



## **2018/2019 Regulatory Landscape of the Malaysian Banking Industry**

In response to the Bank Negara  
Malaysia 2018 Financial Stability  
and Payment Systems Report

# Foreword



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2018 was event-filled, with both global and domestic developments unfolding at a fast pace. Trade tensions, policy uncertainties and fluctuations in commodity prices around the world have made an impact on business performances and the financial market landscape. On the domestic front, the unprecedented transition of government at the federal level resulted in new fiscal, economic and reform priorities. Despite this, the Malaysian financial system remained resilient, supported by strong financial institutions and orderly market conditions.

While the 2019 regulatory environment appears more settled, regulators continue to set high expectations aimed at maintaining a strong, resilient financial sector with firms having robust financial and operational resilience, supported by strong risk management and compliance capabilities. Regulators will continue to prioritise the completion of the domestic implementation of Basel III prudential reforms for banks. In the insurance sector, enhancing valuation standards that drive capital requirements will be the focal point for the coming year. Furthermore, expectations on both banks and insurance companies to strengthen their position in the financial industry such as recovery and resolution planning, conduct risk management and AML/CFT controls will heighten.



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With the banking industry moving towards digitisation, new dimensions of risk management have emerged. The pace of technological change therefore demands deep thinking about the new risks associated with advances in financial technology, and the appropriate regulation of processes, products and institutions to avoid regulatory gaps and to ensure financial stability and adequate consumer protection.

The shifts in Malaysia's economic priorities and structure will no doubt present a new set of challenges for the financial industry, and banks have to be ever-ready.

On behalf of Deloitte Malaysia, we are pleased to present our very first edition of the "2018/2019 Regulatory Landscape of the Malaysian Banking Industry", a compilation of our views on the emerging risks and trends that financial institutions are facing today, in line with the Bank Negara Malaysia 2018 Financial Stability and Payment Systems Report. We hope that this provides you with helpful insights to prepare for the upcoming regulatory developments.

For any enquiry or clarification, please feel free to contact Justin at [keang@deloitte.com](mailto:keang@deloitte.com).

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# Implementing the post-crisis agenda





# The next wave of Basel III

## What are the key challenges?



### a) Extension to observation period for NSFR

The Net Stable Funding Ratio (NSFR) is a minimum standard that requires banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. Towards the end of 2017, Bank Negara Malaysia (BNM) announced its plan to further extend the observation period for NSFR for another year amidst the need to further evaluate the maturity and robustness of the liquidity and funding practices of banks, as well as the uneven progress in implementation at the global level.

At the global level, the 15th Progress Report on adoption of Basel Regulatory Framework reported that 25 out of 28 member jurisdictions have issued draft or final rules for the NSFR. 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%, indicating that local banks are well positioned in terms of liquidity.

### b) Enhancement to Pillar 3 disclosures

BNM published an exposure draft on revised requirements for Financial Institutions (FIs) to disclose key information relating to regulatory capital and risk exposures (Pillar 3 requirements) in June 2018 amidst the increased global focus on the need to uphold good corporate governance through reduction of information asymmetry.

The Policy Document will come into effect on 1 January 2019 and imposes requirements on data volume and detail that is far more intensive and prescriptive compared to the superseded guidelines to enhance the comparability and consistency of a bank's disclosure requirements. Disclosure needs to be made in varying timelines and stricter format templates.

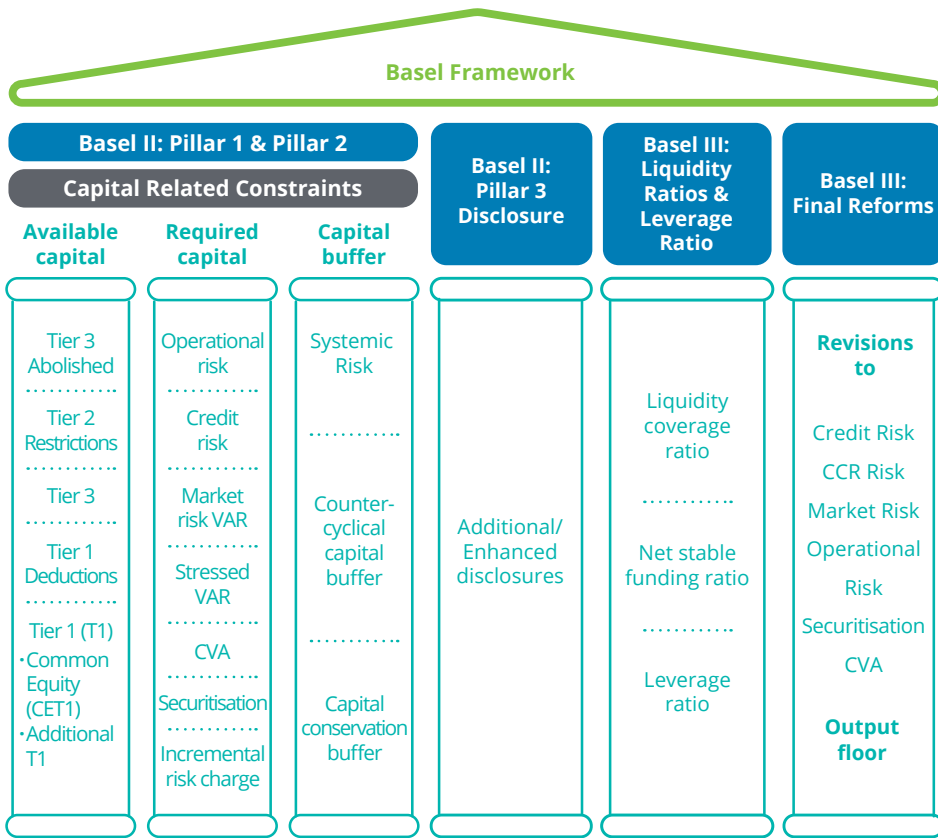
### c) Framework for D-SIBS

On 3 April 2019, BNM issued the exposure draft that sets out the assessment methodology to identify domestic systemically important banks (D-SIBs) and the corresponding applicable reporting requirements applicable to FIs.

The exposure draft mirrors the methodology set out in the Basel Committee on Banking Supervision (BCBS) Framework on global systemically important banks (G-SIBs) with the objective of enhancing the going-concern loss absorbency of SIBs and reduce the probability of their failure. Financial Institutions identified as G-SIBs or "Too Big to Fail" will be required to hold additional CET 1. In the Southeast Asia region, Indonesian D-SIBs are required to hold an extra 1.0% to 2.5% of its risk-weighted assets depending on its profile, Philippines requires its D-SIBs to maintain an additional 1.5% to 2.5% and Singapore imposes a 2.0% requirement on its D-SIBs. In the latest exposure draft published by BNM, FIs assessed as D-SIBs in Malaysia will be required to hold additional capital amounting to 0.5% to 2.0% of its risk-weighted assets.

It forces the larger FIs to be self-insured, and gives re-assurance to taxpayers that public funds would not be used to save a troubled G-SIB.

