

Cross-Sector Developments

101	Financial Markets
103	Prudential Policy
104	Financial System Integrity
105	Enforcement Actions
105	Money Services Business
105	Consumer Protection Frameworks and Empowerment
108	FinTech Innovation
111	<i>Box Article: Mid-term Review of the Financial Sector Blueprint (2011 – 2020)</i>
118	<i>Box Article: A New Model for Money Services Business – Towards Greater Modernisation and Professionalism</i>

Cross-Sector Developments

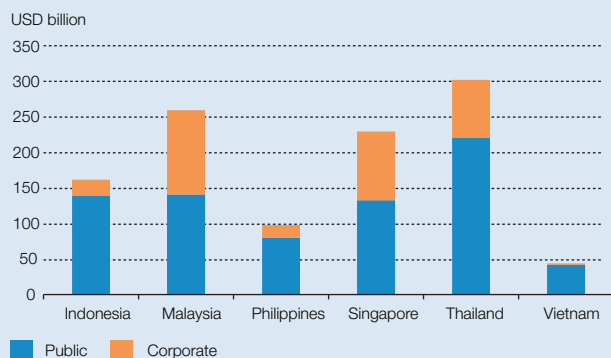
FINANCIAL MARKETS

Malaysia's debt securities market continued to be a key source of financing for the public and corporate sector, and remains one of the largest in Southeast Asia (Chart 5.1) at 95.6% of gross domestic product. Outstanding long-term government bonds and corporate bonds grew by 6.1% to RM1.2 trillion in 2016, with issuances of corporate bonds led by the *finance, insurance and real estate; infrastructure; and electricity, gas and water supply* sectors. The share of corporate financing from the bond market rose marginally to 37.4% of total corporate financing as at end-2016 (2015: 36.8%). Sukuk continued to account for a higher proportion of total outstanding debt securities at 56.4% (Chart 5.2).

In the foreign exchange (FX) market, shifts in investor sentiment surrounding major global events in the second half of the year exerted downward pressure on most major and regional currencies, including the ringgit. This largely reflected uncertainties over policy adjustments in major economies following the United Kingdom's vote to

Chart 5.1

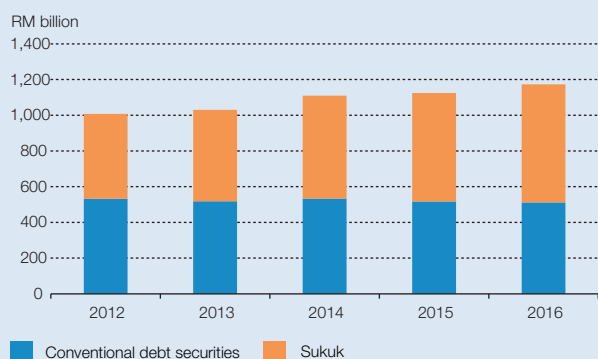
ASEAN Outstanding Local Currency Debt Securities Market



Source: Asian Bonds Online

Chart 5.2

Outstanding Debt Securities and Sukuk (Public and Corporate)



Source: Bank Negara Malaysia

exit the European Union and the outcome of the United States (US) presidential election, as further discussed in the Chapter on 'Risk Developments and Assessment of Financial Stability in 2016' under 'Managing Risks from Financial Market Volatility'.

Volatility in the ringgit was further exacerbated by uncertainty in the outlook for global crude oil prices and speculative activity in the non-deliverable forward (NDF) market, which resulted in a material divergence between the offshore ringgit rate and onshore-traded ringgit prices. The domestic FX market recorded a lower average daily turnover of USD8.1 billion, 20.6% lower than the previous year. Ringgit currency pairs traded at a daily average volume of USD4.4 billion, of which spot and forward transactions averaged USD1.9 billion daily. Liquidity in the domestic FX market also reflected rising supply and demand imbalances in FX flows (also discussed in the Chapter on 'Risk Developments and Assessment of Financial Stability in 2016'), which further contributed to ringgit volatility. For the year as a whole, the ringgit depreciated by 4.3%, ending at RM4.4860 against the US dollar.

In May 2016, the Bank established the Financial Markets Committee (FMC) comprising senior-level officers from the Bank, Securities Commission Malaysia, financial institutions and other key participants in the financial markets to provide a more inclusive forum to advance strategies in developing Malaysia's financial markets. The FMC announced several measures in December 2016 aimed to promote a deeper, more transparent and well-functioning onshore FX market, which includes providing flexibility to market participants in the ringgit hedging market. Financial institutions were also reminded to observe robust due diligence and Know-Your-Customer (KYC) processes to ensure that they do not facilitate speculative activities in the ringgit NDF market. The implementation of these measures supported greater liquidity in the domestic FX market, as evidenced by an increase in the onshore ringgit FX transaction volume to a daily average of USD5.9 billion, while transactions in the ringgit NDF market contracted to a daily average of USD1.3 billion as at end-2016.

During the year, the FMC also adopted a new methodology for the setting of USD/RM reference rates. The methodology which came into effect on 18 July 2016, is in line with global best practices and aims to improve market transparency by using daily market transaction data instead of quotes submitted by onshore banks in setting the reference rate. This further strengthens the credibility of the rate setting

mechanism and reduces opportunities for the exertion of undue influence on the reference rate setting process.

In October 2016, the Bank, in collaboration with the banking industry, launched the retail Negotiable Instrument of Deposit (NID) and Islamic Negotiable Instrument (INI) programme to broaden retail participation in the financial markets, thus further enhancing the depth and liquidity of the market. As retail NIDs and INIs have a lower investment threshold and can be traded over-the-counter in the secondary market, the programme will expand access for retail investors to money market instruments that are of relatively low risk. The development of the retail NID market is also expected to increase demand for ancillary services, such as alternative trading platforms and custodial services catering to retail investments provided by financial institutions and non-banking entities, such as financial technology (FinTech) companies.

The retail NID and INI programme was launched by the Bank to promote the development of a dynamic financial market through greater retail participation

Promoting high standards of conduct and transparency in the domestic wholesale financial

Measures to Broaden and Develop the Onshore Financial Markets

- Liberalisation and deregulation of the onshore ringgit hedging market:
 - a. Residents (including fund managers) allowed to hedge US dollar and China Offshore Spot (CNH) exposures up to a limit of RM6 million per client per bank, supported with a one-off declaration for FX hedging intent. Hedging of FX exposure beyond this limit continues to be free provided that the transaction is supported with an underlying commitment;
 - b. Resident and non-resident fund managers allowed to actively manage their FX exposures up to 25% of their invested assets upon registration with the Bank, thus providing more flexibility for dynamic hedging; and
 - c. Non-resident financial institutions that are not part of the banking groups of licensed onshore banks also allowed to participate in the Appointed Overseas Office (AOO) framework. Under the AOO framework, additional flexibilities on ringgit transactions are provided to improve access by foreign investors and corporates to the onshore FX market. These flexibilities include FX hedging for the institution's own account or on behalf of clients for current and financial account commitments, and the offering of ringgit trade financing facilities.
- Streamlined treatment for investment in foreign currency assets of resident entities with domestic ringgit borrowing to invest in foreign currency assets in both the onshore and offshore market, up to a prudential limit of RM50 million per calendar year for each corporate group.
- Rebalancing the demand for ringgit by allowing exporters to retain up to 25% of export proceeds in foreign currency, with the balance converted into ringgit. Foreign currency amounts above the threshold may be retained through same rate reconversion to support foreign currency obligations up to the value of six months.

markets remains an important priority of the Bank to ensure fair, orderly and efficient markets. During the year, the Bank published an exposure draft on the Code of Conduct for the Malaysian Wholesale Financial Markets for consultation. The code formalises as binding obligations the Bank's expectations for market participants in the wholesale financial markets to adhere to professional and ethical standards of conduct, making any breaches of these standards sanctionable under the law. The draft standards address conduct requirements on dealing activities, including prohibited conduct and the responsibility of market participants to promote a reputable and fair market place. It also sets out the role of the ACI-Financial Markets Association of Malaysia in preserving orderly markets, which includes self-policing, conducting investigations on the misconduct of its members and referring misconduct cases involving violations of the code to the Bank for further investigation.

Efforts were pursued to further promote the use of local currencies for trade settlement between Malaysia and its neighbouring countries. Following the operationalisation of the Renminbi Liquidity Facility in 2013 and appointment of a renminbi clearing bank in Malaysia by the People's Bank of China in 2015, trade settlement in ringgit and renminbi has continued to gain traction at a compounded annual growth rate of 42.2%. The use of local currencies for trade settlement not only reduces trade transaction costs for businesses, but also promotes greater flexibility in managing FX risks for banking institutions and contributes to the development of regional financial markets. Local currency settlement arrangements were further expanded for ringgit and Thai baht settlements in March 2016 under a framework operationalised with the Bank of Thailand. This was followed by a Memorandum of Understanding entered into between the Bank and Bank Indonesia in December 2016 to establish a framework for bilateral trade settlements in ringgit and Indonesian rupiah. The arrangement with the Bank of Korea was also renewed in January 2017.

PRUDENTIAL POLICY

The Bank issued the final standard for Corporate Governance in August 2016, after careful review of feedback received on the draft standard

and broader engagements with the industry on specific issues raised – mostly in relation to transitioning arrangements. The final standard provides for an extended transition period of up to 2021 for financial institutions to comply with strengthened requirements on board composition and remuneration. Banks and insurance/takaful companies have begun to actively engage the Bank on plans to comply with the requirements, and are making progress towards strengthening internal frameworks around compensation systems and organisational culture to reinforce professional and ethical conduct. Work has commenced to similarly review existing corporate governance standards for development financial institutions (DFIs), with draft changes expected to be published within the first half of 2017 for industry feedback. While aiming to similarly elevate the standards and practice of governance in DFIs, the draft standards for DFIs will continue to take into account the specific developmental mandates and unique ownership structures of DFIs.

