

# Cross-Sector Developments

## FINANCIAL MARKETS

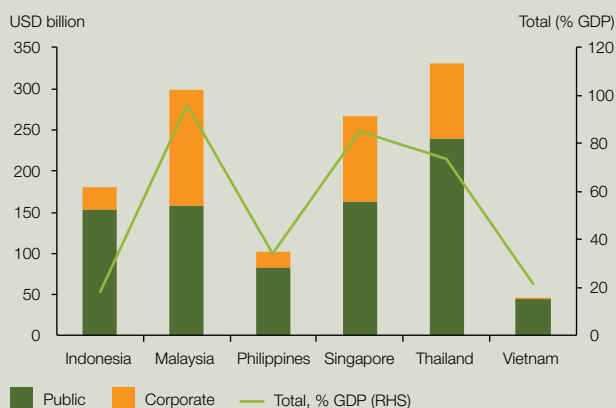
### The Malaysian debt securities market remained deep with diverse participation

The Malaysian debt securities market recorded significant growth over the year, with total outstanding securities increasing by 10.1% to RM1.3 trillion as at end-2017, representing 97.6% of GDP. The market remains one of the largest in Southeast Asia (Chart 5.1). Sukuk continued to account for a larger share of total outstanding debt securities at 58.8% (2016: 56.4%) (Chart 5.2).

Participation in the Malaysian government debt securities market, supported by appointed Principal Dealers, remained robust and diverse with a total secondary trading volume of RM1.3 trillion (2016: RM1.8 trillion). Both Malaysian Government Securities (MGS) and Malaysian Government Investment Issue (MGII) papers garnered strong interest from banking institutions, institutional

Chart 5.1: ASEAN Outstanding Local Currency Debt Securities Market

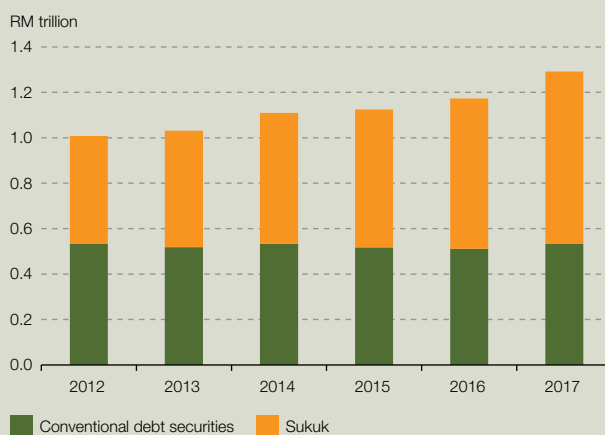
### The Malaysian debt securities market remains one of the largest in ASEAN



Source: Asian Bonds Online

Chart 5.2: Outstanding Debt Securities and Sukuk (Public and Corporate)

### Sukuk accounts for a larger share of total outstanding debt securities



Source: Bank Negara Malaysia

investors and insurance companies, registering a healthy average bid-to-cover ratio of 2.198 times throughout the year (2016: 2.275 times).

This diverse and broad investor participation in the domestic debt securities market continued to support domestic market resiliency. Amid a challenging global financial market outlook and persistent uncertainty, Malaysia experienced higher volatility in capital flows, mainly resulting from portfolio adjustments by non-resident investors. In the first quarter of 2017, the unwinding of non-deliverable forward (NDF) positions by short-term non-resident investors, particularly financial institutions and fund managers, saw a material sell-off in non-resident bond holdings. Despite this, bond yields remained relatively stable, owing to the active participation of domestic institutional investors. Volatile capital flows peaked in the first quarter of 2017 and began to subside in April, with the announcement of the second

series of the Financial Markets Committee (FMC) measures which, among others, facilitated foreign exchange (FX) risk management activities through dynamic hedging flexibilities for both resident and non-resident investors (Chart 5.3).

The proportion of non-resident investor holdings in Malaysian government bonds stood at 28% of total outstanding at end-January 2018, compared to the peak of 34.7% in November 2016. Non-resident holdings are now better distributed across different maturities, with a lower concentration of 12% in securities with a tenor of less than 12 months (2016: 17%), thus posing lower risks of market volatility. Longer-term investors such as foreign central banks, governments, pension funds and insurance companies constituted close to 51.2% of overall non-resident holdings. Investments from these long-term investors contribute to greater market stability, owing to positions that are less predisposed to swings in market sentiment, and which serve at times to counteract short-term investor activities.

### Strong ringgit appreciation largely driven by positive economic performance

During the year, the ringgit appreciated by 10.4% against the US dollar, closing at RM4.0620 compared to RM4.4860 at end-December 2016 (Chart 5.4). The recovery of the ringgit reflected the broad weakening of the US dollar and more importantly, better-than-expected performance of the domestic economy on the back of strong export performance and sustained domestic demand. Correspondingly, investor confidence and sentiment improved during the year.

Chart 5.3: MGS Yields

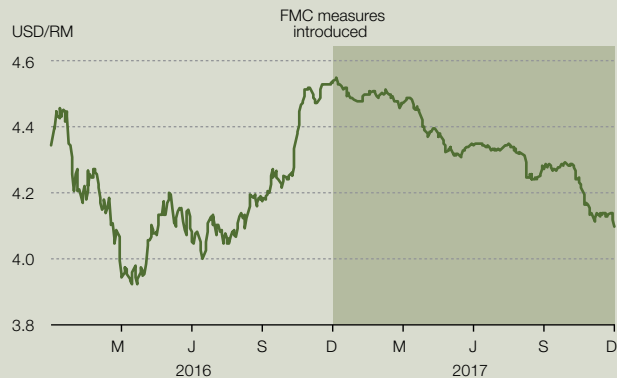
#### MGS yields stabilised owing to active participation of domestic institutional investors



Source: Bank Negara Malaysia

Chart 5.4: Ringgit Exchange Rate against the US dollar

#### Ringgit appreciated 10.4% against the US dollar in 2017



Source: Bank Negara Malaysia

The recovery of the ringgit reflected robust performance of the domestic economy and broad weakening of the US dollar

The one-month implied volatility of the ringgit averaged lower at 4.4%, compared to 9.7% in 2016 (Chart 5.5). Similarly, the ringgit's intraday movements were also less volatile with a daily average of 81 pips, compared to 228 pips in November 2016.

Chart 5.5: Onshore USD/RM one-month Implied Volatility

#### Steady appreciation of ringgit with lower average one-month implied volatility of onshore USD/RM



Source: Bank Negara Malaysia

#### FMC measures contributed positively to financial market development

In December 2016, the FMC together with the Bank announced several measures to promote a deeper, more transparent and well-functioning onshore FX market. In 2017, the FMC introduced the second and third series of measures aimed to improve market liquidity and resiliency. A summary of the measures introduced to-date is provided in Diagram 5.1.

## Summary of FMC Measures



Source: Bank Negara Malaysia

### FMC measures accorded greater FX risk management flexibilities

The existing dynamic hedging framework was streamlined to allow registered institutional investors to fully hedge and actively manage their exposures, including unwinding hedging positions. Registered non-resident institutional investors are also allowed to actively manage an additional 25% of ringgit exposures. For ringgit exposures arising from palm oil derivative contracts (Crude Palm Oil Futures and Options on Crude Palm Oil Futures) traded on Bursa Malaysia, registered non-resident market participants are allowed to hedge their exposures with onshore banks or appointed overseas offices up to the net open position of the contracts.

Residents are also provided the flexibility to actively manage FX risk exposures up to an aggregate net open position limit of RM6 million per client per bank, without having to submit documentary evidence. Previously limited to US dollar and China Offshore Spot (CNH), this provision has since been expanded to include three additional currencies, namely British pound (GBP), euro (EUR) and Japanese yen (JPY). A prerequisite to utilise this flexibility is to undertake a one-off declaration of hedging intent to the onshore banks.

The measures introduced in 2017 primarily focused on increasing flexibility for financial market participants, including corporations, to hedge their FX exposures effectively, and increasing trading flexibilities and instruments.

Since the implementation of these measures, onshore FX liquidity has improved. The positive effect of rebalancing between FC demand and supply saw the average daily trading volume in the onshore FX market increase to USD9.9 billion, compared to USD8.1 billion in 2016. On the other hand, the transaction volume of the ringgit NDF market contracted by 70% since November 2016 to USD1 billion.

The dynamic hedging framework also resulted in increased FX forward transactions by non-resident institutional investors. Demand for hedging instruments by investors actively managing their FX risk exposures through the onshore forward market were met with a range of FX products offered by domestic banking institutions. Response by investors was encouraging with 74 registered fund managers with total eligible assets worth RM123 billion, and 21 registered corporates with a total allowed hedging volume of up to RM9.2 billion availing of the flexibilities as at December 2017. Increased onshore FX hedging of palm oil derivative contracts was also observed among 10 registered non-resident palm oil market participants with exposures of RM27.1 billion.

Additionally, goods and services flows now account for a significant proportion of the onshore FX market transaction volume at 66%, compared to 49.6% in the previous year. This change reflects pricing in the onshore FX market that is now mainly driven by real sector activities, rather than speculative transactions.

### **Local currency settlement framework expanded**

Following the launch of the baht-ringgit settlement framework in March 2016, the Bank, in collaboration with the Bank of Thailand, agreed to expand the framework on 11 December 2017 to include direct investments and income transfers as eligible underlying transactions for settlements in the local currencies. On the same day, the Bank and Bank Indonesia launched a rupiah-ringgit settlement framework to promote trade settlements between Malaysia and Indonesia in local currencies.

These frameworks provide greater FX administration flexibilities for exporters, importers and investors to manage FX risks through settlements of trade and direct investment in local currencies. By reducing exposures to FX settlement risk, the flexibilities help reduce the cost of doing business. To operationalise both frameworks, appointed banks have been accorded additional foreign exchange administration flexibilities in the respective countries to offer local currency-denominated financial products such as deposits and financing. It is envisaged that the increased demand for local currency financial products will further support the development of regional financial markets.

## **FINANCIAL SYSTEM INTEGRITY**

### **Milestones in the implementation of the Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) National Strategic Plan**

The National Coordination Committee to Counter Money Laundering (NCC), comprising 16 agencies, including the Bank, has made significant progress in the implementation of the AML/CFT National Strategic Plan 2015-2020. Key achievements in 2017 include:

- Strengthening of legal mechanisms. Revisions to the Companies Act 2016 have established requirements for enhanced disclosures of beneficial owners of legal persons registered in Malaysia. Additionally, the definition of 'authorised officers' under the Strategic Trade Act Order was broadened to improve the efficacy of Targeted Financial Sanctions (Proliferation Financing). Under the Order, authorities are empowered to compound offences committed and set a minimum fine for any offences specified, in addition to the existing powers for criminal prosecution;
- Improved arrangements for the sharing of information and training of industry compliance officers on terrorist financing risks, resulting in higher quality suspicious transaction report submissions; and
- Developed parameters for requesting mutual legal assistance and extradition across all law enforcement agencies to ensure that cooperative arrangements with Malaysia's international counterparts support an effective and concerted response to money laundering and terrorism financing (ML/TF) threats. These achievements also reflect the NCC's continued commitment to meet the Financial Action Task Force recommendations set out in the 2015 Mutual Evaluation Report on Malaysia.

## Making digital currencies transparent in Malaysia

Due to the recent proliferation of digital currencies, the Bank has imposed AML/CFT obligations on digital currency exchangers along with requirements for disclosure of key information to promote greater transparency and enable monitoring of market activities. Any person offering services to exchange digital currencies either to fiat money or to another digital currency and vice versa will be subjected to obligations under AMLA (Schedule 1). Reporting obligations of digital currency exchange businesses, which include requirements on transparency and disclosure, are further elaborated in the policy document on AML/CFT – Digital Currencies (Sector 6) published by the Bank in February 2018.