The diagram in the next page depicts the evolution of the Basel III Framework:



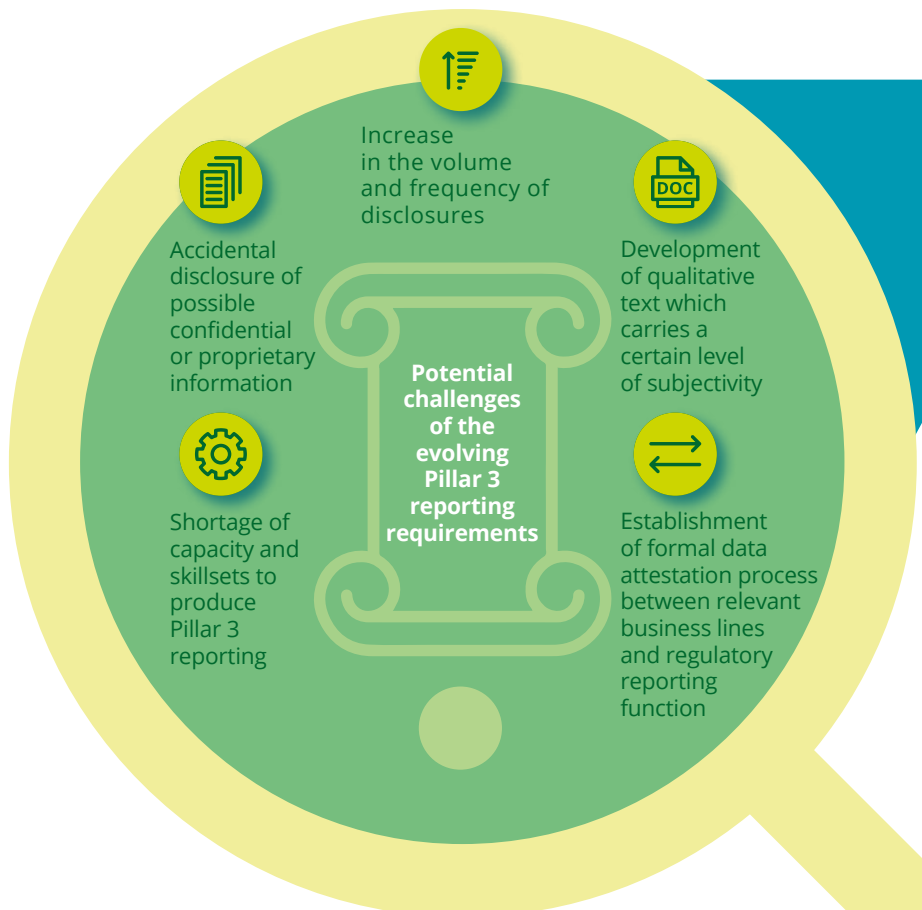
**Deloitte's view**

As the significance of the upcoming Basel III reforms becomes more apparent, there are increasing concerns on the impact to banks arising from the regulatory requirements to comply with stringent capital and liquidity holding measures and enhanced market discipline through increased disclosures.

When NSFR was first announced, Net Interest Margin (NIM) was impacted as all banks compete for longer term deposits to boost their ratios. While the pressure for banks to chase Retail Deposits have eased momentarily in light of BNM's announcement for deferment, banks should still continue to give sufficient thought into achieving the right product mix that balances the regulatory requirements and profitability to ensure that banks can meet the minimum NSFR requirement of 100% come 2020, while keeping ahead of competition.

Banks can no longer view Pillar 3 reporting as a one-off paper exercise. Instead, they need to evolve and transition to a more regular business-as-usual approach, supported by adequately-skilled resources. Internal control mechanisms need to be implemented to ensure the data quality meets the standards required for external reporting.

The impact of these upcoming Basel reforms may differ from one bank to another, but what is clear is that capital and liquidity requirements will only be heading towards one direction, which is upwards. On a side note, the proposed implementation dates of the full package of Basel III reforms may seem a long way from now, but given its pervasive impact, banks should undertake an early impact assessment to allow for a more proportionate and structured implementation of the individual Basel components. What we do not need is a disruption to the industry as banks struggle to understand what these reforms truly mean only at the eleventh hour.







## Allowing FIs to fail safely with RRP

### What is the direction for Islamic Banks?

Recovery and Resolution Planning (RRP) is intended to equip regulators with better tools when the next financial crisis hits. In essence, it aims to minimise the need for public funding when banks are in a turmoil by allowing for an orderly failure of the banks. The RRP developed should identify feasible recovery options to survive a range of severe but plausible stressed scenarios.

At the international level, the standards set out by the FSB in its Key Attributes of Effective Resolution Regimes for Financial Institutions have created the global framework for development of recovery and resolution plans from the conventional lens.

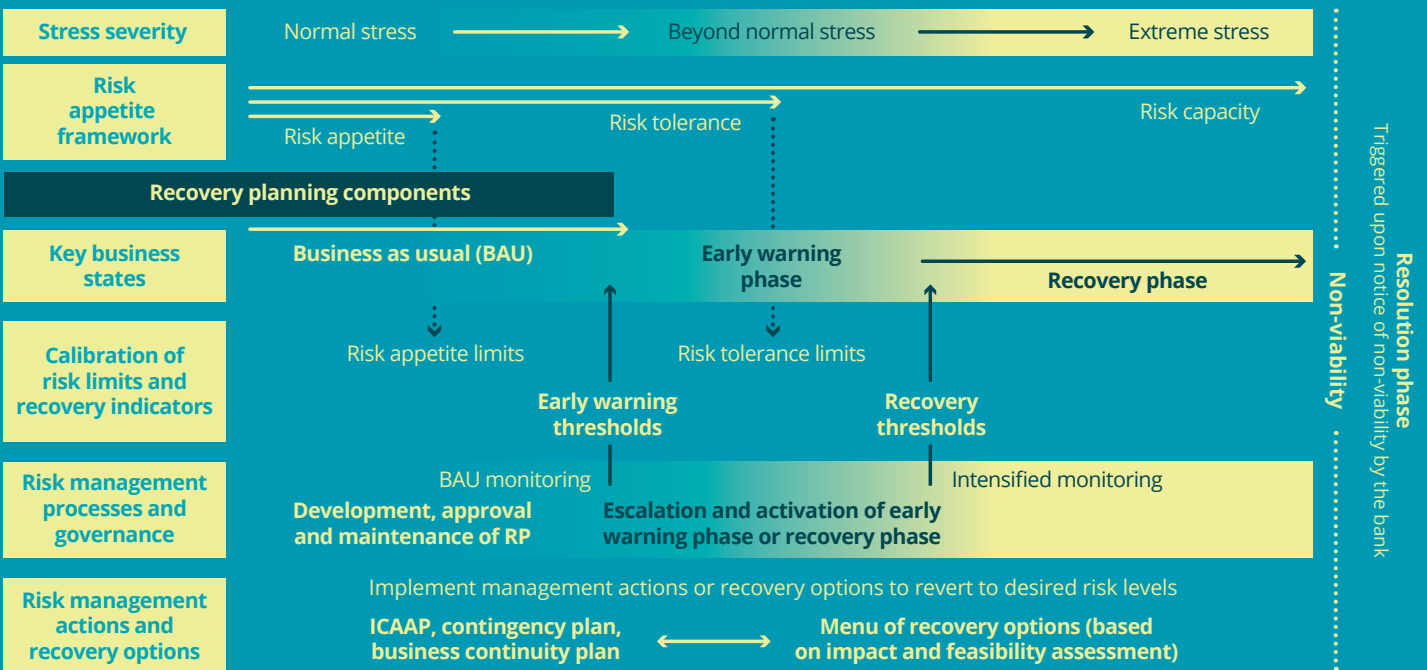
The Islamic Financial Services Board (IFSB) Working Paper Series on Recovery, Resolution and Insolvency Issues addresses this topic from the Islamic stand, shedding light on a number of legal, structural and operational issues in the context of recovery and resolution. However, the discussion on its formulation remains surface level, presenting challenges to Islamic Banks that aims to implement recovery and resolution planning while remaining Shariah compliant.