Additionally, the Bank issued the revised standards on Operational Risk Management in May 2016. The revised standards require financial institutions to establish a robust operational risk management framework that is commensurate with the size and complexity of the institution's operations. A transition period of up to two years has been provided for financial institutions to meet the new requirements. Although progress remains uneven, the Bank has observed considerable improvements in financial institutions' operational risk management practices. Institutions are generally more proactive and holistic in managing operational risk, with an increasing use of forward-looking tools to forecast operational risk events and losses. Financial institutions are also employing clearer lines of accountability for operational risk management and more structured methods for operational risk data collection. In the first quarter of 2017, the Bank will begin publishing the Operational Risk Landscape Report based on submissions by financial institutions to the Bank's Operational Risk Integrated Online Network (ORION) system. The report, which will be published bi-annually, provides a system-level overview of operational risk losses to help financial institutions compare their own experience against industry norms, and support efforts by financial institutions to continuously strengthen internal controls and assess their exposures to operational risk.

FINANCIAL SYSTEM INTEGRITY

The Bank and 15 other member agencies of the National Coordination Committee to Counter Money Laundering continued to implement action plans under the National Anti-Money Laundering and Countering Financing of Terrorism Strategic Plan (2015-2020) in 2016. A follow-up assessment by the Financial Action Task Force (FATF) in 2016 noted that Malaysia has made considerable progress in improving compliance with anti-money laundering/counter financing of terrorism (AML/CFT) international standards since the publication of the Mutual Evaluation Report on Malaysia's AML/CFT regime in 2015.

The Bank continues to build on and strengthen its collaboration with other agencies and organisations as part of efforts to maintain strong defences against money laundering/terrorism financing (ML/TF) risks, particularly among designated non-financial businesses and professions. This included working with several self-regulatory organisations such as the Kuala Lumpur Bar Committee and Malaysian Institute of Accountants throughout the year to jointly conduct outreach programmes and guide efforts by individual firms to improve the management of ML/TF risks.

FATF recognises that Malaysia has made considerable progress in strengthening compliance with AML/CFT international standards since the publication of the Mutual Evaluation Report on Malaysia in 2015

The Bank also co-operates closely with the Royal Malaysian Police (RMP) and foreign Financial Intelligence Units (FIUs) in its efforts to combat terrorism financing (TF). Vigilance over the use of the financial system to finance terrorism activities has heightened globally since the emergence of militant terrorist groups in the Gulf countries in 2014. During the year, the Bank shared 68 potential TF activities with the RMP and also made 11 requests for information from foreign FIUs under the Egmont Group of FIUs. At the international level, the Bank participated in the first regional risk assessment of TF in Southeast Asia, which was conducted by FIUs from Australia and Indonesia. The assessment focused on high-risk TF methods and channels,

Diagram 5.1

Priority Actions Identified from the Regional Risk Assessment of Terrorism Financing in Southeast Asia



Source: Regional Risk Assessment on Terrorism Financing 2016 by Pusat Pelaporan dan Analisis Transaksi Keuangan (PPATK) and the Australian Transaction Reports and Analysis Centre (AUSTRAC), used under CC BY 4.0 license (www.creativecommons.org/license)

including those that present joint-country or intra-regional risks (Diagram 5.1). Based on the assessment, recommendations were proposed for:

- (i) the development of a secured system for regional governments to share details of persons of interest related to TF activities;
- (ii) further study of patterns and trends in cross-border movements of funds/value; and
- (iii) enhanced assessments of high-risk non-profit organisations (NPOs).

Following the recommendations, the Bank is collaborating with foreign FIUs in the region to adopt a more rigorous risk assessment on NPOs which are susceptible to TF risks and to identify critical regional border points exposed to the illegal movement of funds to finance terrorist activities.

During the year, the Bank published three technical notes on reporting obligations by reporting institutions (RIs) with respect to countering TF risks, key highlights of which are summarised in Table 5.1. The technical notes provide more detailed guidance in specific areas to support the effective implementation of AML/CFT measures by RIs.

Table 5.1

Technical Notes for Reporting Obligations on the Counter Financing of Terrorism

Technical Notes	Purpose
Targeted Financial Sanctions on Terrorism and Terrorism Financing	Guides RIs in implementing targeted financial sanctions in relation to TF through a detailed mechanism, which includes a thorough screening of customers and in-depth reporting requirements.
Foreign Terrorist Fighters	Assists financial institutions in identifying financial transactions which are highly likely to be linked to financing for foreign terrorist fighters.
Terrorism Risk Indicators	Provides risk indicators developed by the FATF to guide financial institutions in identifying and mitigating TF risks.

Source: Bank Negara Malaysia

ENFORCEMENT ACTIONS

To instil market discipline and deter future misconduct in the financial system, the Bank applies a range of enforcement tools, including administrative, civil and criminal enforcement actions, in dealing with statutory offences and non-compliances with standards issued by the Bank. In 2016, 13 entities and individuals were prosecuted for operating illegal activities and schemes, with nine convictions obtained. These were mainly for offences related to illegal money services and illegal deposit taking. The Bank also initiated 38 new investigations into suspected illegal activities and regulatory breaches by entities and individuals. Table 5.2 provides a summary of enforcement actions taken by the Bank in 2016.

The Bank also collaborated with other enforcement agencies to investigate and prosecute syndicated crimes. In 2016, the Bank, together with the National Revenue Recovery Enforcement Team of the Attorney General’s Chambers, the RMP and the Royal Malaysian Customs jointly raided a syndicate of illegal money services business (MSB) operators, following 16 months of intelligence and ground surveillance on the syndicate, which was found to have illegally transferred funds from Malaysia into neighbouring countries. Investigations on the syndicate members are currently ongoing.

MONEY SERVICES BUSINESS

The retail and wholesale money-changing segments of the MSB industry continued to grow by 21.1% and 38.5% respectively in 2016 (2015: RM60.7 billion and RM7.7 billion respectively). This was

attributable to the strong demand for common currencies such as the US dollar, Singapore dollar, euro and regional currencies from both inbound and outbound travellers. Meanwhile, overall outward remittances declined slightly by 1.9% to RM34.3 billion (2015: RM34.9 billion), due to lower repatriation of salaries and remuneration through banking remittance channels. Non-bank remittance service providers, however, continued to register a modest growth of 4.6% in outward remittances by migrant workers, mainly to Indonesia, Bangladesh and India. Developments in the MSB industry are further elaborated in the box article ‘A New Model for Money Services Business—Towards Greater Modernisation and Professionalism’.

CONSUMER PROTECTION FRAMEWORKS AND EMPOWERMENT

The Ombudsman for Financial Services (OFS) commenced operations on 1 October 2016, marking an important step forward in ensuring an effective framework for the protection of financial consumers in Malaysia. The OFS provides an independent alternative avenue for consumers to resolve disputes relating to financial services or products offered by its 175 member financial service providers (FSPs) covering banking institutions, DFIs, insurers, takaful operators, insurance and takaful brokers, payment instrument issuers and financial advisers. While largely evolved from the former Financial Mediation Bureau, key aspects of its governance and operations have been strengthened and enhanced to deliver greater efficiency in the handling of disputes and improve incentives for FSPs to engage more constructively with customers.

Table 5.2

Enforcement Actions Taken in 2016

Area	Enforcement Actions
Illegal deposit taking	<ul style="list-style-type: none"> • A charge was pursued against an individual for illegal deposit taking under section 25(1) of the Banking and Financial Institutions Act 1989 (BAFIA). • An individual was convicted for a charge under section 112(1)(c), read together with section 25(1) of the BAFIA, resulting in fines amounting to RM100,000 and imprisonment.
Non-compliance with prudential requirements	<ul style="list-style-type: none"> • Compounds amounting to RM5.4 million were imposed on one Islamic bank for failure to comply with statistical reporting requirements under section 78 of the Central Bank of Malaysia Act 2009. • Administrative monetary penalty amounting to RM1.4 million was imposed on a bank for failure to submit audit findings under section 48(1) of the Financial Services Act 2013 (FSA).
Unauthorised provision of money services	<ul style="list-style-type: none"> • 12 charges were pursued against three entities and nine individuals for the unauthorised provision of money remittance services under section 4(1) of the Money Services Business Act 2011 (MSBA). • Two entities and five individuals were convicted for eight charges of unauthorised provision of money remittance services under section 4 and section 23 of the MSBA, resulting in fines amounting to RM370,000 and imprisonment.
Non-compliance with regulatory requirements	<ul style="list-style-type: none"> • Compounds amounting to RM39,000 were imposed on three MSB operators for failure to issue receipts to customers for exchange transactions under section 27 of the MSBA. • Administrative monetary penalties amounting to RM12,000 were imposed on eight MSB operators for failure to maintain minimum capital funds under section 22 of the MSBA. • Administrative monetary penalties amounting to RM20,500 were imposed on 13 MSB operators for failure to submit their audit reports within the specified period under section 31(9) of the MSBA.
Non-compliance with foreign exchange administration requirements	<ul style="list-style-type: none"> • Compounds amounting to RM22.9 million were imposed on seven institutions for failure to comply with foreign exchange administration requirements under section 214 of the FSA and section 225 of the Islamic Financial Services Act 2013 (IFSA).
Non-compliance with AML/CFT policies	<ul style="list-style-type: none"> • Compounds amounting to RM1.7 million were imposed on one bank for failure to comply with reporting obligations and record-keeping requirements under section 14(1)(b) and section 17(1) of the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA). • Compounds amounting to RM1.6 million were imposed on one bank for failure to comply with reporting obligations and AMLA Orders under section 14(1)(b) and section 50 of AMLA.

