

2015

DEVELOPMENT OF THE FINANCIAL SECTOR

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DEVELOPMENT OF THE FINANCIAL SECTOR

The financial sector remained on course towards achieving the outcomes outlined in the Financial Sector Blueprint 2011-2020 to support Malaysia's transition to a high income, high value-added economy. Amid a challenging economic environment, total outstanding financing to the economy has continued to expand at a healthy pace, with efforts to increase access to financial services for the underserved continuing to pay off. Facilities for the financing of new growth areas such as green finance, structured trade and commodity finance, in addition to financing for small and medium enterprises (SMEs), also continued to support higher value-added activities.

In the Islamic banking sector, the successful migration of customers' deposits into Islamic deposits or investment accounts is expected to enhance the role of Islamic finance in supporting entrepreneurship. Market reform measures in pricing and commission structures are being progressively advanced in the insurance and takaful industry to foster greater innovation, promote sustainability and improve choice and value for consumers.

Ensuring relevant skills, competencies and a strong ethical foundation for the financial sector workforce remained a key priority of the Bank. This continued to be pursued in close collaboration with key institutions. During the year, several strategic initiatives were progressed to further raise standards of professionalism, ethical conduct and technical competence of the workforce. The Bank also announced the establishment of the Asia School of Business in collaboration with the Massachusetts Institute of Technology Sloan School of Management to deliver world-class executive education infused with an Asian perspective for business professionals, including those from the financial sector.

Under Malaysia's Chairmanship of the Association of Southeast Asian Nations (ASEAN) in 2015, a number of key milestones were achieved in regional financial integration, including the finalisation and launch of the ASEAN Banking Integration Framework to provide greater market access and operational flexibility for Qualified

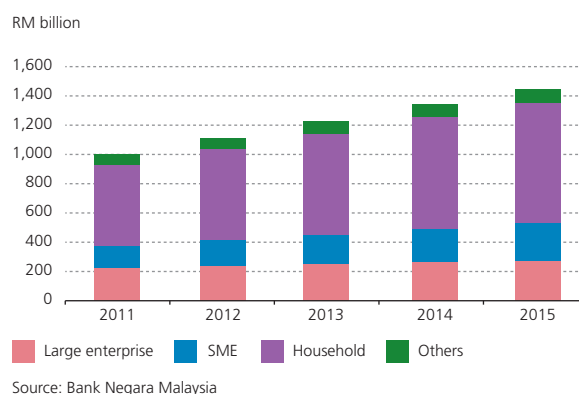
ASEAN Banks. Concurrently, a mutual recognition framework was established to facilitate cross-border offerings of collective investment scheme products within ASEAN, contributing towards regional capital market development. The Bank also continued to expand central bank arrangements to promote the use of local currencies for trade settlement, the latest being with the Bank of Thailand.

FOSTERING EFFECTIVE AND EFFICIENT INTERMEDIATION OF FUNDS

Despite the challenging external environment, lending activity remained supportive of the economy. Outstanding financing by the banking system expanded by 7.9% to RM1,445.1 billion (2014: RM1,339.7 billion), with the Islamic banking sector recording a significantly higher growth of 16.4% to account for 27% of total outstanding bank financing to the economy. Outstanding financing to households and businesses grew by 7.7% and 8% respectively, while financing to SMEs increased by 15% to RM259.7 billion (2014: RM225.9 billion).

Chart 2.1

Outstanding Banking System Financing



Efforts to promote financing of new growth areas were further intensified during the year, particularly in trade and green finance, in line with a focus on strengthening capacity within the financial sector to support higher value-added activities. The expanded offering of structured trade and commodity financing (STCF) solutions

by domestic banks improved access to finance for commodity producers and trading companies. This resulted in the establishment of dedicated STCF desks in 12 banks to support financing transactions for international trade of high value commodities. Another innovation in trade finance solutions includes the Bank Payment Obligation (BPO), an irrevocable undertaking by a bank to pay another upon successful electronic data matching. Five domestic banks have adopted the BPO since the Uniformed Rules for BPO were introduced by the International Chambers of Commerce in 2013. Taken together, these developments will further enhance Malaysia's competitiveness as a trading hub in the region.