From a timeline perspective, RRP has gained traction in Europe since 2013. However, Asia Pacific has been slow to adopt global measures to create recovery and resolution plans with their focus directed towards the establishment of recovery plans. To date, there is no indicative date as to when the full roll out of Recovery Planning to the industry will be enforced.



**Deloitte's view**

In the aftermath of the global financial crisis, recovery planning has been introduced to strengthen the crisis preparedness of banks. Operationalising and embedding recovery planning will become far more tangible for firms in the coming year. Banks need to understand their operational and financial dependencies to respond to potential disruption and change better through proper integration of RRP with the existing BAU monitoring. The extent of RPP across the risk continuum is depicted in the diagram below:



ICAAP – Internal Capital Adequacy Assessment Process

With the recent release of the Exposure Draft on D-SIBs, it remains a question mark on whether the Central Bank will only impose on D-SIBs the requirement to submit a RRP with the other banks submitting a lighter touch Recovery Plan, an approach that is widely adopted by countries which have finalised the Recovery Planning Policies. We view that there needs to be a cultivation of proportionality in imposing regulations on banks, to differentiate the prudential requirements for institutions of varying size, systemic impact and complexity.

Islamic Banks are not exempted from the requirements of Recovery Planning. However, despite Islamic Banks' increasing popularity and growing market share, the application of the key recovery and resolution principles in the context of Islamic finance industry practices and Shariah requirements often slips under the radar of the industry practitioners. Differentiation in the application of the principles for a conventional bank and an Islamic Bank is often blurred.

Early engagements with Shariah experts are required to explore the interpretations of the Shariah concepts and how they create challenges in an actual recovery and resolution scenario. Conceptually, the unique rights and liabilities of Islamic Banking products would have an implication on the recovery and resolution options. For example, distressed sales in a recovery scenario would often have to be done with the understanding that haircuts would need to be taken against the value of the asset, but Islamic Practitioners have held that debt assets cannot be sold at lesser than its par value. Situations as such add further complexity towards assessing a bank's ability to recover its capital position. From the Governance perspective, the roles of the Shariah Board needs to be clear to avoid uncertainties about their involvement in the setting of Recovery and Resolution strategies. The risk is that the Recovery and Resolution Planning becomes a one-off academic exercise with little consideration given to its feasibility and effectiveness.



## The end of LIBOR is nearing

### How prepared are banks?

It was announced in July 2017 that the UK Financial Conduct Authority (FCA) would no longer persuade or compel banks to submit the London Interbank Offered Rate (LIBOR) by 2021, making it clear that reliance on LIBOR could no longer be assured beyond this date. LIBOR is a benchmark that is regulated and administered in the UK, but has been adapted by banks globally. Today, LIBOR is embedded in contracts involving banks, asset managers, insurers and corporates, which are estimated to be at US\$350 trillion globally on a gross notional basis. The rate is so embedded in existing banking practices and relied upon by market participants that the transition away from LIBOR will be one of the most, if not the most, challenging transformation programmes faced by the finance industry today.

2018 has seen regulators turning up the pressure by stating that firms should treat the discontinuation of LIBOR as a certainty and that progress has been relatively slow. In the UK, a joint "Dear CEO" letter from the UK Prudential Regulation Authority (PRA) and the FCA was sent to large banks and insurers in September, requiring Boards to sign off on a comprehensive risk assessment of LIBOR transition in respect of their firms. Swiss regulators have also been proactive in reaching out to firms. Further afield, US regulators are holding bilateral discussions with firms, and the Bank of Canada has called on FIs to consider their 'readiness' for benchmark reform.

## Deloitte's view

Working groups in each jurisdiction are identifying the most suitable risk-free rate (RFR) in the market, with plans to develop them in the near future. Some of the considerations include easing availability of sufficient and reliable underlying market data, enhancing robustness to changes in market structure, setting appropriate controls and governance, and reviewing the expected or actual market funding rates ratio of the RFR. These selected RFRs include pre-existing rates, reformed versions of pre-existing rates and newly-created rates.

However, RFRs are constructed differently from LIBOR. RFRs generally do not incorporate risk whereas LIBOR reflects perceived credit risk, therefore fixings for RFRs tend to be lower. This could mean that a trade which transitions from LIBOR to a RFR could have a different market value over time. In other words, there might be 'winners and losers' in an RFR transaction. Hence, valuation methodologies should be revised. Liquidity in the market for RFRs is also likely to be a restraining factor from the start.

In the UK, the Sterling Risk-free Reference Rates Group (Sterling RFR Group) has recommended that GBP LIBOR should be replaced by the Sterling Overnight Index Average (SONIA). The confirmation of this replacement on 29 November 2017 by the FCA further underlines the importance of understanding the potential impacts and practical considerations of the transition.

### Key differences between UK LIBOR and SONIA

#### UK LIBOR

- Various maturities
- Built-in credit component
- Forward-looking
- Deep liquidity (US\$30 trillion worth of underlying transactions)

#### SONIA

- Overnight
- Nearly credit risk-free
- Backward-looking
- Relatively less liquid compared to LIBOR (US\$610 billion worth of underlying transactions)

While many market participants in the US and UK have already embarked on transition programmes, globally, the pace of transition is not accelerating. This is, in part, due to the absence of any formal regulatory or legal mandate. However, banks have to accept that the discontinuation of LIBOR is not a possibility, but a certainty. Banks have to act now. Regulatory and supervisory scrutiny is expected to grow, with focused intervention in areas that are underdeveloped. Boards and Senior Management should expect questions regarding their timelines, governance plans, assessment of financial exposures and conduct risks, with enquiries becoming more focused and detailed over time.

A disorderly transition from LIBOR would be detrimental to individual firms as well as to the broader market. There is, therefore, a strong incentive for each individual bank to perform an impact analysis, identify key risks and challenges, and manage these risks as early and efficiently as possible to avoid problems further down the line. Below are some of the potential impacts that may arise during the transition period:

Area	Legal	Systems and processes	Valuations and risk management	Accounting	Tax
<b>Potential impact</b>	Contract amendments will lead to increased transition costs and operational risks. A significant administrative effort associated with transitioning contracts to the alternative RFRs will be required.	Significant challenges may arise when the required institutional infrastructures (e.g. trading and clearing data, systems and operational procedures) are established to support the transition to the alternative RFRs.	Transition of legacy contracts could potentially result in less effective hedges and/or market valuation issues, and may require adjustments to address inherent differences between the interbank offered rates and alternative RFRs.	The transition may result in complications related to fair value designation, hedge accounting and inter-affiliate accounting structures.	The transition may result in changes in the amount of taxes due or acceleration of payments on financial contracts or tax structures.

LIBOR transition will be like no other transformation programme that banks have undertaken. While firms may consider 2021 to be a long way off, the fact is that the complexity, magnitude and scope of the task ahead allow no room for complacency.

