Minimum Due Diligence for Foreign Exchange Transactions For Non-Residents

This document must be read in conjunction with the foreign exchange administration (FEA) rules under Notice 1, Direction to Financial Institutions issued by BNM in June 2013 and any other Supplementary Notices and Supplementary Directions to Financial Institutions. This document serves as a guide for market participants on the minimum due diligence required of all onshore banks when dealing with non–residents(NR) for foreign exchange (FX) transactions, either directly with the onshore banks or via their Appointed Overseas Office (AOO).

Why is due diligence required?

- The 'Direction to Financial Institutions' issued in 2013 requires financial institutions to establish internal controls and procedures to ensure compliance with foreign exchange administration (FEA) rules, which includes obtaining relevant documentation for verification and audit purposes.
- The set of due diligence outlined in this document serves as the minimum standard for all onshore banks. Onshore banks may exercise the due diligence process above the minimum standard in accordance to their risk management framework whilst balancing market efficiency.

What is the minimum standard due diligence?

- NRs entering into FX transactions are required to declare the purpose of the transaction to the onshore banks or AOO. This is required for ROMS[1] reporting purposes.
- Documentary evidence, as guided by Know Your Customer (KYC) principle, should be requested from the customer for verification to ensure due diligence and compliance to FEA rules.
- Onshore banks are to set their own guidance on the requirement for documentary evidence, where such documents may be obtained either pre- or post-transaction as guided by KYC principle.
- Onshore banks are to ensure that any spot sale of ringgit by NRs must be supported by delivery of ringgit on gross basis.

Are these due diligences applicable to all transactions?

- For new customers, onshore banks, and/or by extension AOO, should take a prudent stance to ensure they are satisfied with the NRs' awareness and compliance to FEA rules, including obtaining documentary evidence for the initial FX transactions, where required.
- For existing customers, onshore banks may elect to obtain document on selective basis, instead of every transaction as guided by KYC principle.
- Verification on the purpose of transactions based on declaration from the NR shall be supported by internal checks on the status of the NR (such as FEA compliance track record) as guided by KYC principle.
- Non-resident institutional investors are allowed to enter into FX transactions arising from FX exposures with any licensed onshore bank or AOO (subject to proof of underlying where relevant), regardless of whether a direct custodial relationship for cash or securities exists.
- A third party FX bank (i.e. any licensed onshore bank or its AOO that facilitates FX transactions of the NR, but does not maintain the NR's external account neither acts as the NR's securities custodian) in facilitating FX transaction of a NR may –
  - ✓ obtain a declaration from the NR to ascertain the purpose of the transaction; and

[1] ROMS refers to the Ringgit Operations Monitoring System owned and operated by Bank Negara Malaysia for monitoring of cross-border flows and developments in the foreign exchange market.

- ✓ undertake a confirmation on the underlying asset of the NR post-transaction as guided by KYC principle.
- For every FX trade, establishing the purpose and underlying at the onset is required for reporting purposes in ROMS.

Dealings with Non-Resident Financial Institution (NRFI)

- NRFIs that are mandated to manage, or act as a custodian to their NR clients' ringgit assets, are allowed to undertake FX transactions on behalf of their own clients, including for FX exposures from ringgit assets that may not be under their custody[3] with any licensed onshore bank and/or AOO. Examples of these NRFIs are custodian bank, trust bank, retrust bank etc.
- In facilitating a transaction by a NRFI on behalf of its client (via an onshore bank or AOO), the following purposes do not require an NDF attestation from the NRFI:
  - ✓ International trades in goods and services with a resident;
  - ✓ Equities or instruments listed in Bursa Malaysia; or
  - ✓ Any spot transactions undertaken by a NRFI that is mandated to manage or act as a custodian for its institutional investors' ringgit assets.

  All other transactions by a NRFI on behalf of its NR clients require an NDF attestation from the NRFI.
- In facilitating a transaction by a NRFI for its own account (via an onshore bank or AOO), an NDF attestation is required from the NRFI for all purposes other than:
  - ✓ International trades in goods and services with a resident; and
  - ✓ Equities or instruments listed in Bursa Malaysia

  All other transactions by a NRFI for its own account require an NDF attestation from the NRFI.
- NRFIs without any proprietary FX trading whom only facilitate NR clients' trades may seek an exemption from the attestation requirement from BNM.
- Prior to facilitating an FX transaction, the bank that facilitates the FX transaction may contact BNM to verify the attestation status of the NRFI.
- For every FX transaction, obtaining the name of the NRFI's customer and purpose is required for ROMS reporting purpose.

Any difference in the due diligence for transactions on firm versus anticipatory basis?

- FX transactions on forward basis for current account transaction may be on firm commitment or anticipatory basis if the FX transactions are done directly with onshore banks.
- FX transaction on forward basis for financial account transactions shall be undertaken on firm commitment basis for transactions done directly with onshore banks.
- All FX transactions through AOO must be based on firm commitment basis.
- Unwinding or cancellation of any forward transaction where the underlying remains, requires BNM's approval (with the exception of FX transactions that are explicitly permitted by regulations i.e. Dynamic Hedging, Corporate Hedging Framework, etc.).