The invocation of reporting obligations does not imply the authorisation, licensing, endorsement or validation by the Bank of any entities involved in the provision of digital currency exchange services. Section 24 of the Central Bank of Malaysia Act 1958 recognises ringgit as the only legal tender in Malaysia, and thus members of the public are advised to ensure that they understand and carefully assess the risks involved in dealing in digital currencies.

## Strengthening legislative and regulatory framework to counter ML/TF risks

The Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA) was also strengthened during the year through amendments to the Second Schedule of AMLA. The amendments broaden the scope of predicate offences relating to ML/TF risks. Sixty-one new predicate offences from several legislations have been prescribed, including the recently amended Companies Act 2016 and the new Interest Scheme Act 2016. Of these offences, 11 relate to abuse of powers by company directors for their personal gain while nine offences concern interest schemes and other threats to investors' interest.

## Fostering international commitment and partnerships

The Bank hosted the third Counter-Terrorism Financing (CTF) Summit in November 2017, in partnership with the Australian Transaction Reports and Analysis Centre and Indonesia's Pusat Pelaporan dan Analisis Transaksi Keuangan. Key highlights from this year's summit include:

- Launch of the report on Regional Terrorism Financing (TF) Risk Assessment of Non-Profit Organisations (NPOs) and on Cross-Border Movement of Money and Bearer Negotiable Instruments in the region. This report marks the delivery of commitments made in the Nusa Dua Statement at the 2016 summit. The Regional TF Risk Assessment on NPOs covers eight Asia-Pacific nations: Malaysia, Australia, Brunei, Indonesia, New Zealand, the Philippines, Singapore and Thailand; and
- Adoption of the KL Communique, which embodies the commitment of the regional working group to

continue to address TF risks via joint initiatives, widens the CTF Summit's scope to include high-risk financial crimes and pledges to expand collaboration with other Southeast Asian countries, particularly through expanding membership of the newly established Southeast Asia Counter Terrorism Financing Working Group. The KL Communique also calls on regional authorities to improve data collection, enhance information sharing and develop 'red flag' indicators of high-risk NPO activity to help financial institutions and law enforcement agencies better detect and respond to suspicious activity.

In May 2017, the Bank entered into a formal cooperative framework with the financial intelligence units of Australia, Indonesia and Malaysia (also known as the Trilateral Regulatory Exchange Programme, REP). The objectives of the REP are to: (i) improve risk-based supervision models, including the development of sectoral and thematic risk assessments; (ii) facilitate knowledge sharing on the regulation of the remittance industry; and (iii) propose relevant and appropriate regulatory approaches for the regulation of virtual currencies, payment platforms and new emerging technologies.

## Combating money laundering through industry collaboration and enhanced supervision

Engagements with the banking industry associations through the Compliance Officers Networking Group focused in particular on the need for increased scrutiny of account holders suspected of serving as mule account holders. This aims to prevent financial institutions' account facilities from being misused for criminal activities,

especially by syndicates that ‘rent’ accounts for the purpose of moving illicit funds without detection. Banking institutions are expected to undertake greater due diligence for such account holders and enforce necessary counter-measures where account holders fail to provide reasonable justification for their transactions. Such measures include the closing of accounts and submission of suspicious transaction reports to the Bank.

In light of the growing sophistication and complexity of ML/TF risks, the Bank established a dedicated unit during the year to oversee AML/CFT matters for Designated Non-Financial Businesses and Professionals (DNFBPs). The DNFBP supervision unit conducted 38 on-site examinations across six sectors: real estate agents, accountants, company secretaries, trust companies, law firms and casinos. The reviews identified challenges in fully implementing customer due diligence (CDD) requirements in five of the six sectors, mainly due to the lack of awareness and understanding of AML/CFT reporting obligations. To address this, the Bank conducted 37 engagement and awareness sessions throughout the year for these sectors.

## ENFORCEMENT ACTIONS

During the year, the Bank took various enforcement actions to address statutory offences and non-compliances with relevant laws and requirements. A summary of the enforcement actions taken in 2017 is provided in Table 5.1.

Specific to cases involving illegal financial schemes, joint enforcement investigations were conducted with relevant law enforcement agencies under the Sub-Committee on Offences related to Financial Fraud and Scams (SCOFFS) established by the NCC. In 2017, SCOFFS conducted six joint raids on companies suspected to be conducting illegal financial scheme businesses, resulting in assets valued at more than RM400 million seized to assist investigations. These companies are currently being investigated for various offences under AMLA, the Financial Services Act 2013, the Penal Code, Companies Act 2016 and the Income Tax Act 1967. In addition, the Bank has directed financial institutions and money services business providers to heighten their vigilance in detecting accounts which are used by the perpetrators of financial scams. This includes enhancing CDD processes to prevent financial institutions from becoming conduits for illegal schemes.

Table 5.1

Enforcement Actions Taken in 2017	
Area	Enforcement Actions
Illegal deposit taking	<ul style="list-style-type: none"> <li>One entity was convicted under section 25(1) of the Banking and Financial Institutions Act 1989.</li> </ul>
Unauthorised provision of money services	<ul style="list-style-type: none"> <li>Six entities were convicted for unauthorised provision of money services business under section 4(1) of the Money Services Business Act 2011.</li> </ul>
Non-compliance with regulatory requirements	<ul style="list-style-type: none"> <li>Administrative monetary penalties amounting to RM400,000 were imposed on one bank for failure to comply with approval conditions under section 291(1) of the Islamic Financial Services Act 2013 (IFSA).</li> <li>Compound amounting to RM1.8 million was imposed on one bank for failure to comply with Shariah requirements under section 29(3) of the IFSA.</li> </ul>
Non-compliance with foreign exchange administration requirements	<ul style="list-style-type: none"> <li>Compounds amounting to RM3.7 million were imposed on two banks and one non-bank entity for failure to comply with the foreign exchange administration requirements under section 214(2) and section 214(6)(f) of the Financial Services Act 2013.</li> </ul>
Non-compliance with AML/CFT requirements	<ul style="list-style-type: none"> <li>Compound amounting to RM1.4 million was imposed on one bank for failure to comply with reporting obligations and CDD requirements under section 14 and 16 of the AMLA.</li> <li>Administrative monetary penalties amounting to RM7.9 million were imposed on one bank for failure to comply with reporting obligations and CDD requirements under section 14 and section 16 of the AMLA.</li> <li>Three entities were convicted under section 4(1) of the AMLA for offences relating to money laundering.</li> </ul>

Source: Bank Negara Malaysia

As of December 2017, financial institutions have exited 884 accounts of business entities and their beneficiaries related to illegal financial schemes.

Effective January 2018, the Bank will also publish enforcement actions taken against financial institutions and intermediaries for non-compliance with rules and regulations. This aims to further increase the impact of enforcement actions as a credible deterrent.

## PRUDENTIAL FRAMEWORK

### Strengthening Conduct, Culture and Risk Management in the Financial Industry

Two key papers on employee screening and responsibility mapping were issued to reinforce the ethical standards and integrity of the financial industry. This area of work complements existing regulatory expectations on governance and conduct by strengthening the focus on softer elements of behaviour and culture. An elaboration of the Bank's approach to influencing behavioural outcomes within the financial sector is set out in the box article on 'Strengthening Conduct and Culture in the Financial Industry'.

#### (i) Employee Screening

The Bank issued the final standard on Employee Screening in March 2018 following a one-month consultation in October 2017. The policy aims to promote an ethical workforce within the financial sector through strengthened screening practices for recruitments by financial institutions. With greater transparency of the conduct histories of new hires, financial institutions are expected to be better placed to make informed hiring decisions. While financial institutions will continue to retain full discretion over final hiring decisions, conduct histories surfaced during screening should be taken as a signal for greater scrutiny in the character assessments of the new hires.

Salient requirements of the standard are as follows:

- A financial institution must undertake employment reference checks of prospective new hires with past and current employers of the individuals;
- A financial institution receiving a request related to an employee reference check must provide relevant information in response to the request, including information on past disciplinary proceedings the individual may have been subject to, irrespective of whether the disciplinary proceedings have been concluded; and

- A prospective employee must provide a statutory declaration on his/her past criminal convictions and pending criminal investigations.

Financial institutions have been given until 30 June 2018 to prepare for implementation of the new requirements.

#### (ii) Responsibility Mapping

The Bank also issued a discussion paper on Responsibility Mapping in February 2018, detailing a conceptual framework to strengthen the accountability of key senior roles within financial institutions. Preliminary concepts being considered entail a formal prescription of responsibilities for significant senior roles with legal liabilities attached for breaches of those responsibilities.

Responsibility Mapping aims to reinforce an appropriate tone from the top in shaping organisational culture and behaviour, and in regulating conduct within financial institutions in a sustainable way. The discussion paper addresses the need for a sharper focus on individual accountability to complement and give effect to existing oversight arrangements that promote prudent and ethical conduct. The Bank expects to engage further with the industry on more detailed proposals for implementation over the course of 2018.

#### (iii) Outsourcing

In September 2017, the Bank issued an exposure draft on the revised standard on outsourcing for public consultation. The requirements seek to ensure that financial institutions' risk management practices in relation to outsourcing arrangements remain robust and are commensurate with the nature and level of risk of the arrangements. This is particularly important in light of the more extensive nature of outsourcing by financial institutions in recent years to improve operational efficiency and flexibility in managing business changes. Strengthened requirements on the conduct of due diligence on service providers and protection of data confidentiality aim to mitigate the potential risks posed by outsourcing relationships, including heightened legal risks from any unauthorised disclosure of confidential information. In addition, the revised requirements will ensure the Bank's continued ability to effectively supervise financial institutions in respect of outsourced activities, particularly where the arrangements could pose threats to the ability of financial institutions to maintain critical functions during stress periods and resolution.

Key enhancements to the outsourcing standard include:

- Strengthened governance and risk management requirements imposed on the board and senior management in managing outsourcing risk;
- Heightened expectations of the due diligence process carried out on service providers;
- Stronger data protection requirements for both customer and proprietary information of financial institutions, including upon termination or cessation of outsourcing arrangements; and
- Enhanced expectations to preserve business continuity and the ability to effectively implement recovery and resolution plans.

## CONSUMER PROTECTION FRAMEWORK AND EMPOWERMENT

The protection and empowerment of financial consumers remains a key priority of the Bank with focus on three key areas, as illustrated in Diagram 5.2.

### Strengthening Protection of Retail Borrowers

During the year, the formulation of a consumer credit law, a joint initiative between the Bank, the Ministry

of Domestic Trade, Co-Operatives and Consumerism (KPDNKK) and Ministry of Urban Wellbeing, Housing and Local Government made further progress. The new law aims to deliver more consistent standards in the level of protection afforded to retail borrowers and support the effective management of risks in the consumer credit market. A draft Bill is expected to be published for public consultation by KPDNKK in 2018. Key elements of the Consumer Credit Bill are summarised in Table 5.2.