Source: Bank Negara Malaysia

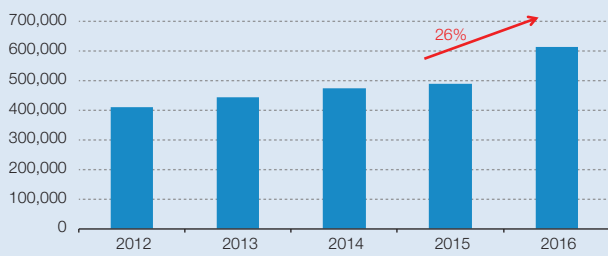
Enquiries and advisory services handled through BNMLINK and TELELINK – the Bank’s point of contact with the public – continued on an upward trend in 2016 (Chart 5.3). An average of 2,562 enquiries, advisory services and complaints were handled by the Bank per day, 27% higher from 2015. Conversely, fewer complaints were recorded against FSPs (Chart 5.4). The Bank’s engagements with consumers and FSPs indicated that consumers are more aware of avenues available for them to address their enquiries and concerns. FSPs in turn are continuing to incorporate feedback shared by the Bank from its management of public complaints to improve the way that FSPs manage and respond

to customer issues. Such feedback has evolved to include not only individual concerns relating to a specific FSP, but also broader emerging issues observed within the financial industry in Malaysia.

Efforts by the Bank together with its partners to raise the level of financial literacy were further bolstered by the establishment of the Financial Education Network (FEN) in November 2016. Its initial members comprise the Bank, Securities Commission Malaysia, the Ministry of Education, Employees Provident Fund, Malaysia Deposit Insurance Corporation, Credit Counselling and Debt Management Agency and Permodalan Nasional Berhad, with membership expected to expand further as needed

Chart 5.3

Enquiries and Advisory Services Handled by the Bank



Source: Bank Negara Malaysia

to drive targeted initiatives. The FEN aims to increase the impact of financial education initiatives and identify new opportunities to improve financial literacy through greater inter-agency alignment, closer collaboration as well as a strong focus on impact assessments. To this end, the FEN will work with relevant government ministries, industry associations and consumer groups to deliver, monitor and measure financial education initiatives under a coordinated national strategy. A current priority of the FEN is to improve public awareness and education on the need for long-term financial planning. This is reflective of inadequacy in retirement savings, which has also been highlighted by the Bank in previous reports, and a continuing concern over the lack of attention to long-term financial planning observed among a majority of Malaysians¹.

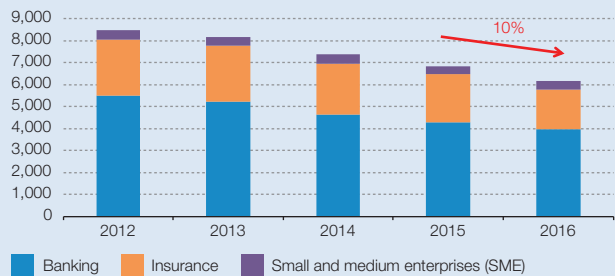
The Financial Education Network comprising regulators and key financial education stakeholders was established in November 2016 to coordinate and drive a national financial education strategy in Malaysia

The Bank also collaborated with the Department of Social Welfare to improve financial access for persons with disabilities (PWDs). Financial institutions were encouraged to provide more bespoke services which cater to the needs of the disabled, and to continue to improve physical infrastructure accessibility for PWDs at all their financial access points. To date, FSPs have trained more than 10,000 front liners to provide appropriate support for the special needs of PWDs. A DFI has also launched a special

¹ Based on the International Survey of Adult Financial Literacy Competencies conducted by the Organisation for Economic Co-operation and Development/International Network on Financial Education in 2016.

Chart 5.4

Complaints Received by the Bank



Source: Bank Negara Malaysia

financing programme dedicated to providing PWDs with working capital for agriculture and agro-based businesses. Promoting the responsible usage of financial services continues to be a focus of the Bank's outreach and education initiatives, in particular among the lower income and rural communities. These efforts have led to more affordable financial product offerings by FSPs that participated in the programmes, including insurance and takaful products that help provide financial protection against unexpected adverse events such as fire and flood disasters.

During the year, 56 new entities were added to the Financial Consumer Alerts (FCA) list of non-authorized or non-approved entities (available on the Bank's website), bringing the total number of entities on the list to 277. Many of the entities identified on the list are suspected to be carrying on activities which contain elements of deposit taking. It is important for the public to be aware of evolving fraud methods and to take precautionary steps to protect themselves from such schemes. These continued to be key themes in the Bank's education campaigns throughout the year. Important information is widely disseminated by the Bank through multiple channels, including social media and the Bank's MyBNM mobile application, which provides users with up-to-date information on consumer-related matters and financial crimes.

Work to develop a consumer credit law for Malaysia was advanced during the year to strengthen the legal protection of borrowers in their dealings with credit providers. Currently, consumer credit activities fall under the purview of several laws such as the FSA, IFSA, Hire Purchase Act 1967, Pawnbrokers Act 1972 and Moneylenders Act 1951. Provisions under these laws are not always aligned, resulting in the inconsistent protection of borrowers. Different approaches to regulation (e.g. by provider or product) have also given rise to gaps in the regulatory framework that can

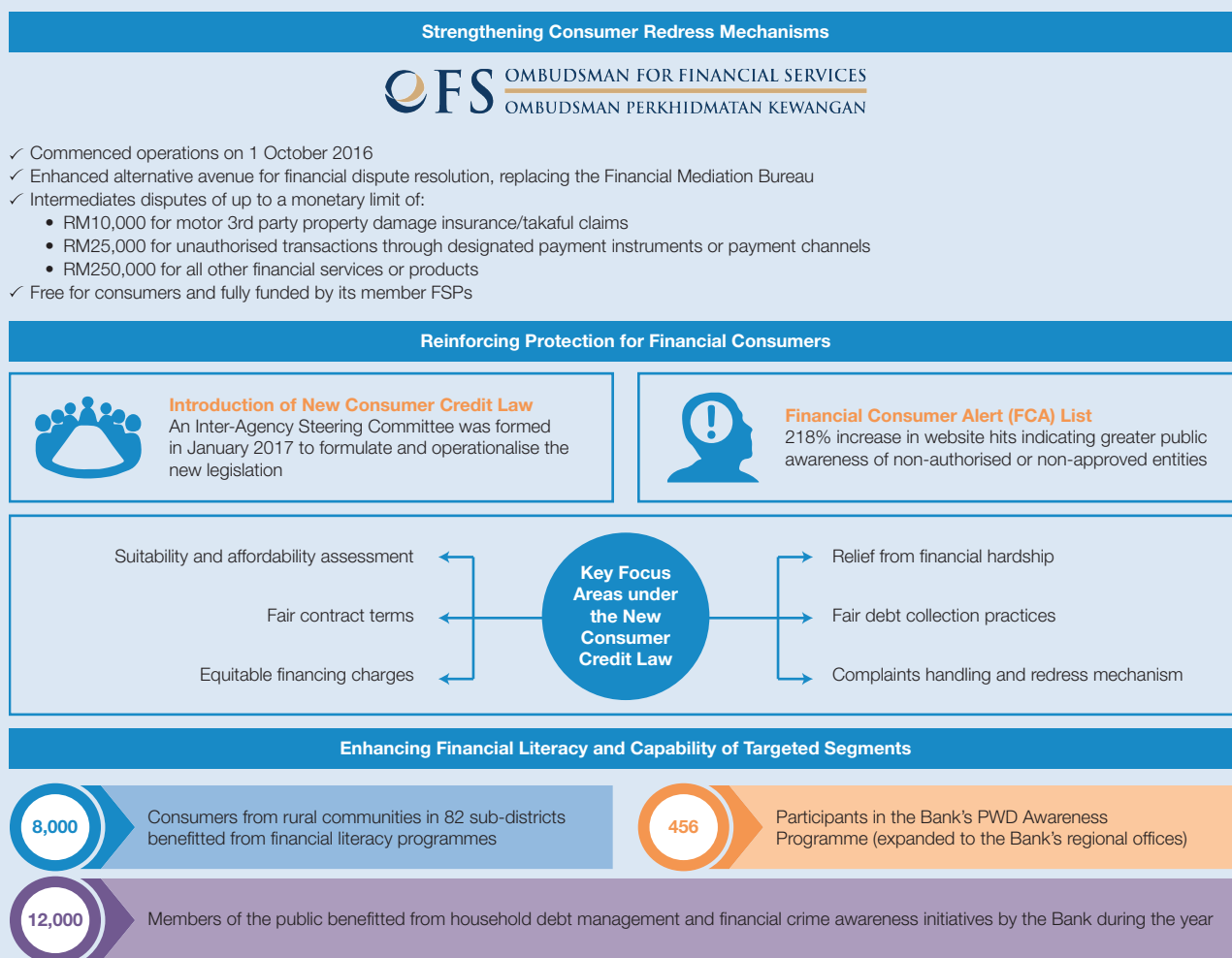
undermine the objective of providing appropriate protection to borrowers. The Bank, Ministry of Domestic Trade, Co-operatives and Consumerism and Ministry of Urban Wellbeing, Housing and Local Government moved forward with plans to formulate and consult more widely with key stakeholders on a consolidated consumer credit law during the year. The law will, among other things, provide more comprehensive protection for borrowers, including in the areas of affordable financing, debt relief, disclosures and debt recoveries. The proposed law will also aim to improve inter-agency regulatory and supervisory coordination, and strengthen enforcement mechanisms in respect of consumer credit activities. Key highlights of the initiatives to enhance consumer protection and empowerment in 2016 are summarised in Diagram 5.2.

