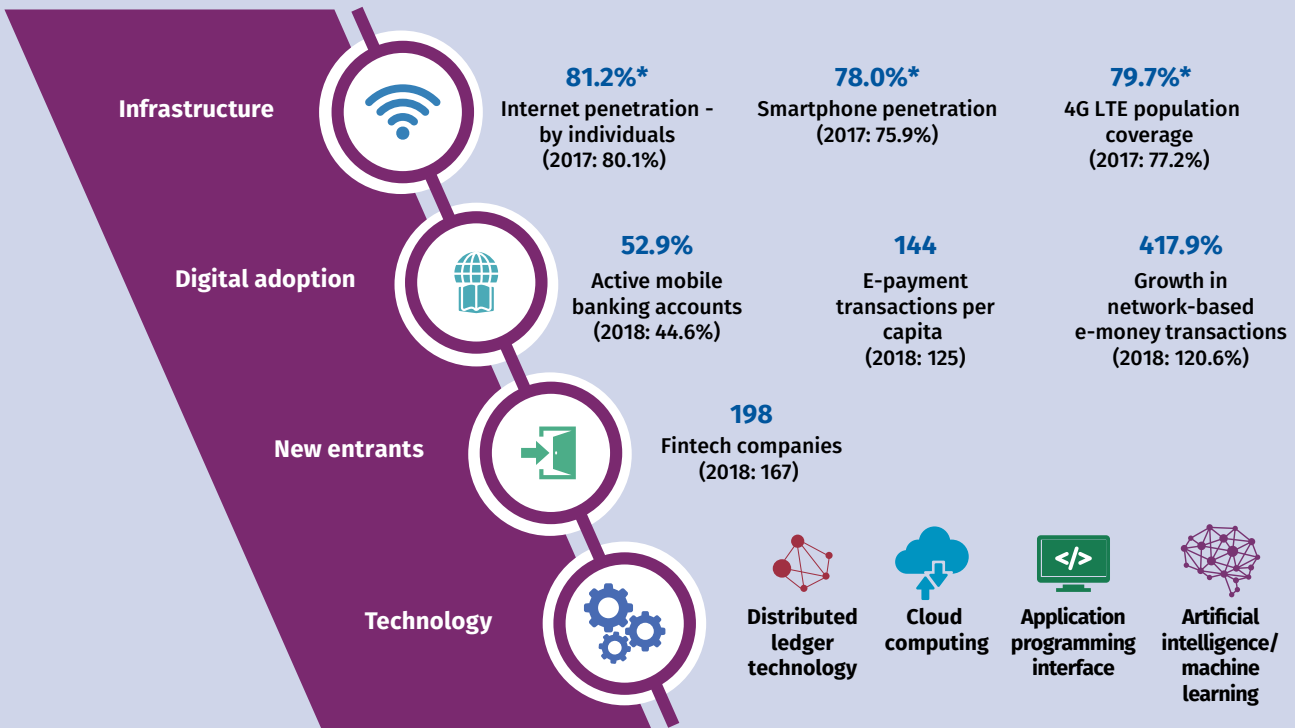


## Unlocking the Potential of Innovation: Preparing for a Digital Future

Digital innovation is bringing sweeping changes to the way financial services is consumed and delivered in Malaysia. Diagram 1 provides a highlight of the driving factors towards digitalisation in the nation. At the industry level, financial service providers are increasingly looking to reinvent business models and capture the potential of digital innovation. At the customer level, end users have acclimatised to a more connected and convenient lifestyle.

Diagram 1: Factors driving digitalisation in Malaysia



\* 2018 data

Source: Department of Statistics Malaysia, Malaysian Communications and Multimedia Commission, Bank Negara Malaysia, Fintech News Malaysia

### Our approach to digital innovation

As the central bank, we are mandated to promote a sound, progressive and inclusive financial system. For this reason, we strive to ensure that the financial sector continues to innovate responsibly for the benefit of the economy and the good of Malaysians. While the Bank works towards enabling innovation, we are also mindful of emerging risks associated with advances in financial technology and new business models. This calls for a balanced approach that carefully considers the potential benefits and risks that these developments bring.

