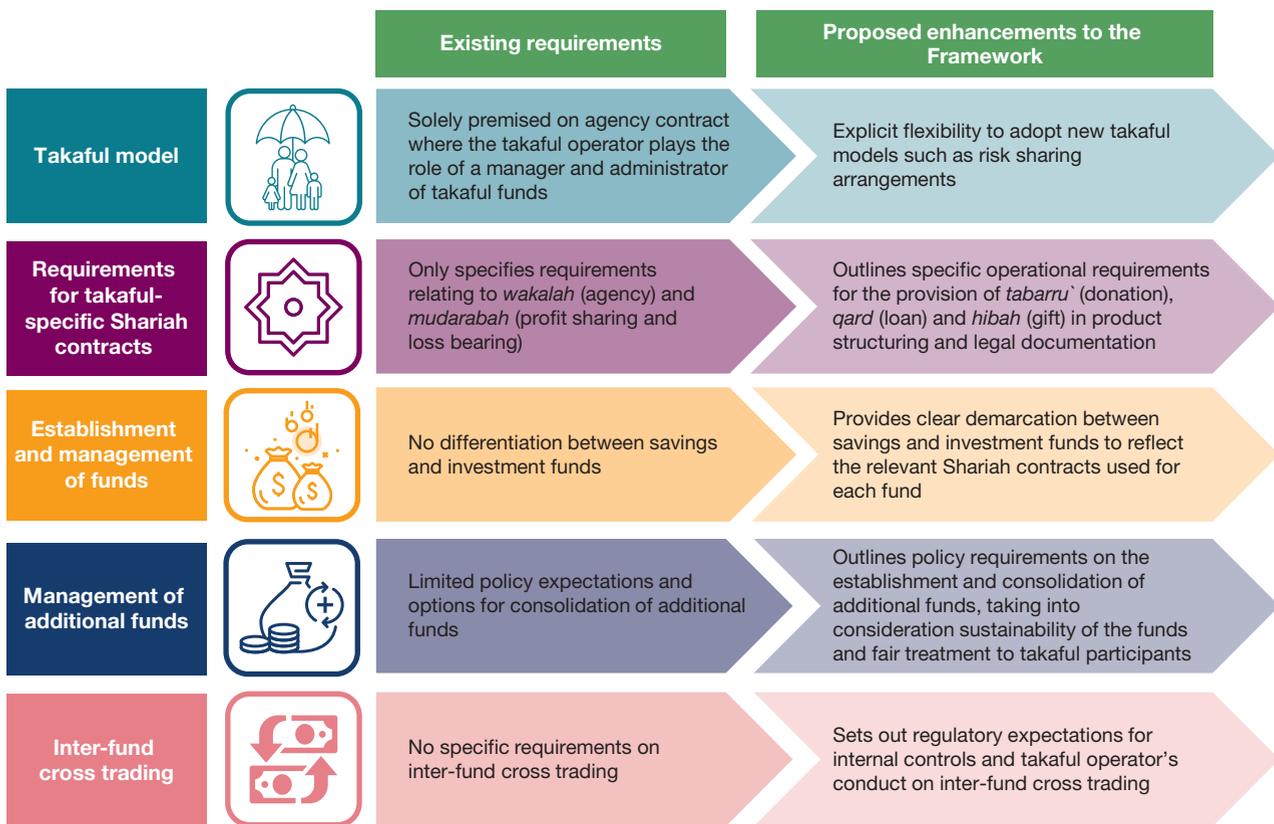
Table 3.1

Shariah Standards Issued in 2018		
Shariah contracts	<i>Rahn</i> (Pledge)	<i>Bai` al-sarf</i> (Exchange of money)
Application	Pawnbroking and secured financing	Foreign currency deposits, financing or investment, remittance and bureau de change
Description	Define accepted uses of collateral and allowable charges	Clarify the approach to spot settlement and rate of exchange for currency exchange
Intended impact	Consistent practices on the use of collateral as a risk mitigant in Islamic financing solutions (e.g. Islamic pawnbroking businesses)	Smooth operations and strong market practices for currency exchange

Source: Bank Negara Malaysia

Diagram 3.3

Proposed Enhancements to the Takaful Operational Framework



Source: Bank Negara Malaysia

## SUPERVISORY DEVELOPMENTS

### Implementation of accounting standards

#### **MFRS 9**

The Malaysian Financial Reporting Standards 9: Financial Instruments (MFRS 9), which is based on a more forward-looking approach to estimate provisions, came into full effect on 1 January 2018, in line with the global implementation timeline. To ascertain the adequacy of oversight and controls, the methodology and models used to estimate expected credit losses (ECL) and system capabilities, the Bank conducted a thematic review on banking institutions' implementation of MFRS 9. Overall, banking institutions transitioned reasonably smoothly to the new accounting standard, helped by their regulatory reserves which mitigated the impact of additional provisions. Banking institutions also generally demonstrated robust implementation approaches, although improvements in certain aspects of implementation were required for some banking institutions. Key observations made during the thematic review are summarised in Diagram 3.4.