### Increased expectations on customer information management and fair treatment of consumers

As financial service providers (FSPs) gain access to an ever-increasing amount of data and information in the course of their operations, the protection of customer information against theft and misuse becomes critical in maintaining public confidence in the financial system. In October 2017, the Bank published the standards on the Management of Customer Information and Permitted Disclosures. The standards address requirements for FSPs to institute strict policies and procedures to safeguard the security and confidentiality of customer information throughout the information

Diagram 5.2

#### Key Focus Areas for Consumer Protection and Empowerment in 2017



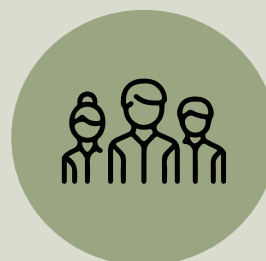
Promoting Responsible Conduct towards Financial Consumers

- Formulation of Consumer Credit Act (CCA)
- Issued policy document on Management of Customer Information and Permitted Disclosures
- Development of exposure draft to ensure fair dealing towards financial consumers
- Enhancement to industry Customer Service Charter
- Survey on Customer Satisfaction Index



Strengthening Redress Mechanisms

- Operationalisation of the Ombudsman for Financial Services (OFS)
- Introduction of Consumer Complaints Redress Profiling Framework







Expanding Outreach to Consumers

- Organised Karnival Kewangan in major cities throughout the country
- Expanded "Train-the-Trainers" programme
- Outreach to raise awareness on illegal financial schemes

Source: Bank Negara Malaysia

Table 5.2

### Key Elements of the Consumer Credit Bill

 <b>Regulatory scope</b>	<ul style="list-style-type: none"> <li>Covers retail borrowers who obtain credit, wholly or predominantly for personal, domestic or household purposes and includes both conventional and Shariah-based credit activities</li> </ul>
 <b>Governance and oversight</b>	<ul style="list-style-type: none"> <li>Establishment of the Council for Consumer Credit Malaysia as an inter-agency coordination platform for the implementation of the CCA</li> <li>KPDNKK as the principal administrator of the CCA</li> <li>The Bank, the Securities Commission Malaysia and the Malaysia Co-operative Societies Commission continue to regulate entities under their purview</li> </ul>
 <b>Authorisation</b>	<ul style="list-style-type: none"> <li>Credit providers extending credit to retail borrowers will require authorisation from the respective regulators and be subject to gatekeeping requirements such as minimum capital requirement and fit and proper criteria for directors and senior officers</li> </ul>
 <b>Key consumer protection requirements</b>	<ul style="list-style-type: none"> <li>Credit providers to comply with minimum requirements relating to advertisement, solicitation, credit agreement, financing charges, credit assessment, debt collection practices, debt relief, complaints handling and dispute settlement</li> <li>Empowers regulators with flexibility to enforce stricter conduct requirements on credit providers under the regulator's purview</li> </ul>

Source: Bank Negara Malaysia

lifecycle, from collection to disposal. This includes protection from unauthorised access, modification or disclosures and ensuring staff are sufficiently trained to implement controls effectively. Additionally, the policy sets out expectations on, and the accountability of, FSPs in ensuring the proper handling of customer information by appointed representatives, agents and outsourced service providers.

The Bank is currently in advanced stages of finalising specific proposals to promote the fair treatment of financial consumers, focusing on standards for fair dealing and responsible behaviour towards financial consumers. The Bank expects to issue an exposure draft on the proposals within the first half of 2018. The requirements will address the Bank's heightened expectations on the board and management to have a strong and consistent tone-from-the-top on placing fair treatment of consumers at the centre of business operations. In addition, greater emphasis is given to the importance of providing clear and concise product information for customers to make informed choices and offering products that are appropriate to the customers' needs and financial circumstances. These standards are intended to complement other policies previously issued by the Bank, by encouraging FSPs to direct and influence behaviour beyond compliance and promote fair treatment of consumers as an integral part of the business culture of all FSPs.

### Improving the service quality of the banking, insurance and takaful sectors

During the year, the industry undertook further initiatives to improve the overall quality and efficiency of customer services by revising the industry's Customer Service Charter (Charter), which was first introduced in 2011. The original Charter was substantially enhanced to include minimum service standards that reflect the guiding principles for good customer service. These principles are premised on understanding customers' needs; delivering timely, transparent, personable and efficient services; making financial products accessible; and providing a fair, timely and transparent claims settlement process for the insurance and takaful sector. The revised Charter was adopted by banking institutions in September 2017 and is expected to be adopted by insurers and takaful operators in the first quarter of 2018. As a means to gauge FSPs' performance against the Charter, results from the first independent Customer Satisfaction Index (CSI) survey conducted for the banking sector and insurance/takaful sectors are expected to be published by the end of the first and third quarter of 2018, respectively. Moving forward, plans are for the CSI survey to be carried out once every two years to assess the level of customer service in the financial sector on a continuing basis.

## Strengthening dispute resolution channels for consumers

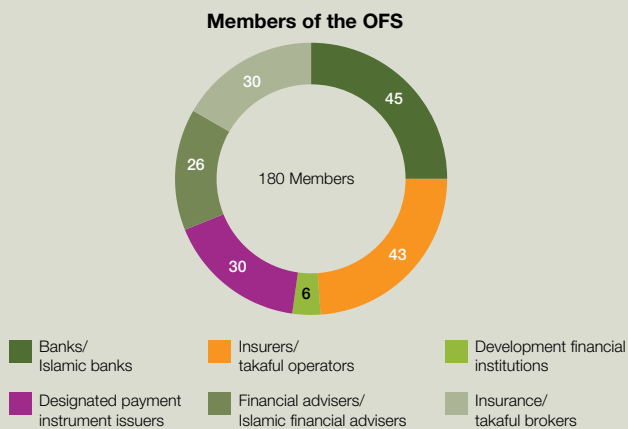
An essential element in ensuring the fair treatment of consumers is the availability of dispute resolution channels. In this respect, the Ombudsman for Financial Services (OFS), formerly known as the Financial Mediation Bureau (FMB), serves as Malaysia's primary alternative avenue for dispute resolution relating to financial services and products. Since commencing operations in October 2016, the OFS resolved 1,274 cases received in the first 15 months of operations (Chart 5.6). Nearly three quarters of these cases were resolved with both the complainant and the FSP arriving at an amicable

outcome during the mediation stage, compared to 43% under the previous scheme i.e. FMB. This reflects improvements made to dispute resolution arrangements under the OFS. Seventy-seven percent of the new cases resolved were settled within six months, while the remaining took longer to resolve mainly due to gaps in documentation. The imposition of case fees on FSPs from 2017 appeared to encourage more proactive management of complaints by FSPs, with complaints referred to the OFS declining by 17% during the year.

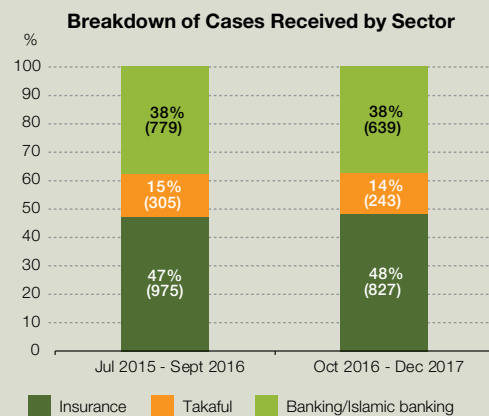
To further strengthen redress management for financial consumers, the Bank has established a Consumer

Chart 5.6: Snapshot of the OFS during the first 15 months of Operations

### Improvements to dispute resolution process under the OFS promote more efficient and amicable settlement

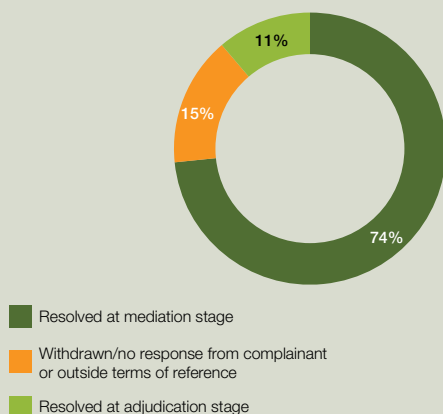


**Increased membership under the new OFS structure driven by participation of insurance and takaful brokers, payment instrument issuers and financial advisers**



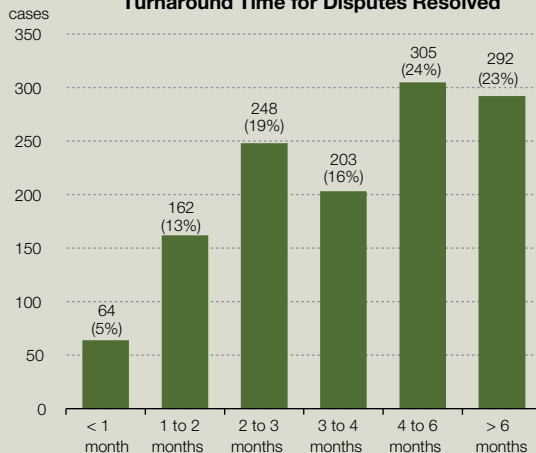
**The total number of cases received reduced by 17% to 1,709 cases. This indicates more proactive management of complaints by FSPs**

#### Breakdown of Cases Resolved and Closed



**Out of the cases resolved and closed, 74% were settled through mediation where both the complainant and the FSP agreed on an amicable settlement**

#### Turnaround Time for Disputes Resolved



**77% of the cases resolved were settled within six months, with 37% settled within three months**

Source: Bank Negara Malaysia, OFS Statistical Reports

Complaints Redress Profiling Framework, a surveillance tool for assessing FSPs' handling of consumer complaints and redress practices. The quality of complaints management in FSPs is assessed against five key drivers of fair complaint handling, namely effectiveness of senior management, compliance and policy, quality assurance, staff competence and transparency practices. Based on a profiling assessment undertaken during the year, a majority of FSPs were observed to have made improvements in their complaint practices and compliance requirements. In particular, a number of financial institutions have taken steps to strengthen senior management oversight functions through improved management information that focuses on the effectiveness of FSPs in resolving complaints at the first level of complaint management. Reflecting this focus, most FSPs have streamlined the complaint management processes to improve response times and feedback loops to enhance product and service offerings.

### Greater public awareness and strengthened consumer empowerment

The Bank's public outreach efforts expanded significantly in 2017 as presented in Diagram 5.3.

During the year, the Bank organised a series of *Karnival Kewangan* events, a new flagship nationwide initiative featuring a range of services and educational activities to increase public awareness and knowledge on financial services, including their

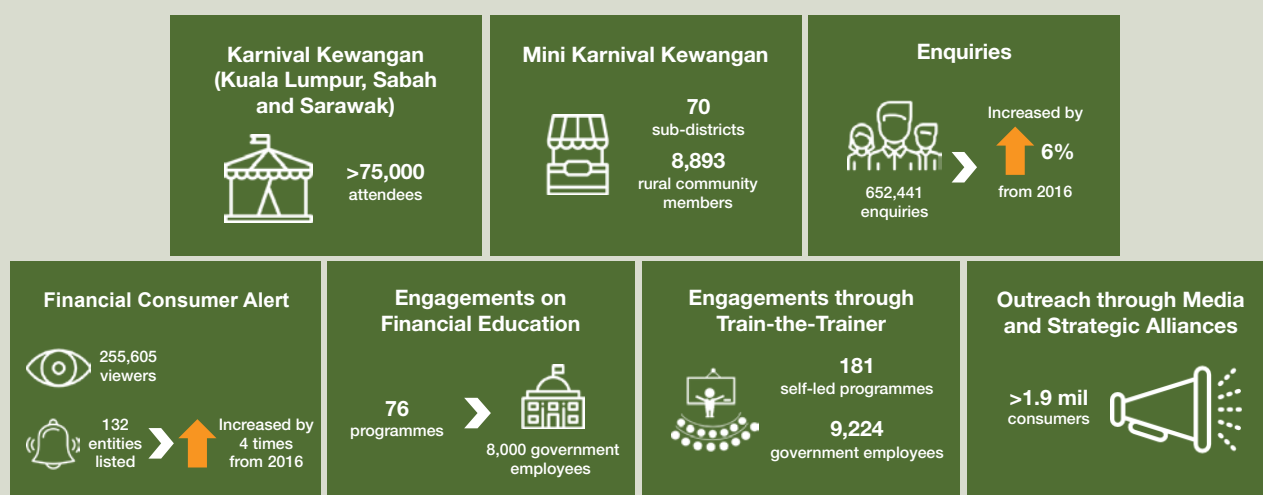
rights as consumers. The events were supported by the participation of local FSPs and government agencies. The first *Karnival Kewangan* was held in Kuala Lumpur, followed by Kota Kinabalu and Kuching. In total, the three events attracted more than 75,000 attendees. Building on the experience and momentum of these campaigns, a series of smaller-scale Mini *Karnival Kewangan* were organised at 70 sub-districts throughout the nation.