Our thinking is guided by three principles:

1. **Parity.** We will strive to create a level playing field for both incumbents and new entrants in the market. While prudential and market conduct rules will need to be tailored to address new technologies and business models, we will ensure that similar activities are treated similarly across different types of players.
2. **Proportionality.** We recognise that the rigour and intensity of our regulations must be proportionate to the risks involved. For this reason, the Bank considers the size of a provider, its nature of business and the complexity of its activities in our regulatory and supervisory approach. We also consider risks in terms of impact to the entire financial system. Accordingly, we generally subject large and complex financial institutions to higher standards. Institutions with smaller footprints usually pose less systemic risk and thus, may be accorded more simplified requirements.

3. **Neutrality.** We recognise the need for our regulations to be neutral and provide sufficient flexibility to enable novel ways of achieving an outcome. We are technology agnostic and so are open to the use of different technological tools, systems and approaches.

### Fostering digital innovation in practice

The use of new technologies not only promises efficiency gains for financial institutions, they also open up new opportunities for financial institutions to grow their business and serve their customers better. Our regulatory framework is designed to enable financial institutions to adopt new technology platforms and transform legacy systems, while ensuring that the associated risks are well-managed.

In particular, the Bank's regulatory framework<sup>1</sup> provides a foundation for financial institutions to better manage their technology risks. For example, cloud services promise scalability and efficiency for organisations. However, the use of cloud also raises a number of risks and concerns. Given clients of cloud infrastructure share resources on multiple levels, the extent of vulnerabilities and risk of contagion are additional issues to be considered. For this reason, the Risk Management in Technology (RMiT) policy document which we issued in 2019 sets out a number of safeguards and parameters for the adoption of cloud by financial institutions. Thus far, more than 15 financial institutions have begun to use cloud technology for non-critical systems such as productivity, collaborative and research management tools. Additionally, several financial institutions have also consulted us on leveraging cloud technology for critical systems. We also recently revised our Outsourcing policy document to, among others, allow financial institutions to enter into technological partnerships with third parties. Such partnerships enable financial institutions to quickly acquire technological capabilities, while allowing continued focus on their core business.

The Bank also seeks to provide a facilitative environment for financial institutions to reach and interact with customers through the use of technology. For example, our efforts to enable electronic Know-Your-Customer (e-KYC) and to promote interoperability across electronic wallet (e-wallet) operators help transform mobile devices into powerful financial access points. Further details on e-KYC and interoperable payments are provided in this chapter and the chapter on 'Promoting Safe and Efficient Payment and Remittance Systems', respectively. During the year, we also issued an exposure draft on the insurance and takaful aggregation business. Aggregators make it easy for customers to shop around and compare insurance and takaful products across different providers.

At the same time, the Financial Technology Regulatory Sandbox (Sandbox) which we introduced in 2016 serves as a platform to enable innovative solutions to be deployed and tested in a live environment, but within specified parameters and time frames. So far, the Sandbox has enabled the Bank to calibrate our policies through an evidence-based approach while helping Sandbox participants validate and refine the value propositions of their solutions. Customers have also benefitted through more affordable, accessible and efficient solutions, which have served to encourage wider adoption of digital financial services. Going forward, we expect that the Sandbox will continue to be a reliable channel to test new solutions that face regulatory challenges, especially those with high potential to fill in market gaps.

We also recognise the importance of promoting digital innovation, especially where it can enhance the quality and affordability of financial services. On this, the Bank is putting in place a licensing and regulatory environment that welcomes new entrants. In 2019, we announced plans to issue digital bank licences and subsequently consulted on the applicable licensing framework. Through innovative application of technology, digital banks can enhance access to affordable and quality financial solutions, particularly for the underserved and hard-to-reach market segments. With their new and innovative business models which promise positive customer outcomes, digital banks are also expected to complement incumbents in addressing market gaps. Further details on digital banking are provided in this chapter.

<sup>1</sup> Such as the RMiT and Outsourcing policy documents.

### **Going forward**

Looking ahead, we will continue to focus on evolving a financial services industry that best serves the needs of Malaysians. This also means simultaneously keeping a close eye on risks that may emerge or be amplified as digital innovation becomes a more prominent feature in our financial system. Data security, consumer protection and financial integrity, in particular, are among the important issues that will continue to warrant attention going forward.