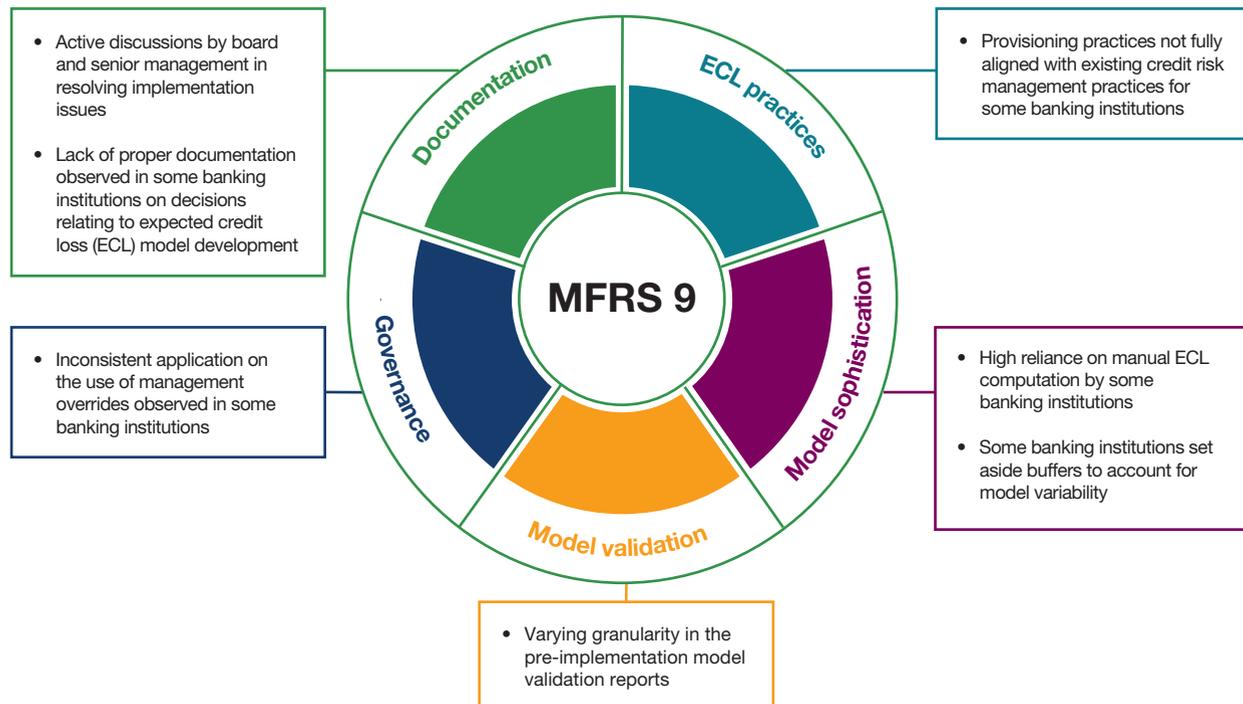
The thematic review also confirmed the expected variability in provisioning practices across banking institutions, which are mainly driven by differences in the underlying data used, modelling approaches available to estimate ECL and the application of expert judgement. In response to this observation, the Bank conducted a hypothetical portfolio evaluation (HPE) exercise in October 2018 to ascertain the degree of variability in provisioning levels. Under this exercise, nine banking institutions were provided with a hypothetical portfolio of mortgage and corporate exposures and were required to estimate ECL provisions based on internal models and methodologies. The Bank is currently engaging with individual banking institutions and external auditors to finalise the assessment of the HPE exercise. Findings from both the thematic review and the HPE exercise will be used to determine whether a regulatory response is needed to ensure that the MFRS 9 is implemented in line with its intended outcomes.

#### **MFRS 17**

The MFRS 17: Insurance Contracts will markedly change insurers' and takaful operators' (ITOs) recognition, measurement and presentation of insurance and takaful contracts in their financial

Diagram 3.4

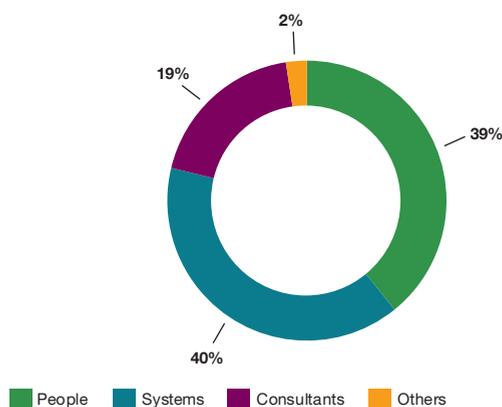
### Key Observations in the Malaysian Financial Reporting Standards 9 (MFRS 9) Thematic Review



Source: Bank Negara Malaysia

Chart 3.1: Estimated MFRS 17 Budget Allocation

**Systems and people constitute the largest proportion of estimated implementation costs**



Source: Bank Negara Malaysia

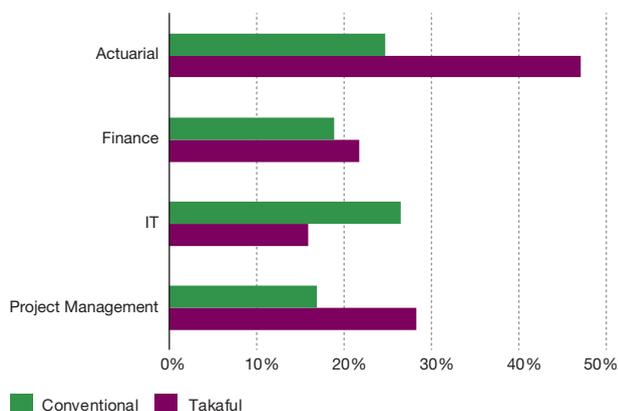
statements. In 2018, the Bank undertook various industry-wide surveys to gauge the level of preparation by ITOs to implement the standard and better understand the operational and technical issues faced in implementation.

A majority of ITOs have set up project management teams to spearhead the adoption of the standards, with key deliverables, broad project plans and monitoring mechanisms identified. However, progress across the industry remains uneven, with many ITOs still working on gap analyses. In addition, internal estimates of the implementation costs and resource requirements also show significant variance across the industry, reflecting the differences in operational capabilities and access to external support. The bulk of implementation costs is attributed to upgrading systems and people (Chart 3.1). ITOs reported the highest demand for talent in the actuarial, finance, IT and project management fields, and this is more pronounced in the takaful industry (Chart 3.2). Considerable reliance on external expertise is thus expected to address this gap.

A number of interpretation and application issues have been identified by the ITOs, mostly relating to newly introduced concepts in the standards, including contract boundaries and the measurement of reinsurance contracts. There are additional challenges for takaful operators: (i) the new standards do not directly address some of the unique features of takaful contracts, such as the sharing of surplus and its

Chart 3.2: Proportion of Vacancies for MFRS 17 Expertise

**High demand for talent, particularly actuarial expertise in the takaful industry**



Source: Bank Negara Malaysia

recognition as liabilities; and (ii) there is a need to ensure that any proposed new methodologies are consistent with Shariah principles. The Bank will consider these issues along with changes to the prudential requirements on valuation methodologies in developing supplementary regulatory requirements to support the implementation of MFRS 17 in a manner consistent with prudential objectives. The Bank plans to consult on these requirements in the second half of 2019.

### Managing conduct in the wholesale financial market

Following the issuances of the Code of Conduct for the Malaysia Wholesale Financial Markets and the Principles for a Fair and Effective Financial Market for the Malaysian Financial Market in 2017, the Bank conducted a thematic review to assess banking institutions' compliance with expectations set out in these documents. The assessment centred on 14 banking institutions with large treasury operations, specifically the market makers for foreign exchange transactions and principal dealers. The summary of the thematic review is reflected in Diagram 3.5.