More than 75,000 people attended three *Karnival Kewangan* events featuring a range of services and educational activities to increase public awareness and knowledge on financial services and rights as consumers

Complementing education initiatives that were pursued for the public at large through the Credit Counselling and Debt Management Agency (AKPK), the Bank also conducted financial education engagements with government employees as part of the effort to raise awareness on prudent financial management and illegal financial schemes. To create a multiplier impact in financial education, the Bank established a Train-the-Trainers programme in collaboration with counsellors from The Royal Malaysian Police (RMP), Ministry of Health and Sarawak Chief Minister's Office. As a result, a total of 181 self-directed programmes have been conducted by trained counsellors with 9,224 participants.

Diagram 5.3

#### Outreach to Malaysian Financial Consumers in 2017: Key Statistics



Source: Bank Negara Malaysia

## Common modus operandi of phone scams and money game schemes

In 2017, among the highest cases of fraud were phone scams and money game schemes with total losses reported amounting to RM22.3 million. Phone scams commonly involve persons impersonating the Bank or RMP officers, requesting victims to transfer money or risk being blacklisted. Victims were contacted on non-working days to ensure that the call could not be validated and were duped into opening internet banking accounts using specified account details to transfer funds to the scammer's account. In the case of money game schemes, operators often posed as currency trading companies offering monthly returns as high as 20%. Investment packages would be priced as low as USD50 to encourage investors from different income brackets to join the scheme. Investors would typically receive returns for several months before they were informed that the scheme operator's website had been hijacked and monies invested were lost.

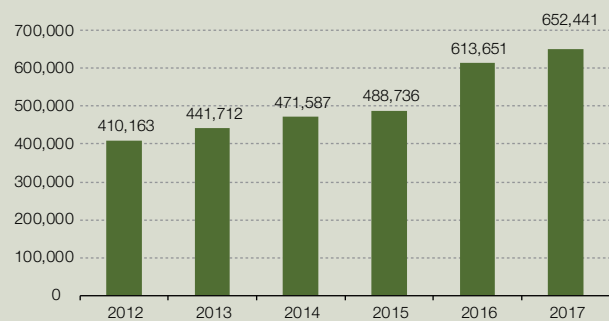
## Heightening Awareness on Financial Crime

In view of the rapidly evolving modus operandi of various financial fraud and crimes over the last few years, public awareness of steps that consumers can take to protect themselves continue to be a main priority for the Bank. Through various initiatives targeted at empowering financial consumers, including through the mediums of social media, television and radio, the Bank has reached out to nearly two million individuals to caution and provide guidance on how to recognise and avoid falling victim to financial fraud.

The Financial Consumer Alert (FCA) list established by the Bank in 2012, aims to alert members of the public on companies and websites that are neither authorised nor approved under the relevant laws and regulations administered by the Bank to carry on regulated financial activities. In 2017, the FCA list received over 250,000 website visits, a four-fold increase compared to its first year of publication on the Bank's website. The significant increase in public awareness is a welcome development and is particularly important amid the growing number of entities listed in the FCA (2017: 409 entities, 2016: 277 entities).

Chart 5.7: Enquiries Handled by the Bank

### Higher enquiries on financial matters reflect more proactive financial consumers



Source: Bank Negara Malaysia

Financial consumers were also more proactive, as reflected in the higher number of enquiries received by BNMLINK and TELELINK, the Bank's key point of contact for enquiries and redress on financial matters raised by the general public (Chart 5.7). Conversely, fewer complaints were received by the Bank against FSPs in 2017 (Chart 5.8).

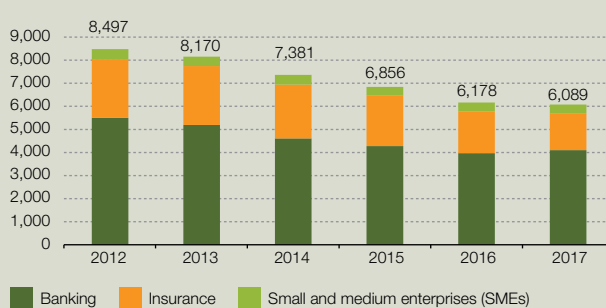
## MONEY SERVICES BUSINESS (MSB)

### Greater migration to formal MSB channels through digitalisation

The growing usage of electronic remittance services remained an important enabler for the migration of remittances from informal to formal channels, with increased utilisation of mobile and online platforms (e-remittances). Total outward remittance recorded by the MSB industry in 2017 amounted to RM33 billion, of which about 2% is estimated to be from transactions previously conducted through informal channels (2016: 9%). In absolute terms, estimates of remittance through informal channels were lower than in 2016, by about 8%. Greater convenience and accessibility provided by e-remittance platforms have attracted higher numbers

Chart 5.8: Complaints Received by the Bank

### Complaints received against FSPs by the Bank on a declining trend



Source: Bank Negara Malaysia

of retail consumers, increasing the market share of e-remittances to 12.3% in 2017 (2016: 7.8%). Key statistics for the remittance industry in 2017 are summarised in Diagram 5.4 below.

During the year, the Bank issued a supplementary policy document on AML/CFT for Money Services Business, which allowed approved e-remittance service providers to conduct Know-Your-Customer through digital platforms (electronic Know-Your-Customer, eKYC) when on-boarding a new customer. This eliminated the need for a physical presence at the operator’s premises, thus making transactions more cost and time efficient. All individual customers with a banking account may utilise the eKYC facility. A government measure requiring salaries of foreign workers to be paid by employers directly into banking accounts, as announced in Budget 2018, will also facilitate the conduct of eKYC for foreign workers. Collectively, these measures are expected to spur greater usage of formal remittance channels.

### The Bank issued a policy document to enable e-remittance service providers to conduct KYC through digital platforms when on-boarding a new customer

In the wholesale and retail currency exchange segment, increased retail demand, supported by the growing reach of branches and agents, resulted in sustained growth in currency exchange transactions which increased from RM84 billion to RM97 billion during the year. This increase continued to reflect the demand for common currencies including Singapore dollar, US dollar and Thai baht.

Diagram 5.4

#### Key Statistics of Remittance Business for 2017

Outward remittance	<b>RM33 billion</b>
Number of e-remittance service providers	<b>17</b> <small>Increased from 10 from 2016</small>
Cost of remittance transactions	<b>2.96%</b> VS <b>5%</b> <small>Benchmark set by World Bank</small>

Source: Bank Negara Malaysia

### Education and awareness key to driving migration to formal MSB channels

Throughout the year, the Bank conducted numerous nationwide awareness campaigns, including through social media channels, to educate consumers on the benefits of dealing with authorised providers and the risks of using informal channels.

Building on the successful impact of Project Greenback 2.0 in Johor Bahru, which completed a two-year run in December 2017 (Diagram 5.5), the Bank will be implementing Project Greenback in a second remittance champion city in Malaysia – Kota Kinabalu. Launched in March 2018, the project is expected to benefit more small and medium enterprises (SMEs) and foreign workers by applying innovative approaches developed under the first project and promoting e-remittances on a wider scale.

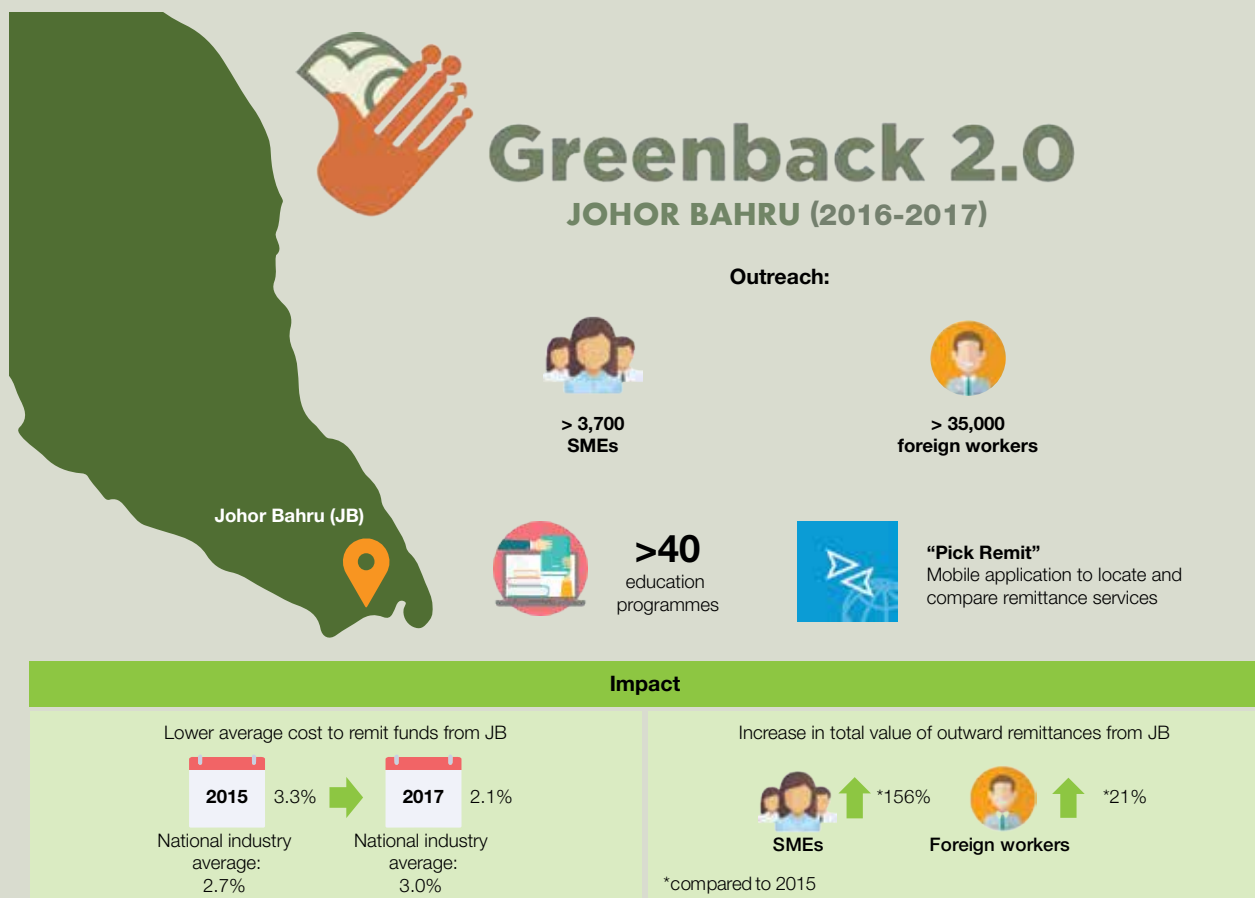
As an initiative to further encourage the usage of formal MSB channels, a new mobile application by the Malaysian Association of MSB (MAMSB) has been introduced to provide customers with convenient access to price comparisons, locations of MSB companies, customer reviews and avenues to lodge complaints and report illegal MSB activities. This development, which has been actively encouraged and supported by the Bank, will significantly increase the level of transparency and competition in the MSB sector, in turn benefiting consumers through improved efficiencies and quality of services provided.

### Elevating the professionalism of the MSB industry

Raising the ethical and professional standards of the MSB industry continued to be a key priority for the Bank. In 2017, the Bank made it mandatory for all MSB compliance officers to be certified or accredited by recognised accreditation bodies. This will ensure all relevant officers are sufficiently competent and technically-equipped to undertake their responsibilities in the areas of regulations, particularly with respect to AML/CFT compliance. The industry expects to accredit at least one-third of all compliance officers employed in MSB companies by end-2018. Additionally, principal MSB licensees are required to ensure that all their agents register as MAMSB members. This is to ensure consistent standards of compliance and professionalism, in line with the rising number of MSB agents appointed in the industry.

Diagram 5.5

**Snapshot of Project Greenback 2.0**



Source: Bank Negara Malaysia

Going forward, the Bank expects further consolidation of the industry to contribute to the emergence of more professional and stronger industry players with expanded capabilities to compete effectively and meet higher compliance standards.