# Culture and conduct





JAKUTSK

CHABAROWSK  
WLADIWOSTOK

MAGARAN  
SACHALIN

IRKUTSK  
KLAN-DAYAR

KAMON  
WANGKOK

2 3 4 5 6

PERING  
CHANGSHA  
MANILA  
PERTH  
HONGKONG  
KUALA LUMPUR  
SINGAPUR

HONGKONG  
TOKYO  
SEOUL

SYDNEY  
CANBERRA  
MELBOURNE

KAMON  
WANGKOK  
PHNOM PENH  
JAKARTA



# Generating sustainable value through Shariah compliance

What does it take to elevate Shariah compliance in the Islamic finance industry?



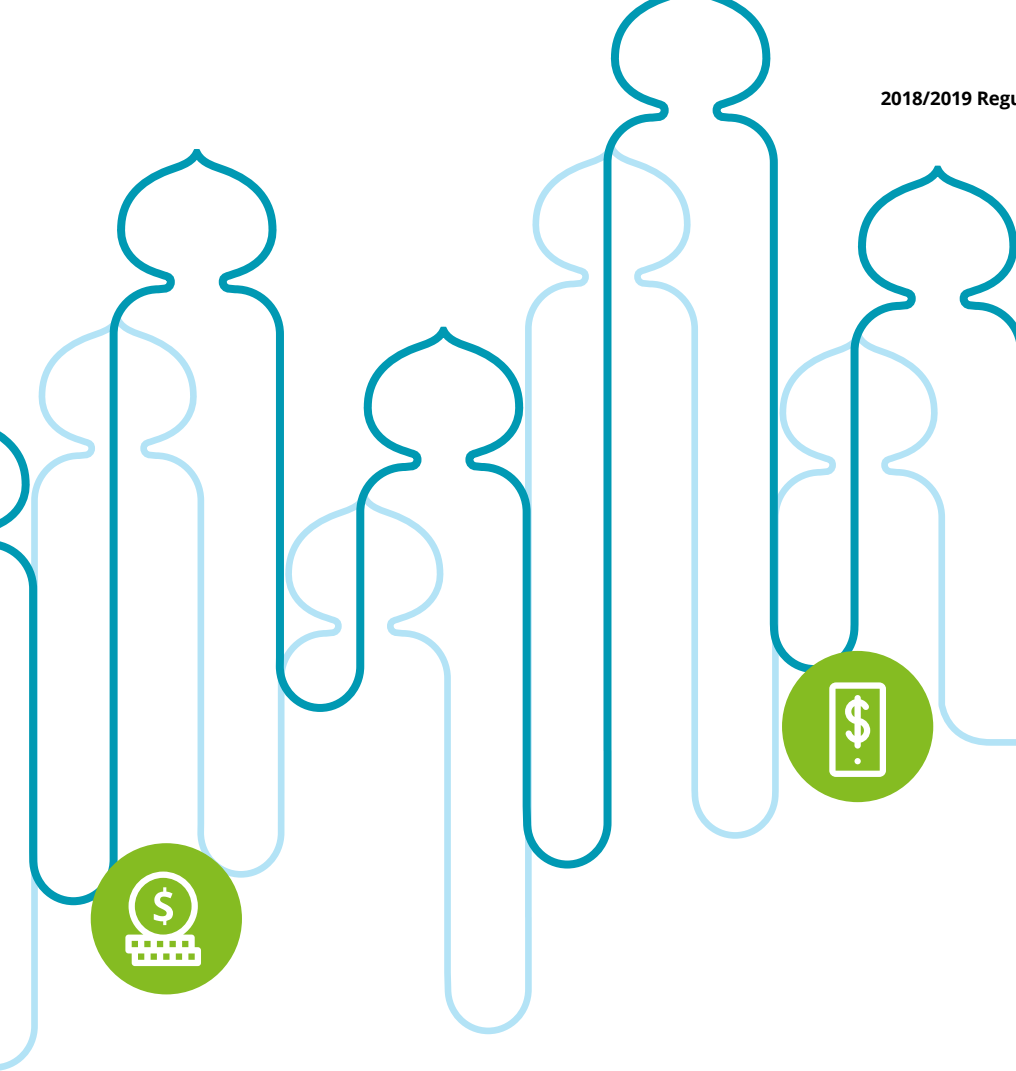
## a) Growth of Islamic capital market and Takaful operations

Islamic Banks shall continue to benefit from the popularity of sukuk supported by the nation's excellent Islamic finance infrastructure, an established Shariah legal framework and additional tax benefits. The Islamic capital market is encouraged by the driving of Value-based Intermediation (VBI) agenda to introduce sukuk that benefits communities and the environment, especially with the success of the world's first Sustainable Development Goals (SDG) sukuk launched by a licensed foreign Islamic Bank in 2018. Potential growth in financing for the small and medium-sized enterprises (SMEs) could be driven by the Malaysian government's initiative to develop Islamic finance and grow the nation's SMEs market via the SME Shariah-Compliant Financing Scheme of RM1 billion provided to finance Halal product exporters.

SMEs enjoy a profit subsidy rate of two percent with the scheme made available through Islamic Financial Institutions (IFIs). These growth prospects complement the potential merger between an Islamic Bank and a Development Financial Institution (DFI) in 2019, similarly to a merger that panned out well in early 2018.







## b) Shariah governance framework

Islamic financial business has grown over time and has become more sophisticated. The need for a more complex regulatory framework is thus needed to govern the changing environment. In the second half of 2019, BNM will finalise the long awaited Shariah Governance Framework, after incorporating feedback received on the draft issued in 2017. The key policy considerations in finalising the Shariah Governance Framework are of greater clarity in the oversight accountabilities of the Board and Shariah committee, enhanced criteria and conditions for the appointment of Shariah committee members, and application of proportionate Shariah governance arrangements.

A Shariah Governance Framework must establish a sound and robust Shariah governance structure with emphasis on roles of key functionalities. On top of that, the independence of the Shariah Committee needs to be observed at all times to ensure fair and objective judgement, and any internal and highly confidential information obtained by the Shariah Committee during their duties needs to be kept confidential. Robust Shariah compliance functions such as Shariah review, Shariah audit, Shariah risk management and Shariah research need to be in place.

## Deloitte's view

At present, the nation's Islamic Financial Institutions (IFIs) are essentially focusing on methods to generate profit with utmost efficiency. On the contrary, the adoption of Value-based Intermediation (VBI) deliberates on creating values and impact beyond profit, consistent with its core values which are the 3Ps: Profit, People and Planet. The VBI Community of Practitioners (COP) made up of nine Malaysian Islamic Banks are currently pioneering the regulator-backed sustainable impact of Shariah-compliant banking and their input as leading industry practitioner led to additional guidance documents in Implementation Guide for VBI, VBI Investment and Financing Impact Assessment Framework (VBIAF), as well as VBI Scorecard in the final quarter of 2018. These guidelines serve to provide the required structured mechanism in the transformation of existing banking practices into a value-based banking structure.

We foresee that IFIs are likely to face challenges in re-aligning their overall risk strategy as BNM calls for enhancement to their Risk Management Frameworks to supplement the IFIs' existing credit risk management. Other decision-making and strategy-planning processes are made more complex due to the requirement to emphasise on the sustainability of community wellbeing and environment, as well as the Islamic financial ecosystem while ensuring that stakeholders' interest and the IFIs' priorities of Shariah principles are not compromised. Moreover, industry players remain skeptical as to whether proper leadership and culture practices of IFIs in championing VBI can remain consistent even during difficult times (e.g. economic recession).