### Enhancing risk management and reserving practices for insurers and takaful operators

In recent years, the Bank has observed the steadily declining sales of traditional participating life business, with the total number of in-force

## Thematic Review on Wholesale Market Conduct

### Areas reviewed



- Adequacy of risk management practices and surveillance systems in identifying, monitoring and mitigating wholesale market misconduct
- Design of incentive structures that may lead to wholesale market misconduct (e.g. remuneration, gift and entertainment practices)
- Effectiveness of internal policies, procedures and processes in identifying and mitigating actual or potential misconduct by dealers

### Key results of review



- Robust internal policies, procedures and processes are in place to promote fair and transparent wholesale market conduct
- Active discussions are held between the board and senior management on wholesale market misconduct, facilitating timely remedial actions
- Heightened scrutiny observed by the board and senior management on wholesale market conduct issues, particularly where a breach has been identified

### Areas for improvement



- Potential to employ more sophisticated trade surveillance monitoring systems, including automation of processes in detecting trade anomalies and potential misconduct
- Continuous development of skills and expertise of control functions to improve their ability to accurately identify and address weaknesses in current processes for mitigating wholesale market misconduct

Source: Bank Negara Malaysia

participating life policies shrinking by 14.6% from 2013 to 2017. In contrast, IL business experienced significant growth, with a 42.7% growth recorded in the total number of in-force policies over the same period. The decline in participating life policies was also accompanied by an increased interest in alternative products such as non-unitised and non-discretionary account-based savings products. In an informal survey conducted in 2018, half of the conventional life insurers expect a further decline in the traditional participating life business. Among the reasons cited for slower growth were: (i) a shift in insurers' business strategy from traditional insurance products to alternative products; and (ii) the low consumer understanding on how a traditional participating policy works, including the non-guaranteed nature of bonuses paid under such policies.

Given the decline in the participating life business, it is important for insurers to better anticipate and manage the risks arising from the smaller risk pools, and assess the impact on claims, expenses and investment returns arising from the shrinking business. In this regard, the Bank has required insurers to assess the financial impact of these trends on the solvency of the participating funds and take pre-emptive measures to ensure their ability to meet policyholders' reasonable expectations over the long-term. To strengthen the level of transparency in IL and other account-based products and achieve greater consistency in sales practices, the

Bank has also enhanced the disclosure practices for these products so that consumers are given relevant and adequate information to facilitate their decision-making.

In addition, observations of inconsistent practices among general ITOs in the management of claim liabilities and high risk business lines have led to the issuance of supervisory requirements for general ITOs to maintain adequate case reserves for unpaid claims in line with the statute of limitations, and strengthen risk management practices for long-term fire insurance and takaful business.

### Improving supervisory capacity and international cooperation

As regional and international linkages expand, the Bank continues to cultivate close cooperation arrangements with other central banks and supervisory authorities in order to promote effective oversight over financial institutions with cross-border operations. In November 2018, the Bank signed a Memorandum of Understanding (MoU) with the Dubai Financial Services Authority to promote effective supervision of financial institutions operating in both countries. The MoU outlines cooperation and coordination in the areas of exchange of information, facilitation of cross-border on-site supervision, issuance of licences and combating ML/TF risks.

During the year, the Bank also participated in supervisory college meetings of 10 foreign financial institutions with operations in Malaysia, and hosted one for a regionally-active domestic banking group. Bilateral meetings with five other foreign supervisory authorities were also held to facilitate effective coordination of supervisory oversight and activities involving cross-border financial groups. In addition to facilitating deliberations on key risks and supervisory concerns, these avenues of cooperation provided the Bank with a more comprehensive view of group-wide risks faced by financial institutions and actions being taken to address such risks.

The Bank also took part in two crisis management groups (CMGs) conducted by the United Kingdom Prudential Regulatory Authority for a global systematically important insurer and an Asian CMG coordinated by the Hong Kong Monetary Authority for a G-SIB. These CMGs aim to improve the readiness of home and key host authorities in effectively managing the recovery and resolution process of an institution by uncovering potential barriers to the implementation of a financial institution's recovery and resolution plans, and understanding their effects on the markets in which the institution operates.

## STRENGTHENING AND SAFEGUARDING FINANCIAL SYSTEM INTEGRITY

### Results of the 2017 NRA

Malaysia remains committed to protecting the integrity of the financial system from money laundering and terrorism financing abuse. In this regard, the Bank, as the Competent Authority under the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA), and the chair of the NCC, plays a pivotal role in coordinating nationwide efforts to strengthen the AML/CFT regime in Malaysia. In July 2018, the NCC endorsed the results of the NRA that was conducted in 2017. The NRA is a periodic assessment to identify, assess and understand ML/TF risks in the country. Utilising datasets spanning three years from 2014 to 2016, the NRA assessed the following areas: (i) serious crimes that pose ML threats; (ii) terrorism and TF risks, including a specific assessment on the vulnerabilities of non-profit organisations (NPOs) to TF risk; and (iii) vulnerabilities of financial and non-financial sectors to ML/TF risks.

Key findings on serious crimes are summarised in Table 3.2. Recognising that these risks are continually evolving, the NCC has committed to conduct the NRA every three years, to facilitate better understanding of the prevailing ML/TF risk landscape and strengthen the responsiveness of risk controls to changes in the risk environment.

Table 3.2

#### Terrorism and Terrorism Financing (TF) Risk and Money Laundering Threat of Serious Crimes

Type of serious crime	Threat level	Type of serious crime	Threat level
Corruption	High	Counterfeiting of currency	Medium
Fraud		Environmental crimes	
Illicit drug trafficking		Illegal remittance	
Organised crimes		Insider trading and market manipulation	
Smuggling		Kidnapping	
Counterfeiting and piracy of products	Medium High	Murder	Low
Forgery		Extortion	
Robbery and theft		Illicit arms trafficking	
Human trafficking/migrant smuggling		Illicit trafficking of stolen goods	
Sexual exploitation		Sea robbery	
Tax evasion			
Terrorism and TF			

Source: Bank Negara Malaysia

Guided by the outcomes of the NRA, the National AML/CFT Strategic Plan will be reviewed in 2019 to incorporate strategies to address the identified gaps and mitigate vulnerabilities. These include strategies to enhance the existing legal and regulatory frameworks to combat financial crimes, reallocate resources towards areas that pose higher risks and sectors facing high vulnerabilities, and intensify outreach efforts to enhance the level of awareness on ML/TF risks.