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[3] For example: Global Custodian A custodies equity and Global Custodian B custodies bonds. Global Custodian A is allowed to manage spot FX exposure for equity and bonds for the NR ringgit assets.

FX transaction by non-residents for underlying ringgit assets with a licensed onshore bank or Appointed Overseas Office (AOO)

		Spot[5]		Forward[6] (passive hedging)	
NR counterparty	**Requirement on NR counterparty**	**Onshore bank**	**AOO**	**Onshore bank**	**AOO**
A. NRFIs[7], other than in (B)	Proof of Underlying[8]	Not required	Yes: Firm commitment		
	Attestation	Yes – except for equity[9]			
	Registration with BNM	Not applicable: deemed as proprietary transaction			
B. NRFI in the capacity of custodian / trust managing **ringgit assets** on behalf of NR client (in full / partially)	Proof of Underlying[8]	Not required	Yes: Firm commitment		
	Attestation	Not required		Required[10] – except for equity	
	Registration with BNM	Not required	Required[11]	Not required	Required[11]
C. NR institutional investor	Proof of Underlying[8]	Not required	Yes: Firm commitment		
	Attestation	Not required			
	Registration with BNM	Not required			

5 Any spot sale of ringgit by non-residents must be supported by delivery of ringgit on gross basis

6 For dynamic hedging, NRFIs (B) and NRs (C) could submit a one-off registration to Bank Negara Malaysia (BNM) for flexibility to actively manage FX risks exposure from underlying MYR asset via **FX forwards without further need to show documentation.** Sighting of underlying and monitoring will be conducted by BNM under the dynamic hedging programme.

7 By definition, non-resident financial institution (NRFI) includes banking institution, custodian and trust bank

8 Requirement to have proof of underlying has to be read together with the Minimum Due Diligence for Foreign Exchange Transaction for Non-residents

9 For NRFIs (A) that have not attested, the facilitating bank (LOB or AOO) shall ensure that the underlying transaction is limited to equity

10 May seek exemption if no FX desk i.e. no currency market making activities

11 Registration by NRFIs (B) only, NR client is not required

What is the due diligence on non-resident for hedging purposes?

Forward Transactions			
No	**Non Residents**	**Type of hedging**	**Min. Due Diligence**
1	• Corporates	• Passive hedging • Corporate hedging framework • FCPO/OCPO hedging framework	1. Minimum standard due diligence to be performed, including verification of registration/approval (where required) *2.* Disposal or extinguishment of the underlying must be followed with cancellation of the original FX hedge.
2	• Institutional Investors • Custodian/trust banks	• Passive hedging	1. Minimum standard due diligence to be performed 2. Disposal or extinguishment of the underlying – (a) must be followed with cancellation of the original FX hedge; or (b) the forward contract can be maintained provided the onshore bank ascertains that the NR's total ringgit assets including ringgit funds in the external account are equal or exceeding the total amount of forward contracts of the NR 3. Sighting of NDF attestation or exemption letter for custodian or trust banks Note: • FX contracts for RM assets may be undertaken on portfolio basis or backed with specific underlying • For custodian or trust banks, verify the registration status if FX transaction is undertaken via AOO
3	• Institutional Investors • Custodian/trust banks	• Dynamic hedging	1. Verify the approved LEI number with BNM prior to allowing any trades 2. For custodian or trust banks, verify the approval status with BNM 3. LEI must be reported in ROMS for every FX trade Note: • No documentary requirement for the underlying • FX contracts for RM assets may be undertaken on portfolio basis or backed with specific underlying

What are the types of documentary evidence required?

The tables below serve as a guide on the types of documentary evidence. Onshore banks can determine based on their own KYC standards the type of documentary evidence that is sufficient to ensure compliance to FEA rules.

Current Account Transactions		
No	**Purpose**	**Examples of document to support transaction (non-exhaustive)**
1	Goods & Services	Invoice, Bill of lading, Purchase order, Delivery order, Supply contract, Service / Tenancy / Rental agreements, Payment advice
2	Foreign worker remittance or remuneration for expatriates	Work permit, Payslip or Letter from company
3	Repatriation of dividend, royalties or fees	Extract of AGM, Board resolution, BNM approval, Invoice / Agreement / Payment advice

Financial Account Transactions		
No	**Purpose**	**Examples of document to support transaction (non-exhaustive)**
1	Purchase or sale of ringgit equities / bonds	Purchase / Sale tickets, Broker confirmations / statements, Local custody confirmation / statements
2	Placement of ringgit deposits with a financial institution in Malaysia only for spot transaction	Deposit brochure / Term-sheet / Prospectus or confirmation of the respective investment product
3	Purchase or Sale of property in Malaysia	Sales & Purchase Agreements, Contract agreements
4	Purchase, sale or margin call on ringgit futures	Purchase / Sale tickets, Broker confirmations / statements / Margin calls, Local custody confirmation / statements
5	Other ringgit-denominated financial instruments or Islamic financial instrument as approved by the relevant regulator	Deposit Brochure/ Term-sheet / Prospectus or Confirmation of the respective investment product
6	Lending to intercompany onshore	Documentation regarding intra-group payment or agreement, Debit notes, BNM approval letter
7	Direct investment to Malaysian entities	Sales & Purchase agreement