Diagram 5.2

FINTECH INNOVATION

The recent advent of FinTech is increasingly redefining the provision, distribution and consumption of financial services. Innovative FinTech solutions are creating new opportunities to boost access to finance for businesses and consumers, and enhance the effectiveness and efficiency of financial services in supporting Malaysia's economic transformation. The Bank is committed to the development of a safe and supportive regulatory environment for FinTech innovations in Malaysia. In June 2016, the Bank established the Financial Technology Enabler Group (FTEG), tasked with formulating policy measures and strategies to facilitate the adoption of technological innovations by the industry. An overview of key initiatives and programmes that have been rolled out by the group is provided in Diagram 5.3.

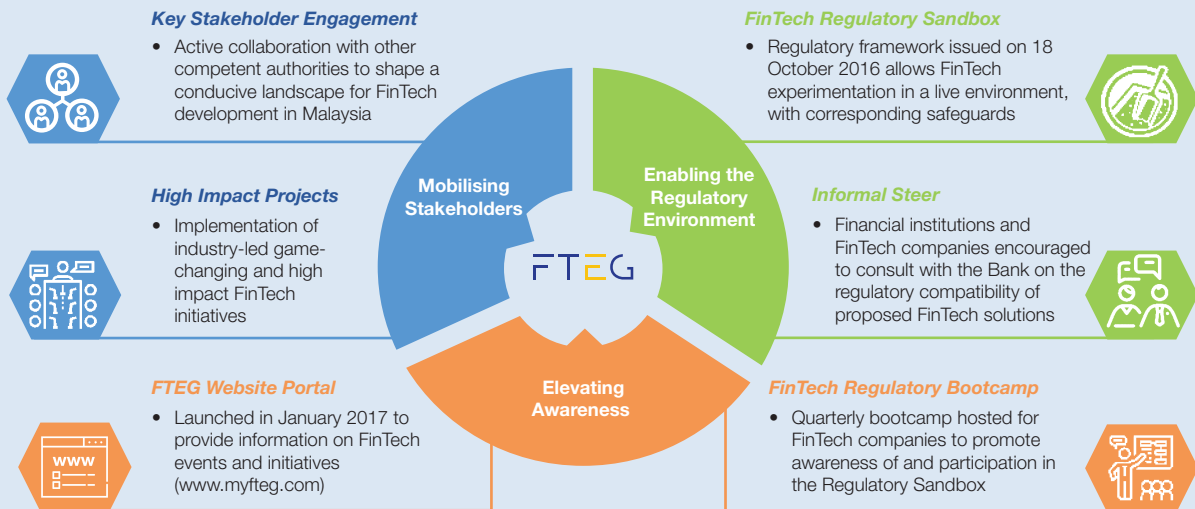
Key Initiatives to Enhance Consumer Protection and Empowerment in 2016



Source: Bank Negara Malaysia

Diagram 5.3

Key Initiatives under the Financial Technology Enabler Group



Source: Bank Negara Malaysia

An important development in 2016 was the publication of finalised parameters for the Regulatory Sandbox (Sandbox) in October. The Sandbox allows for the experimentation of innovative FinTech solutions in a live market environment, where the proposed solutions have clear potential to:

- improve the accessibility, efficiency, security and quality of financial services;
- enhance the efficiency and effectiveness of financial institutions' risk management processes; or
- address gaps in, or open up new opportunities for, financing or investments in the Malaysian economy.

During the testing period for solutions accepted into the Sandbox, appropriate flexibilities will be granted under the Bank's existing regulatory policies. This may include prudential or market conduct requirements that are adapted in line with limited exposures created in a test environment. To date, one solution has commenced live testing, while the Bank has preliminarily accepted another five solutions for testing in the Sandbox. The solutions include new methods for delivering comparative insurance product information, peer-to-peer currency exchange models and electronic money remittance services. The commencement of live tests is conditional upon the ability of applicants to meet requirements specified by the Bank on a case-by-case basis.

To catalyse the development of a thriving FinTech ecosystem in Malaysia, the Bank will embark on several priority development areas moving forward. These are:

- adopting an open application programme interface (API) to enable data sharing with third parties without compromising data privacy and security;
- creating a common KYC utility to facilitate a more effective and efficient approach by financial institutions to manage compliance obligations. This also aims to reduce fraud and improve the delivery of personalised financial services;
- developing guidelines for cloud computing to harness operational efficiencies while protecting data integrity in financial services;
- examining applications of distributed ledger technology to evolve new infrastructure, arrangements and processes that will transform the way financial services are delivered; and
- enhancing cybersecurity resilience within the financial services sector.

It is envisaged that collaborative actions by the industry will play an important role to achieve scale, efficiency and cost-effectiveness in driving these priorities. Several industry working groups have been formed to develop more detailed proposals in the areas identified for implementation in the coming year, focusing initially on the establishment of a

centralised electronic KYC on-boarding process for the opening of bank accounts and the application of distributed ledger technology for trade financing. The Bank also continues to collaborate closely with key stakeholders and competent authorities such as Securities Commission Malaysia and Malaysia Digital Economy Corporation in ensuring a facilitative environment for FinTech innovations.

Collaboration between industry players is pivotal in advancing priority development areas identified, which will accelerate the development of a thriving FinTech ecosystem in Malaysia moving forward

The Bank is mindful that the more pervasive use of technology in the operations of financial institutions inherently increases exposures of the financial system to cyber threats that can undermine the seamless provision of critical financial services and threaten

financial system integrity. It is therefore imperative that in embracing innovation, close and careful attention is given to ensuring the financial system maintains strong and robust defences against cyber attacks, particularly around security infrastructure and operational controls. As part of broader ongoing efforts to strengthen the industry's resilience against cyber threats (also see the Chapter 'Payment and Settlement Systems'), the Bank established the Industry Cyber Working Group as a platform to encourage financial institutions to share best practices in technology risk management, coordinate efforts to mitigate cyber risks and allow confidential exchange of intelligence on cyber threats. To heighten the level of cyber preparedness and resilience of the industry to cyber threats, the Bank has required all banking institutions to undertake a comprehensive assessment of cyber threats and strengthen controls to address these threats. This includes regular updating of security standards and protocols for web services encryption, and clearly defining arrangements to ensure timely reporting of security incidents by third-party service providers.

Mid-term Review of the Financial Sector Blueprint (2011 – 2020)

By Ian Lee Wei Xiung and Kershia Tan Wei

Launched on 21 December 2011, the Financial Sector Blueprint (Blueprint) sets out a 10-year strategic plan to increase the resilience, efficiency and competitiveness of Malaysia's financial sector. Building on strengthened foundations that followed the implementation of the Financial Sector Masterplan in the previous decade, the Blueprint encapsulates 69 recommendations and 214 initiatives to promote a financial sector that will continue to perform its role effectively in supporting the sustainable growth of the Malaysian economy.

The recommendations reflect a changing economic and financial landscape shaped by forces that include growing income inequality, demographic changes, post-crisis regulatory reforms, the increasing importance of the services sector in the economy, greater regional and global interconnectedness and technological advancements. Against this backdrop, nine key objectives are addressed in the Blueprint (Diagram 1).

Diagram 1

Key Objectives Under The Blueprint



Source: Bank Negara Malaysia

This article reviews the progress and achievements under the Blueprint to date. It also reviews emerging trends and developments, as well as their implications for the prioritisation of initiatives under the Blueprint going forward.

Progress and Achievements

Steady progress has been made towards realising the Blueprint's objectives, with 41% of the identified initiatives fully implemented and another 44% progressing as planned. Collectively, these initiatives cover most of the high-impact initiatives across all nine key objectives of the Blueprint (Diagram 2). In particular, measures to safeguard the stability of the financial system and strengthen key enablers for financial development have helped cultivate the necessary environment for greater innovation and growth of the financial sector. Further details of these measures are provided in Diagram 3.

Impact assessments of initiatives that have been implemented show encouraging results, with the longer-term benefits of certain measures expected to be realised over time, or in the case of prudential safeguards, during periods of financial stress.