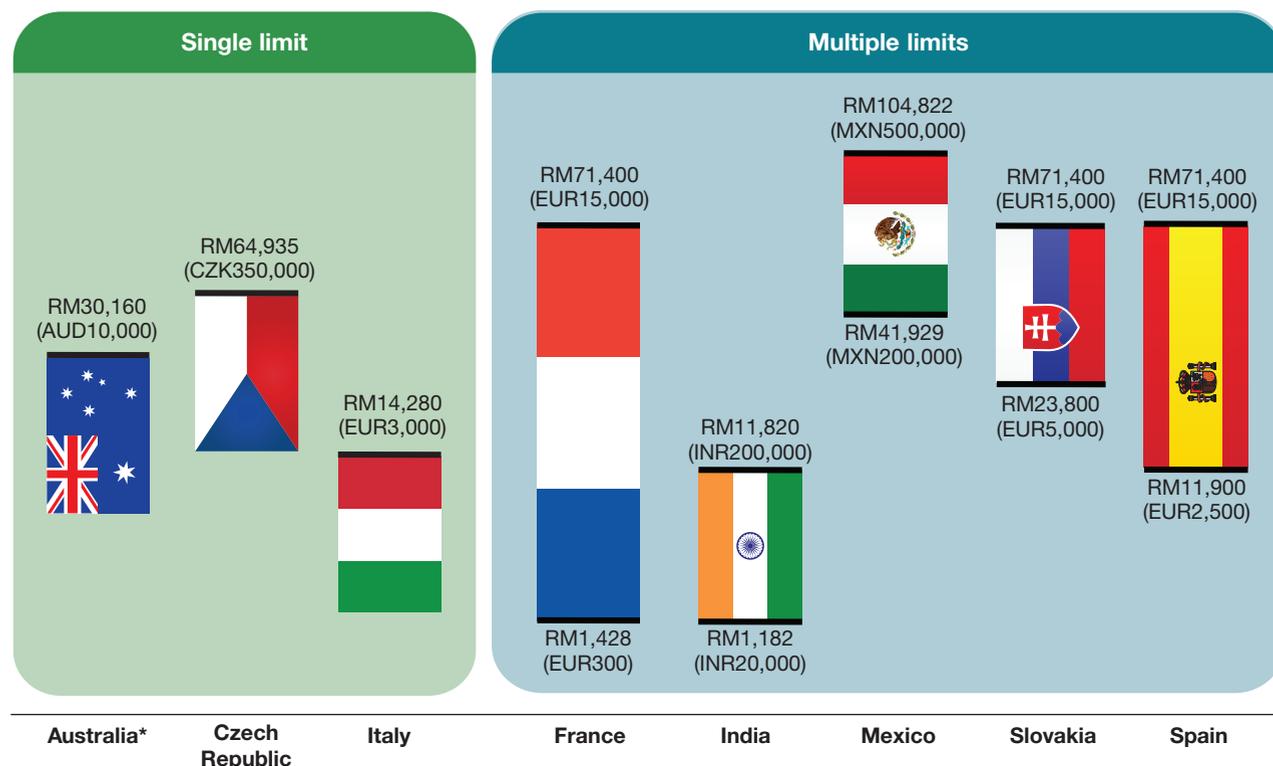
### Strengthening the ML/TF framework

As evidenced by the 2017 NRA's findings, cash is extensively used by criminals to store, move and disburse illegal proceeds. Given that the use of cash as a medium of payment remains prevalent in Malaysia, measures continue to be taken to mitigate the risk of abuse of cash for criminal activities. Effective 1 January 2019, the Bank reduced the cash transaction reporting threshold from RM50,000 to RM25,000. The cash threshold reports (CTRs), a submission requirement imposed on banking institutions

and other reporting institutions from various sectors since 2006, complements the suspicious transaction reports (STRs) as a valuable source of information used for financial crime investigations by law enforcement agencies (LEAs) in Malaysia. Recent assessments have shown that the current threshold of RM50,000 is disproportionately high relative to other countries, and does not appropriately reflect the size and prevalence of cash usage in the Malaysian economy. This facilitates proceeds from illegal activities being placed by criminals in financial institutions at amounts just below the threshold to avoid detection. By lowering the threshold, such behaviour can be more easily detected through enhanced monitoring and better visibility on suspicious transaction patterns. Other potential measures are also being considered by the Bank, in collaboration with other LEAs, to complement the CTRs and STRs in responding to risks of abuse of cash for criminal activities. This includes studying the suitability of introducing an economy-wide transaction limit for cash transactions made in Malaysia. This measure is similarly imposed in a few jurisdictions (Diagram 3.6).

Diagram 3.6

#### Implementation of Cash Transaction Limit(s) in Selected Jurisdictions



\* Effective 1 July 2019

Note: For jurisdictions with multiple limits, the limits differ according to categories such as purpose of transaction, business sector, parties involved and whether parties to the transaction are residents or non-residents. Currency conversions are based on average exchange rate for the year 2018

Source: The Australian Government the Treasury, European Consumer Centre, Central Board of Direct Taxes – India, Forbes

To promote greater awareness and understanding of ML/TF risks as well as to foster closer collaboration between financial institutions and LEAs, the Bank published several 'red flag' and typologies reports throughout the year. These reports provide critical intelligence on financial crimes such as terrorism and proliferation financing, corruption and fraud. These reports also elaborate emerging trends and techniques used in financial crimes, to facilitate improved identification and early detection by reporting institutions, while assisting LEAs in combating such crimes.

### The Bank reduced the cash transaction reporting threshold from RM50,000 to RM25,000 to enhance monitoring of potentially suspicious transaction patterns

The Bank also introduced a public-private partnership (PPP) platform in early 2017 to enable closer collaboration between LEAs and selected financial institutions. The PPP facilitates prompt and effective exchange of financial intelligence in combatting ML/TF risks as evidenced by the increased number and improved quality of STRs on TF, identification of new entities suspected to be connected to TF, and swifter enforcement actions by LEAs. Towards the end of 2018, the Bank hosted the 2018 Compliance Conference with the theme "National Risk Assessment: Achieving Compliance and Enforcement Equilibrium", bringing together more than 1000 local participants from both the financial and non-financial sectors. The conference provided an important opportunity for the Bank and LEAs to share the latest developments on ML/TF activities and regulatory priorities to combat ML/TF risks effectively.

### Re-rating of Malaysia's technical compliance of FATF Recommendations

In October 2018, the FATF Plenary acknowledged Malaysia's Third Year Follow-Up Report on measures taken to address gaps identified in the 2015 Mutual Evaluation exercise conducted on Malaysia's AML/CFT framework. Reflecting the substantial progress made, the Plenary agreed to the re-ratings of the level of Malaysia's technical compliance in respect of four FATF Recommendations (Table 3.3). In particular, the following efforts were recognised in the revised ratings:

- (i) the enhancements to Malaysia's legal framework to address deficiencies in transposing the

- United Nations Targeted Financial Sanctions on Proliferation designations into domestic freezing obligations and prohibitions;
- (ii) the establishment of dedicated platforms to enhance coordination and collaboration between LEAs, such as the Sub-committee on Implementation and Enforcement of Cross Border Cash and Bearer of Negotiable Instruments;
- (iii) strengthened risk assessments on the NPO sector;
- (iv) the issuance of guidance, 'red flag' reports, typologies and updates to support the effective implementation of preventive measures against ML/TF risks, and enhanced reporting of suspicious transactions; and
- (v) enhanced collaboration arrangements through PPP platforms.