**Enhancing the Bank’s supervisory and regulatory capabilities**

The Bank has also taken steps to bolster the regulation, supervision and surveillance of the MSB industry by leveraging on data analytics and modelling tools to detect suspicious transactions, supervise industry players and conduct surveillance on illegal MSB activities. Technology is also being deployed to improve regulatory efficiency. This includes the development of an online platform for submissions of regulatory applications by MSB licensees, which is expected to be launched mid-2018. Proposals are also being considered to

enhance the Money Services Business Act 2011 to support swifter and more effective enforcement actions against illegal MSB operators.

**FINTECH INNOVATION**

**Fostering innovation through the Regulatory Sandbox**

The Bank remains committed to advancing technological innovation in areas that will enable more efficient and accessible financial services. Since the implementation of the fintech Regulatory Sandbox in October 2016, 53 applications have been received, of which seven solutions have been admitted into the Sandbox while most of the remaining applicants were guided to implement their solutions based on existing frameworks that are already supportive of such solutions. The approved solutions under the Sandbox include digital money services businesses, insurance

aggregator platforms, biometric authentication and secured chat platform for banking transactions. The Sandbox enables fintech companies and financial institutions to test innovative products, services and business models in a live market environment within specified testing parameters and safeguards. The live testing of digital money services businesses since June 2017 has enabled the use of eKYC capabilities to facilitate over 2,000 customers in performing online remittances amounting to RM20.7 million, while insurance aggregator platforms tested in the Sandbox saw more than 17,000 customers make insurance and takaful purchases through the platforms.

Seven solutions have been admitted into the Sandbox which include digital money services business, insurance aggregator platforms, biometric authentication and secured chat platform for banking transactions

Diagram 5.6

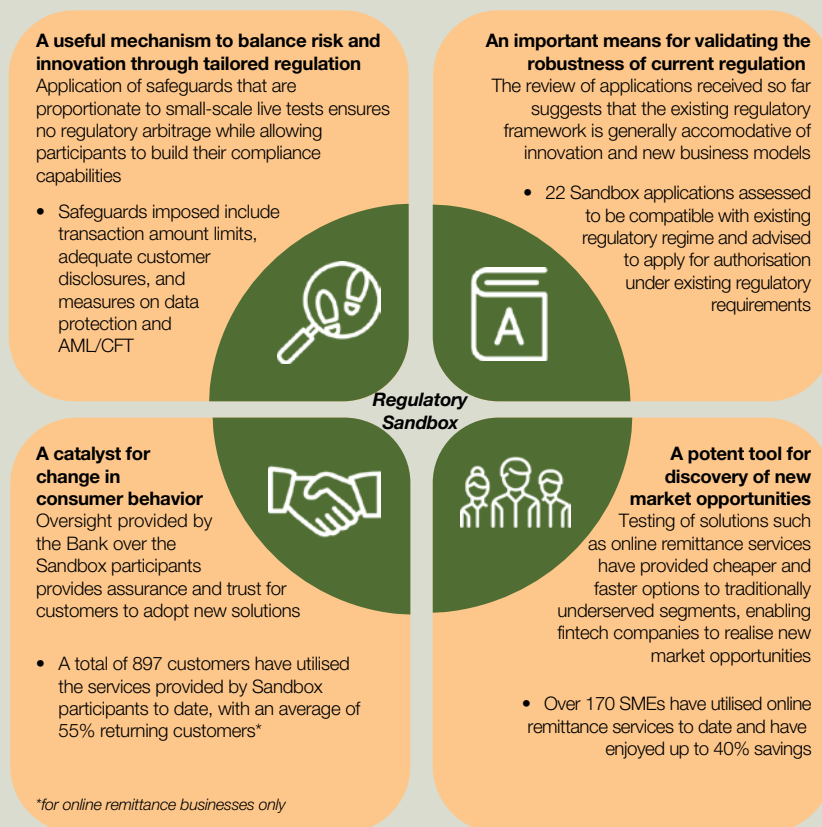
## Evidence-based policy development

In addition to testing the commercial viability and scalability of fintech solutions in a live environment, the Sandbox also serves to support an evidence-based approach in developing appropriate regulations for innovations in financial services. For example, the successful testing of online money services businesses in the Sandbox provided valuable input for the development of the policy document on eKYC requirements for licensed remittance service providers, particularly in determining the appropriate control measures to be adopted. The Bank is also developing a regulatory framework for online product aggregators based on the experience of three aggregators participating in the Sandbox.

## Greater awareness and collaboration through strategic engagements

In a bid to broaden interest in fintech developments among the wider public, the Bank organised Fintech

### Key Reflections from the Regulatory Sandbox Framework



Source: Bank Negara Malaysia

Hacks, a nationwide campaign in which the public was invited to provide views and opinions on the pain points, or areas that can be improved, in the delivery and consumption of financial services. Through the initiative, the Bank had also reached out to 11 universities across Malaysia to engage with students and build awareness. In total, approximately 750 submissions were received from the public. The Bank also conducted four quarterly regulatory boot camps to help educate and engage with over 500 fintech companies and individuals on the applicable laws and regulations administered by the Bank. The Bank through the Financial Technology Enabler Group (FTEG) continues to engage directly with both the local and international fintech community to deepen understanding of the fintech landscape and uncover opportunities for greater strategic collaboration. Engagements during the year included a high-level seminar organised in collaboration with the Embassy of Sweden and Business Sweden, in addition to a capacity building workshop held with several ASEAN regulators to share Malaysia's experience in developing and operationalising the Sandbox. Going forward, the Bank envisions that greater market integration and strategic collaboration within the region will facilitate market access and enhance the potential for regional mobility of fintech solutions.

### **Industry collaboration vital in accelerating adoption of technology**

The Advisory Committee on Technology for Finance (ACT-Fin), a multi-stakeholder advisory group, was established in August 2017 to advise FTEG on the development of strategic initiatives and accelerate the adoption of technology within the financial services industry. ACT-Fin comprises thought leaders with diverse backgrounds and deep knowledge and experience in banking, payments, consultancy, IT and telecommunications as well as relevant Government agencies with prominent roles in fintech development. The committee will provide technical perspectives relating to new and emerging technologies within the financial sector.

Throughout the year, the Bank collaborated with the industry in the development of identified high-impact initiatives, such as the adoption of a common KYC utility, distributed ledger technology and open application programming interfaces, API. These collaborations identified several priorities for use

cases supported by these technologies, including secured data sharing, enhancing customer due diligence and improving efficiency in trade finance. Further policies and road maps in these areas will be published in phases in 2018.

### **Robust cyber risk management capabilities**

The increasing use of technology, while hugely beneficial in terms of efficiency and effectiveness, has also resulted in financial institutions being more exposed to cyber-attacks. One of the key risk mitigation measures in managing cyber risks is conducting regular IT systems penetration testing. In the effort to elevate the standards and rigour of penetration testing, the Bank has facilitated the establishment of an industry working group (Persatuan Penguji Keselamatan Siber Kuala Lumpur, Selangor dan Putrajaya) to develop penetration testing standards for the domestic cyber security industry. These standards will be based on an internationally-recognised certification and accreditation framework developed by the Council of Registered Security Testers, CREST.

To strengthen the Bank's supervisory and response capabilities in relation to cyber risk, the Bank expanded its IT supervision unit during the year. Based on the supervisory unit's onsite reviews on selected financial institutions, risk controls were found to be generally adequate. However, the team also identified weaknesses in the cyber security defence mechanisms of several financial institutions, such as lapses in the detection of suspicious IT activities and untimely implementation of IT security patches. The financial institutions involved were directed to heighten their level of cyber preparedness and implement more effective defence mechanisms.

The Bank continued to work with various counterparts in conducting surveillance and intelligence activities, including financial institutions, government agencies (such as the Malaysian Communications and Multimedia Commission, CyberSecurity Malaysia and the National Security Council) and security practitioners. Where potential cyber threats were detected or actual cyber security incidences had occurred, the Bank issued immediate advisory alerts to financial institutions to ensure prompt mitigation actions are undertaken. In 2017, a total of 15 advisory alerts were issued.

## Strengthening Conduct and Culture in the Financial Industry

By Stephanie Tan Yen Li and Katie Lee Sheah Tsan

### Introduction

Effective corporate governance by financial institutions is critical to strengthen public trust and confidence in the financial system. Recent instances of conduct failures present a major threat to this continuing trust, as they can be seen as a reflection of underlying weaknesses of governance in financial institutions. Recognising that addressing misconduct calls for a multifaceted approach, a number of regulators have begun to focus on reinforcing ethical and professional behaviour in the financial sector. This article reviews developments in the Bank's approach towards influencing behavioural outcomes in the domestic financial industry, focusing on both contextual and individual factors that can affect behaviour.

### The Evolution of Financial Reforms

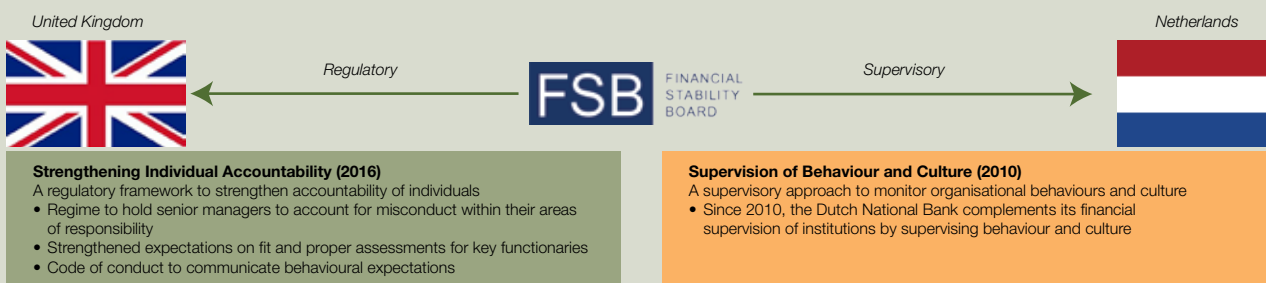
Approaches to corporate governance have traditionally been characterised by a focus on the strength of systems and processes within financial institutions. Requirements relating to board composition, disclosures and control functions endeavour to ensure that governance structures form sound foundations for effective management of risks within organisations. However, the global financial crisis revealed that failures were also driven by behavioural deficiencies<sup>1</sup>.

This has led to a series of corporate governance reforms<sup>2</sup> that form part of the global regulatory reform agenda. In addition to raising the bar with respect to corporate governance arrangements, these reforms also introduce a focus on the behavioural aspect of governance. Of significance are efforts in aligning incentive systems with prudent risk-taking behaviour in financial institutions. While this continues to gain traction, widely publicised cases of retail banking fraud and rigging of key benchmark rates in major financial systems underscore the need for sharper efforts to tackle misconduct risk. Given these developments, authorities are turning their focus to regulatory and supervisory approaches targeted at the root causes of unethical behaviour. To date, two jurisdictions are notably advanced on these fronts (Diagram 1). On a broader level, international efforts are presently being coordinated by the Financial Stability Board to develop a toolkit for supervisors and institutions to address vulnerabilities to misconduct.

Experience suggests that as financial systems become more sophisticated, risks of conduct failure are typically heightened. Therefore, promoting ethical conduct and culture within the financial industry is an objective the Bank shares with the international regulatory community.

Diagram 1

#### Key Measures to Address Misconduct Risk



Source: Bank of England, Dutch National Bank

<sup>1</sup> The Financial Crisis Inquiry Report, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, January 2011.

<sup>2</sup> For example, Basel Committee on Banking Supervision: Principles for Enhancing Corporate Governance, Dodd Frank Wall Street Reform and Consumer Protection Act and G20/OECD Principles on Corporate Governance.

