

Promoting a Progressive and Inclusive Financial System

The Bank is committed to promoting a progressive and inclusive financial system, one that will allocate financial resources effectively and efficiently to meet the needs of Malaysia's economy and its people.

In 2019, our efforts to develop the financial sector were dedicated to recalibrating regulations to cater for new innovative realities, deepening financial markets and encouraging sustainable and inclusive offerings. We continued to focus our efforts on uplifting financial inclusion among consumers.

Enabling the digitalisation of financial services

The digitalisation of finance has the potential to improve the way financial services is delivered to consumers. For individuals and businesses alike, this may mean easier, faster and cheaper ways to access services and manage their finances. To realise this potential, the Bank strives to ensure that our regulations do not prevent greater digitalisation in the financial sector and at the same time, also serve to ensure that financial institutions are effectively managing the associated risks.

In 2019, we issued an exposure draft on the use of electronic Know-Your-Customer (e-KYC) technology

Diagram 1: Development efforts in 2019

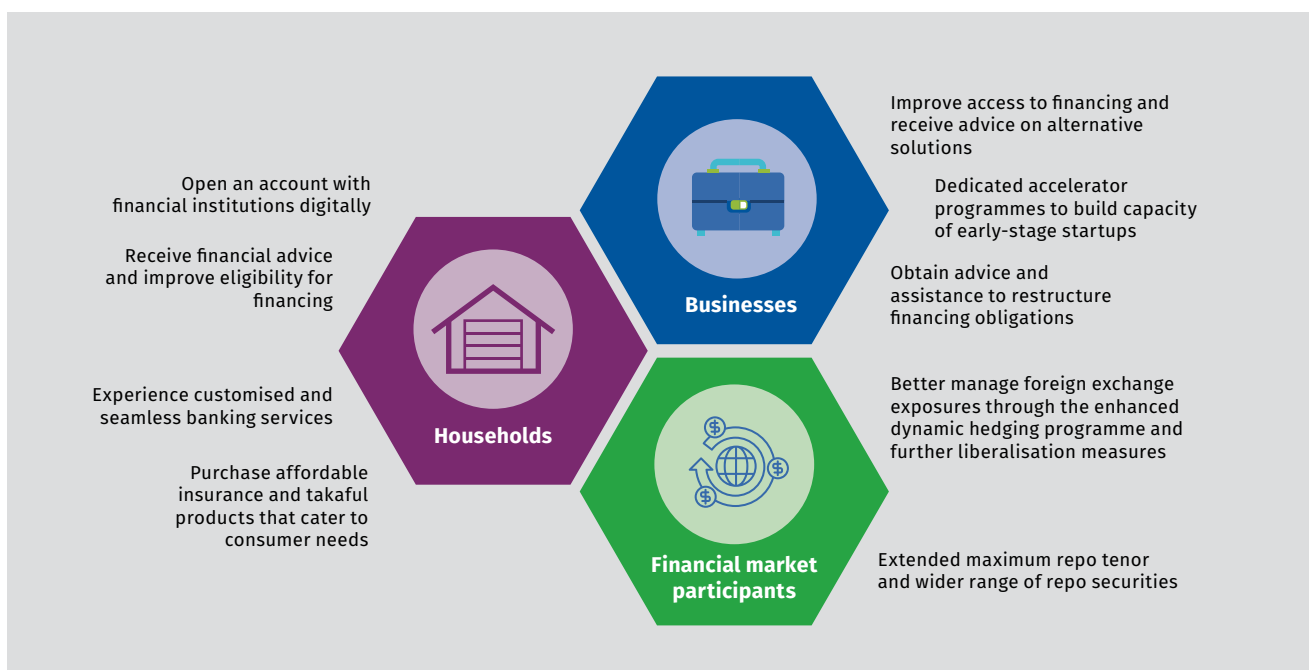
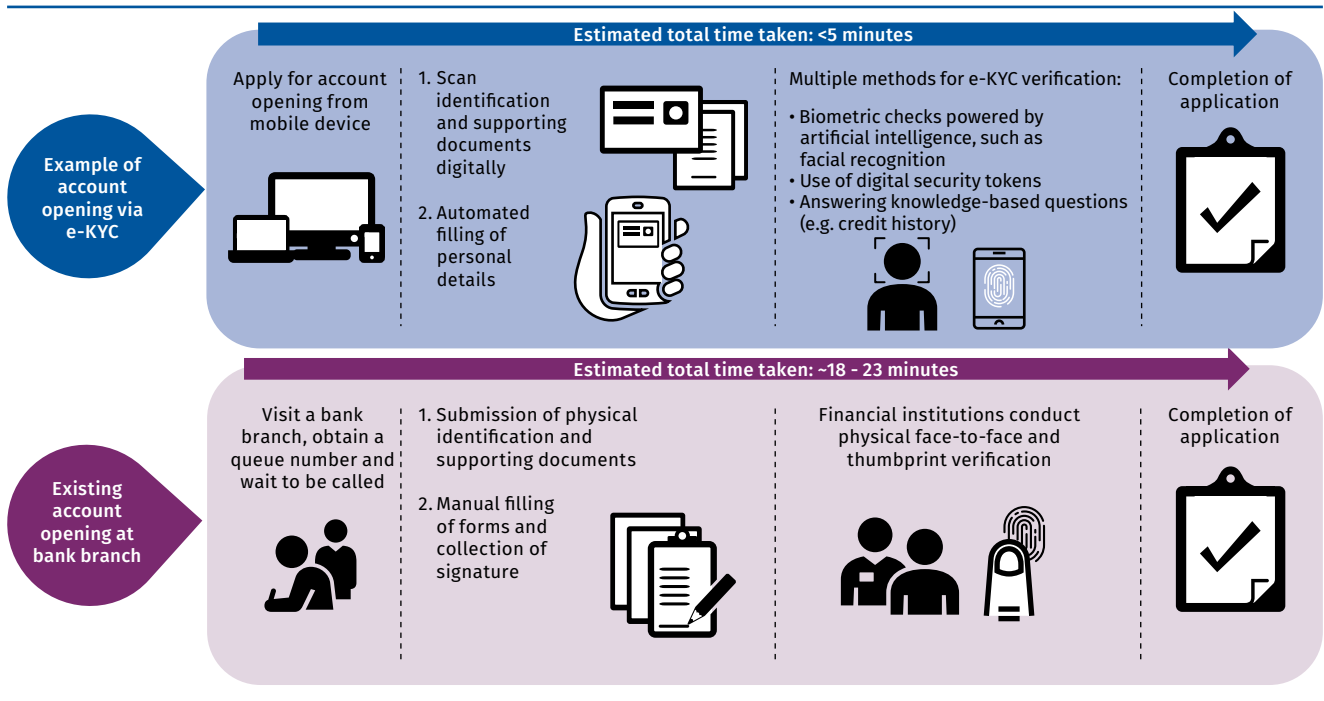