Following the outcome of the re-rating exercise, Malaysia is rated "Compliant" or "Largely compliant" for 38 out of 40 FATF Recommendations (Table 3.4). Ongoing initiatives are being taken to address gaps identified in the remaining two FATF Recommendations, relating to transparency and beneficial ownership of legal persons and legal arrangements, including undertaking risk assessments and making the necessary legislative amendments to facilitate full compliance to the FATF Recommendations.

### Enhancing AML/CFT supervision

#### **Banking and insurance sectors**

In 2018, the Bank consolidated its supervisory resources to further strengthen its focus and specialisation in the supervision of ML/TF risks within the financial sector. This resulted in the establishment of a dedicated AML/CFT unit within the supervision sector. During the year, the unit (collectively with prudential supervisors) conducted on-site AML reviews on 54 banking institutions, six DFIs and 49 ITOs. The reviews indicated that financial institutions have made notable progress in strengthening their AML/CFT controls and practices. There was also increased vigilance in tackling illegal financial schemes and mule accounts, with improvements observed in the policies and processes of financial institutions to identify and close these accounts. To enhance the skill sets of staff, there was also greater commitment by financial institutions to promote professional certifications among compliance personnel. Financial institutions continue to make further investments in

Table 3.3

**Re-ratings of Technical Compliances**

FATF Recommendation	Mutual Evaluation (2015)	3rd Year Follow-Up (2018)
5. Terrorist financing offence	LC	C
7. Targeted financial sanctions related to proliferation	PC	C
32. Cash couriers	LC	C
34. Guidance and feedback	LC	C

C – Compliant  
 LC – Largely compliant  
 PC – Partially compliant

Source: Financial Action Task Force

technology, systems, and manpower to improve the transaction monitoring and screening processes. This is complemented by ongoing efforts to strengthen the competence of front-line staff and assurance functions, particularly in conducting risk assessments for business segments or customer categories with higher inherent ML/TF risks.

### Work is in progress to further enhance the Bank's AML/CFT supervisory activities through greater usage of technology and data analytics

The Bank also enhanced its AML/CFT Risk-Based Supervisory Framework to incorporate the NRA methodologies and risk assessments for TF. Work is in progress to further enhance the Bank's AML/CFT supervisory activities through greater usage of technology and data analytics.

### Designated Non-Financial Businesses and Professions (DNFBPs)

The 2017 NRA indicated medium high to high ML/TF risks faced by a few DNFBP sectors such as dealers in precious metal and stones, lawyers, company secretaries, moneylenders and pawnbrokers. This is predominantly driven by high risk characteristics, including easy access, a degree of customer anonymity, and high risk products and services, while the control measures in place are generally found to be weak to marginal. Accordingly, the Bank's DNFBP supervision division intensified its review of the five higher risk sectors in 2018. The review highlighted improved implementation of AML/CFT obligations in

Table 3.4

**Latest Overall Ratings of Technical Compliances**

Rating	Mutual Evaluation (2015)	3rd Year Follow-Up (2018)
Compliant	16	20
Largely compliant	21	18
Partially compliant	3	2*
Non-compliant	0	0

\* Recommendation 24 on transparency and beneficial ownership of legal persons and Recommendation 25 on transparency and beneficial ownership of legal arrangements

Source: Financial Action Task Force

some areas, with strengthened institutional infrastructure embedded as part of the reporting institutions' business operations. These include basic customer due diligence (CDD), record keeping and management information systems. Nevertheless, key gaps remain in a number of areas, including the conduct of CDD on beneficial owners, enhanced and ongoing due diligence, risk assessment and customer risk profiling, and controls for combating terrorism financing.

Awareness of ML/TF risks and effective controls remain a key barrier to effective compliance by DNFBPs. In view of this, the Bank launched the National AML/CFT Compliance Programme in 2018, with the motto "Comply to Protect". A total of 32 awareness sessions were conducted in eight major cities in Malaysia throughout the year, including the inaugural Compliance Conference 2018 for DNFBPs which attracted more than 390 participants. Moving forward, supervisory activities for DNFBP sectors will be further intensified, especially in sectors identified in the 2017 NRA as having higher exposure to ML/TF risks. The Bank will also be undertaking a comprehensive review of the AML/CFT requirements for DNFBPs and Other Non-Financial Sectors (Sector 5), to provide additional guidance on the implementation of AML/CFT measures in these sectors, taking into account their associated ML/TF risks.

### Digital assets

The evolution of digital assets continues to be observed. This has been characterised by developments in initial coin offerings (ICOs), the use of digital tokens as a means of payment, and the trading or exchange of digital assets

through digital currency exchangers (DCEs). Recognising the potential risks that these developments can pose to the integrity of the financial system, DCEs were designated as reporting institutions under the AMLA in February 2018, and required to make a declaration on their activities to the Bank. Minimum disclosure requirements were also introduced for these institutions to enhance the transparency of their activities, alongside expectations to put in place adequate policies and procedures to manage ML/TF risks. A total of 49 DCE declarations were received, of which 29 declared exchangers reported no activity in 2018 while the remaining reported a decreasing trend in the number and value of transactions.

Although digital assets can be used as a representation of value, they generally lack the characteristics of money, unlike banknotes and coins that are backed by the Government (otherwise known as fiat currency). The use of digital assets as a means of payment has therefore remained limited in Malaysia. The Bank has publicly stated that digital assets are not legal tender and are not subject to the Bank's consumer protection framework. Members of the public are thus advised to carefully evaluate the risks when dealing with digital assets.

The Bank has also strengthened its cooperation with other domestic regulatory authorities to manage risks associated with digital assets to the financial and payment systems in Malaysia. Building on the October 2012 MoU between the Bank and the Securities Commission Malaysia (SC), the coordination arrangements were expanded in December 2018 to include the regulation of digital assets in Malaysia. These arrangements clarify the Bank's oversight of compliance to laws and regulations relating to payments and currency matters and the SC's responsibility for the regulation of the issuance of digital assets in connection with ICOs and the trading

of digital assets at digital asset exchanges in Malaysia. Accordingly, the SC will also supervise compliance with AML/CFT requirements that are applicable to digital asset exchanges.

## Money Services Business (MSB)

In 2018, the Bank continued to focus on reducing vulnerabilities in the MSB industry to ML/TF risks. Outcomes from the Bank's data analytics function resulted in 46 targeted surveillance operations launched by the Bank on unauthorised remittance businesses during the year. Of these, 14 unauthorised retail operators were identified and ordered to cease operations.

During the year, the Bank also undertook a review of the Money Services Business Act 2011 (MSBA). The review aims to strengthen the effectiveness of enforcement actions against illegal MSB activities by unauthorised operators, and non-compliances by licensees with regulatory requirements that protect consumers and prevent abuse of the industry for illegal purposes. The Bank has issued a consultation paper in March 2019 to solicit public feedback on the proposed amendments to the MSBA. The proposed amendments are expected to deliver swifter, more punitive and visible enforcement actions to deter and combat unauthorised remittance and currency exchange services. At the same time, the Bank seeks to expand the scope for administrative enforcement actions to promote greater discipline in the industry, while reflecting a more proportionate approach to enforcement that is commensurate with the severity of offences committed.