In support of the national green technology agenda, the Government extended the Green Technology Financing Scheme (GTFS) for a period of two years until 2017, with RM1 billion in available funding. Launched in 2010, the GTFS has thus far extended RM2.5 billion in financing to 214 qualified institutions, most of which were to companies that promote clean and efficient energy generation, such as solar energy producers. The implementation by the Sustainable Energy Development Authority Malaysia of the feed-in-tariff system that encourages electricity generation from renewable sources is expected to further increase the take-up rate for financing from the GTFS and contribute towards a sustained increase in investments in the green energy sector.

A multi-bank investment platform launched in February 2016 expanded opportunities for customers to invest in a wide range of Shariah-compliant ventures

During the year, the Islamic banking sector completed an industry-wide exercise to migrate customers' Islamic deposit accounts into Islamic deposits or investment accounts according to the requirements of the Islamic Financial Services Act 2013. Under the exercise that was carried out over two years, customers, depending on their risk appetite, may choose to convert their deposits into investment accounts that offer different rates of return but are not principal-guaranteed. At the expiry of the two-year deadline in June 2015, 8% or RM32 billion of total deposits in the

Islamic banking system had been converted into investment accounts. This was followed with the launch of the Investment Account Platform (IAP) by the industry in February 2016 to complement the operationalisation of investment accounts. The IAP is an integrated multi-bank investment platform, allowing retail and corporate customers to view, invest in and efficiently monitor a wide range of Shariah-compliant ventures evaluated by different Islamic banks. It also expands financing opportunities for entrepreneurs with viable projects to reach a wider investor base, while improving cost and operational efficiencies for participating banks by enabling them to leverage on a shared platform and services.

Promoting access to financing for SMEs is one of the key enablers to achieve the goal of increasing the SME sector's contribution to the national gross domestic product to 42% by 2020 (2015: 35.9%). Various programmes have been introduced to increase the supply and the diversity of funding for SMEs. These programmes continued to leverage on the important role and participation of banks in the growth and development of SMEs. Under the 2016 Budget, an additional funding of RM1 billion, valid until 31 December 2017, was provided by the Government for the Shariah-compliant SME Financing Scheme (SSFS) which provides a 2% profit rate subsidy on financing facilities extended by Islamic banks. Over 879 SMEs have already taken advantage of the SSFS since its introduction in 2012.

An additional funding of RM1 billion was allocated by the Government for the Shariah-compliant SME Financing Scheme

The Credit Guarantee Corporation Malaysia Berhad (CGC) continues to support an inclusive ecosystem for SME financing. In a move to address specific financing needs of women entrepreneurs, CGC introduced the BizWanita-I, a RM30 million Shariah-compliant scheme which enables eligible women business owners to borrow up to RM300,000 without collateral over a maximum period of seven years. The BizWanita-I scheme complements the BizMula-I scheme that provides financing to start-ups in operation for less than three years, in supporting the different needs of SME businesses and entrepreneurs.

Provision of Business Remittance Services by Non-banks to SMEs

Under the Bank's current regulatory regime, non-bank remittance service providers (RSPs) are allowed to offer business remittances as part of the provision of complete remittance solutions to the market. SMEs are expected to particularly benefit from such services, in light of the growing share of cross-border trade activities involving SMEs. In 2015, the total value of business remittances increased by 122.1% to RM722.1 million (2014: RM325 million), mainly reflecting demand from SMEs. With better accessibility and longer operating hours, business remittance services offered by the RSPs provide SMEs with a convenient and efficient alternative to banks for cross-border payments not exceeding RM50 million.

Moving forward, a key driver of future growth in the financial sector will be derived from harnessing the role of financial technology to expand the boundaries of quality, efficiency and value-add in products and services offered to consumers. Advances in financial technology have seen the introduction of new business models and technologies such as crowdfunding platforms, robo-advisors, digital currency and payment innovations that are beginning to replace more traditional forms of financial intermediation. While these developments may challenge existing business models, they can also enhance growth potential. The Bank aims to provide a regulatory environment that is conducive for financial institutions to innovate and to respond to potentially disruptive technological changes in an agile manner, while operating within appropriate risk parameters that safeguard the safety and soundness of the financial system.