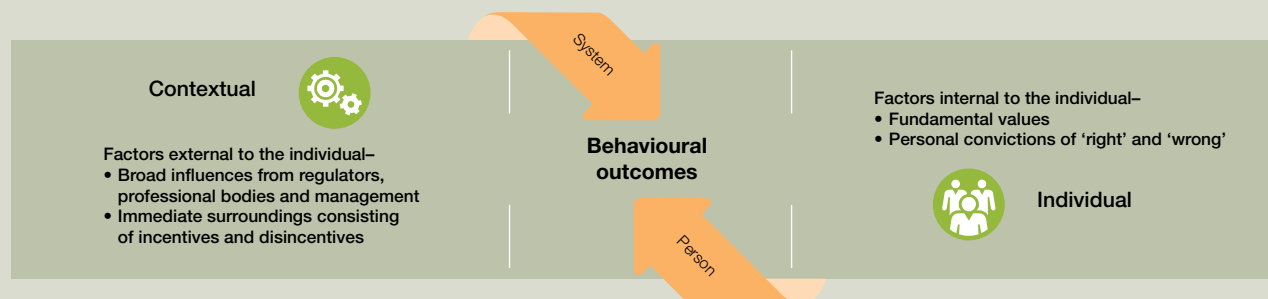
## The Bank's Approach to Influence Behavioural Outcomes

The Bank adopts a two-pronged approach (Diagram 2) to influence the conduct of individuals within the financial sector—

- cultivate a system that promotes and reinforces the norms of honesty and integrity; and
- foster conditions for financial institutions to make informed hiring decisions. This includes improving access to information that is relevant to determine if an individual meets the expected standards of probity for employment in the financial sector.

Diagram 2

### Two-pronged Approach to Influence Behavioural Outcomes



Source: Bank Negara Malaysia

The focus on systems alongside individual probity draws from various studies in the field of psychology. Such studies have shown that factors external to the individual (contextual factors) have a significant and important influence on behavioural outcomes. Specifically, systems create behavioural contexts that influence how individuals act in particular situations, often separate from moral or ethical values they may hold<sup>3</sup>. In this perspective, the root of misconduct may not simply be a problem of ‘bad apples’, but also ‘bad barrels’ and ‘bad barrel-makers’. These findings were similarly reflected in various experiments which suggest that the sphere of influence that an individual is subject to can substantially weaken the norms of honesty and integrity<sup>4</sup>. The system as a whole therefore needs to promote and advocate desired norms for behaviour in the financial industry, to complement the current focus on ensuring key individuals are fit and proper.

### Contextual Factors

Contextual factors make up the prevailing culture within which an individual operates. The Bank employs a balance of measures to shape cultural outcomes both across the financial sector and within each institution.



#### Regulation

Regulations introduced by the Bank formalise its expectations on acceptable conduct for the industry. In the updated Corporate Governance standards issued by the Bank in 2016, the focus on behavioural aspects of governance was strengthened through specific expectations for ethical cultures to be embedded within financial institutions. A key determinant of corporate culture is the tone set by the board and senior management through their decisions, actions and attitudes. On this basis, the standards place a responsibility on the board and senior management to promote a corporate culture which reinforces ethical, prudent and professional behaviours. An important part of this is ensuring that the tone set from the top is reflected in the actions and decisions of middle management as they are more likely to interact directly with the wider population of staff, counterparties and customers. These standards also call for the improved articulation and enforcement of codes of conduct, better alignment of remuneration systems and effective implementation of whistleblowing mechanisms. This is illustrated in Diagram 3.

<sup>3</sup> Zimbardo (2007).

<sup>4</sup> Cohn et al (2014) and Milgram (1963).

Diagram 3

### Corporate Governance Enhancements to Strengthen Institutional Culture



Source: Bank Negara Malaysia

Recognising the significance of the board and senior management's influence over organisational culture, the Bank is currently reviewing the allocation of accountability for individuals in these senior roles. The intention is to make it the direct responsibility of those at the helm of institutions to promote a sound organisational culture and address misconduct risk. A discussion paper on Responsibility Mapping, issued in February 2018, outlines the Bank's ideas for clarification of roles, responsibilities and accountability of individuals in senior positions. Precision on the expectations over each senior role will encourage individuals in these positions to take greater ownership of the areas under their purview and set the appropriate tone from the top. A formal consultation on more substantive policy proposals for the framework can be expected in the second half of 2018.

In addition, the Bank has also issued the Code of Conduct for Malaysia Wholesale Financial Markets and Principles for a Fair and Effective Financial Market for the Malaysian Financial Market in April and October 2017, respectively. Collectively, these aim to shape the desired conduct and practices of individuals involved in the financial markets, thus promoting a financial market environment which is trusted and resilient.

#### Supervision

The Bank, through its supervisory function, also monitors practices and cultural nuances within financial institutions to complement regulatory efforts.

In 2017, the Bank enhanced its internal supervisory framework to incorporate a focus on organisational culture and misconduct risk within financial institutions. This aims to provide added insights as to whether an institution's corporate culture is likely to influence positive or negative behaviours. Components of the supervisory assessment on culture and conduct, and the methodologies, are detailed further in Chapter 2: Banking Sector. It is expected that this framework will be iteratively refined as the Bank further develops its supervisory capabilities to discern cultural and behavioural dynamics.

#### Enforcement

Effective enforcement additionally serves as a credible deterrent against misconduct, thus contributing towards influencing a positive culture within the industry. As announced last year, the Bank will begin to make public, details of enforcement actions for significant contraventions and breaches from 1 January 2018 onwards. This is intended to strengthen the deterrent effect of enforcement actions.

**Industry-led initiatives – Professionalising the industry**

Organisations such as professional bodies play a key role in promoting professional conduct and integrity by current and future members of the financial industry. In this respect, the Asian Institute of Chartered Bankers (AICB) has introduced the Chartered Banker accreditation in 2016. The curriculum accords a significant emphasis, amongst others, on professional ethics. Through a joint declaration with the AICB in 2016, banking institutions have expressed commitment to enrol key employees and board members in this programme. The Bank has also conveyed an expectation for graduates being employed into the banking industry to be members of the AICB, and to complete a mandatory programme on ethics and professional standards. The professional qualifications offered by AICB, not only equip its members with the technical know-how to effectively discharge their functions, but also instil the principles and desired standards for their professional conduct. These efforts complement the work of the Financial Services Professional Board, which expounded a set of principles through the Code of Ethics for the Financial Services Industry, in 2016. Collectively, they contribute to stronger foundations for professional and ethical standards of conduct in the financial sector.

**Individual Factors**

While contextual factors play a significant role in influencing behaviour, individual (or personal) factors also have a key influence on behavioural outcomes. These factors refer to the beliefs, values and convictions of an individual. A key objective is to uphold uncompromising ethical standards for individuals who work in the financial sector.

Diagram 4

**Overview of Contextual and Individual Factors to Influence Behaviour**



Source: Bank Negara Malaysia

With this in view, the Bank seeks to strengthen the conditions for informed hiring decisions, and mitigate the recycling of individuals with a history of misconduct between institutions. This is achieved by addressing underlying obstacles to information symmetry, which may compromise a financial institution's ability to determine the probity of individuals it hires. In March 2018, the Bank finalised the standards on Employee Screening. The standards serve to elevate screening practices of financial institutions and improve transparency of an individual's conduct history. Effective 1 July 2018, financial institutions will be required to screen the employment history and criminal records of new hires. On receiving a request for reference information, financial institutions must provide information on an individual's conduct history with the institution. This in turn will place financial institutions in a better position to make informed recruitment decisions.

## Conclusion

The strength of public trust and confidence in the financial sector is dependent on observable behaviours of the individuals within it. This underscores the importance of ensuring the highest standards of integrity and professionalism within the Malaysian financial sector, bolstered by a deep and pervasive ethical culture. Garnering the collective efforts and support of those with the capability to influence the environment within which individuals operate is certainly important. As detailed above, the Bank employs regulatory, supervisory and enforcement mechanisms to foster a system that promotes honesty and integrity. More importantly, this must be complemented by corresponding industry efforts to lift professional standards of conduct. In particular, boards and senior management must take decisive steps moving forward to drive cultural changes both within their financial institutions and across the financial sector.

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# Financial Sector: Employment Conditions and Preparing the Workforce for the Future

By Ian Lee Wei Xiung and Elysia Lim Fei Ying

## Introduction

A driving force of progress in the Malaysian financial system has been its diverse and adaptive workforce. With globalisation and technological advancements having a profound impact on the global value chain, productivity, and consequently jobs, this article examines: (i) current employment trends in the Malaysian financial sector<sup>1</sup>; (ii) emerging developments within the financial sector workforce; and (iii) implications and strategies for workforce planning and talent management going forward.

## State of the Industry: Key Highlights and Observations on Employment Trends

### Positive job creation and hiring appetite by financial institutions

Net hiring trends by the financial sector have been positive in recent years (Chart 1). At end-2017, 164,884 were employed by the financial sector, with Malaysians comprising a significant majority of the workforce (99.6%). Over the past three years (2015-2017), a total of 24,630 jobs were created, of which 90.6% constituted high-skilled positions<sup>2</sup> (Chart 2). Layoffs and discharges remained low, averaging only 7.5% of total separations<sup>3</sup> in 2017 (Table 1), indicating largely voluntary movements due to retirement, resignations and transfers. Over 75% of jobs created in 2017 were filled within the year, with over 80% of these jobs filled within six months. Looking ahead, the trend for job creation is expected to remain positive, with both banks and insurers/takaful operators expecting additional jobs to be created in 2018.

### Broad-based movement towards a high-skilled workforce

Another key development observed is the shift in composition of the workforce towards high-skilled workers in the last three years. As at end-2017, high-skilled workers comprised 74.4% of banking sector employees (2015: 69.1%) and 83.4% of insurance/takaful sector employees (2015: 79.1%) (Chart 3). This significantly exceeds the national average for total employment in Malaysia, where only 27.2% of employed persons are within the high-skilled worker category. A more detailed analysis on the ongoing and future implications of a movement towards a high-skilled workforce is further discussed in the later part of this article.

Chart 1: New Hires against Separations

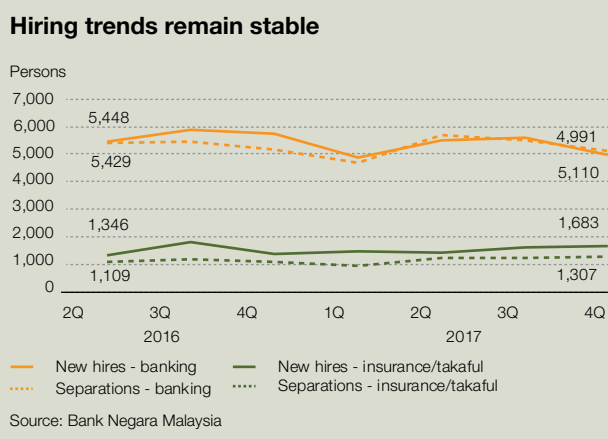
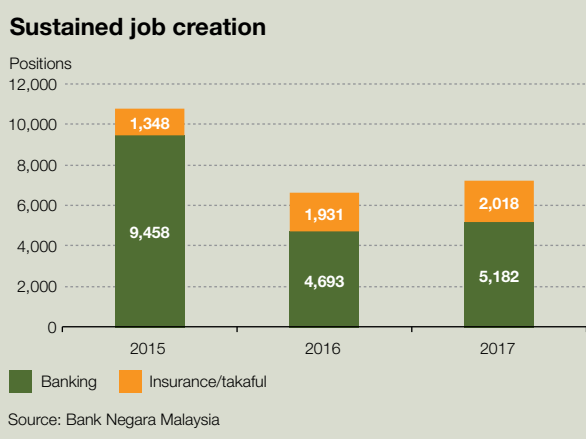


Chart 2: New Jobs Created



<sup>1</sup> Unless otherwise specified, the financial sector comprises banks (commercial banks, investment banks, Islamic banks, international Islamic banks and development financial institutions), insurers and takaful operators.  
<sup>2</sup> Positions are categorised based on the Malaysian Standard Classification of Occupations 2013 (MASCO 2013). For the financial sector, high-skilled positions are those within the Managers, Professionals and Technicians and Associate Professionals groups specified in the MASCO 2013. Mid-skilled positions are those within the clerical occupations and operative workers group, while low-skilled positions are those within the elementary workers group.  
<sup>3</sup> Separations comprise the following sub-categories: (i) Quits/resignations (excluding retirements); (ii) Layoffs and discharges; and (iii) Other separations (retirements, transfers to other locations, deaths or separations due to employee disability).