Efforts to preserve the integrity of the MSB industry were further supported by continuous capacity building programmes to raise the standards of professionalism and compliance in the industry. The certification and

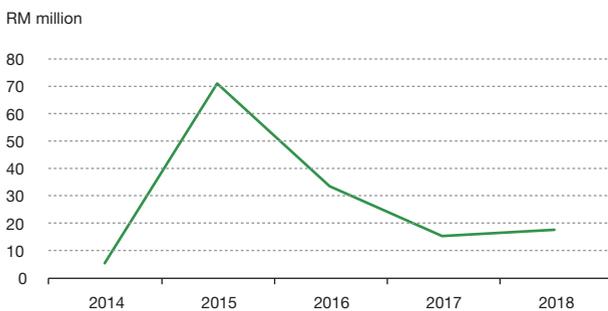
### Use of data analytics by the Bank in surveillance, supervision, and enforcement activities

The use of data analytics since 2017 has significantly improved the Bank's capacity to effectively regulate and supervise MSB through enhancements in the following areas:

- (i) supported more effective assessments of ML/TF risks associated with MSB activities through the development of ML/TF-related typologies using modelling tools and big data analytics, to provide deeper insights into customer behaviour, transaction patterns and the modus operandi of criminals and unauthorised providers of MSB. This in turn translated into more targeted supervisory and enforcement actions;
- (ii) targeted deployment of supervisory resources on more critical and high risk areas, thus facilitating more timely interventions and enforcement actions to safeguard the integrity of the MSB industry; and
- (iii) enabled greater efficiency gains in the turnaround time for the processing of regulatory applications from industry players, with more robust and frequent risk profiling of licensees.

Chart 3.3: Total Monetary Penalties Imposed

**Slight increase in the amount of penalties imposed in 2018**



Source: Bank Negara Malaysia

accreditation of MSB Compliance Officers (COs) as required by the Bank in 2017 continues to make good progress. To date, one-third of all COs (covering almost all of the larger MSB companies) have obtained their accreditation, while the remaining two-thirds are expected to be fully accredited by end-2019. Effective 22 January 2019, all directors and CEOs of medium and large MSB licensees are also required to attend the MSB Directors Education Programme (MSB-DEP) which provides targeted exposure to MSB directors and CEOs on regulatory requirements and sound practices in the management of risks inherent in the conduct of MSB.

**The enhanced Money Services Business Act is expected to result in swifter, more punitive and visible enforcement actions to deter and combat unauthorised remittance and currency exchange services**

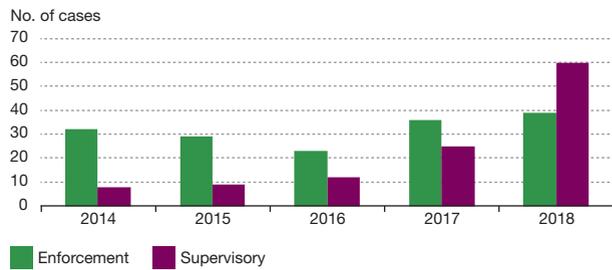
Moving forward, the Bank is also considering the prospect of extending the issuance of licences beyond the current maximum tenure of three years to qualified MSB licensees. This considers the enhancements in the Bank's regulatory and supervisory capabilities and strengthened industry compliance in recent years. Such a move will also enable the Bank to direct its resources more efficiently to the ongoing supervision of ML/TF risks.

**ENFORCEMENT ACTIONS**

Effective and timely enforcement actions by the Bank serve as a credible deterrent against non-compliances with applicable laws and

Chart 3.4: Number of Supervisory and Enforcement Actions Taken

**Increasing use of supervisory actions to address non-compliances**



Source: Bank Negara Malaysia

regulatory requirements. This in turn promotes conduct in the financial industry that is consistent with sound and responsible business practices. A summary of the enforcement actions taken in 2018 is provided in Table 3.5. Beginning 2019, details of individual enforcement actions will be published on the Bank's website.

**The Bank has increased its use of targeted supervisory actions in recent years to encourage sustained positive changes in financial institutions' compliance behaviour and culture**

While punitive enforcement actions (such as imposition of monetary penalties, civil or criminal actions) will continue to be pursued for serious non-compliances and unlawful or illegal activities, the Bank has increased its use of targeted supervisory actions in recent years to encourage sustained positive changes in financial institutions' compliance behaviour and culture (Chart 3.3 and Chart 3.4). In particular, directions of compliance, supervisory orders and enforceable undertakings have been an effective way to secure a financial institution's commitment and resources to implement remediation plans that address specific concerns or weaknesses in risk management systems, compliance frameworks and internal governance arrangements. The Bank will continue to ensure that any enforcement and supervisory actions are appropriate, taking into account the impact of the non-compliance and whether the actions are likely to deter or prevent further non-compliances.

Table 3.5

**Enforcement Actions Taken in 2018**

Area	Enforcement Actions
Illegal deposit taking	<ul style="list-style-type: none"> <li>One entity was convicted under section 25(1) of the Banking and Financial Institutions Act 1989</li> </ul>
Issuance of designated payment instrument without approval	<ul style="list-style-type: none"> <li>One entity was convicted under section 25(1) of the Payment Systems Act 2003</li> </ul>
Non-compliance with money services business (MSB) requirements	<ul style="list-style-type: none"> <li>Ten entities and one individual were convicted for unauthorised provision of money services business under section 4(1) of the MSB Act 2011 (MSBA)</li> <li>Administrative monetary penalties (AMPs) amounting to RM6,000 were imposed on four MSB providers for failure to comply with capital requirements under section 22(1) of the MSBA</li> <li>AMPs amounting to RM10,000 were imposed on six MSB providers and RM42,000 on four MSB providers for breaching sections 31(9) and 34(1) of the MSBA respectively, in relation to requirements for the submission of audit reports to the Bank</li> <li>Two entities were convicted for the unauthorised use of words indicating the provision of money services business under section 23(1) of the MSBA</li> <li>Compounds amounting to RM135,000 were imposed on two MSB providers for failure to comply with regulatory requirements relating to the appointment of directors under section 30(1) of the MSBA</li> </ul>
Non-compliance with regulatory requirements	<ul style="list-style-type: none"> <li>AMPs amounting to RM11.7 million were imposed on 31 banking institutions for failure to comply with statistical reporting requirements under section 143 of the Financial Services Act 2013 (FSA) and section 155 of the Islamic Financial Services Act 2013 (IFSA)</li> <li>AMPs amounting to RM4.8 million were imposed on three banking institutions for failure to comply with policies relating to the protection of customer data under section 48 of the FSA and section 58 of the IFSA</li> <li>AMP of RM725,000 was imposed on one banking institution for failure to comply with corporate governance requirements under section 63 of the IFSA</li> <li>Compound of RM100,000 was imposed on one banking institution for failure to comply with the United Nations Security Council Resolutions under section 82(1) of the Central Bank of Malaysia Act 2009</li> <li>Compound of RM650,000 was imposed on one banking institution for failure to comply with foreign exchange administration requirements under section 214(2) of the FSA</li> </ul>
Non-compliance with AML/CFT requirements	<ul style="list-style-type: none"> <li>Compounds amounting to RM120,000 were imposed on two banking institutions for failure to comply with reporting obligations under section 14 of the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA)</li> <li>Compounds amounting to RM312,500 were imposed on three banking institutions for failure to comply with customer due diligence requirements under section 16 of the AMLA</li> <li>Six entities and one individual were convicted for money laundering offences under section 4(1) of the AMLA</li> </ul>