Diagram 2: Schematic flow of bank account opening through e-KYC



for individual account openings in the financial sector. Adoption of e-KYC allows customers to open accounts digitally, without the need to present themselves at physical branches. For financial institutions, e-KYC lowers the cost and time taken to on-board new customers. This reduced friction can help increase the uptake of services in addition to promising greater customer convenience. An illustration of the potential customer journey through e-KYC is provided in Diagram 2. While proposing to allow for the use of e-KYC, the exposure draft also sets out a number of requirements to ensure that e-KYC is secure and effective.

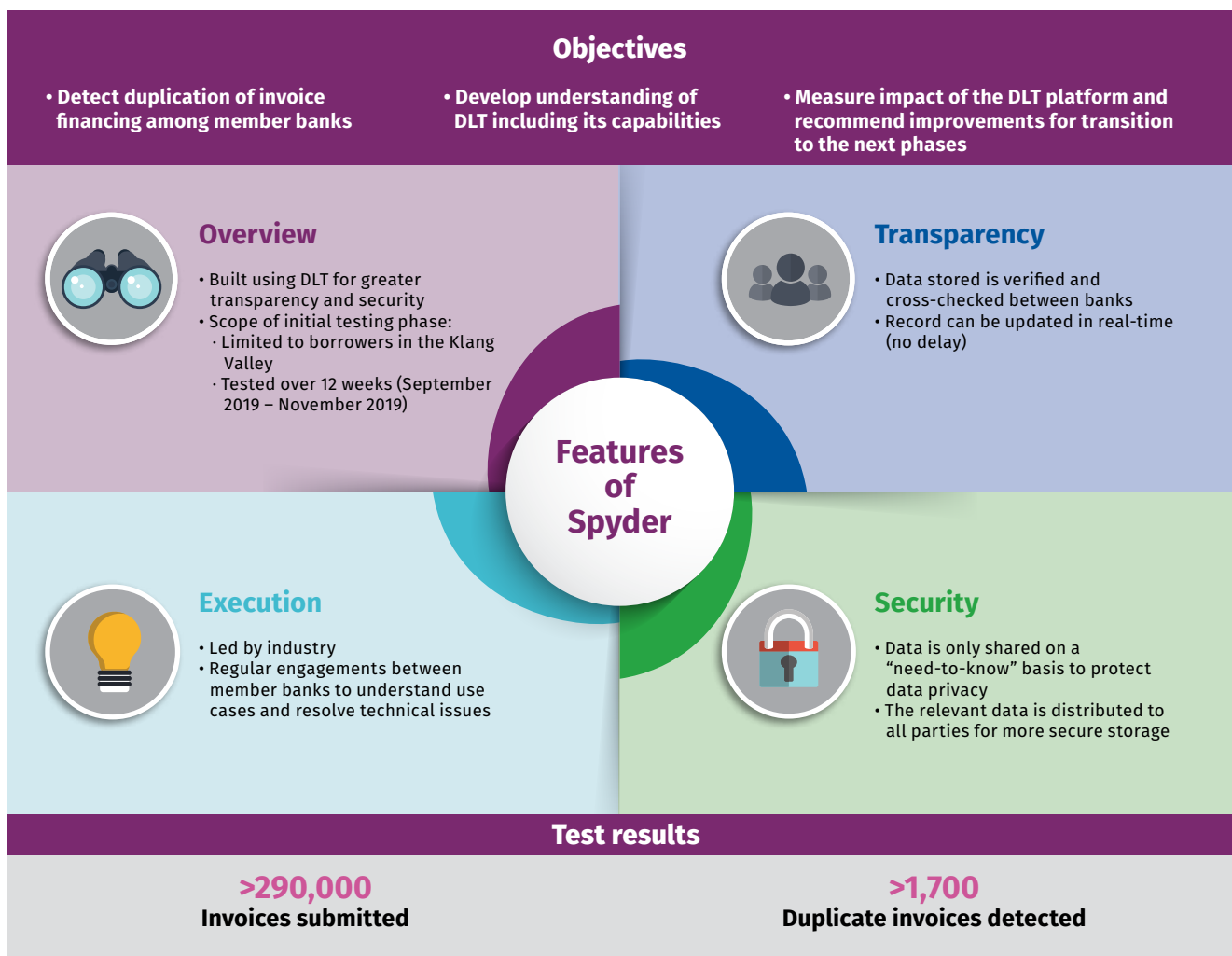
During the year, the Bank also announced plans to license digital banks. The licensing of new players with innovative business models is expected to serve the economy and contribute to the well-being of Malaysians. Digital banks can play an important role in encouraging meaningful access to financial services and the responsible usage of suitable and affordable solutions by financial consumers. For this purpose, we issued an exposure draft setting out our proposed approach to licensing digital banks. The proposed licensing approach is designed to facilitate the growth of digital banking models in a safe and sustainable manner, while addressing unmet customer needs, particularly those of underserved and unserved segments. The Bank has also published details of a simplified regulatory framework that

will apply to new entrants during their initial years of operations. This is intended to reduce barriers to entry while allowing a reasonable time frame for digital banks to achieve compliance with equivalent rules applied to existing licensed banks.

The financing of trade has traditionally involved lengthy processes and paperwork. In 2019, a joint working group with nine banks developed a solution to digitalise trade finance. In the first phase, we developed a proof-of-concept, Spyder, at the Bank's innovation lab. Spyder is a distributed ledger technology (DLT)-based solution which allows banks to securely share invoice information with each other. It helps reduce fraud and errors in the trade finance process. For businesses, this also promises a more seamless trade finance experience. In November 2019, we concluded the testing phase of Spyder. Moving forward, the joint working group will build on this solution to integrate third parties along the supply chain such as shipping companies, customs, insurers and takaful operators for a more comprehensive end-to-end trade finance process.

