

Dr Zeti Akhtar Aziz: Banking and information and communications technology developments - legal aspects

Address by Dr Zeti Akhtar Aziz, Governor of Bank Negara Malaysia, to the Banking and Financial Law School, Kuala Lumpur, 24 April 2001.

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Distinguished Guests

Ladies and Gentlemen

Good morning,

It is indeed a great pleasure to welcome all delegates to the 3rd Annual Banking and Financial Law School. The objective of the Banking and Financial Law School is to contribute to a structured learning programme for members of the legal profession who provide legal counsel to financial institutions. Indeed, Bank Negara Malaysia, the Bar Council and IBBM have been collaborators in this effort for a long time.

The theme for this year's law school is the impact of developments in ICT - Information and Communications Technology - upon legal aspects of financial services in Malaysia. It is a subject that is of increasing interest to bankers and central bankers around the world. There is increasing recognition of the enormous potential for these developments to transform the financial industry in a manner that will bring tremendous gains to businesses and consumers. There is also mounting evidence that ICT is not only creating new alternative delivery channels, but is bringing about compelling changes to the financial landscape that may threaten the very existence of the traditional financial institutions. Whether or not such developments do in fact take place, it is of paramount importance that financial institutions and central banks are well placed to manage the challenges and opportunities brought about by developments in Information and Communication Technology. Essentially, the potential benefits from the new technology need to be exploited without undermining the security and stability of the financial system.

Ladies and Gentlemen,

Central bankers around the world operate within a wide range of economic systems and structures. Within the context of each respective systems, an administrative, regulatory and legal infrastructure is necessary to protect and develop the interests of commerce. As lawyers, you would appreciate that business and commerce flourished with the invention of limited company law. The limited liability company structure and provisions of company law provides the structure for managing complex business risks. The corporate structure spawned economic development across the globe, and over the years have evolved into entities with their own character and identity. A global protocol comprising business practices and ethics evolved largely from man-made common law. With the development arising from advances in information and communications technology, a new phase of growth has emerged. Although often based on the notion of the limited company, the identity of these new businesses are very different. These newly emerging entities do not recognise national boundaries, nor local jurisdictions or markets. Instead of operating within the established contracts and international agreements, crafted and executed by law firms and government agencies, these new entities are operating within the context of their own rules in the world of e-commerce. The Internet provides an unregulated, open communication channel and information repository that is growing at an exponential rate. The rate of economic development within e-commerce has far exceeded the rate of development of the legal and administrative infrastructure. Indeed, the market is often of the view that such infrastructure may in fact be limiting and cause more harm than good.

Consumers however hold a different view, and have approached the developments with more cautious optimism. While there will be gains on efficiency and convenience, this is balanced against the security and other risks associated with these developments. Consumers need to be provided with confidence that contracts will be honoured, and deposits are secure. New business rules will only be viable if the appropriate laws necessary to give confidence to the users are formulated and implemented. Lawyers need therefore to understand the drivers of the new economy, the evolution taking place in the e-commerce business models and the new risks inherent in the digital infrastructure.

Ladies and Gentlemen,

Allow me to provide our perspective on some of the broad issues facing the financial system and central banking in this electronic age. Central banks continue to have the responsibility to manage the economy and the financial system to assure macro-economic and financial stability. Much of the stability, will stem from the confidence that investors, including retail depositors have in the financial system. Financial transactions and commitments must be undertaken in a manner that provides no room for question on the integrity of the payment channel within the country. In the event that there are irregularities or omissions, there must be clear rules and procedures to safeguard the interests of all relevant parties. Therefore, a sound regulatory and legal framework must be in place to provide this minimum level of comfort. Such a framework would need to include the relevant legislation, technical skills to implement the requirements of the legislation and sufficient flexibility to cope with the continuing changes taking place in the world of electronic banking today.