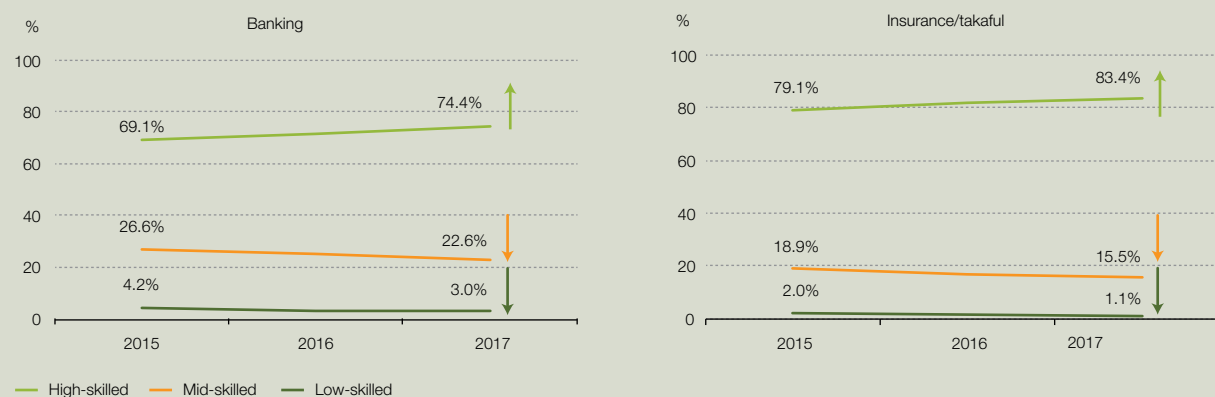
Table 1

**New Jobs Created against Layoffs and Discharges in 2017**

	1Q 2017	2Q 2017	3Q 2017	4Q 2017
<b>NEW JOBS CREATED</b>				
<b>Banking</b>	<b>1,753</b>	<b>1,220</b>	<b>1,482</b>	<b>727</b>
High-skilled	1,721	1,160	1,403	657
Mid-skilled	29	57	79	69
Low-skilled	3	3	0	1
<b>Insurance/takaful</b>	<b>556</b>	<b>525</b>	<b>494</b>	<b>443</b>
High-skilled	552	519	492	438
Mid-skilled	3	6	2	5
Low-skilled	1	0	0	0
<b>LAYOFFS AND DISCHARGES</b>				
<b>Banking</b>	<b>193</b>	<b>284</b>	<b>311</b>	<b>664</b>
High-skilled	169	226	269	402
Mid-skilled	18	53	37	224
Low-skilled	6	5	5	38
<b>Insurance/takaful</b>	<b>158</b>	<b>137</b>	<b>80</b>	<b>111</b>
High-skilled	73	55	28	56
Mid-skilled	85	77	52	55
Low-skilled	0	5	0	0

Source: Bank Negara Malaysia

Chart 3: Employment by Skills

**Broad-based upskilling of the workforce**

Source: Bank Negara Malaysia

**Proportional growth in productivity and median salary**

Consistent with the shift towards a more high-skilled workforce, salaries in the financial sector have continued to increase. Over the 2011-2016 period, the real median salary in the financial sector<sup>4</sup> grew at a Compounded Annual Growth Rate (CAGR) of 1.8% a year, broadly in line with growth in the sector's labour productivity<sup>5</sup>, which expanded at a CAGR of 1.7% a year over the same period. In comparison to other industries, salaries in the financial sector remain supported by relatively high levels of productivity (Table 2).

<sup>4</sup> Real median salary is derived from adjusting the median salary for the financial sector by the Consumer Price Index (Source: Department of Statistics Malaysia). For the calculation of salaries and productivity within this sub-section, the financial sector includes banks (commercial banks, investment banks, Islamic banks, international Islamic banks and development financial institutions), insurers and takaful operators as well as capital market service operators and other financial providers.

<sup>5</sup> Measured by real value-added per worker.

Table 2

**Real Median Salary and Productivity of Selected Economic Activities in 2016**

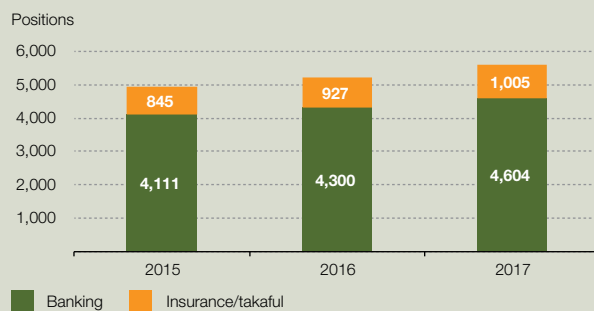
Economic Activity	Monthly Real Median Salary (RM)	Annual Real Value-added per Worker (RM)
Mining and quarrying	3,168	1,134,476
Information and communication	3,038	294,998
Financial and insurance/takaful activities	2,648	201,224
Manufacturing	1,389	106,413
Construction	1,354	39,225
Wholesale and retail trade, repair of motor vehicles and motorcycles	1,302	67,395
Agriculture, forestry and fishing	1,042	51,264
Accommodation and food and beverage services activities	1,007	26,373

Source: Department of Statistics Malaysia

**There are some remaining job vacancies despite positive overall hiring appetite**

Despite positive overall hiring trends by the financial sector, job vacancies remain at over 5,600 (Chart 4), with high-skilled positions consistently accounting for more than 80% of total job vacancies over the past three years. Based on a survey conducted by the Bank, a majority of job vacancies (over 3,500 positions) were high-skilled positions within the commercial banking sector as at end-September 2017. Among these, high-churning business functions, such as sales and marketing have the largest number of vacancies (33%, 1,185 positions), while highly-specialised functions such as risk management, legal, compliance, project management and credit management were the second largest group (15%, 509 positions). More than 75% of these job vacancies in the commercial banking sector were for entry-level or experienced technicians and associate professionals, indicating strong industry-wide demand for junior- to mid-level employees in high-skilled business functions. Commercial banks cited that the limited number of candidates with the necessary qualifications, exposure and knowledge was among the key challenges faced in filling the vacancies. The evolution of job requirements within the highly-specialised functions underscores the need to focus not only on the absolute supply, but also the quality of supply to meet industry demand for higher-skilled talent.

Chart 4: Job Vacancies

**Some job positions remain vacant**


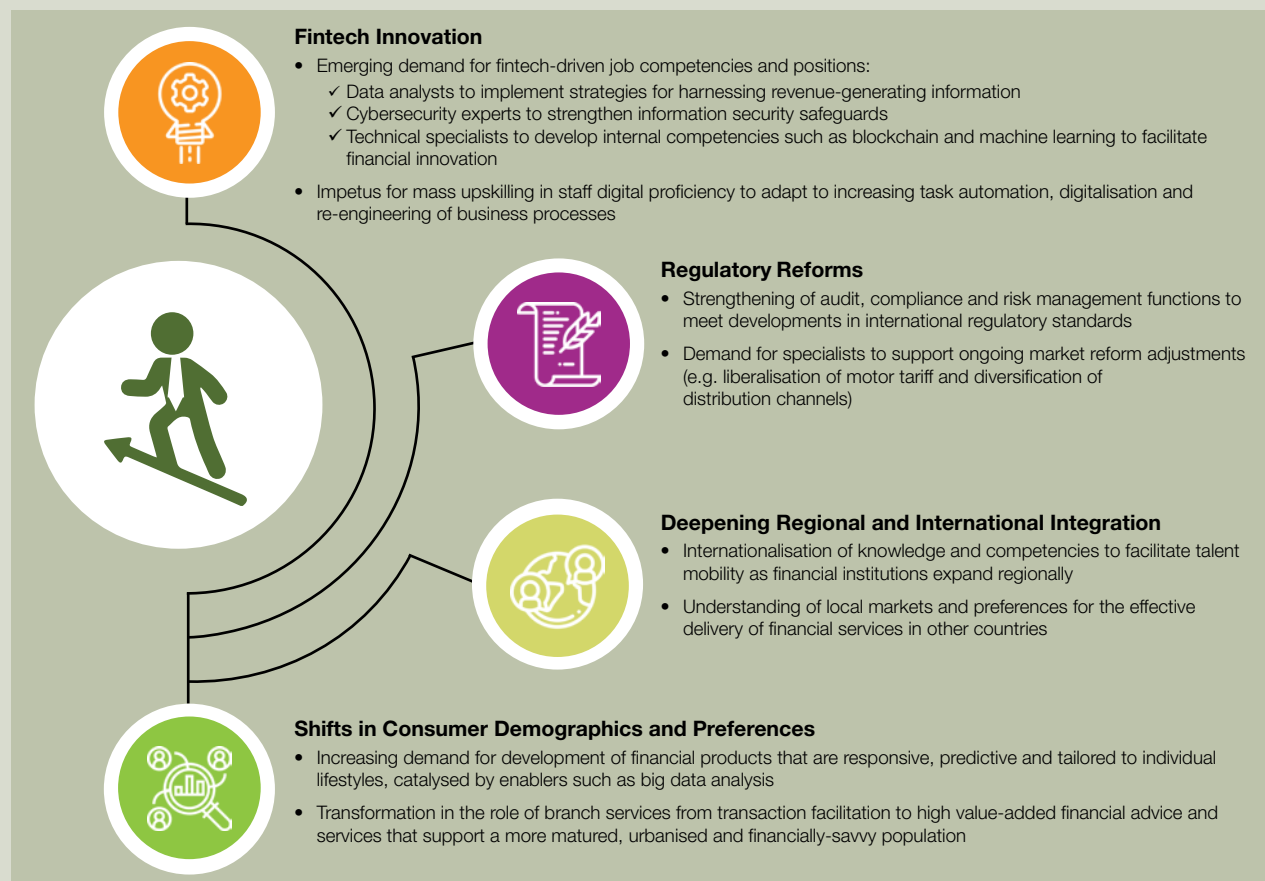
Source: Bank Negara Malaysia

## An Evolving Workforce: Trends and Developments Shaping the Future Landscape

The above observations highlight important shifts in job creation, hiring trends and workforce composition that are taking place amid the changing financial landscape. Looking ahead, several factors will be key in shaping the workforce needs of the Malaysian financial sector (Diagram 1). In particular, these factors include the pervasive impact of technology on both business strategy and processes, higher and more complex demands from the ongoing regulatory reforms, expanding cross-border operations and changes in consumer interactions.