Diagram 2

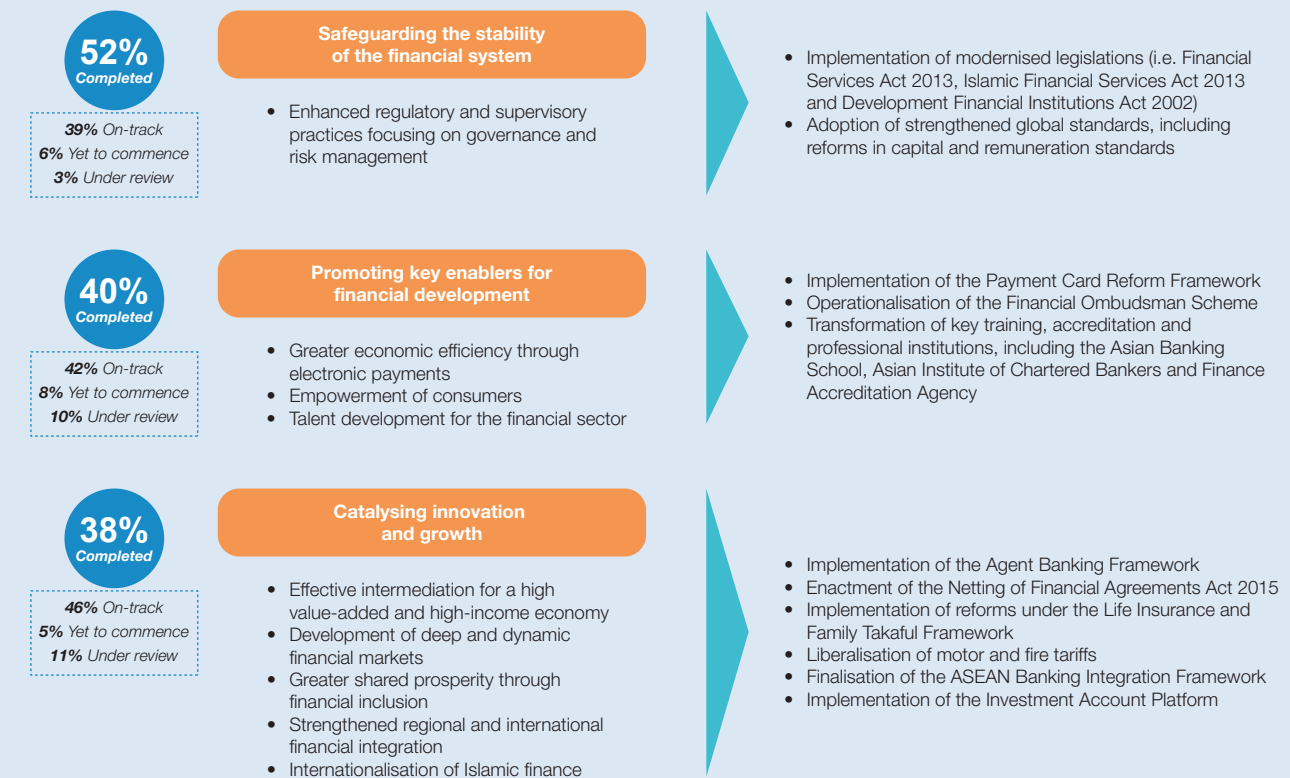
Overall Progress of Blueprint Initiatives



Source: Bank Negara Malaysia

Diagram 3

Highlights of Key Initiatives














Source: Bank Negara Malaysia

The positive impact of initiatives implemented under the Blueprint has been most notable in the areas of financial inclusion, regulation and supervision, regional financial integration and migration to electronic payments (Diagram 4). Financial inclusion has expanded significantly, mainly supported by the growing presence of agent banks. This has been accompanied by increased consumer awareness and the development of a stronger consumer protection framework. Furthermore, financial institutions in Malaysia have weathered episodes of financial turbulence, weaker growth and compressed margins in recent years with strong financial buffers and the continued observance of prudent risk-taking. Stronger regulatory and supervisory co-operation among authorities in the region - the closest in recent memory - have also provided conditions for enhanced regional growth and stability. Meanwhile, the growth in the usage of electronic payments has delivered further efficiency gains for the Malaysian economy through lower costs of handling cash and cheques.

Diagram 4

Impact of Initiatives under the Blueprint

KEY IMPACT	
<p>GREATER SHARED PROSPERITY THROUGH FINANCIAL INCLUSION</p> <ul style="list-style-type: none">  97% of sub-districts¹ have access to financial services (2011: 46%)  92% of customers have active deposit accounts (2011: 87%) 98% of customers have performing financing accounts (2011: 97%) 	<p>ENHANCED GOVERNANCE AND RISK MANAGEMENT PRACTICES</p> <ul style="list-style-type: none">  International endorsement of Malaysia's regulatory and supervisory regime from the International Monetary Fund and Financial Action Task Force  Continued resilience of domestic financial institutions during periods of heightened volatility and slower economic growth
<p>STRENGTHENED REGIONAL AND INTERNATIONAL FINANCIAL INTEGRATION</p> <ul style="list-style-type: none">  15 countries hosting the operations of Malaysian banking institutions  Greater expansion of Malaysian banks into the ASEAN region through the ASEAN Banking Integration Framework  Institutionalisation of an EMEAP²-level crisis management and resolution framework  Establishment of seven new locally-incorporated foreign banks with strong value propositions since 2011 	<p>GREATER ECONOMIC EFFICIENCY THROUGH ELECTRONIC PAYMENTS</p> <ul style="list-style-type: none">  97 electronic payment transactions per capita in 2016 (2011: 49)  31% growth in credit transfer transaction volume in 2016 (2011: 25%), accompanied by an accelerated decline in the number of cheques issued to 133 million in 2016 (2011: 205 million)  RM1.1 billion investment commitment to enhance the payment card infrastructure between 2015 and 2020

¹ Population of at least 2,000

² The Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) is a co-operative organisation of central banks and monetary authorities in the East Asia and Pacific region

Source: Bank Negara Malaysia

Overall, greater financial development has been accompanied by positive economic spillover effects in relation to the participation of Malaysians in the financial sector. As at end-2016, the financial sector employed close to 164,592 people¹, with 6,100 additional jobs created since the first quarter of 2013. This accounts for approximately 3% of total employed workers in Malaysia. As one of the higher-productivity, knowledge-based sectors, 74% of financial sector employees are high-skilled professionals. Reflecting this, average salaries in the financial sector grew by an average rate of 11.4% between 2013-2016, amounting to RM7,790 per month (per worker) in 2016

¹ Includes employees of commercial banks, Islamic banks, investment banks, international Islamic banks, development financial institutions, insurers and takaful operators.

(2013: RM5,661), while productivity increased at an average rate of 4%² over the same period. Nevertheless, while Malaysian financial institutions continue to restructure operations in line with the evolving financial landscape, vacancies remain ample (2016: 4,800 positions vacant), especially for high-skilled positions.

In addition, the financial sector has also contributed positively to the value of gross domestic product (GDP). The real value-added of financial services to GDP stood at over RM75.3 billion in 2016, accounting for 6.8% of real GDP. Over the 2011-2016 period, the value-added of the financial sector expanded at a compounded annual growth rate (CAGR) of 2.7%. Growth has, however, been more moderate in recent years, mainly due to the challenging economic environment, leading to lower growth in both lending and capital market activities, amid heightened competition.

While significant progress has been made, there remain several areas of sizeable untapped potential. Malaysia's insurance and takaful industry is still some way from saturation, reflecting its significant potential for growth. Though insurance penetration, as measured by life insurance and family takaful policies per population, has increased to 54.2% (2010: 51.1%), growth has remained subdued for the past five years. In the general insurance and takaful sector, domestic capacity for larger and more specialised risks is reaching its limits, which in turn has an impact on Malaysia's reinsurance outflows. Among the challenges faced by the industry are the lack of underwriting expertise for large and specialised risks, low levels of risk awareness and limited affordable products, particularly for small and medium enterprises (SMEs) as well as low-income groups.

As Malaysia transitions into a high value-added, high-income economy, an area for further development is financial intermediation for new growth areas that are more knowledge- and technology-intensive, and that have high innovation content. While such activities are expected to intensify going forward, bank financing remains heavily focused on more traditional sectors. For instance, less than 1% of SME financing approvals in 2016 were granted to new growth segments such as green technology, biotechnology and other innovative industries focusing on intellectual property as well as information and communications technology (ICT). The key constraints in traditional financing solutions for these industries are further discussed in the box article 'The Role of Alternative Finance to Fund the Needs of a New Economy'. These include the lack of collateral, limited credit history and high information asymmetries. Overriding concerns to protect deposits, which remain a key source of funding for banks, also underscore the need and opportunities to develop alternative financing solutions for new growth industries.

Emerging Trends and Developments

To a large extent, the key considerations that underpinned the recommendations in the Blueprint continue to remain relevant (Diagram 5).

Nonetheless, developments over the past five years have prompted the consideration of new initiatives to achieve the objectives of the Blueprint, at the same time shifting certain existing initiatives into sharper focus.

One such development has been the rise of financial technology (FinTech). FinTech has extended the provision of financial services beyond the traditional purview of banks, and has the potential to fundamentally change the way financial services are delivered and consumed. This in turn could materially alter the competitive dynamics of the financial sector and the nature of financial intermediation. The Bank expects the growing adoption of FinTech to have wide-ranging implications for areas such as payments, financial inclusion, Islamic finance, consumer protection and money services business. Going forward, FinTech will also impact the composition and types of jobs that will be offered in the financial sector. In particular, labour-intensive tasks that are repetitive and predictable in nature are at high risk of being automated. While the net impact of FinTech on jobs is still inconclusive, it is imperative for the industry to re-skill and up-skill the current workforce with technology-complementing competencies in order to reap the gains from technological adoption, while mitigating its disruptive impact on the workforce.

² Productivity in the financial sector is proxied by the sum of net interest income, fee income and insurance/takaful premiums less claims, divided by the number of workers employed in the banking and insurance/takaful sectors.