To promote a more comprehensive ecosystem for trade finance facilitation, we issued a policy document on Trade Credit Insurance (TCI) and Trade Credit Takaful (TCT) in May 2019. The offering of TCI and TCT complements traditional bank-intermediated trade finance solutions – such as

Diagram 3: Snapshot of Spyder



letters of credit – and opens up an additional avenue for businesses to protect themselves against the risk of non-payment of goods and services by buyers. It also empowers businesses to better manage country risk, thus opening up access to new markets.

Recent years have also seen greater use of technology in financial markets. In particular, the electrification of financial markets promises greater efficiency and transparency in the intermediation and price discovery process. In an effort to support this development in Malaysia, we published a framework for Electronic Trading Platforms (ETP) in November 2019. The framework sets out our expectations on the controls and governance for registered ETP operators in Malaysia, aimed at ensuring market integrity and orderly conditions are preserved. This includes requirements to ensure that ETP operators, among others, protect the confidentiality of customer and

trading data, and that they manage the technology risks of the platforms.

We continue to intensify our engagements with industry and other stakeholders in driving the digitalisation agenda forward. In June 2019, we hosted MyFintech Week and the Financial Industry Conference, which saw over 2,000 speakers and participants in attendance engaged in conversations on what is shaping the future of finance in Malaysia. While MyFintech Week and the Financial Industry Conference featured sessions that cut across a range of areas and issues, the digitalisation of finance was a prominent theme. The event also showcased various innovative financial solutions, including those developed by the 16 Malaysian startups that participated in the accelerator programmes held in conjunction with the event. Key highlights from the event, including the solutions showcased are further detailed in Diagram 4.

Diagram 4: MyFintech Week and Financial Industry Conference 2019



Encouraging diverse and sustainable financial product offerings

A progressive financial system must be responsive to the changing needs of individuals and businesses. This means a financial system that provides a broad range of suitable financial offerings to meet these needs. New offerings should not only create economic value, but also contribute to a positive environmental and social impact.

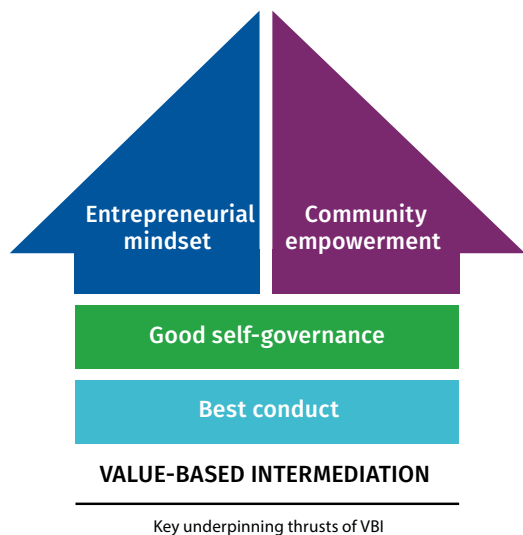
An important area of focus during the year was working with the insurance and takaful sector to develop proposals for the next phase of Motor and Fire Tariff reforms. The proposals will seek to build on earlier measures to encourage greater innovation and efficiency in the insurance/takaful market, while providing incentives for individuals and businesses to manage risks better. In 2019, the industry introduced more than 200 new motor and fire products to meet different protection needs. Among others, these included the waiver of compulsory excess for unnamed drivers, limited special perils and daily coverage for e-hailing. Greater pricing flexibility is necessary for the

industry to develop more innovative and customised products, but we will also ensure that appropriate safeguards are in place to preserve access to and affordability of insurance/takaful products. We also continue to work with relevant stakeholders to address important structural issues to reduce the time taken and risks of fraud in the processing of claims. For further information, refer to BNM Annual Report 2019 Feature Article titled 'Improving the Motor Claims Process'.

During the year, the industry, through the Medical Cost Containment Task Force, commenced work to study the causes of medical claims inflation and possible remedial measures. The study will inform future strategies to ensure healthcare services – including medical and health insurance/takaful – remain sustainable, accessible and affordable. If left unaddressed, this issue will likely lead to increases in premiums for all policyholders in the long run, making medical insurance/takaful less affordable and out of reach for many Malaysians. The BNM Annual Report 2019 Feature Article titled 'Managing Medical Claims Inflation' attempts to assess the underlying factors for claims inflation and explore ideas to promote the sustainability of the medical and health insurance/takaful segment.

