

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.

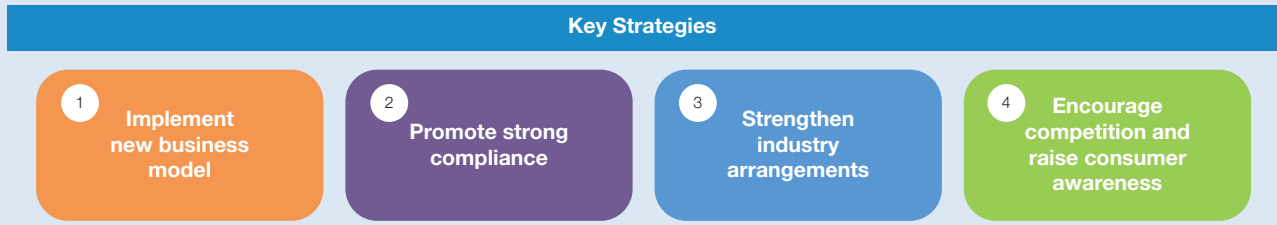
As part of efforts to further increase transparency and the effectiveness of outreach activities, the Bank collaborated with the World Bank in November 2015 to establish Johor Bahru as the first Greenback champion city in Asia. The Project Greenback 2.0 aims to increase efficiency in the market for remittances 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



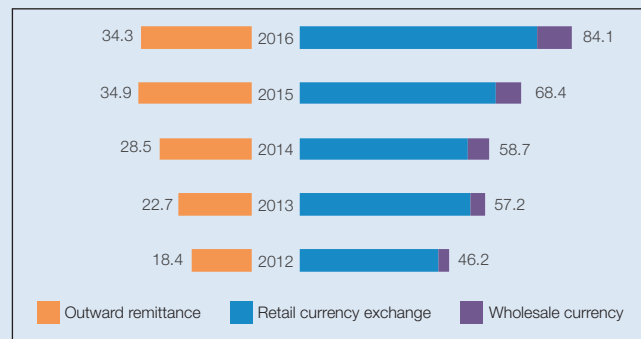
Summary of Achievements

	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.
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Chart 1

Steady Increases in MSB Transactions

(a) Value (RM billion)



	<p>(b) Volume (million)</p> <table border="1"> <caption>Data for Figure (b): 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>~20</td> </tr> <tr> <td>2014</td> <td>~14</td> <td>~22</td> </tr> <tr> <td>2015</td> <td>~16</td> <td>~23</td> </tr> <tr> <td>2016</td> <td>~16</td> <td>~25</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	~20	2014	~14	~22	2015	~16	~23	2016	~16	~25
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<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.

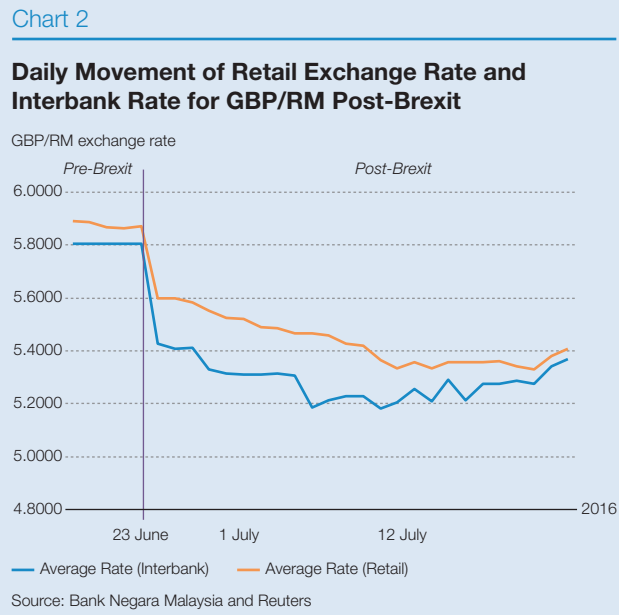
The Bank is also undertaking a broader review of current regulations that require financial service providers including MSB companies to perform physical face-to-face customer verifications. The review aims to consider the use of biometric and other forms of digital customer identification methods to 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);



- **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.