Diagram 5

Key Considerations and Strategies Underpinning the Blueprint

CONSIDERATIONS	STRATEGIES
1. Maturing and urbanised population	• Development of a more sustainable pension system for retirement
2. Large and growing middle-income class	• Enhanced coverage for medical and health insurance products and services, including long-term care and other forms of disability insurance
3. Growth of knowledge-intensive services	• Development of a more diversified, vibrant and sustainable funding ecosystem beyond traditional bank financing
4. Strong base of dynamic and competitive SMEs	• Promotion of a holistic ecosystem and strategic partnerships between domestic and regional institutions to support increasing trade and investment activities
5. Transition to higher value-added activities	• Development of intermediaries, financial markets and supporting infrastructure to facilitate the provision of large and long-term project financing, including enhancing the public-private partnership framework
6. Greater global and regional integration	

Source: Bank Negara Malaysia

Another important development has been the moderating external and domestic macroeconomic assumptions over the medium-term horizon. While earlier targets under the Blueprint envisioned the financial system growing at an annual rate of 8-11%, this is now expected to moderate, in line with the average annual growth rate of around 6.8% achieved over the 2011-2016 period. This is likely to increase the pressure for financial institutions to re-examine existing business models and look beyond traditional business segments to harness new areas of growth. Additionally, these macroeconomic trends have also heightened the focus on the role of the financial sector in providing solutions to the socio-economic challenges associated with housing affordability, urban poverty and the resilience of households to financial shocks.

Greater volatility in the international and domestic financial markets also presents new challenges for the management of financial stability. This has been driven by uncertainties surrounding monetary policy in the United States, combined with global economic and political developments, including increased volatility in commodity prices. Given the openness of Malaysia's financial markets, enhancing the depth, breadth and overall resilience of financial markets, including the foreign exchange and derivatives markets, has become more important.

Globally, businesses and individuals are also increasingly reflecting sustainable development and growth considerations in economic decision-making. Examples of these include growing movements towards Sustainable, Responsible and Impact Investing (SRI) and the adoption of Environmental, Social and Governance (ESG) criteria in investment decisions. This presents important growth opportunities for Islamic finance, which emphasises the protection and improvement of social welfare as its core tenet. Currently, Islamic financial activities in Malaysia are already governed by a comprehensive Shariah contract-based regulatory framework, providing a strong foundation for the financial sector to undertake a larger role in sustainable development through the offering of SRI solutions.

Priorities Moving Forward

With four years remaining to accomplish the aspirations of the Blueprint, an overview of the key priorities leading up to 2020 is outlined in Diagram 6. This takes into account developments discussed in the preceding section, which will entail a re-examination of regulatory settings and development strategies in several areas.

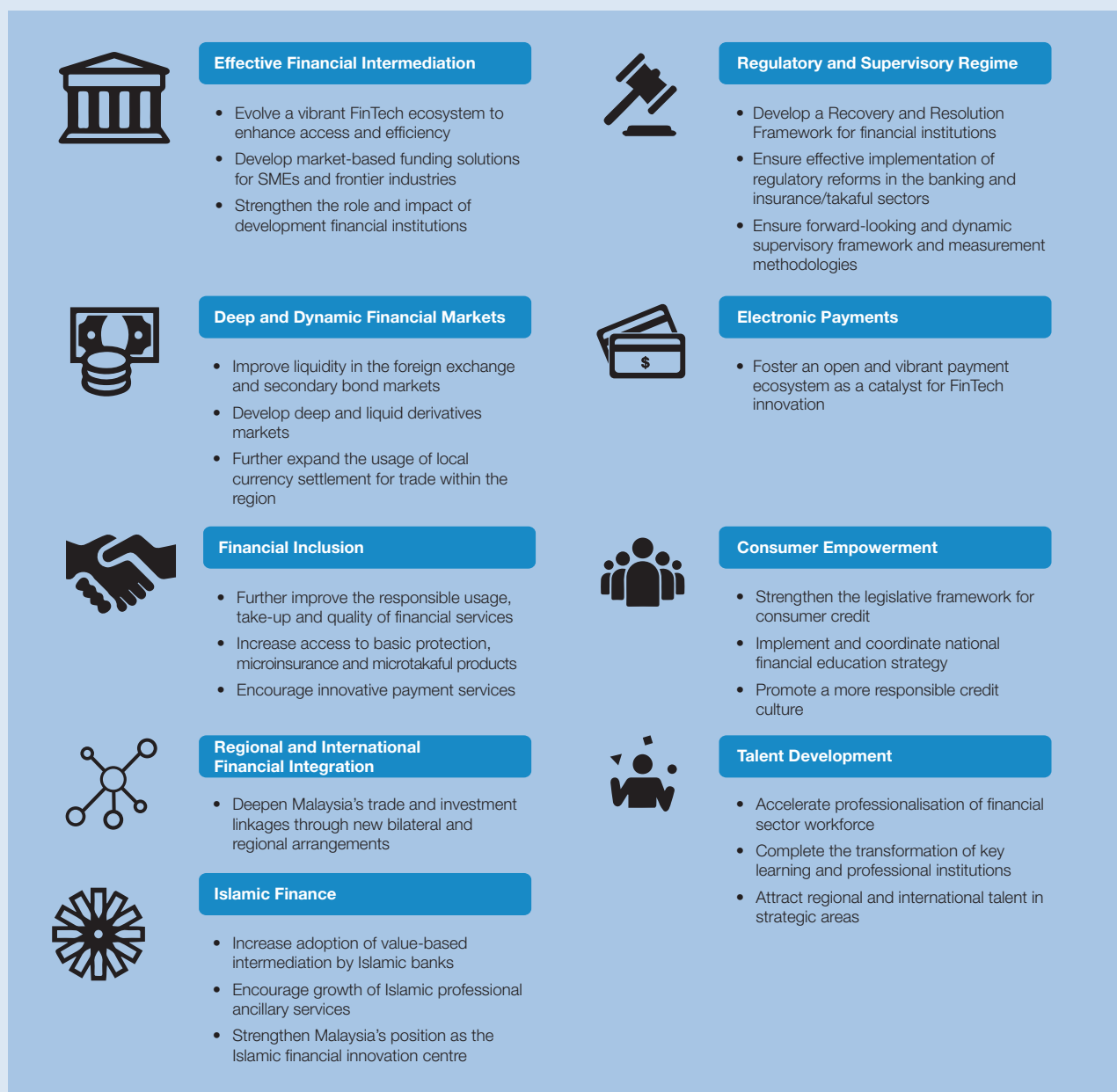
Among them is the evolution of a vibrant alternative financing and FinTech ecosystem to support future innovation and expand funding sources for SMEs. This includes the development of more market-based funding solutions

to diversify sources of financing and reduce reliance on bank-based funding. Greater focus will be accorded to financing frontier industries and early stage start-ups by improving the framework for alternative financing solutions such as factoring and leasing. The role of development financial institutions will also be reviewed to better serve and support the development of targeted socio-economic sectors.

The Bank seeks to encourage a larger role for the industry to lead initiatives that will improve the delivery of financial services through the adoption of FinTech. Recent examples of this are the initiation of two high-impact technology-based projects to be led by the industry, including the development of distributed ledger technology to drive greater efficiency in trade financing and simplifying the Know-Your-Customer process through digital means.

Diagram 6

Priorities Moving Forward under the Blueprint



Source: Bank Negara Malaysia

To address the challenges and realities arising from greater financial market volatility, the Bank will continue to focus on developing deep and liquid financial markets, including ensuring the availability of cost-effective hedging instruments to manage risk exposures. Towards this end, the Bank, together with the Financial Markets Committee (FMC) have introduced several measures aimed at improving market stability and broadening the onshore hedging market. Further details on these measures and the role of the FMC are provided in this Chapter.

Increased emphasis will also be given to elevating the role of insurance and takaful to meet the protection and risk management needs of Malaysian households and businesses. Measures will be pursued to accelerate insurance penetration and reduce the protection gap by making basic protection, microinsurance and microtakaful products more widely available. This will be supported by the implementation of a proportionate regulatory approach for microinsurance and microtakaful to provide a conducive operating environment for the industry to develop products that are better catered to currently underinsured segments. Further diversification of insurance and takaful distribution channels is also expected to significantly improve the availability and take-up of protection products. In the general insurance and takaful sector, the Bank will continue to focus on wide-ranging reforms, including the phased liberalisation of the motor and fire tariffs as well as improving the quality of service and management of costs with respect to claims settlements. These initiatives will be pursued with due regard to the balance between domestic and foreign participation in the insurance and takaful sector, in line with interests that will best serve Malaysia.

A New Model for Money Services Business – Towards Greater Modernisation and Professionalism

By Mark Lee Kian Meng and Mohd Izwan Ali Mohd Long

The transformation of the money services business (MSB) industry in Malaysia, which comprises the remittance, money changing and wholesale currency businesses, has evolved to become a more dynamic and efficient industry with significantly strengthened safeguards to prevent its use for financial crime. Over the last five years, the industry has registered double-digit growth in the remittance and currency exchange segments, averaging at 16.8% and 16.2% per annum respectively from 2012 to 2016. Approximately a quarter of this is estimated to be from the transactions previously conducted through informal channels. This was supported by a significant expansion in the number of access points to MSB services and more efficient competition which lowered remittance cost to less than 3%, below the World Bank's target of 5%. The quality of service also reflects higher standards of professional conduct by providers of money services, with greater protection accorded to consumers.

The transformation of the industry was the result of broad reforms undertaken by the Bank to enhance the regulatory and supervisory framework for money services, with the view to improve conditions for providing competitive, efficient and safe remittance and currency exchange services. This article provides an overview of this transformation over the period from 2011 to 2016 and priorities to further develop the MSB industry going forward, in line with the Bank's key roles in promoting financial inclusion and protecting the integrity of and confidence in the financial system.