Value-based Intermediation (VBI)

VBI embraces the proposition of intermediation activities that have a clear and distinct focus on generating a positive and sustainable impact to the economy, community and environment.



Features of VBI are universally applicable across the financial sector (both conventional and Islamic financial players) -

- *Higher overarching objective that emphasises maximising positive value/impact and prevention of negative impact on the economy, society and environment*
- *Strong link to real economic activities and embedded risk management feature (avoidance of speculative and harmful activities)*
- *Holistic perspective in the pursuit of socio-economic development*

VBI accords equal emphasis to economic value creation and the upholding of ethical values. Business strategies and performance are therefore evaluated and measured against broader considerations that extend beyond commercial profits alone. Approaches to risk assessments also seek to better align lending and investment decisions with sustainable business practices.

For example, a VBI-oriented bank may provide post-financing advisory services to complement its financing to a corporate client in the agriculture sector. The post-financing advisory services could be on sustainable business operations such as proper resource management for land irrigation and environmental restoration.

While the commitment to support sustainable development is one that should be observed by all financial institutions, Islamic financial institutions, guided by their Shariah underpinnings, are well-positioned to pioneer efforts to generate a positive impact on the environment and community. For this reason, the Value-based Intermediation (VBI) agenda was launched in 2017 in an effort to reinforce the intent of Shariah to promote good and prevent harm.

In November 2019, the Bank jointly issued with the industry a VBI assessment framework setting out guidance on impact-based factors that Islamic financial institutions should consider when providing financing and investment. These include environmental, social and governance (ESG) factors. With this framework, Islamic financial institutions are encouraged to nurture their customers, investors and other stakeholders to adopt more sustainable practices. For example, when assessing any financing

for construction projects, a customer would be encouraged to satisfy sustainable infrastructure ratings such as the Sustainable INFRASTAR issued by the Construction Industry Development Board Malaysia (CIDB). Such sustainable ratings serve as a guiding tool for customers to demonstrate that their infrastructure projects incorporate balanced ESG considerations. While written with Islamic financial institutions in mind, the guidance can also be adopted by conventional players.

In the takaful sector, the Bank is working with the industry to develop guidance for value-based takaful applications. The Malaysian Takaful Association has also taken the lead to align current takaful business with the objectives of VBI. Several takaful operators have begun identifying strategies that focus on value and impact creation to address social inclusion and the financial needs of certain segments. For example, traditionally-excluded segments such as people with disabilities (including mental illness)

can now obtain affordable protection which covers accidental death, natural death, medical treatment and hospitalisation allowance due to accident.

Deepening financial markets

The Bank also rolled out measures to further deepen the Malaysian financial market and improve market access.

The dynamic hedging programme was first introduced in 2016 to provide an avenue for investors to actively manage their foreign exchange risk exposures onshore. The programme was further enhanced in 2019 to cater to the different growing needs of investors. To this end, we opened up participation in the programme to trust banks and global custodians. We also provided the option for investors to enter into forward contracts to buy ringgit beyond the current 25% threshold upon approval by the Bank. These revisions are set to improve investor experience and contribute towards enhancing liquidity in the domestic market. As at end-2019, there are 105 market participants registered in the programme, managing a total of USD38 billion in assets.

In 2019, we also announced several measures to liberalise foreign exchange administration policies. The liberalisation aims to provide greater flexibility for corporates, market participants and investors to better manage their foreign exchange risk exposures. These measures have benefitted market participants and corporates, particularly small and medium enterprises (SMEs) involved in global supply chains. Since the liberalisation, an estimated 1,200 SMEs have utilised the flexibility to settle domestic trade activities in foreign currency, with total transactions amounting to an equivalent of RM327.6 million. As part of ongoing efforts, the Bank will continue to review the applicability and efficacy of our policies.

Similarly, we accorded greater flexibility to market participants in the repurchase agreement (repo) market. Having considered industry feedback, we revised the repo framework to provide for an extended maximum repo tenor of five years and a wider range of repo securities, among other revisions. The flexibilities will enhance liquidity in the repo market and support market-making activity in the bond market.