BNM's continuous effort in strengthening the talent development ecosystem for Islamic finance should see greater emphasis upon Islamic finance players to have competent Shariah scholars, not only within their Shariah Committee members, but also amongst the Board of Directors, Senior Management and other working level staff at operational level. With the new regulatory framework (new Shariah Governance Framework and Rahn policy document) coming into force in the second half of 2019, IFIs will experience greater scrutiny on the governance of their Shariah standards and its operational requirements.



## Managing market conduct risk through addressing drivers and restoring trust

### How to implement a Conduct Risk Programme?

2018 has seen regulators turning up the pressure on banks in relation to market conduct. From the consumer market conduct front, BNM has proposed many requirements to ensure that borrowers are treated in a fair and transparent manner in the areas of repricing practices, protecting financial consumers from unfair loan or financing contract terms, and to take measures to help individual borrowers in persistent credit card debt. Most of the effective dates of these requirements will be by end-2019.

In the financial markets space, a thematic review on wholesale market conduct was conducted by BNM in 2018 to assess the adequacy of risk management practices and systems in place, as well as design of incentive structures that may lead to wholesale market misconduct. The review revealed that there is still room for improvement in the area of acquiring more sophisticated trade surveillance monitoring systems, for the purpose of detecting trade anomalies and potential misconduct.

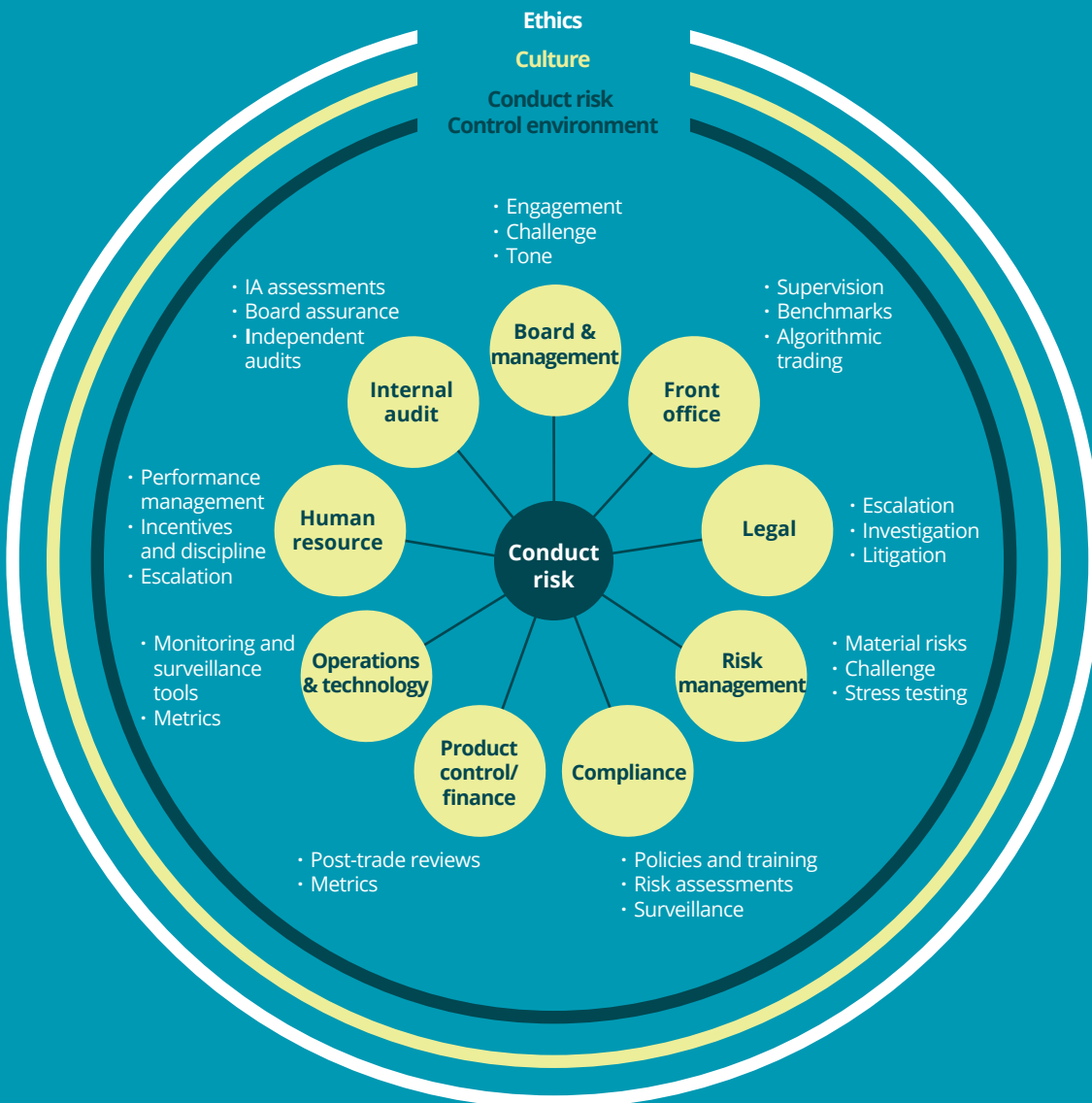
Notwithstanding, banks are on track in meeting the requirements stipulated in the Code of Conduct for the Malaysia Wholesale Financial Markets and Principles for a Fair and Effective Financial Market for the Malaysian Financial Market guidelines published in 2017. There were robust internal policies, procedures and processes in place to promote fair and transparent wholesale market conduct, as well as active discussions held between the Board and Senior Management on wholesale market misconduct, facilitating timely remedial actions.



**Deloitte's view**

Conduct risk is defined as the risk that a firm's employees or agents may harm customers, other employees, the integrity of the markets, or the firm itself. Some common drivers and behaviours that could lead to detrimental conduct-related outcomes include challenges faced by large and complex organisations with diverse and detached teams, employees not held accountable for poor conduct, as well as weak systems for monitoring and surveillance. Despite the conduct risk management theme gaining traction among banks, many are still struggling to manage this risk. A common challenge faced by banks is the difficulty in changing the current mindset or culture of the institution. In addition, there is a lack of urgency by the Board and Senior Management to address this risk. Today, misconduct is still prevalent in many banks.

Banks need to first understand the misconduct taking place in their workplace and understand the role that culture plays in shaping good and bad conduct before focusing on building detective and preventative capabilities to identify and manage misconduct. When developing conduct risk programmes, banks need to pay close attention to the design and implementation of controls targeted at addressing conduct risks across the three lines of defence. In addition, there must be good collaboration between business units and control functions to ensure the effectiveness of its implementation. Below is a depiction of the high-level components of a Conduct Risk Programme:



While there are many regulations and initiatives in place to promote a fair, transparent and ethical environment, it is ultimately the responsibility of individual banks to manage conduct risk.

# Raising the bar in combating ML/TF

## Why do banks need to act now?

Malaysia is embarking on continuous efforts to strengthen and safeguard the financial system integrity. This was evident when Malaysia's Anti-Money Laundering/Countering Financing of Terrorism (AML/CFT) framework was awarded a "Compliant" status by the FATF Plenary for completing 38 out of 40 FATF Recommendations. Ongoing initiatives are being taken to address gaps identified in the remaining 2 FATF Recommendations, relating to transparency and beneficial ownership of legal persons and legal arrangements.