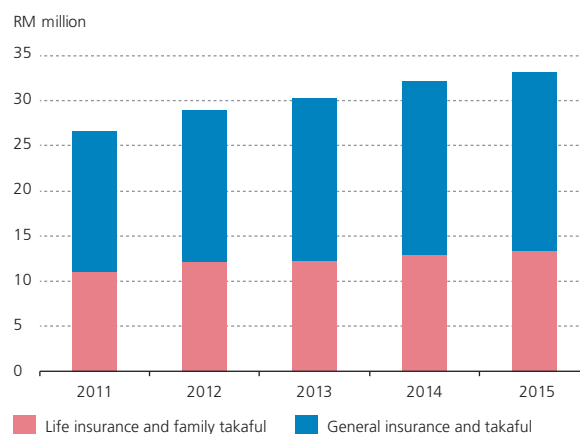
PROMOTING COMPETITIVE AND INNOVATIVE INSURANCE AND TAKAFUL SECTORS

During the year, total assets of the insurance and takaful industry expanded by 5.6% to RM264 billion. Within the life insurance and family takaful sector, the growth of takaful contributions has been notable, accounting for almost 18% of new premiums and contributions. Insurance and takaful provide an important avenue for the public to save and invest, in addition to offering a form of risk protection in events such as death, disability and retirement. In this regard, Malaysia remains some way from achieving the target of 75% penetration rate, as measured by the percentage of the population covered by life insurance and family takaful policies. In 2015, the penetration rate decreased slightly to 54.9% (2014: 55.5%). In the general insurance

and takaful sector, the combined claims ratio edged higher to 60.2% (2014: 58.4%), reflecting more challenging business conditions, especially in the marine, aviation and transit line of business.

Chart 2.2

Insurance and Takaful: New Premiums and Contributions



Source: Bank Negara Malaysia

After several years of planning and intensive engagements, the various components of broad-based reforms in the insurance and takaful sector have been finalised. The Life Insurance and Family Takaful Framework (the Framework) Notification Paper, issued in November 2015, outlines a three-pronged strategy that will provide greater operational flexibility in the design of incentive structures for the sale of life insurance and family takaful products, promote the development of alternative distribution channels and strengthen arrangements for ensuring high quality service and advice by intermediaries. A phased approach to implementation, extending from 2016 to 2019, will allow the necessary changes to be reflected in the practices of insurers and takaful operators and socialised

with consumers, who have an important role in encouraging greater market discipline in the industry going forward.

One of the key initiatives to be implemented in the initial stage is the introduction of the balanced scorecard (BSC) to better align current remuneration structures for intermediaries with quality service and advice. The BSC aims to improve incentives for intermediaries to:

- (i) ensure the suitability of advice based on financial needs of a consumer;
- (ii) effectively service life policies and family takaful certificates throughout their terms; and
- (iii) pursue continuous professional development with a strong focus on ethical and professional conduct in the sales and marketing of life insurance and family takaful products.

This will be achieved through the incorporation of non-sales related key performance indicators (KPIs) for determining the remuneration of intermediaries. Relevant KPIs include indicators linked to the completion of customer fact find forms and the volume of consumer complaints. A pilot run of the BSC will commence in 2016 before its full implementation in 2018. Along with other components of the Framework, it is envisaged that the reforms will have an important impact in increasing the insurance penetration rate in Malaysia.

The Framework outlines a three-pronged strategy that allows greater operational flexibilities, promotes diversified distribution channels and strengthens market conduct of intermediaries

Parallel reforms in the general insurance and takaful sector were also implemented with the issuance of the policy document on the Phased Liberalisation of Motor and Fire Tariffs (the Policy Document) in 2016. This follows earlier revisions to the tariffs that have been made since 1992 and builds on previous measures to prepare the industry and the public for greater price competition in the only segment of the market where prices are still regulated. It also paves the way for the pricing of motor and

fire insurance policies that is more reflective of risks. Details on the Policy Document are elaborated in the box article 'Liberalisation of the Motor and Fire Tariffs'.

Reforms in the general insurance and takaful sector will result in the pricing of motor and fire insurance policies to be more reflective of risks

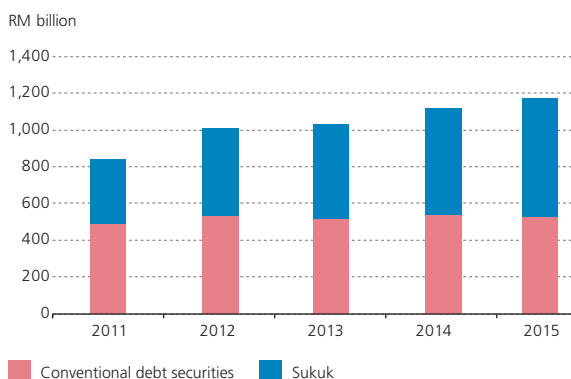
DEVELOPING DEEP AND VIBRANT FINANCIAL MARKETS