Enabling access to finance and financial inclusion

Financial inclusion is essential for a more equitable society. In line with the nation's approach to encourage shared prosperity across all groups, the Bank continued to take active steps to advance financial inclusion.

The financial sector continues to play an important role in supporting home ownership, particularly for first-time home buyers. In 2019, over 365,000 home financing accounts were approved, amounting to RM158 billion. Of this, more than 53% were to first-time home buyers and over 100,000 accounts were for the purchase of affordable homes priced less than RM300,000. To complement financing by the industry, we established the RM1 billion Fund for Affordable Homes in 2018. As at January 2020, the fund was fully utilised, enabling more than 4,700 households to purchase their first homes in conjunction with the Government's Home Ownership Campaign. Following the full utilisation of the fund, first-time home buyers continue to have access to financing from the banking system, with seven out of every ten housing loan applications approved by banks.

Purchasing a home is a big commitment for any household and often the single largest investment for many. For these reasons, financial access initiatives are also complemented by efforts to promote responsible borrowing. During the year, we worked with *Agensi Kaunseling dan Pengurusan Kredit* (AKPK) to roll out an online financial education module called *Rumahku*. The module has helped 40,000 individuals improve understanding on financial commitments related to home ownership and borrow within their means. The module has received positive feedback, with 90% of participants satisfied with the content.

In October 2019, we expanded the eligibility criteria for businesses seeking assistance under the Small Debt Resolution Scheme (SDRS). The expansion enables the scheme to also assist dormant or terminated businesses with alternative sources of income to restructure their financing obligations. The goal is to avoid bankruptcy among SMEs and to assist them in settling debt obligations prior to legal action. Since its inception, the SDRS has facilitated the restructuring of over 1,190 business accounts, amounting to more than RM1.6 billion in financing.

Improving access to financing through *Khidmat Nasihat Pembiayaan (MyKNP)* and *imSME*

Over the years, various initiatives have been pursued to increase access to financing within the country. Despite these efforts, pockets of individuals and businesses continue to face challenges in obtaining credit.

In August 2019, the Bank – together with Credit Guarantee Corporation Malaysia (CGC), AKPK and the financial industry – launched MyKNP, an advisory service to assist businesses and home buyers who are unsuccessful in their financing applications.

As a one-stop-centre, MyKNP helps prospective borrowers to better understand the factors which could explain their unsuccessful applications and receive advice on how to improve their chances of securing financing in the future. This could include helping a prospective borrower learn about the types of supporting documentation that financial institutions use to evaluate the credit standing of an individual or business. A prospective borrower could also be offered suggestions to improve his or her financial position, such as ways to generate more income or rationalise existing debt and other commitments before reapplying. For SMEs, MyKNP may also refer unsuccessful applicants to alternative avenues to meet their financing needs. As at December 2019, a total of 249 SMEs and home buyers have been assisted via MyKNP.