Industry Characteristics Prior to 2011

Prior to 2011, the money services industry faced multiple challenges. It was a highly fragmented industry with more than 1,000 licensed companies conducting MSB, which lacked the conditions for effective competition and sustainable growth. About 80% of the industry players were small in size, without the resources or capacity to meet regulatory requirements and observe professional standards of conduct necessary to support the effective monitoring and identification of risks. Given the cash-intensive nature of money services, the industry was increasingly exposed to the risk of being used as a conduit to facilitate money laundering and terrorism financing (ML/TF) activities. This was further compounded by the proliferation of unlicensed currency exchange and remittance providers that facilitated unrecorded transactions, including those by foreign workers in the country. These conditions underlined weak safeguards to prevent financial crimes, which in turn risked undermining the safety and integrity of the industry and the broader financial system.

Passage of the Money Services Business Act 2011

The passage of the Money Services Business Act (MSBA) by the Parliament in 2011 paved the way for key legislative and regulatory reforms in the MSB industry. Prior to the MSBA, remittance, money changing and currency wholesale activities were governed under three separate pieces of legislation, namely the repealed Money-Changing Act 1998, the Payment Systems Act 2003 and the Exchange Control Act 1953. Bringing these fragmented pieces of legislation governing the industry together under a cohesive and streamlined regulatory framework served to provide a clear strategic focus for the development of the industry and promote greater clarity and consistency in the regulatory framework. This was also important to align the industry with the objectives of its transformation.

The introduction of the MSBA laid out a single, unified regulatory framework for MSB activities. It establishes requirements to observe minimum standards of professional conduct by MSB companies, provides for greater protection of consumers and strengthens safeguards against ML/TF activities. It also introduced strengthened licensing criteria to ensure that only credible businesses were permitted to operate in the industry.

Key Strategies in the Transformation of the MSB Industry

1. Implementation of new operating model for money services

A key element of the MSBA was the implementation of a new model for MSB which ultimately became an important catalyst for structural change in the industry. The new model featured three key changes:

- The implementation of a proportionate regulatory regime which reflects regulatory settings that are commensurate with the scale, scope and complexity of business. This includes tiered regulatory requirements, which allow MSB companies to operate at a level commensurate with its financial and operational capacity, and the adoption of a risk-based approach for Anti Money Laundering/Counter Financing of Terrorism (AML/CFT) measures. These arrangements supported smaller companies in meeting appropriate regulatory requirements, while ensuring that heightened risks posed by larger companies or in specific business segments continue to be effectively managed;
- An expanded scope of business which allows a MSB company to operate remittance, money changing and wholesale currency businesses under a single entity, subject to the demonstration of strong compliance, governance and management standards. This has improved the viability of MSB companies and enabled investments to build stronger financial and operational capacity. Over the period from 2012 to 2015, the overall profitability of MSB companies improved significantly, averaging 47% per annum for the MSB industry as a whole; and
- The implementation of the principal-agent arrangement which allowed for larger MSB companies to appoint smaller companies as their agents. This arrangement improved conditions for effective monitoring and supervision of MSB activities, and were also instrumental in minimising dislocations arising from adjustments by smaller companies to significantly strengthen regulatory requirements. The new arrangement allowed smaller companies to continue serving local communities with the benefit of being able to leverage on operational systems and controls provided by principals to meet increased compliance obligations. For principals, this arrangement offered opportunities to expand and grow their businesses at lower costs.

Over a period of 18 months from the coming into force of the MSBA, all existing MSB companies were re-assessed against strengthened licensing criteria to affirm their eligibility for a licence to conduct MSB. This included an assessment of their capacity to meet compliance obligations and the integrity of those in control of and responsible for the business. Companies identified with involvement in unauthorised activities or conduct associated with the facilitation of financial crime were required to cease operations, and faced enforcement actions. Smaller companies with limited resources were encouraged to consider becoming agents to improve their ability to meet compliance obligations.

By the end of the review, 103 MSB companies were required to cease operations, while 67 companies became agents. Licensed MSB companies continue to be subjected to periodic reviews as part of the process for renewing their licences. As at end-2016, the number of licensed MSB companies had been reduced further to 354 as more companies elected to become agents or exited the industry due to material compliance failures or findings of involvement in illicit activities.

2. Promoting strong compliance

Raising compliance standards across the industry was a key priority of the transformation programme. The Bank adopted a two-pronged approach encompassing heightened supervisory activities and an intensive compliance education initiative. Observations from the Bank's on-site supervisory reviews of MSB operations are used to engage MSB companies on specific actions to improve the quality and effectiveness of management oversight and operational controls. Particular attention is given to record keeping controls and AML/CFT measures. More serious compliance failures are met with strong enforcement actions, including the revocation or non-renewal of a MSB licence and prosecution of key responsible persons.

To complement such supervisory engagements, the Bank also developed and delivered structured compliance education programmes designed to build understanding among MSB companies of their compliance obligations. Close to 100 education workshops were organised nationwide over a five-year period, with ongoing plans to repeat and update the programmes over time as needed.

3. Strengthening industry arrangements

The Bank encouraged and facilitated the establishment of the Malaysian Association of Money Services Business (MAMSB) in 2013. MAMSB plays a key role in capacity building through its training and education programmes for MSB companies which serve to improve performance and compliance, particularly in areas relating to AML/CFT compliance, financial reporting, operational controls and conduct towards consumers. In addition, it performs a key advocacy role to raise professional standards and provides an important channel for the Bank and the industry to engage on regulatory and consumer issues and developmental priorities for the industry.

Notable achievements of MAMSB include:

- Adoption of a professional code of conduct for MSB companies, supported by a disciplinary unit within MAMSB to enforce compliance with the code;
- Development of a five-year MSB Strategic Blueprint setting out priorities for implementation by the industry to support the modernisation objectives;
- Leading communications with the public and industry arrangements to provide information and assistance to the public in response to significant developments such as the withdrawal of Indian Rupee (INR) 500 and INR1000 notes in India and the surge in demand for United Kingdom Pound (GBP) following the Brexit vote; and
- Establishment of the MSB Group of Compliance Officers (GOCO) to support and facilitate initiatives to elevate the competence and effectiveness of compliance officers. With the support of GOCO, MAMSB introduced mandatory training requirements on AML/CFT compliance for all compliance officers and is in the process of facilitating the accreditation of all compliance officers in the industry to assure their competence.

4. Encouraging competition and raising consumer awareness

A major plank of the transformation programme also involved measures to encourage effective competition and educate the public on identifying and using formal channels, including non-bank channels, for remittance and currency exchange transactions. Based on findings of a survey conducted by the Bank, a key reason highlighted for the use of informal channels was low awareness of the availability of authorised non-bank channels that provide money services. Extensive consumer awareness and education programmes were mounted by the Bank in collaboration with the MSB industry. The Bank and industry worked with foreign embassies, relevant authorities and organisations in the private sector to raise awareness on access to authorised providers of MSB services, the advantages of dealing with authorised providers and the risks from using informal channels.

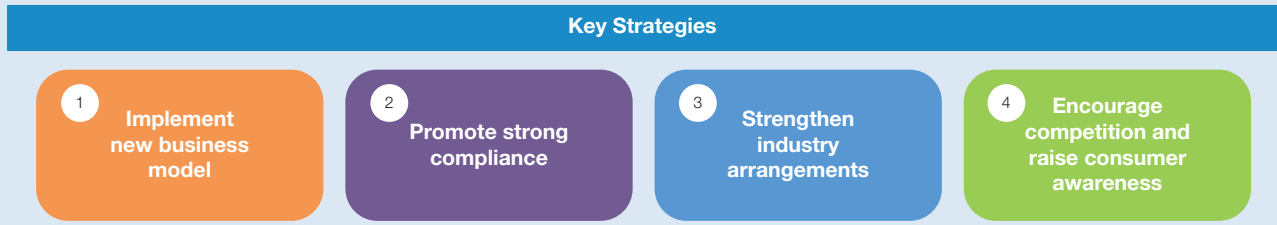
As part of efforts to further increase transparency and the effectiveness of outreach activities, the Bank collaborated with the World Bank in November 2015 to establish Johor Bahru as the first Greenback champion city in Asia. The Project Greenback 2.0 aims to increase efficiency in the market for remittances through an innovative approach, focusing on migrants. Given the growing share of cross-border remittances by small and medium enterprises (SMEs), the Bank also extended the project to SMEs, which is the first time that this has been included within the scope of a Project Greenback.

Initiatives implemented under the Project Greenback 2.0 included the introduction of the 'Pick Remit' mobile application which provides a convenient means for consumers to locate MSB companies and compare costs and services offered. New approaches to outreach and public engagements were also developed and tested with positive results. Plans are underway to replicate similar effective approaches in other parts of Malaysia.

In the wholesale currency segment, the Bank also issued new licences to companies undertaking wholesale currency business to promote efficient functioning of the market. This led to a more competitive market for wholesale currency operations which had been dominated by a small number of banking institutions with limited access for money services companies to source and clear foreign currency stocks. To date, six non-bank currency wholesalers have operations across the country, complementing banks to ensure the adequate supply of a wider range of currencies to retail MSB companies. This in turn has significantly reduced incentives for MSB companies to procure currencies from informal channels and unverified sources located outside Malaysia.