Diagram 1

### Driving Factors Shaping the Future Workforce Needs of the Malaysian Financial Sector



Source: Bank Negara Malaysia

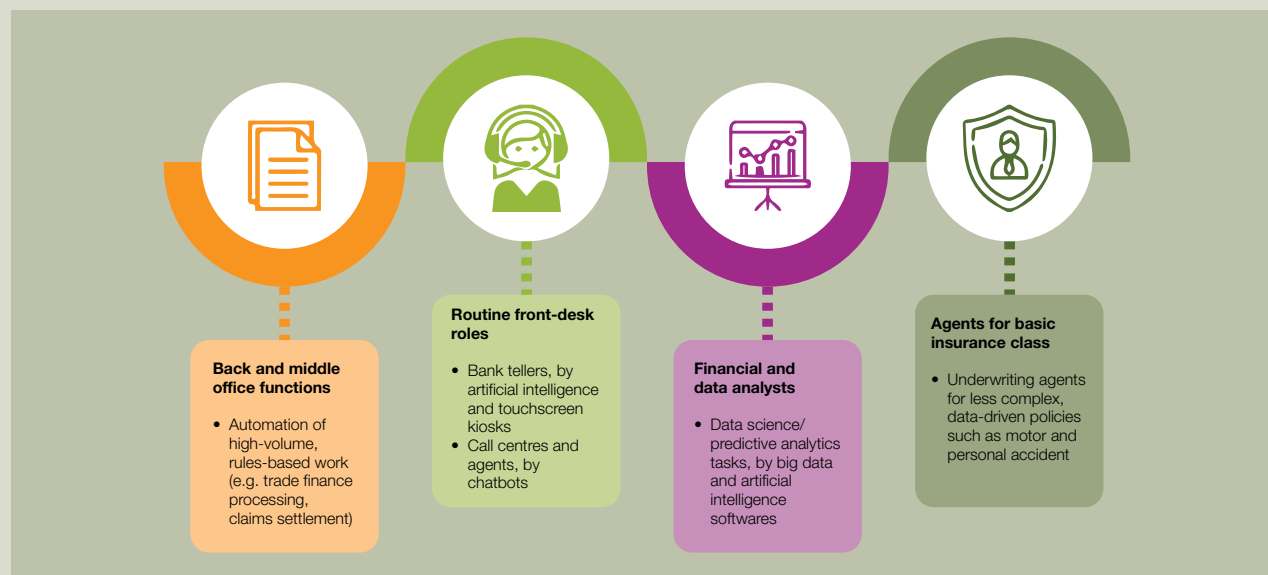
Over the coming years, the confluence of these factors is likely to see new jobs being created within the high-skilled category, accompanied closely by shifts in the role and scope of existing job positions. In particular, technological advancements are expected to expand job opportunities in several key areas, including to support:

- (i) Process streamlining: In a more digitalised society, greater demand will be created for specialised skills to drive continuous process re-engineering to increase efficiencies while delivering superior service;
- (ii) Data analytics: Big data will play a crucial role in expanding business opportunities and managing risks. Financial institutions will need to be able to examine and process large and varied data sets that will increasingly drive decisions;
- (iii) Cybersecurity management: As increasing amounts of sensitive information migrate from paper to cloud, information security will be a paramount concern; and
- (iv) Regulatory and legal compliance: Increasing regulatory complexity will shift greater demands onto technology to support compliance, with risk management, compliance and finance officers taking on more strategic roles in recovery planning, governance, communications and advocacy and organisational development.

The broad reach of digital platforms and changes in consumer preferences have further accelerated changes in the delivery of financial services, replacing physical branch access with mobile- and internet-based connectivity for performing financial transactions. In 2017, banks onboarded over 5.3 million online and mobile banking customers, and notified the Bank of 36 branch closures, broadly in line with declining transaction volumes at these bank branches. While these technological advancements have enabled financial institutions to be more agile and responsive to consumer preferences and a changing competitive landscape, they also herald an irreversible change in the future composition and skillsets of the financial sector workforce (Diagram 2).

Diagram 2

### Types of Jobs and Roles at Risk of Technological Displacement



Source: Bank Negara Malaysia

With a significant majority of jobs in the high-skilled category, technology is more likely to augment and redefine job roles in the financial sector, rather than eliminate occupations altogether over the next decade. The effects of automation will also likely be heterogeneous. Like periods of significant technological advancements in the past, the impact across jobs, worker segments and institutions will be uneven despite overall benefits to society from increased productivity, wages and innovation. In line with trends observed in other advanced countries, the gradual displacement of largely manual and more routine lower value jobs will continue. In Malaysia, the number of low- and mid-skilled workers declined at a CAGR of 16.9% and 8.2% respectively over the past three years. Nevertheless, the proportion of low- and mid-skilled workers in Malaysia's financial sector remains sizeable at 24%.

### Building the Workforce of the Future: Priorities Moving Forward

These developments bring into greater focus several priorities for preparing the financial sector workforce for the future, which include:

- Equipping the workforce with new skillsets that are relevant and practical for the needs of the future. In line with a heightened focus on professionalism as part of ongoing regulatory reforms, this also entails the raising of professional standards and ethical conduct in the workforce;
- Supporting the transition of the workforce through re-training and outplacement assistance as job functions evolve; and
- Expanding the innovative capacity of the workforce to facilitate future growth, particularly through enhancing data capabilities and workforce diversity.

According to a report by the World Economic Forum, the most in-demand occupations in many industries today did not exist ten or even five years ago<sup>6</sup>. The report also quotes that an estimated 65% of children entering primary school today will ultimately end up working in completely new job types that are yet to exist. The potential disruption that this reality presents is significant. While it is difficult to fully anticipate how job markets will evolve in the medium to long term, it is critical to ensure that strong institutions, arrangements and standards exist to support inevitable adjustments in the financial sector workforce. A number of important initiatives are being pursued by the Bank and the financial industry to this end:

**a) Strengthening core competencies and raising professional standards**

The demand for new technical or critical skillsets by the industry calls for strong foundations in core competencies that are continuously updated, and conduct that consistently reflects a commitment to high professional standards. This is being supported by:

- (i) Expectations for key personnel in critical job functions in the banking sector to acquire the appropriate specialised qualifications beginning 2018. This covers the areas of credit, compliance, Anti-Money Laundering and Counter Financing of Terrorism, risk management and audit;
- (ii) Continuing progress towards increasing the number of Chartered Bankers among the senior management and boards of banking institutions as part of a broader initiative to professionalise the Malaysian banking industry;
- (iii) Requirements introduced for reporting submissions made by commercial banks to Bank Negara Malaysia to be undersigned by a Chartered Banker beginning 2021. Similar requirements are also contemplated for the Islamic banking and insurance/takaful sectors;
- (iv) Mandatory accreditation of compliance officers in the money services business sector (further details provided in this Chapter), in collaboration with the Financial Accreditation Agency and Department of Skills Development;
- (v) Requirements for Shariah committee members and key Shariah personnel to attain Shariah certifications such as the Certified Shariah Advisor and Certified Shariah Practitioner to be eligible for appointment; and
- (vi) Transformation of key professional training and education institutions for Islamic finance and insurance/takaful to strengthen their capacity to meet new demands and maintain high professional standards for the workforce. This includes the reconfiguration of existing institutions and consideration of sustainable funding arrangements to support key reforms.

**b) Developing mechanisms to support re-skilling and workforce transition**

While the overall objective is to promote upskilling across the entire financial sector workforce, certain segments, whether by choice or compatibility, will inevitably face the risk of displacement. To mitigate this risk, it is thus important to ensure arrangements are in place to increase workforce mobility and facilitate orderly job transitions. This includes:

- (i) Improving the availability of information on the types of jobs that may be at risk of displacement and projections of the number of jobs likely to be displaced;
- (ii) Identifying new complementary or adjacent job positions that are relevant to the existing skillsets and roles of job segments at risk of displacement; and
- (iii) Providing for an explicit and sustained focus within business plans on strategies to address the transition of staff into new roles, whether within or outside the institution.

Based on the Bank's findings, while some elements of these mechanisms exist within the industry, over 60% of commercial banks, insurers and takaful operators will benefit from having a more comprehensive approach towards workforce transition. The Bank aims in 2018 to work with financial institutions to conduct a holistic assessment of the dynamics of the financial sector workforce, including forecasting skill demand and supply, with the end objective of developing appropriate supporting mechanisms to facilitate workforce transition.

**c) Diversifying the talent pool**

Over the years, a more diverse finance talent pool has emerged, reflecting an increasing openness of financial institutions to new perspectives, ideas and expertise from non-traditional practices or backgrounds to improve business processes and capture new opportunities. As at end-2017, close to a half of new hires employed in the financial sector were from academic backgrounds outside the traditional fields of finance, accounting, economics, business and actuarial science.

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<sup>6</sup> World Economic Forum (2016), 'The Future of Jobs' Report.

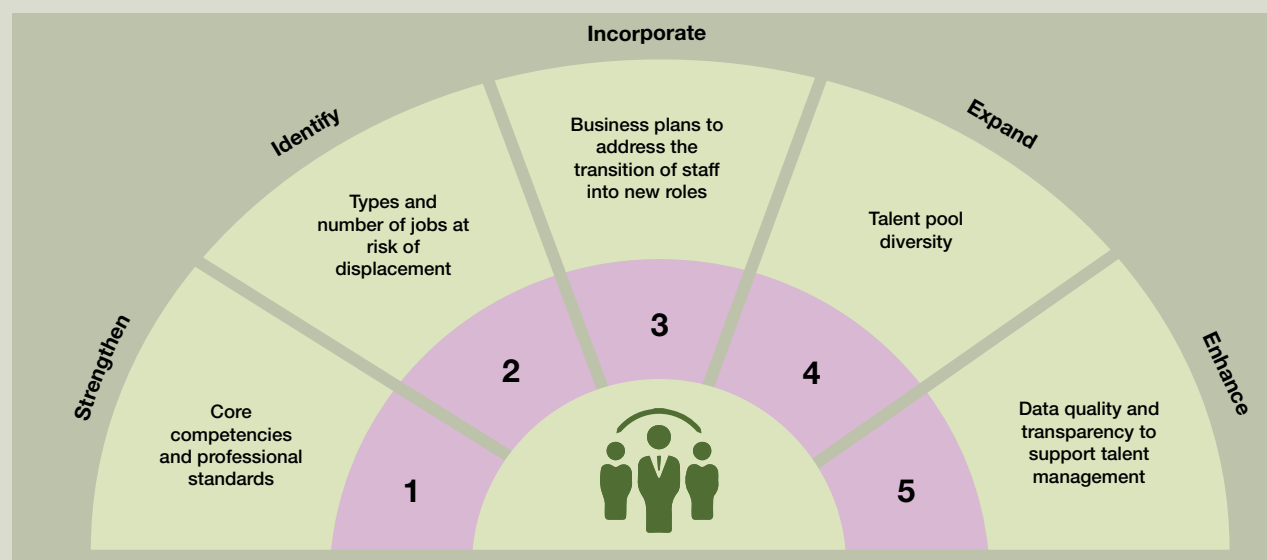
Efforts continue to be pursued to build and diversify the talent pipeline. Intakes to the Financial Sector Talent Enrichment Programme have been expanded to include candidates from new and diverse disciplines. This will be further complemented by the development of a 'Fit-for-Work Programme (FFW)', which is expected to commence in 2018. FFW is a 9-month technical training and placement programme that aims to provide valuable exposure to unemployed graduates in the financial sector, thereby improving their job prospects, while at the same time allowing financial institutions an opportunity to tap into a source of potential talent that may not normally be identified through more common recruitment channels. The programme will build on a combination of selected industry-run training platforms, on-the-job experience and massive open online courses (MOOCs) to help reduce the issue of skills mismatch of graduates and facilitate employment by the financial sector.

#### d) Enhancing data to support talent management and development

To improve market signalling and reduce information asymmetries for both job seekers and training providers, the Bank published the first set of financial sector workforce data in August 2017. The Bank will continue to enhance the reporting system, including the data structures, with the aim of improving the accessibility and quality of labour market statistics. This will better enable industry players to forecast future talent needs and required skillsets, while supporting industry training providers in the development of more customised programmes. The establishment of the Malaysia Bureau of Labour Statistics is also expected to facilitate more accurate and timely comparison of labour market information between the financial sector and other industries.

Diagram 3

#### Imperatives for Building the Financial Sector Workforce of the Future



Source: Bank Negara Malaysia

#### Conclusion

Current trends in the financial sector workforce are indicative of a trajectory towards becoming more technology-intensive and knowledge-driven. This transition has the potential to be highly disruptive in a way that could undermine the broader benefits from a more productive and higher-skilled workforce, unless institutional and industry arrangements are well positioned to not only manage the transition, but enable it by increasing the agility of our workforce. Some of the ways to achieve this are outlined in this article and will continue to be an area of focus going forward to better prepare the workforce for the emerging needs of the future.

#### References

World Economic Forum (2016), 'The Future of Jobs' Report.