

## 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

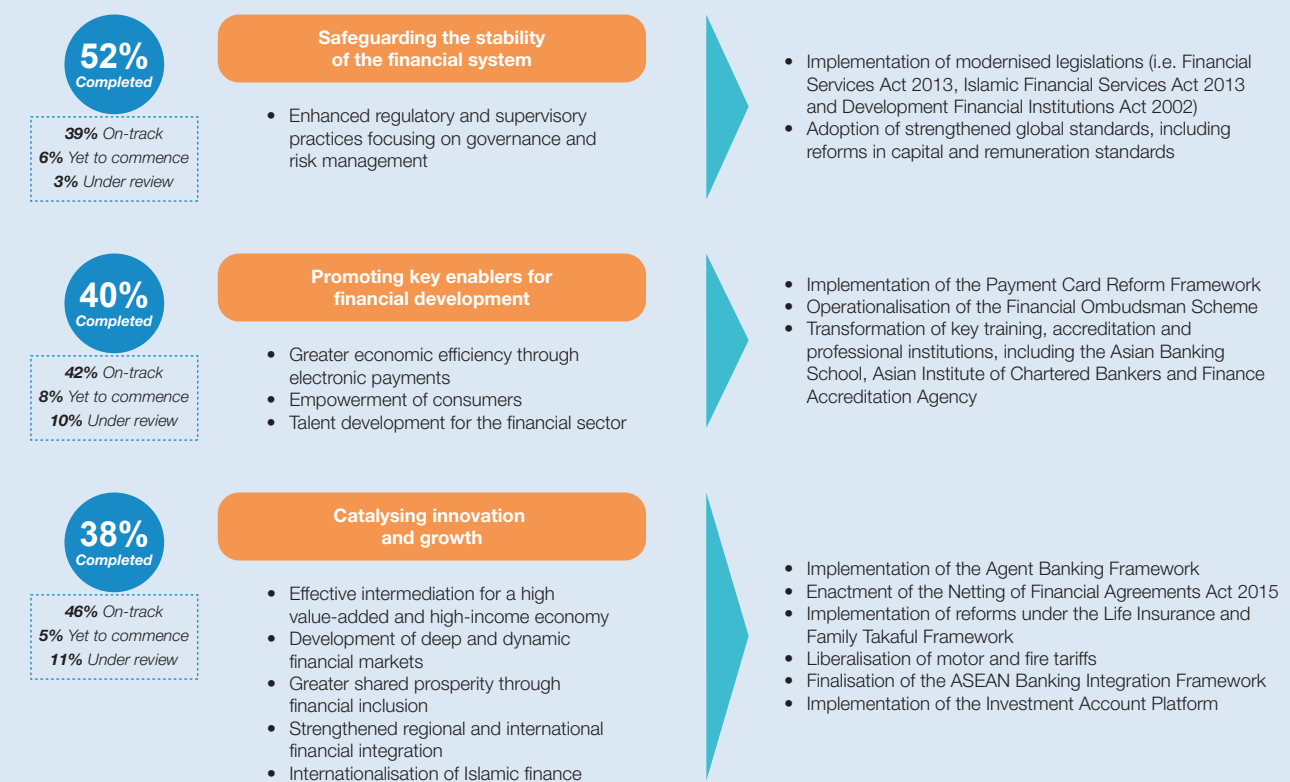
### Overall Progress of Blueprint Initiatives



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><b>GREATER SHARED PROSPERITY THROUGH FINANCIAL INCLUSION</b></p> <p> <b>97%</b> of sub-districts<sup>1</sup> have access to financial services (2011: 46%)</p> <p> <b>92%</b> of customers have active deposit accounts (2011: 87%)</p> <p><b>98%</b> of customers have performing financing accounts (2011: 97%)</p>	<p><b>ENHANCED GOVERNANCE AND RISK MANAGEMENT PRACTICES</b></p> <p> <b>International endorsement</b> of Malaysia's regulatory and supervisory regime from the International Monetary Fund and Financial Action Task Force</p> <p> <b>Continued resilience</b> of domestic financial institutions during periods of heightened volatility and slower economic growth</p>
<p><b>STRENGTHENED REGIONAL AND INTERNATIONAL FINANCIAL INTEGRATION</b></p> <p> <b>15</b> countries hosting the operations of Malaysian banking institutions</p> <p> Greater expansion of Malaysian banks into the ASEAN region through the ASEAN Banking Integration Framework</p> <p> Institutionalisation of an EMEAP<sup>2</sup>-level crisis management and resolution framework</p> <p> Establishment of seven new locally-incorporated foreign banks with strong value propositions since 2011</p>	<p><b>GREATER ECONOMIC EFFICIENCY THROUGH ELECTRONIC PAYMENTS</b></p> <p> <b>97</b> electronic payment transactions per capita in 2016 (2011: 49)</p> <p> <b>31%</b> 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)</p> <p> <b>RM1.1 billion</b> investment commitment to enhance the payment card infrastructure between 2015 and 2020</p>

<sup>1</sup> Population of at least 2,000

<sup>2</sup> 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 people<sup>1</sup>, 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

<sup>1</sup> 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%<sup>2</sup> 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.