Diagram 1

Summary of Key Strategies and Achievements in the Transformation of the MSB Industry



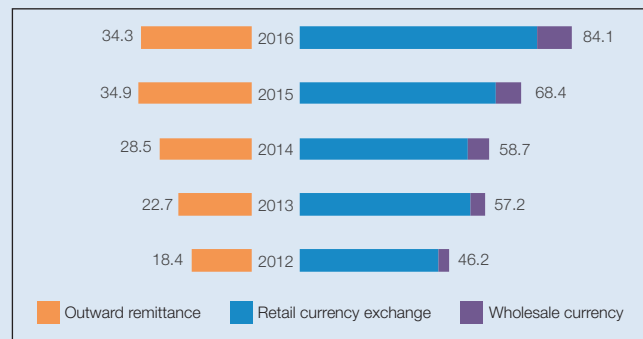
Summary of Achievements

	Impact												
1. Reduced fragmentation with improved viability of MSB companies	<ul style="list-style-type: none"> Number of licensed MSB companies reduced from more than 1,000 as at end-2010 to 354 players in 2016. Small companies with turnover of less than RM30 million accounted for 27% of the total number of licensed MSB companies in 2016, compared to about 80% as at end-2010. Emergence of larger and stronger domestic MSB companies with viable regional aspirations. Stronger financial performance of MSB companies, with an overall average growth in profitability of 47% per annum between 2012 and 2015. 												
2. Wide access to services	<ul style="list-style-type: none"> 2,963 branches and agents of licensed MSB companies nationwide (2012: 2,518). 10 companies providing mobile and/or online remittance services (2012: 4). 												
3. Growth in use of authorised remittance channels	<table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <thead> <tr> <th>Growth</th> <th>Outward Remittance</th> <th>Retail Currency Exchange</th> <th>Wholesale Currency</th> </tr> </thead> <tbody> <tr> <td>CAGR (2012-2016)</td> <td>16.8%</td> <td>14.5%</td> <td>32.6%</td> </tr> <tr> <td>2011-2012</td> <td>17.3%</td> <td>1.3%</td> <td>n.a.</td> </tr> </tbody> </table>	Growth	Outward Remittance	Retail Currency Exchange	Wholesale Currency	CAGR (2012-2016)	16.8%	14.5%	32.6%	2011-2012	17.3%	1.3%	n.a.
Growth	Outward Remittance	Retail Currency Exchange	Wholesale Currency										
CAGR (2012-2016)	16.8%	14.5%	32.6%										
2011-2012	17.3%	1.3%	n.a.										

Chart 1

Steady Increases in MSB Transactions

(a) Value (RM billion)



	<p>(b) Volume (million)</p> <table border="1"> <caption>Volume (million)</caption> <thead> <tr> <th>Year</th> <th>Outward Remittance</th> <th>Retail Currency Exchange</th> </tr> </thead> <tbody> <tr> <td>2012</td> <td>~9</td> <td>~18</td> </tr> <tr> <td>2013</td> <td>~12</td> <td>~21</td> </tr> <tr> <td>2014</td> <td>~15</td> <td>~22</td> </tr> <tr> <td>2015</td> <td>~16</td> <td>~23</td> </tr> <tr> <td>2016</td> <td>~17</td> <td>~26</td> </tr> </tbody> </table> <p>Source: Bank Negara Malaysia</p> <ul style="list-style-type: none"> • Business remittance channelled through non-bank remittance service providers accelerated by approximately six-fold within a period of four years from RM100 million in 2013 to RM653 million in 2016 driven by higher remittances by SMEs. • Under the Project Greenback 2.0 in Johor Bahru, approximately 170,000 new customers registered with licensed MSB companies within 13 months, and the average cost of remittances reduced to 2.02% in 2016 from 3.33% in 2015. 	Year	Outward Remittance	Retail Currency Exchange	2012	~9	~18	2013	~12	~21	2014	~15	~22	2015	~16	~23	2016	~17	~26
Year	Outward Remittance	Retail Currency Exchange																	
2012	~9	~18																	
2013	~12	~21																	
2014	~15	~22																	
2015	~16	~23																	
2016	~17	~26																	
<p>4. Improved regulatory compliance</p>	<ul style="list-style-type: none"> • Positive feedback on the MSB industry in the area of AML/CFT compliance, based on the Mutual Evaluation Exercise by the Asia/Pacific Group on Money Laundering in 2015. This reflected significant improvements in the industry's observance of key AML/CFT measures, including proper record keeping, implementation of robust AML/CFT compliance programmes and industry-wide adoption of IT-based systems to support regulatory compliance. • Continued progress has also been made in implementation of the risk-based approach for AML/CFT measures by MSB companies since January 2015. 																		
<p>5. Improved efficiency and quality of service</p>	<ul style="list-style-type: none"> • Average remittance cost reduced from 3.15% in 2012 to 2.85% in 2016, below the World Bank target of 5%. • Positive results from a customer experience survey on MSB players conducted by the Bank in 2014, with notable improvements in the areas of overall image, service efficiency as well as information transparency and disclosures to customers. 																		

Moving Forward

The Bank will continue to work with the industry to further improve the efficiency of money services, promote conditions for an orderly currency exchange market especially during periods of heightened volatility, and encourage the use of authorised channels for money services. Specifically, future initiatives will focus on:

- **Enhancing take-up of the formal sector for remittances**

The Bank will continue to pursue efforts to increase the migration of remittances from informal to formal channels, particularly foreign worker remittances. A key strategy for this is the expansion of electronic remittance (e-remittance). This entails the delivery of end-to-end digital solutions to enable cashless and more convenient services to the users. Facilities for the payment of salaries of foreign workers through e-wallet or banking channels will also be developed to encourage e-remittance.

- **Encouraging the digitalisation of money services**

The Bank seeks to encourage the wider adoption of financial technology (FinTech) to enhance the convenience and efficiency of money services, thus further increasing the use of formal MSB channels. This will include providing an enabling environment for the digitalisation of MSB services using online and mobile channels to further lower costs and reduce the use of cash. The development of these channels also aims to overcome logistical barriers that currently discourage some segments of the foreign worker population from using authorised channels for remittances. The Bank is currently facilitating 2 companies seeking to provide digital MSB solutions through the Bank's Regulatory Sandbox. These include Peer-to-Peer (P2P) arrangements leveraging mobile application platforms that facilitate near real-time matching of customer transactions for currency exchange and money transfers.

The Bank is also undertaking a broader review of current regulations that require financial service providers including MSB companies to perform physical face-to-face customer verifications. The review aims to consider the use of biometric and other forms of digital customer identification methods to support digitalisation of money services, particularly for low risk transactions. This will take into account the feasibility of compensating arrangements needed to protect the integrity of MSB transactions, and global developments to promote consistency in AML/CFT regimes.

- **Enhancing approaches to surveillance, supervision and enforcement**

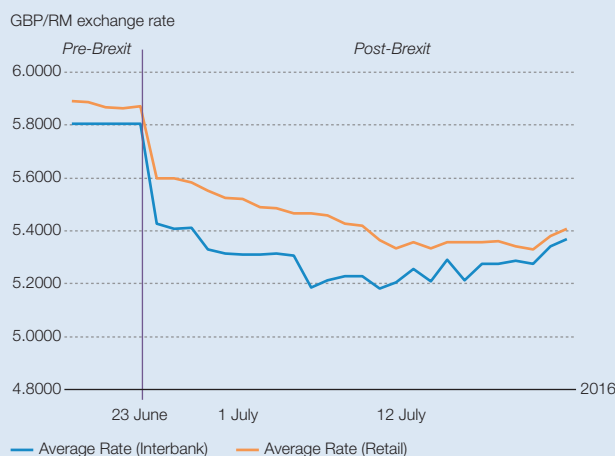
The Bank has rolled out an enhanced supervision and surveillance programme leveraging on data analytics to better support its identification and monitoring of risks in the industry. This will enable the Bank to perform more targeted supervision of licensed MSB companies and facilitate investigations into unauthorised activities. In addition, appropriate enhancements to the MSBA are being considered to improve the timeliness and effectiveness of enforcement actions against non-compliances and unauthorised MSB activities.

- **Facilitating efficient market arrangements for managing currency exposures**

The Bank will pursue initiatives to facilitate broader access by MSB companies to financial management solutions that will enable the industry to respond more effectively to changes in market conditions. This includes facilitating arrangements for MSB companies to hedge their currency exposures with banking institutions. The Bank will also review current arrangements between wholesalers and money changers for currency planning, sourcing and distribution to promote well-functioning market mechanisms at both the institution and industry levels for responding to demand for currencies and efficient pricing. This is particularly important during times of heightened volatility when market frictions can result in a misalignment between the retail and interbank exchange rates (as illustrated in Chart 2);

Chart 2

Daily Movement of Retail Exchange Rate and Interbank Rate for GBP/RM Post-Brexit



Source: Bank Negara Malaysia and Reuters

- **Intensifying education, awareness and professionalism**

The Bank in collaboration with MAMSB, will continue to maintain an aggressive education and awareness programme to encourage the use of authorised channels for money services and facilitate comparisons by consumers of MSB services, including for costs. The Bank and MAMSB will also consider an entrance examination for the industry players to ensure sufficient skills and knowledge. Continuous education for board members will be considered. The Bank will also seek to upscale the Project Greenback 2.0 to other cities across the country, in addition to undertaking nationwide awareness campaigns through traditional and social media and expanding collaborative partnerships with local councils, foreign embassies and regional and international bodies. This will be complemented by the wider use of aggregator applications to further improve transparency and convenient access to information on MSB services.