Over the past year, the Malaysian financial markets continued to support fund-raising and investment activities for productive uses in the economy. Reflecting more bearish market conditions during the year, total outstanding debt securities in 2015 increased at a slower pace of 5.2% (2014: 8.2%) to RM1,175.1 billion with sukuk accounting for a higher proportion of the total, at 54.8% or RM644.4 billion (2014: 52.2%). New issuances were more modest, with RM276 billion raised in 2015 (2014: RM495 billion). In the foreign exchange market, the average daily turnover was also lower at USD10.2 billion (2014: USD11.8 billion).

Malaysia's debt securities market, at 101.6% of gross domestic product, remains one of the largest in South East Asia. Borrowers and investors

Chart 2.3

Outstanding Debt Securities and Sukuk (Public and Private)



Source: Bank Negara Malaysia

Liberalisation of the Motor and Fire Tariffs

The Bank will be gradually liberalising the Motor and Fire Tariffs with the first phase commencing in 2016. In the new environment, the insurance and takaful industry will have the flexibility to offer motor and fire products with new features or differentiated scope of cover, at market-based prices. This flexibility is expected to spur product innovation, while the application of risk-based pricing will incentivise good risk management behaviour among consumers. The healthy competition generated will also benefit consumers who will gain access to a wider array of motor and fire products, along with higher quality services provided by professional intermediaries. To facilitate an orderly transition both for risk owners and the industry to the new operating environment, a liberalisation roadmap has been developed by the Bank. The roadmap sets out the phases under which existing tariff requirements relating to product features, coverage limits and product pricing will be gradually withdrawn. It also importantly provides for the implementation of strengthened prudential and market conduct requirements necessary to ensure that insurers and takaful operators continue to operate in a safe and sound manner and treat consumers fairly. This article elaborates on the implementation roadmap and the specific objectives behind the phased liberalisation approach.

Phased Liberalisation to Support an Orderly Transition

The liberalisation roadmap provides for the removal of tariff requirements in phases (Diagram 1). This allows gradual adjustments to be made by both the industry and consumers which is important since motor and fire products are widely required by vehicle and property owners, either by law or to protect assets under financing. Motor and fire are also the two largest classes of business for general insurers and takaful operators, accounting for approximately 65% of total industry premiums (including contributions in the context of takaful) on average over the past five years.

During the first year of implementation, the industry will be allowed to offer new products or extensions to the scope of coverage of existing products under the tariffs. The prices of these new products and additional covers will be determined by the market. This will provide an early opportunity for industry players to develop and refine their product and pricing strategies as well as upgrade distribution and operational capabilities. The expected supply of a wider variety of motor and fire products by the industry will also provide additional choice for consumers to purchase insurance or takaful protection that suit their individual needs.