No doubt you are familiar with the initiatives that have been undertaken by the Malaysian Government to establish the Multimedia Super Corridor (MSC). A major component of the project was the introduction of new legislation, the Digital Signature Act, Computer Crimes Act and Communications and Multimedia Act, all of which will provide the pillars of the legal framework for e-commerce transactions in Malaysia. At this point in time, the legislation remains largely untested, but e-commerce transactions are already being performed on a daily basis. Currently, in the banking arena there is still a clear demarcation between the electronic, paperless world of the Internet, and the more paper intensive, manual signature based world of conventional banking transactions. In the meantime, the pace of transition from manual over-the-counter services, to remote electronic delivery channels are expanding. The growing demand for on-line real-time financial services, reinforced by increasing pressures for cost efficiencies in banking operations will lead to greater digitisation of banking transactions.

This changing environment requires financial institutions to be adaptive and responsive. At the same time, a regulatory framework that will enable markets to evolve needs to be in place. The rapid advances in ICT needs a regulatory framework that promotes innovation, while reinforcing the prudential limits to ensure that elements of instability do not emanate from such innovations. Regulators will need to take into account the nature and dimensions of the change so as to devise the appropriate regulatory response that will provide a conducive environment for the financial industry to develop. Towards this objective, Bank Negara Malaysia has formulated the Financial Sector Masterplan to provide the direction and road map for the development of the financial sector which takes into account the changing financial requirements of the economy going forward and the implications of the changes brought about by the changes in technology.

The Financial Sector Masterplan aims to evolve a competitive, resilient and dynamic financial system, with best practices, that are able to meet the more sophisticated demands of consumers and businesses, able to embrace advancements in technology, able to face the challenges from globalisation and liberalisation and able to withstand the economic cycle, thereby contributing to overall economic growth and stability. The Financial Sector Masterplan highlights the need to give greater attention to the development of ICT by the financial services sector. As part of this process, the surveillance of the financial sector through the use of ICT will also be enhanced.

Ladies and Gentlemen,

During this three-day programme, it will be impossible to capture the many issues that are relevant to legal aspects of e-commerce. However, among the important issues is the global dimension of e-commerce. E-commerce is as much a global topic as it is a domestic issue, and in recent years has become a part of the international agenda for the World Bank, World Trade Organisation and similar bodies. Although there is no framework in the WTO that governs e-commerce trade, WTO members adopted a declaration on global e-commerce in 1998 in which members have agreed to the following:

- i. Not to impose customs duties on electronic transmissions of goods or services. This practice is to be reviewed at the next WTO Ministerial Conference and any extension will be agreed upon by consensus; and
- ii. To set up a comprehensive work programme (WP) to examine all trade-related issues arising from e-commerce. So far, the work programme has been exploring how e-commerce should be dealt with in the context of existing WTO Agreements. For financial services, the relevant work of the work programme is being undertaken by the WTO Council for Trade in

Services which looks at the treatment of e-commerce in the General Agreement on Trade in Services (GATS) legal framework.

The work of the WTO would thus be of considerable interest to banking institutions that provide transaction or advisory services on international trade conducted through an e-commerce virtual trading exchange. The banking institution's in-house legal counsel would need to be aware of these developments, and understand the potential implications. In particular, matters of jurisdiction and interpretation of local regulations will pose many dilemmas. In view of this, policymakers within the financial services sector have a vested interest in resolving differences, and creating a more harmonious legal environment within the global system. To promote international awareness of differences in legal jurisdictions, international bodies such as the World Bank, have established a series of databases that are accessible through the Internet.

Closer to home, there are various regional initiatives underway to promote and build on e-commerce initiatives. One example is the APEC Electronic Commerce Task Force, which was established during the First Senior Officials meeting held in Penang, Malaysia, in February 1998. The work plan of the task force is built on and complements the work being undertaken in a number of established APEC bodies, in particular the Telecommunications Working Group (TEL WG), the Transportation Working Group (TPT WG), the Industrial Science and Technology Working Group (IST WG) and the Committee on Trade and Investment (CTI) and its sub-committee on Customs Procedures (SCCP). The Task Force is in the process of concluding Stage One of its 12 month work-program and is embarking on Stage Two, which includes an ambitious but vital program of regional technical cooperation. Initiatives such as these can be expected to dramatically alter the rules of international trade, and consequently the opportunities accorded to financial institutions. But these initiatives will tread on the corridors of international law, and will require legal experts to develop new and innovative contracts in the digital world.