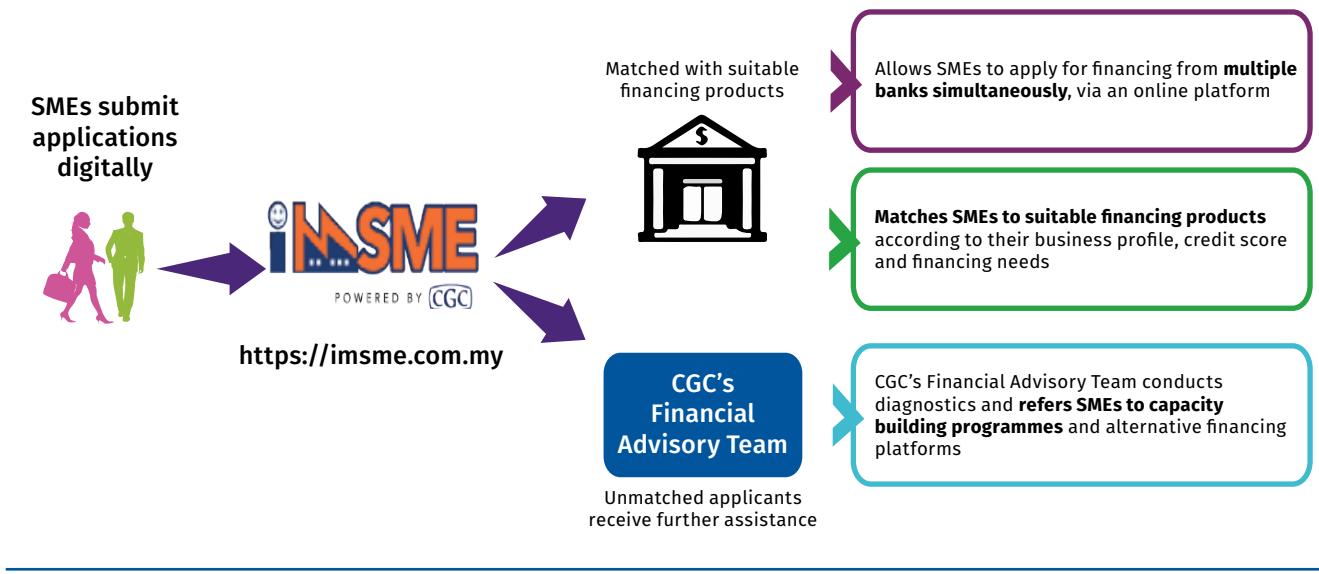
SMEs can also access imSME, an online financing referral platform developed by CGC which matches SMEs to suitable financing products according to their business profile, credit score and financing needs. Through the platform, SMEs can submit financing applications online to various financial institutions simultaneously and receive responses from lenders within two days of application. This reduces the time and expense that SMEs would otherwise have to incur to obtain quotes from several banks. Twenty-five conventional and Islamic financial institutions currently provide financing solutions through this platform.

An SME which fails to be matched with a financial institution on imSME will be offered advice to improve its financing viability through targeted capacity building programmes. For example, a food distributor that was rejected due to poor financial record was subsequently referred to a capacity building programme. The programme equipped the food distributor with better knowledge on financial management and common evaluation criteria to obtain financing as a way to improve its eligibility for future applications. The SME may also be referred to an alternative finance provider. Under imSME, over 1,800 SMEs have successfully obtained financing amounting to RM179 million.



Governor Nor Shamsiah Yunus at the launch of the MyKNP initiative which assists unsuccessful borrowers to improve financial eligibility.

imSME: Online financing referral platform for SMEs



Building awareness among SMEs on financing options through imSME.

For halal businesses, Islamic finance has a critical role in supporting the growth of micro-enterprises and firms operating in this segment. Engagements with the industry revealed a low awareness of Islamic business financing facilities among halal-certified companies. Efforts therefore have been focused on promoting the use of Islamic finance solutions among the halal business community. These include business engagement programmes held during the year providing insights to halal businesses on the variety of

Islamic financial solutions as well as experience sharing by current business users of Islamic finance. Through industry business matching sessions during these programmes, requests for over RM320 million in financing and RM27 million in protection coverage for takaful were obtained. The BNM Annual Report 2019 Feature Article titled 'Transforming the Economy and Society through Islamic Finance' further explains the importance of end-to-end Shariah compliance to support the halal ecosystem.



Business matching session between entrepreneurs and Islamic financial institutions during the Islamic Finance Rendezvous Series in Penang.

Development financial institutions (DFIs) play an important role in supporting access to finance for strategic sectors in the economy. To increase the developmental impact and value offering of DFIs, a plan was announced by the Government in the 2020 Budget Speech for the merger of several DFIs to create an enlarged entity that is better positioned to address the expanding financing needs of the economy going forward. With greater size and capacity, this will also enable DFIs to be better able to manage risks and withstand shocks.

Going forward

For 2020, the Bank will continue our ongoing efforts to develop a progressive and inclusive financial sector to serve Malaysian households and businesses.

Beyond ensuring the effective implementation of existing developmental initiatives, we will also sharpen focus in a number of areas. These include:

- Anchoring the direction of future priorities in the face of rapid change, under a new blueprint for the financial sector;
- Facilitating sustainable and inclusive growth through structural reforms in the insurance, takaful and DFI sectors;
- Evolving well-designed regulations for digitalisation and innovation in financial services;
- Sharpening financial inclusion strategies to promote financial resilience and contribute towards the Sustainable Development Goals (SDGs);
- Advancing initiatives that increase the impact and inclusivity of Islamic finance; and
- Promoting outreach, education and awareness programmes for targeted segments such as lower income households and SMEs.