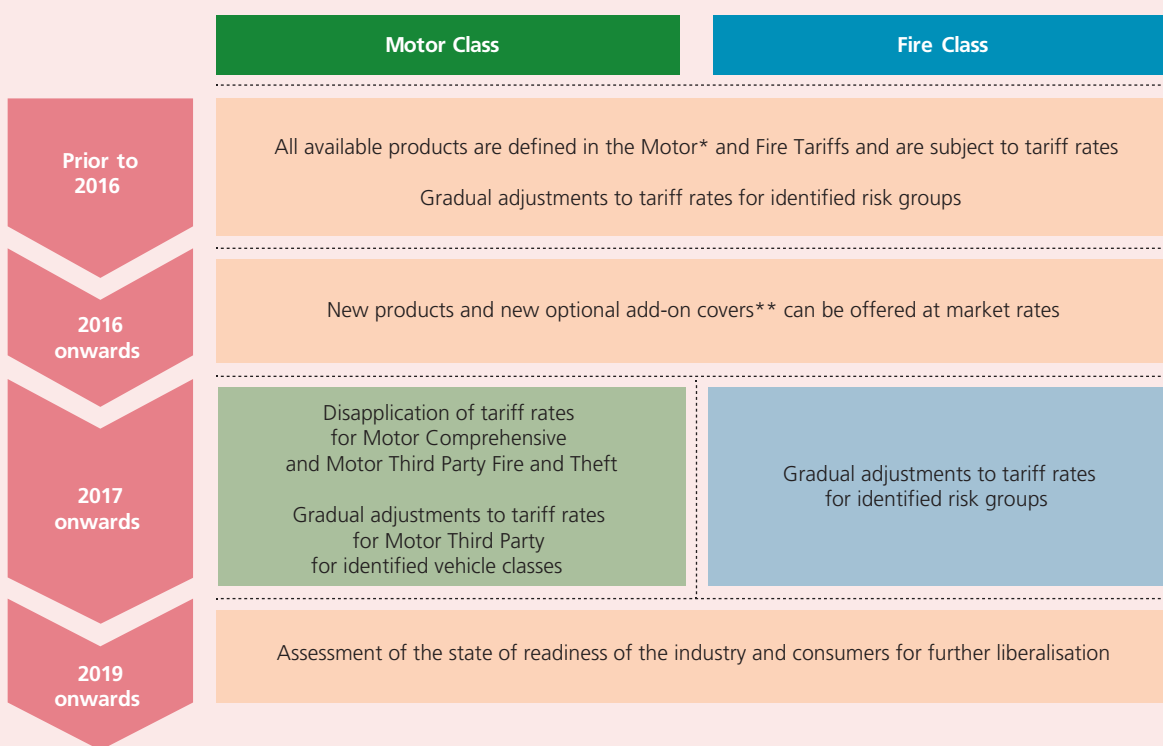
In the second year of implementation, premium rates for Motor Comprehensive and Motor Third Party Fire and Theft (TPFT) products will be determined by the market. Current rates in these product lines are assessed to be reasonably close to their technical levels (based on average loss experience), thus mitigating the risk of sharp adjustments which may cause a disproportionate impact on consumers. Accompanying this change will be enhancements to consumer protection requirements to ensure proper governance over product design and pricing as well as the fair treatment of consumers. Insurers and takaful operators are expected to enhance existing procedures and internal capabilities to enable risks to be properly assessed and prices to be set appropriately and consistently. The standard of disclosure will also be increased, particularly in terms of the pricing components and scope of coverage, to facilitate comparison and enable consumers to make informed purchasing decisions.

Premium rates for Motor Third Party products will continue to be regulated with gradual adjustments to more closely reflect the loss experience of these products. At present, some rates remain substantially below technical levels which are not sustainable over the long term. Based on a recent study, the total premiums collected annually on Motor Third Party products were approximately RM520 million, while incurred claims and expenses have increased to almost RM680 million. This means that for every ringgit of premium received for a Motor Third Party product, insurers and takaful operators paid out an average of RM1.30 in claims and related costs, with some vehicle classes incurring up to RM2.90. Given the sizeable pricing gap relative to risk, an immediate deregulation of rates is likely to result in steep premium increases and thus, affecting large numbers of consumers. In view of this, a more measured approach is necessary to provide time for ongoing initiatives to narrow the pricing gap

to take effect, including initiatives aimed at checking the inflation of claims costs and addressing leakages and fraud. These initiatives will be complemented by efforts to inculcate responsible driving habits and adoption of road safety measures. The phased approach will also facilitate the collection of higher quality data at a more granular level by insurers and takaful operators to better inform pricing decisions.

Diagram 1

Phased Liberalisation of Motor and Fire Classes



Note:

* More detailed explanation on the types of motor insurance can be found in the Motor Claims Guide on the InsuranceInfo website, http://www.insuranceinfo.com.my/landing_pages/accident_info/download/guide.pdf.

** Refers to a new type of product/cover not defined under the Motor and Fire Tariffs or any variation to or extension of product/cover defined under the Motor and Fire Tariffs.

Source: Bank Negara Malaysia

The liberalisation in motor premium rates will be accompanied by a reduction in fire premium rates for certain risk classes, as part of an overall rebalancing of pricing between these classes of business. Over time, as the pooling of risks becomes more refined, premium rates for the two classes are expected to become more consistent with the underlying risk profiles. The progress of the liberalisation will be reviewed in 2019, with an assessment of the impact of these measures on consumers as well as the industry.