### **a) Reduction of CTR threshold**

Cash remains the prevalent medium of payment in Malaysia. New initiatives are taken to mitigate the risks of abuse of cash for criminal activities. Effective 1 January 2019, the threshold for cash transaction reporting (CTR) reduced from RM50,000 to RM25,000. This is subsequent to recent assessments showing that the initial threshold does not commensurate with the size and prevalence of cash usage in Malaysia. A lower threshold increases the monitoring scope for suspicious transactions and reduces the risk of non-detection reporting. Another potential measure includes benchmarking to other jurisdictions in introducing an economy-wide transaction limit for cash transactions made in Malaysia. Instead of using one single threshold for CTR, multiple limits could be introduced, taking into account the purpose of transaction, business sector, parties involved and whether parties to the transaction are residents or non-residents.

### **b) Enhancing AML/CFT supervision**

To focus and strengthen the supervision in AML/CFT, BNM established a dedicated AML/CFT unit within the supervision sector. The reviews conducted by the AML/CFT unit indicated that banks have made notable progress in strengthening their AML/CFT controls and practices. In keeping up with the evolving environment, work is in progress to further enhance the supervisory activities through greater usage of technology and data analytics.

**Deloitte's view**

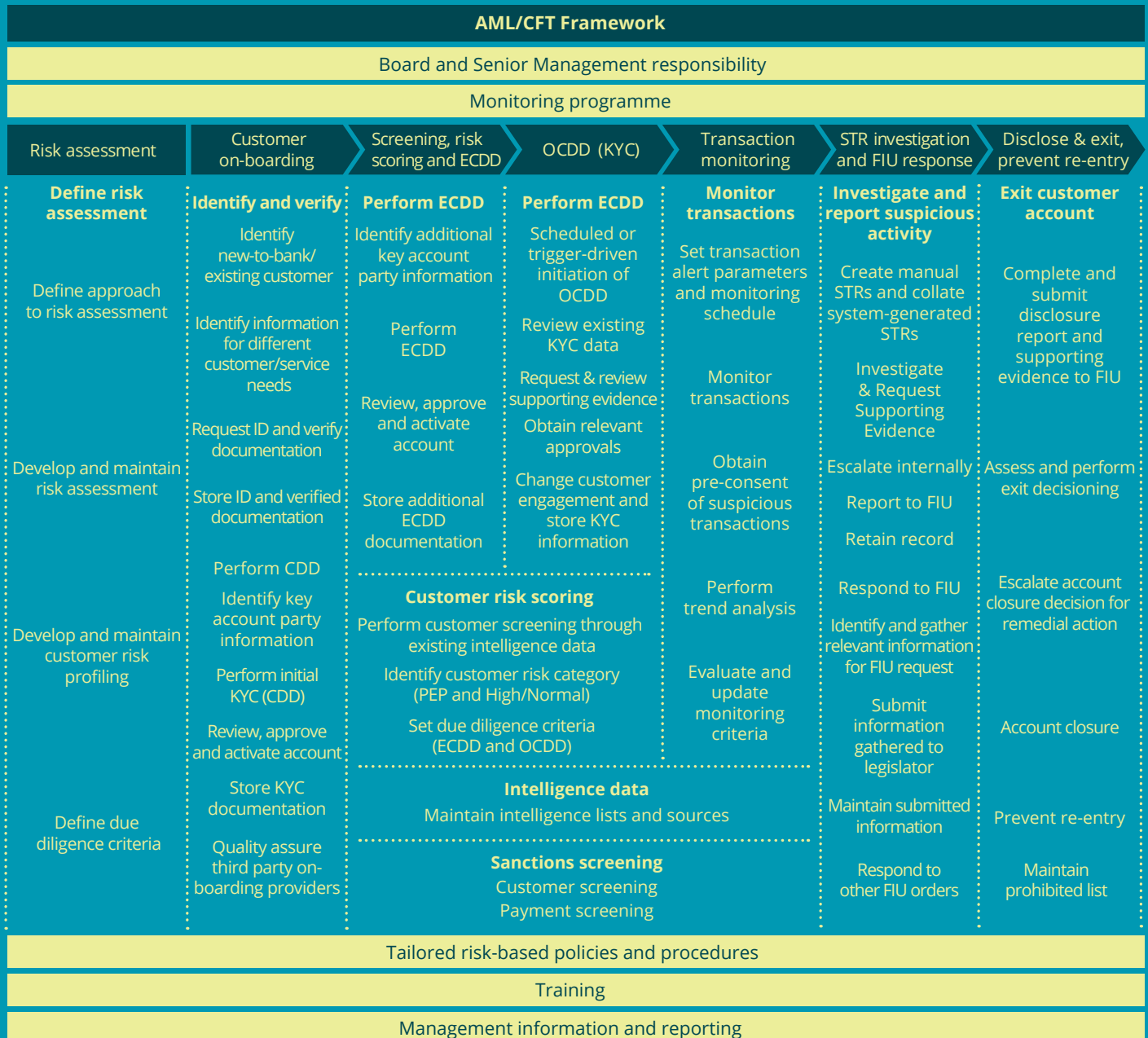
Channels of business have evolved from conventional methods to online platforms. Social media and e-wallet services are gaining popularity, not just among genuine financial consumers but also terrorists and money launderers. With these rapid advancements of complex transactions and the fast-moving operating landscape, banks need to invest in more dynamic and time-critical systems to detect and mitigate ML/TF effectively. The use of data analytics in enhancing the transaction-monitoring system has been gaining traction among banks. Artificial intelligence and machine learning have

the capacity to digest more information, hence providing better insight to clients' behaviour, transactional pattern and effectiveness of the existing parameters based on the data collected.

In addition, with the increasing expectations from regulators to meet ever-stringent regulatory requirements, banks are tasked with investing in more resources and talent development within the compliance function. A factor that sets a bank apart from others is the ability to cultivate risk culture within the institution. This starts with the tone at the top, with the Board and

Senior Management driving the effort and direction of AML/CFT risk appetite for all three lines of defence.

Furthermore, the synergy and collaboration between business units and control functions have never been more crucial. Banks need to shift their paradigm on the role of compliance functions as the sole "gatekeepers" to ML/TF. Both parties should be more receptive towards working together to manage the bank's risk appetite in relation to AML/CFT. Below is a depiction of the AML/CFT Framework:



# Harnessing and managing innovation





40%

27%



CUSTOMER SERVICE LEVELS

CHECK

# SERVICE LEVELS ANALYSIS



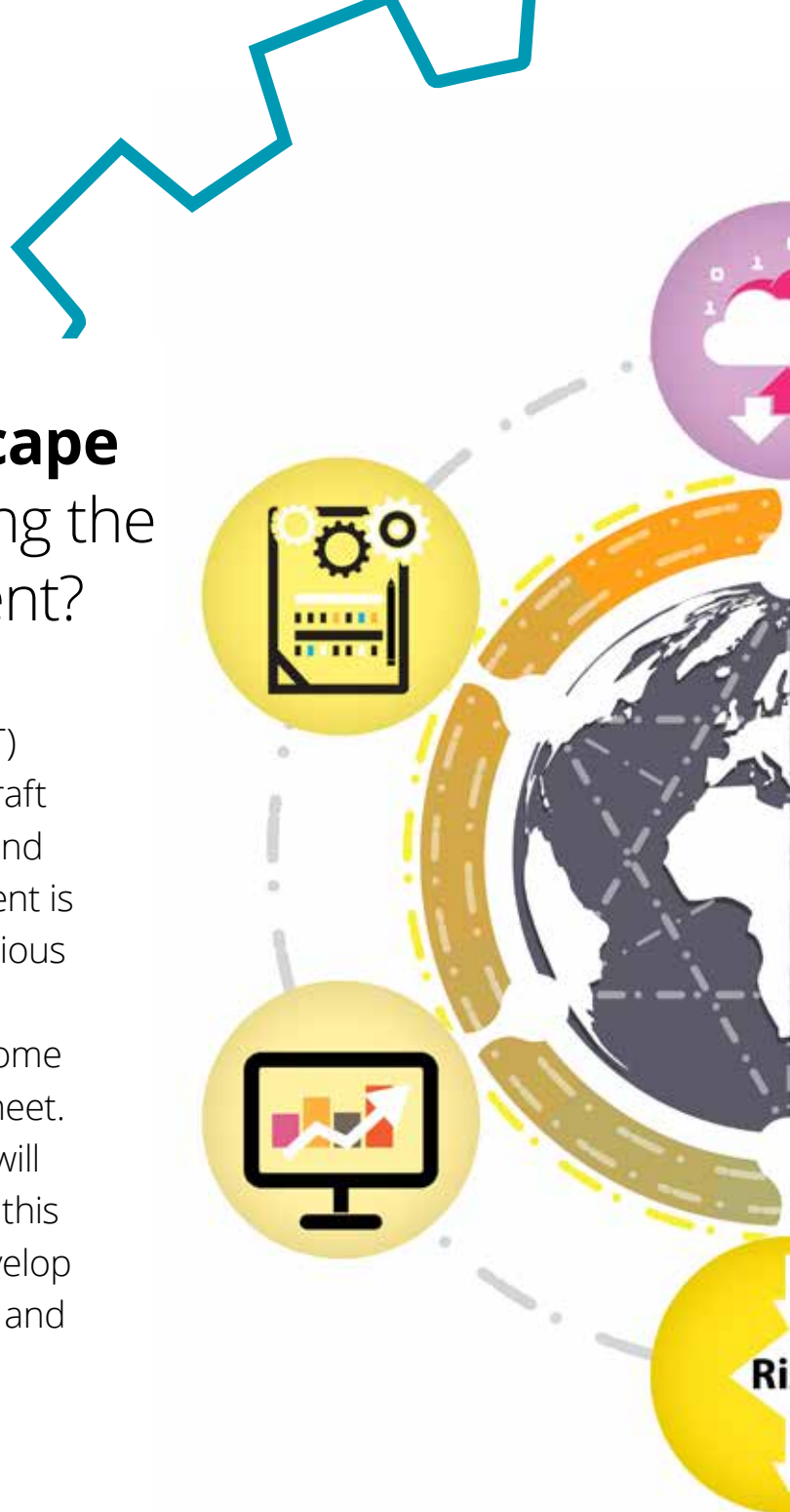
# Keeping pace with the technology risk landscape

## How is technology shaping the future of Risk Management?

The Risk Management in Technology (RMiT) document was released as an exposure draft by BNM in September 2018 for feedback and comments from the industry. This document is meant to serve as a compilation of all previous policies, guidelines, circulars, letters and notices for banks in Malaysia, along with some new updated requirements for banks to meet. As per the exposure draft, the document will be enforced in June 2019. The objective of this is to provide a foundation for banks to develop an effective risk management programme and to better manage technology risks.

Below are summarised key items which would require banks' attention:

- The Board composition should include at least a member with technology competency. The Board needs to obtain adequate advice and guidance, and should be continuously informed on cyber security preparedness, education and training.
- There is a requirement for banks to set up a Technology Risk Management Framework (TRMF) and a Cyber Resilience Framework (CRF). The Board must periodically review these two frameworks.
- A Chief Information Security Officer (CISO) needs to be designated to oversee the TRMF and CRF.
- Banks must ensure that their production data centres and Disaster Recovery (DR) sites (for large banks only) meet at least Tier-III requirements.
- All critical systems and interfaces must be designed for High Availability and must not exceed downtime of more than four hours and a maximum of 90 minutes downtime per incident.
- Stronger two-factor authentications are required for transactions with value of RM10,000 and above.
- New cyber security requirements such as the usage of a Security Operations Centre (SOC), conducting independent Compromised Assessments, Anti Distribution Denial of Services (DDoS) mitigations, Data Loss Prevention Measures and establishment of a Cyber Incident Response Plan.







### Deloitte's view

As technology in the financial industry is constantly evolving and transforming, coupled with the industry push to technology and growing customer adoption to bank technology platforms, this BNM document serves to:

- Further mitigate the risks to customers;
- Enhance current bank infrastructure as well as cater to future scalabilities; and
- Improve and mature risk management processes in order to effectively manage the IT risk landscape.

Most of the requirements that are newly introduced in the RMiT document may not be too difficult for banks to comply. However, the main anticipated challenges for banks may concern the Board's preparedness to meet the requirements as well as having a Tier-III production data centre. Most banks in Malaysia may need to place substantial investments to upgrade their current data centres to meet the requirements.

Getting the right personnel with expertise and competencies in IT Risk Management as well as Cyber Security in order to implement and operationalise these requirements would be a key challenge as well.

# Evolution of money service, payment and settlement systems

## How are banks keeping up?

The report outlines important indicators, proof of an ever-present move towards more sophisticated and advanced requirements in payments and settlement services – brought forward both by increasing retail consumer and corporate needs. Following closely with this evolution of needs is an ever-growing urgency for risk management and cyber security services to likewise, stay on par. While the BNM 2018 Financial Stability and Payment Systems Report proves that there is a marginal increase in fraud cases in this space, vis-à-vis the actual growth in e-payment services being realised, the industry should remain cognisant of the fact that while these services evolve, so do threats to its security.

### Deloitte's view

There are five (5) salient points that warrant elaboration:

#### a) Liquidity measurement and optimisation

Liquidity management is fast coming to the forefront of payment services. Enabling fast, informed decision around liquidity management is an ideal state most banks strive to achieve, but they face tremendous pressure in meeting these requirements mainly due to the lack of appropriate infrastructure, and overemployment of tactical (short-term) solutions in existing system setups. The accentuation of liquidity management continues to stress banks for the need to provide instant, 24/7 payment platforms with widening connectivity, cross-border and cross-currency capabilities. The adherence to Basel III requirements on liquidity is a step in the right direction to pave the way to better liquidity management, but there is still a lot of work required for Malaysian banks to be on par with the rest of the global market. Some initiatives we see in Europe and the Americas include the promotion of a "cashless society". The current leader is Sweden, which is expected to become the first global cashless country in 2021. In addition, we see significant shifts in the interbank space, such as consolidation

of the ECB target services to a common ESMIG platform, or introduction of the Target Instant Payment Service (TIPS), the R1 service of EBA and more.

#### b) Security and safeguards against fraud

The introduction of requirements such as TAC, while advocating better control and security, may steer away from the concept of "fully digital banks", a concept that allows for registration without requiring customers to be physically present in a brick-and-mortar bank branch for the purpose of registration. While in a budding stage, we have seen technologies such as 'Federated Digital Identity', remote digital customer onboarding, biometric identity verification, online customer credibility ratings and checks, and PSD2 integrations with third-party providers which allow for a more enriching digital banking experience for consumers. The diagram on the next page outlines Deloitte's view on the 'Federated Digital Identity', it describes the journey from anonymity (Cookies) to an established "Banking Identity". The trustworthiness of a person's identity becomes more established the more milestones in the circle are met. The highest level of authentication is when a person's digital identity can also be regarded as his or her banking identity.