<sup>2</sup> 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.

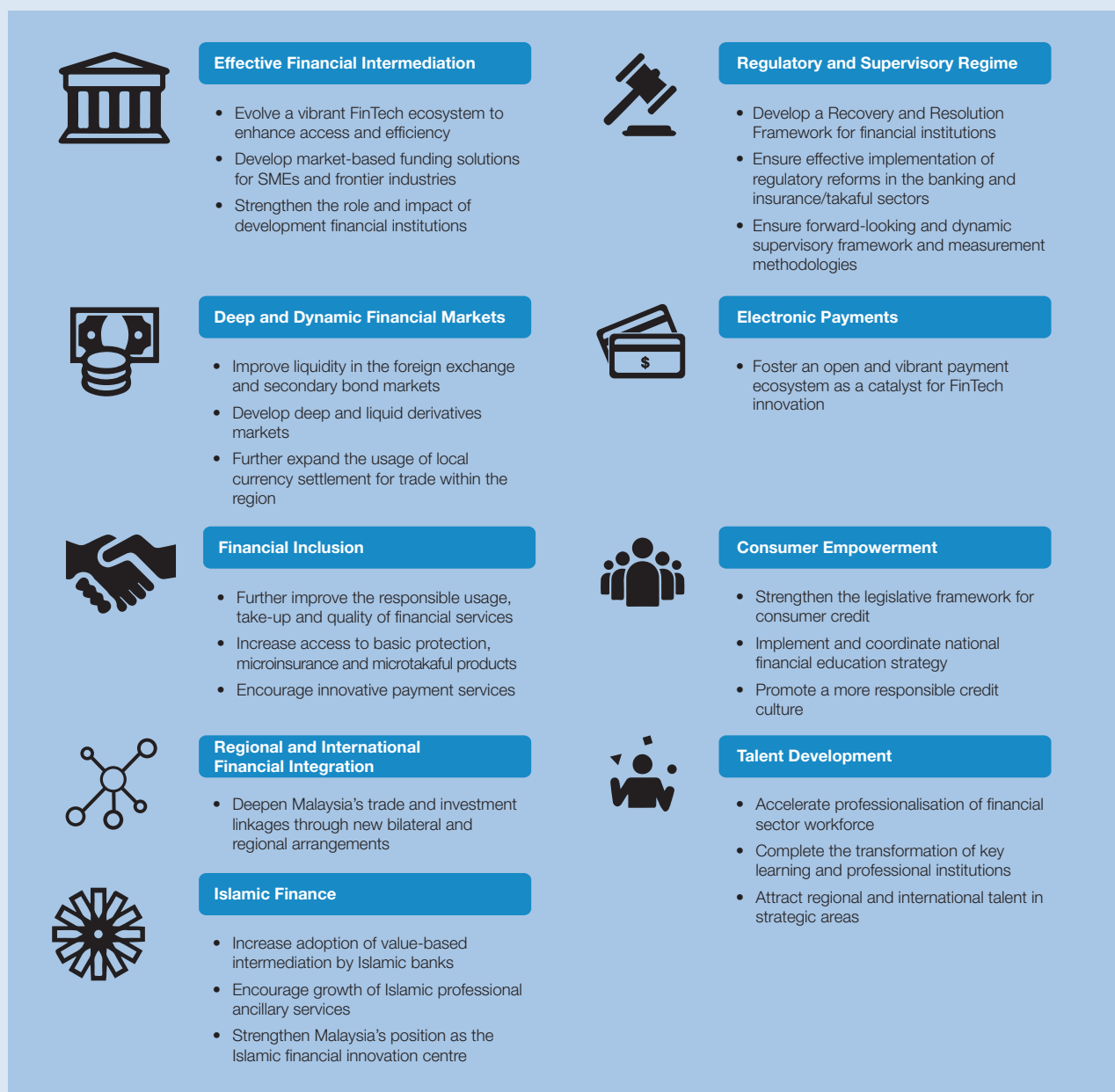
Among them is the evolution of a vibrant alternative financing and FinTech ecosystem to support future innovation and expand funding sources for SMEs. This includes the development of more market-based funding solutions

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.