Objectives and Expected Outcomes of Liberalisation

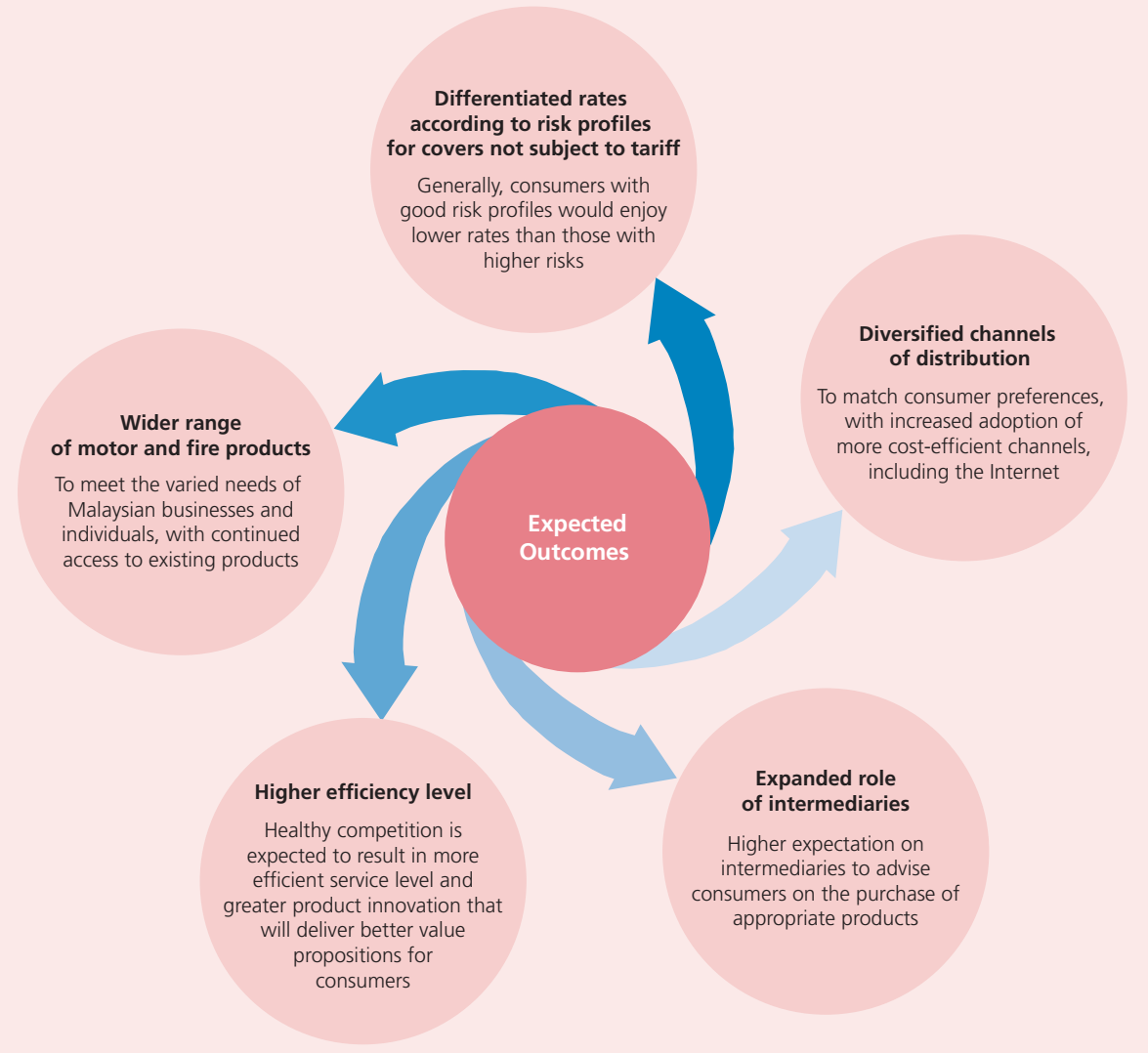
A key objective of the liberalisation initiative is to strengthen incentives for efficiency improvements and sound risk management within the general insurance and takaful sector. Greater flexibility provided for the industry to price motor and fire products will promote competition, in turn driving improvements in underwriting and claims management to deliver the best service and value to consumers. In addition to the need for insurers and takaful operators to upgrade technical capabilities and competencies, it is also expected that broader collaborative efforts, both across the industry and with service providers, will be accelerated to streamline existing practices and minimise leakages and

delays in claims settlements. Such efforts include the establishment of the Fraud Intelligence System by the industry to address insurance fraud, upskilling intermediaries to further enhance professionalism and raising the standard of the repair industry to facilitate more efficient claims processing.