Source: Bank Negara Malaysia

## Strengthening Shariah Compliance Risk Culture

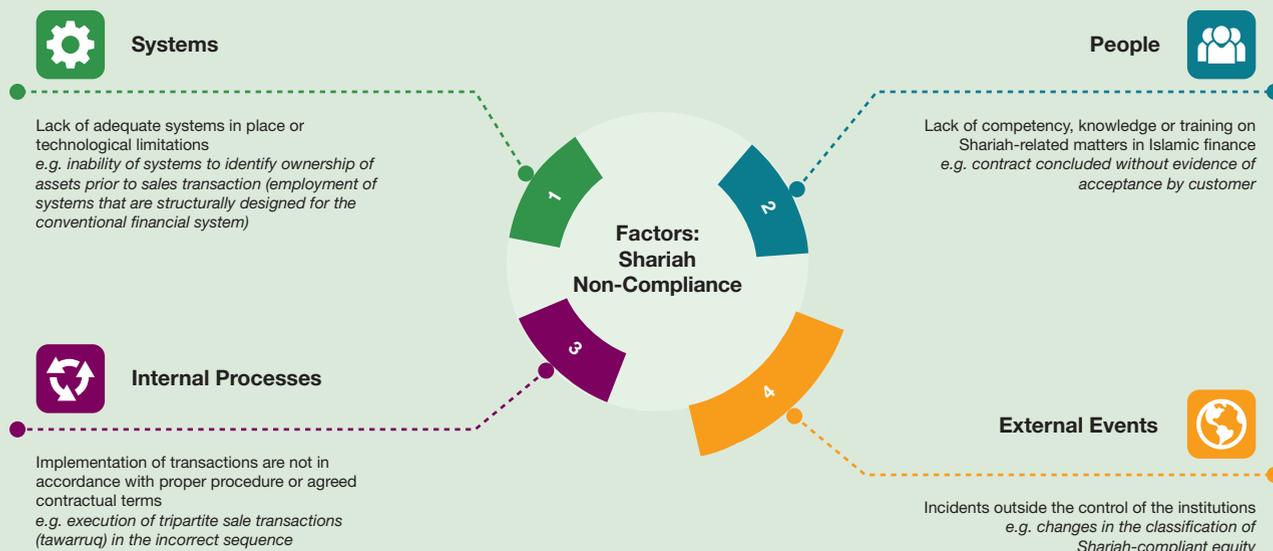
By Faizal Jaafar, Mohd Hairi Mohd Tahir and Nurlida Jasmin Ismail

### Introduction

Shariah is the central tenet of Islamic finance. Its principles, which promote fairness and transparency, underpin the conduct of Islamic finance transactions. Failures in fully observing Shariah principles can thus affect the validity and enforceability of Islamic finance transactions, and increase financial and non-financial risks for Islamic financial institutions. For example, it is prohibited for Islamic financial institutions to recognise income derived from transactions that have not fully observed Shariah requirements. This could lead to safety and soundness concerns for an Islamic financial institution. Incidents of non-compliance on a broader scale can, in turn, undermine confidence in the Islamic financial sector and its stability. The effective management of Shariah non-compliance risk is therefore paramount, especially with the growing significance of Islamic finance as a key component of the financial system, domestically and globally. This article highlights the approach by the Bank and the practices of Islamic financial institutions in inculcating an effective Shariah compliance risk culture.

Diagram 1

### Factors Contributing to Shariah Non-Compliance



Source: Bank Negara Malaysia

### Shariah Compliance in Malaysia

Section 28 of the Islamic Financial Services Act 2013 (IFSA 2013) requires Islamic financial institutions to ensure that their aims and operations, business, affairs and activities are aligned to and in compliance with Shariah principles at all times. In practice, Shariah compliance is supported in Malaysia under a two-tier governance structure that operates at the industry and institutional levels. This is further reinforced through the regulatory framework, supervision and the control functions of Islamic financial institutions.

#### a) Centralised Shariah Advisory Council

At the industry level, the Shariah Advisory Council of Bank Negara Malaysia (the SAC) is the highest authority in the ascertainment of Islamic law for Islamic financial business conducted by institutions regulated by the Bank. While Islam recognises diversity of *fiqh* interpretations and approaches to implementation, the existence of a central authority is critical in providing certainty and uniformity in Shariah interpretations. The role of the SAC in providing national level Shariah certainty for Islamic finance has enabled the orderly development of the

Islamic financial system, mitigating variations and conflicting Shariah interpretations that may undermine public confidence and create gaps in market practices.

**b) Shariah committees of individual Islamic financial institutions**

At the institutional level, each Islamic financial institution has a Shariah committee responsible for advising the management and board on matters relating to Shariah in all aspects of the institution's business, affairs, practices and activities. While the SAC typically deliberates on industry-wide implications of applying a particular Shariah principle, the institutional level Shariah committee focuses on Shariah issues that are specific to the institution. These include those relating to the development of bespoke products and services, as well as business operations. Currently, there are more than 150 qualified Shariah scholars – local and international – who are appointed as Shariah committee members at 55 Islamic financial institutions.

**c) Shariah risk management, Shariah review and Shariah audit functions**

The role of the Shariah committee is supported by designated control functions within Islamic financial institutions, namely the Shariah risk management, Shariah review and Shariah audit functions. These functions are independent of the business lines and responsible to provide an objective assessment and assurance of the effectiveness of an Islamic financial institution's compliance with Shariah and management of Shariah non-compliance risks. The establishment of these control functions and the strengthening of their capacity over time have been instrumental in promoting a strong Shariah compliance risk culture within Islamic financial institutions.