A further development is the e-ASEAN framework agreement that came into being during the Fourth ASEAN Informal Summit in November 2000. The objectives of the framework are to promote cooperation in the development of ICT products and services, with a view to promoting trade and reducing the digital divide within individual ASEAN Member States. Article 5 of the framework explicitly addresses the facilitation of growth in e-commerce, and stipulates that Member States shall adopt electronic commerce regulatory and legislative frameworks that create trust and confidence for consumers. Article 5 also recommends the adoption of the World Intellectual Property Organisation (WIPO) treaties, namely WIPO Copyright Treaty 1996 and WIPO Performances and Phonograms Treaty 1996. The use of alternate dispute resolution mechanisms for online transactions is also emphasised. Article 6 of the e-ASEAN framework agreement addresses the issue of liberalisation of trade in ICT products and services. Actions such as these will accelerate the adoption rate of new technology, reduce the costs of migrating to e-commerce platforms and create pressures for a more globally uniform code of conduct within the trading, banking and payment sectors. An understanding of the developments in ICT, inclusive of the legal, administrative and political ramifications, is important if the opportunities in e-commerce are to be realised.

Ladies and Gentlemen,

Another area that is of significance to bankers and central bankers is the issue of security. Security of information has many attributes, such as confidentiality, privacy, safety, secure transmission and non-repudiation. Financial services is unique compared with most other products in that the entire product can be digitised, and for that reason is eminently suited for conducting business over the Internet. However, should the security of the financial information be breached in any manner, the repercussions are very serious. In the inter-connected world of the Internet, how does one establish accountability for mistakes, fraud or incidences of system failure. For that reason, a great deal of resources and time has been invested in security systems. I also note that there will be an expert to speak on this subject during this programme. Security, and the related subject of audit controls are part of the process to managing the risks associated with financial transaction services offered over the electronic channel. In order to ensure that the Malaysian banking system has proper risk management in place, Bank Negara Malaysia has in place prudential guidelines pertaining to Internet Banking activities.

In the digital era, the science of hacking, filtering, intercepting, spying, on-line copying, transmission corruption and transmission re-routing are elements of a different type of forensic law in cyber-crime management. The study of encoding, encrypting or enciphering data is perhaps not something most lawyers have engaged in so far, but you may find yourselves involved in this in the near future.

There is a great need to maintain an on-going training agenda to aid lawyers and bankers alike to keep pace with the developments in ICT and to be aware of its profound implications to the business of banking. Although there have been training and education programmes that encompass ICT in banking and the law, there are limited opportunities for practicing lawyers to keep abreast of the developments in all these areas. A further element that has increased the urgency for adequate training and education is the increased global competition. The pace of business development in the world e-commerce is very rapid, and opportunities that are not seized soon enough, may be lost to a competitor. Since lawyers and in-house legal counsel are critical to completing business contracts and transactions, your ability to give prompt and quality advisory services will contribute directly to business competitiveness.

Ladies and Gentlemen,

We can expect that banking institutions will continue to invest in ICT, and that customers, especially the limited liability corporate entities, will increasingly demand greater access to on-line financial intelligence and transaction services despite its risks. In this environment, lawyers will be tasked with ensuring that the interests of all relevant parties are protected. Moreover, as the country becomes more open matters of international jurisdiction will become more and more a part of the local agenda, even for the smaller banks and enterprises.

Essentially, there is much to be learnt about the development of e-commerce and its impact on the financial system. This makes it all the more important to have regular exchange of information. I hope the proceedings for the next three days will contribute towards this process. In conclusion I wish you a successful programme. Thank you.