Over time, premium rates would be priced fairly and become more aligned to the underlying risks, thus allowing vehicle and property owners with lower risk profiles to be charged lower premium rates. Similarly, those with higher risk profiles will be appropriately incentivised to undertake measures to reduce risk exposure or improve their risk profiles. The resultant changes in risk behaviour may also reduce the overall incidence of accidents and thefts, which can moderate the inflation in claims costs and premium rates as well as ensure the sustainability of the industry over the long term.

Diagram 2

Expected Outcomes under the New Operating Environment



Source: Bank Negara Malaysia

Another important objective of the liberalisation is to encourage greater product innovation that is responsive to the different needs and preferences of vehicle and property owners. This would include the adoption of new technologies in product development that enable insurers and takaful operators

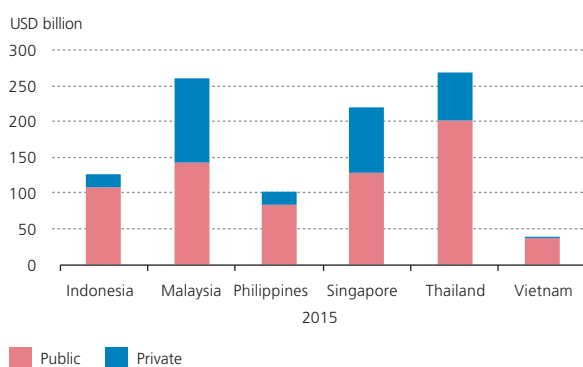
to provide incentives for consumers to adopt safer practices, while delivering better value propositions for responsible consumers. Consumers should also be able to access motor and fire products through their preferred distribution channels, including more cost-efficient channels such as the Internet. Aside from having greater product choice, consumers will additionally benefit from the ability to vary coverage limits or purchase optional extensions. This will enable the scope and level of protection as well as the corresponding premium rates to be customised to match individual risk profiles. During the transition however, existing products will continue to be made available to allow time for consumers to review and adjust their purchasing decisions. To facilitate informed decisions by consumers, the disclosure of product features, coverage limits and premium rates will be enhanced. Intermediaries are also expected to take on an expanded role in explaining new product features and options and assisting consumers to optimise their protection purchases.

The industry is well-placed to make a smooth transition towards a more market-based regime. The regulatory and supervisory efforts undertaken by the Bank over the years have substantially strengthened the resilience of the industry and instilled better governance, risk management and market practices. In particular, the prudential requirements relating to risk-based capital and sound risk management are expected to preserve incentives for sustainable pricing practices and ensure that insurers and takaful operators remain financially sound in the more competitive environment.

Greater flexibility in product design and pricing which corresponds to insurers' and takaful operators' respective risk appetites and capital will also promote more equitable pricing of risks. Together with the cost savings derived from other ongoing initiatives to increase operational efficiency, the liberalisation will contribute towards ensuring the sustainability of the industry over the longer term.

Chart 2.4

ASEAN Outstanding Local Currency Debt Securities Market



Source: Asian Bonds Online

continued to demonstrate confidence in the resilience of the market, with multi-currency issuances further adding to its depth. Issuances by Cagamas Berhad in 2015 amounted to over RM7 billion, surpassing its target of RM6 billion. Other notable issuances include an inaugural issuance of the Singapore dollar-denominated bonds and sukuk totalling SGD362.8 million, which follows the landmark RMB1.5 billion 'Tiger Emas Bond' issued in the previous year. In addition, Petroliam Nasional Berhad (PETRONAS) completed the largest corporate dollar bond issuance in Asia for 2015, successfully raising USD5 billion in four tranches with a strong bid-to-cover ratio of 2.5 times.

To further promote the development of the money market, the Bank reviewed the Repurchase Agreement (Repo) Transactions Policy Document (Repo Policy Document) to allow financial institutions to utilise eligible foreign currency securities as collateral to obtain foreign currency funding under Repo transactions. This is expected to increase the volume of collateralised transactions which will enhance market liquidity. Measures are also being taken to standardise Repo market practices in line with the Global Master Repurchase Agreement, the internationally accepted legal agreement for Repo transactions. The revisions to the Repo Policy Document, which govern that at least one party to a Repo transaction shall be a licensed bank or licensed investment bank, serve to ensure the necessary risk management safeguards are applicable to all Repo transactions.