**c) Payment card transactions in Malaysia**

Its growth is not a trend we often see across the global landscape. Taking markets in Europe for example – the move towards 24/7 instant payment platforms has diminished the need for card services. Newer technologies such as seamless APIs integrations, digital online wallets, QR code payments (which is beginning to be introduced in Malaysia) and proxy payments using contact details rather than the account number further drive the move away from traditional card services and the arguably unpopular concept of the “merchant discount rate”.

It is worth discussing credit cards further; the key benefits of credit cards to the buyer and merchant are simple: when a buyer purchases something, the merchant has a guarantee of a payment, so he or she can release the goods immediately with the assurance of the settlement in the next few days. In the case of instant credit transfers, the merchant not only has payment guaranteed but also the benefit of having the payment remitted immediately. With increased liquidity and potentially nil or low transaction and administrative fees, this is a viable alternative option for merchants. For buyers, it presents greater convenience as each customer has the infrastructure

to perform instant credit transfers on-the-go (mobile phones). The only trade-off for the customer is the loss of the traditional benefits derived from credit facilities (e.g. longer payback period, pre-payments etc.).

**d) Credit transfers displacing cheques**

We have witnessed a move away from cheques since the early 2000s as cheques are inconvenient to prepare, cumbersome to process and are prone to fraud. This move is a natural evolution away from traditional forms of banking and towards digital financial services. Additionally, we believe customers are now considering seamless payment services a necessity. The ability to perform real-time transfers which are 24/7, 365 days a year is fast becoming the ‘new normal’.

**e) Mobile payments**

To begin this topic, we should clarify that a mobile payment service with the backing of a credit card facility might not technically be considered a mobile payment service. So while services like Apple Pay and Samsung Pay provide a greater level of convenience to the average Malaysian consumer, these are not offered to customers who are not using an Apple or Samsung mobile phone, and these services often need to be linked to a credit card.

The banking industry should also give due consideration to other mobile payment service options that will begin to become prevalent such as ‘Mobile Banking’ payments and digital wallets. ‘Mobile Banking’ payments can be described as payments made through a bank’s native application that tap into the customer’s existing banking accounts so that the customer can perform bank transactions from their mobile phones in real time. On the other hand, digital wallets act like centralised systems, allowing customers to open a virtual online account that can store a digital currency of their choosing. These wallets are funded through cards, bank transfers or by a transfer from another digital wallet account. Ideal examples are PayPal, Alipay and Boost.

In closing, we mirror the sentiments and ideas proposed in this BNM annual report. We view this as an exciting time for the industry, ripe with opportunity for the next big thing. At the same time, we call for caution and again emphasise the need for good liquidity management, and the application or exploration of appropriate and sensibly cautionary security measures.



# FSI Regulatory Talk Series

With the continuous evolution of the regulatory landscape, financial services firms need to be prepared to deal with the challenges of diverging regulatory frameworks. As part of Deloitte Malaysia's ongoing efforts in helping the industry understand the emerging changes impacting the Financial Services Industry, we host a series of Regulatory Talks on an extensive range of hot topics surrounding international directives from regulators. We have conducted 8 sessions thus far with over 250 participants from banks, insurance companies and other financial institutions. The following table includes previous and upcoming topics:

## Event details

FSI Regulatory Talk Series	Date & time
<b>Session 1: Recovery &amp; Resolution Planning</b> How should FIs prepare to meet the upcoming RRP requirements?	Friday, 2 November 2018 2:30 p.m. – 5:30 p.m.
<b>Session 2: MFRS 9 Financial Instruments for Bank Internal Auditors</b> MFRS 9 is now live. Are bank internal auditors scaled up to review the implications	Friday, 18 January 2019 9:30 a.m. – 12:30 p.m.
<b>Session 3: BCBS 239 Industry Sharing Session</b> The implementation requires significant time and commitment from banks. What are the lessons learnt?	Wednesday, 23 January 2019 2:00 p.m. – 5:30 p.m.
<b>Session 4: Libor Migration</b> Have you assessed the impacts of LIBOR migration on your bank, across Legal, System & Process, Valuation & Risk Management, Accounting, Tax, Liquidity, Business profitability?	Tuesday, 19 February 2019 2:00 p.m. – 5:30 p.m.
<b>Session 5: FSI Conduct Risk</b> Misconduct has caused multi-million dollar regulatory and criminal fines. How are you managing conduct risk in your organisation?	Monday, 25 March 2019 9:00 a.m. – 12:30 p.m.
<b>Session 6: AML/CFT Review for Bank Internal Auditors</b> Given the rise of AML/CFT breaches in the financial services industry globally, there has been increasing demand and expectations from local regulators on the role of Internal Auditors for AML/CFT reviews.	Tuesday, 9 April 2019 2:00 p.m. – 5:30 p.m.

FSI Regulatory Talk Series	Date & time
<p><b>Session 7: C-suites Roundtable: Combating Conduct Risk, Using Technology and Analytics</b></p> <p>The C-suites roundtable aims to help the Malaysian financial services firms to better understand how analytics tools and technology can help in conduct risk management.</p>	<p>Friday, 10 May 2019 9:00 a.m. – 11:30 a.m.</p>
<p><b>Session 8: D-SIB Framework and Recovery &amp; Resolution Planning</b></p> <p>The eighth session of the Regulatory Talk Series aims to help the Malaysian financial services firms apply the RRP concept in the local context and to also discuss on the D-SIB landscape following the publication of the Exposure Draft on D-SIBS Policy Framework in April 2019.</p>	<p>Monday, 13 May 2019 9:30 a.m. - 12:30 p.m.</p>
<p><b>Session 9: RPA Reporting Lab</b></p> <p>The ninth session of the Regulatory Talk Series aims to address the implementation of the requirements in Data Quality Framework and to discuss on the hotspots for Statistical Reporting.</p>	<p>Upcoming</p>
<p><b>Session 10: Model Risk Management</b></p> <p>The tenth session of the Regulatory Talk Series aims to share the best practice in managing model risk arising from an overwhelming list of models, across regulatory (Basel), risk measurement models, finance (IFRS 9), credit (scorecards) and treasury (valuation and pricing).</p>	<p>Upcoming</p>
<p><b>Session 11: Regulatory Updates for Insurers</b></p> <p>The eleventh session of the Regulatory Talk Series aims to discuss how insurers should respond to new and upcoming regulatory requirements.</p>	<p>Upcoming</p>
<p><b>Session 12: Basel IV Implications</b></p> <p>The twelfth session of the Regulatory Talk Series aims to discuss on the fundamental overhaul of banking capital requirements arising from Basel IV and how banks should prepare for it.</p>	<p>Upcoming</p>
<p><b>Session 13: Operational Risk Transformation</b></p> <p>The thirteenth session of the Regulatory Talk Series discusses the effectiveness of the bank's ORM (particularly on RCSA, controls, KRIs, loss incidents).</p>	<p>Upcoming</p>

For more information on the FSI Regulatory Talk Series, or if you would like to attend the upcoming sessions, kindly refer to our webpage: <https://www2.deloitte.com/my/en/pages/financial-services/events/fsi-regulatory-talk-series.html>



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