**d) Regulatory framework**

Since 2012, the Bank has issued 14 Shariah Standards and Operational Requirements which give effect to rulings by the SAC and serve to promote the effective management of risks in Islamic financial business. This has led to enhanced internal policies and processes of Islamic financial institutions to effectively manage Shariah non-compliance risks in their business undertakings. In particular, the regulatory standards have had an important role in reducing legal and operational risks associated with people and system in the operationalisation and innovation of Islamic financial products and services.

The upcoming revision to the Shariah Governance Framework will further strengthen Shariah governance implementation within institutions. The framework outlines specific expectations for Shariah considerations to be more closely integrated with the business and risk strategies of Islamic financial institutions. It further clarifies the roles, responsibilities and accountabilities of the board, Shariah committee and key organs involved in instituting a robust Shariah compliance risk culture. An increased emphasis is also placed on elevating the professional competence of individuals who helm these roles in respect of their Shariah knowledge and its applications to Islamic finance. Expectations on the independence and quality of control functions to ensure effective management of Shariah non-compliance risks will also be strengthened under the framework.

**Observations on Shariah Compliance**

Shariah applications have wide implications for how an institution operates – encompassing its business practices and processes to the behaviours of senior management and employees. In this section, an overview of Shariah organisational practices observed in Islamic financial institutions is provided.

- At the apex, the board and senior management set the tone for the organisational culture and desired behavioural norms that promote Shariah compliance. Increasingly, more Islamic financial institutions are formally adopting a set of common values and purpose which reflect Shariah principles and underpin the institutions' business strategy and risk appetite.
- Responsibilities for Shariah compliance and risk management are increasingly devolved to business units and employees, reflecting an increasing emphasis on the first line of defence in mitigating Shariah non-compliance risks.

This has been accompanied by greater empowerment and accountability accorded to business units, with greater involvement in the design of business processes and controls to manage Shariah non-compliance risks.

- Considerations of conduct that impact an Islamic financial institution's Shariah compliance have become a more prominent feature of incentive frameworks. Most Islamic financial institutions adopt penalty and reward systems that relate performance measures to Shariah expectations. These strategies serve to reinforce a collective focus of the organisation on ensuring Shariah-compliant practices in all aspects of an Islamic financial institution's business, and building a strong risk culture among employees.
- Greater emphasis has been directed by Islamic financial institutions at building strong foundations in Shariah knowledge and applications within the workforce. Strengthened recruitment practices and higher investment in training and development have been observed. This has been motivated both by an increased focus of Islamic financial institutions on the sound management of Shariah non-compliance risks, as well as the desire to drive greater innovation in the offering of Shariah-compliant financial solutions. Increased accountability of the Shariah committees has also encouraged the upskilling of scholars that are appointed to the committees, especially in areas relating to business operations and industry practices.

Collectively, these developments have led to better alignment between business operations, processes and practices with Shariah expectations, thereby mitigating incidents of non-compliance. Further details of practices observed across Islamic financial institutions are elaborated in Diagram 2.

## Conclusion

Moving forward, the Bank expects continued progress in evolving a strong Shariah compliance risk culture that is well-integrated and self-reinforcing within Islamic financial institutions. This in turn will provide the critical foundations for further growth and innovation in the Islamic finance industry, while also contributing to domestic financial stability.

Consistent with Shariah principles, the adoption of value-based intermediation (VBI) will further sharpen the focus of Islamic financial institutions in ensuring their products, services and practices deliver a positive and sustainable impact on the economy, community and environment. An increased focus on impact-driven strategies, supported by strong governance, is expected to be embedded within and well-integrated into the risk management practices and product innovation strategies of Islamic financial institutions (the progress of VBI implementation is detailed further in the section on Islamic Finance in Chapter 2). The development of VBI scorecard and disclosure practices will enable stakeholders to better assess the institutions' fulfilment of the basic tenets of Shariah. As such, this ensures that Islamic financial institutions meet the overarching objectives of Shariah (*maqasid* Shariah) – which are to preserve and advance the common interest of society at large, by preventing harm and maximising benefits. This will further strengthen the accountability, transparency and integrity of Islamic financial institutions.

Diagram 2

## Increasing Efforts by Islamic Financial Institutions to Strengthen Shariah Compliance Risk Culture

### Observed Practices

#### Tone from the Top



- Internal policies are reflective of Shariah principles, catering to different risks in the implementation of various Shariah contracts
- Shariah consideration integrated within business operationalisation and risk management practices
  - > Integrated IT system ensures execution process of Shariah contracts is systematically observed
  - > Robust risk assessment process to identify and incorporate Shariah non-compliance risk under the ICAAP\*, including quantification
- Strengthened high-level deliberation on Shariah and its application in business and risk strategies
  - > Semi-annual dialogue between Board of Directors and Shariah committee enables effective resolutions of strategic issues
  - > Appointment of Shariah scholars as board members in 11 institutions fosters greater understanding among board members on Shariah matters

#### Accountability and Communication



- Clear roles and responsibilities of all organisational units and employees
  - > Appointment of senior officers responsible for the day-to-day management of Shariah matters
- Regular engagement among employees to enhance awareness on the importance of Shariah compliance
  - > Weekly/monthly dialogue among staff/branch managers to instil awareness on Shariah non-compliance risk
  - > Sharing of good practices or audit findings provides learning opportunities and process improvement

#### Performance Management



- Driving performance improvement to ensure Shariah compliance
  - > Introduced reward mechanism for achieving zero Shariah non-compliance
  - > Introduced 'Mystery Shopper' as a tool to assess frontliners' competency in handling Shariah matters

#### Talent Development



- Enhancing the understanding on Shariah and ensuring attainment of technical proficiency
  - > Recruitment practices of prospective board members, senior management or employees, take into consideration a candidate's knowledge and experience in Islamic finance and Shariah
  - > Enhancement of knowledge via structured training programmes

### Structured Learning Programmes

109 board members completed the Islamic Finance for Board of Directors (IF4Board) programme – To upscale directors' appreciation on the dynamics of Shariah principles in shaping Islamic finance business

38% Shariah committee members enrolled into Certified Shariah Advisors (CSA) programme in 2018 – To upskill the competency of the Shariah committee in applied knowledge of Shariah and business

More than 2,000 employees across 39 financial institutions pursued specialised qualifications in Islamic finance (AQIF, IQIF and CQIF)\*\* – Three-tier qualification to advance knowledge and competency of Islamic finance practitioners in the areas of Islamic banking, takaful, capital market and wealth management

\* ICAAP - Internal Capital Adequacy Assessment Process

\*\* AQIF - Associate Qualification in Islamic Finance; IQIF - Intermediate Qualification in Islamic Finance; and CQIF - Certified Qualification in Islamic Finance

Source: Bank Negara Malaysia