Efforts continued to be pursued to promote utilisation of the renminbi as a currency of settlement. A key development during the year was Malaysia's admission into the Renminbi Qualified Foreign Institutional Investor (RQFII) programme by PR China in November 2015, with an aggregate national investment quota of RMB50 billion. The RQFII programme was launched by PR China in December 2011 to provide an alternative channel for foreign investors to reinvest their offshore renminbi funds in the Chinese financial markets. Since the introduction of the programme, the RQFII quota has been granted to 16 countries with a total quota of RMB1.2 trillion. Malaysia is the 14th jurisdiction to be included in the programme.

The RQFII programme is expected to encourage the development of more renminbi-denominated financial products in response to growing demand for investment opportunities in PR China. To facilitate the implementation of RQFII in Malaysia, the Bank is collaborating with the Securities Commission Malaysia and the China Securities Regulatory Commission to formulate the general rules and procedures for the RQFII quota application process by qualified Malaysian institutions.

Malaysia's admission into the Renminbi Qualified Foreign Institutional Investor programme promotes the utilisation of the renminbi as a currency of settlement

ADVANCING MALAYSIA AS AN INTERNATIONAL ISLAMIC FINANCE MARKETPLACE

Malaysia continues to strengthen its reputation as an international Islamic finance marketplace. Total foreign currency assets of Islamic banks grew by 10.1% in 2015 to RM30.5 billion (2014: RM27.7 billion), reflecting increased cross-border transactions in Islamic finance. Following Agrobank's successful transition into a full-fledged Islamic bank, the total number of Islamic banks operating in Malaysia stands at 27, including 11 banks currently operating as Islamic windows.

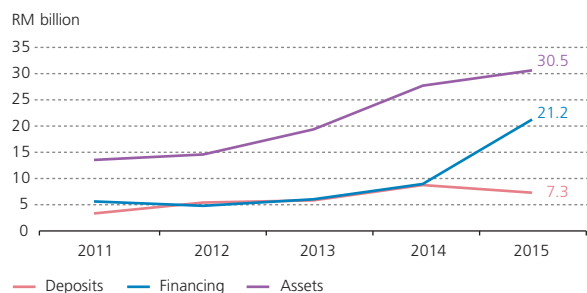
In the sukuk market, Malaysia retained its position as the leading destination for issuances, with a sizeable share of 53% or USD34.8 billion of global new sukuk issuances in 2015. Among the key highlights during the year were two issuances of 'Emas' sukuk by the Government and PETRONAS, bringing the total number of 'Emas' sukuk issued since 2009 to 22. Of these, the inaugural 30-year sukuk issuance amounting to USD500 million by the Government in April 2015 was of particular significance, being the longest tenure sukuk issued by a sovereign to date and serving as a long-dated benchmark Islamic yield curve for other sovereigns. The sukuk set a landmark pricing level for Islamic papers with a yield of 4.2% at issuance where it was priced higher than the conventional bonds of better-rated corporates such as PETRONAS. The sukuk was also the first to adopt a structure that utilises non-physical income generating assets in the form of rights to participate in the provision of services.

The issuance of the USD500 million 30-year sukuk in 2015 marks a milestone as it was the longest tenure sovereign sukuk issued to date and serves as a benchmark for other sovereigns

The year also saw the launch of Malaysia's first sustainable and responsible investment sukuk in May 2015 by Khazanah Nasional Berhad.

Chart 2.5

Foreign Currency Assets, Financing and Deposits of Islamic Banks*

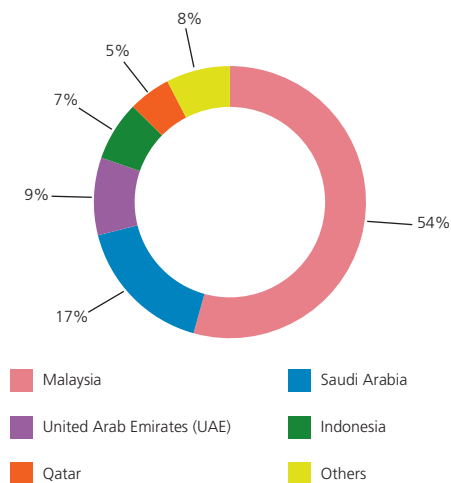


*Including International Islamic Banks and International Currency Business Units

Source: Bank Negara Malaysia

Chart 2.6

Total Outstanding Sukuk Globally in 2015



Source: Zawya

The RM100 million sukuk constitutes the first issuance under a RM1 billion programme which will be channelled towards socially and ethically responsible causes, including the financing of educational projects. In addition, the Bank successfully completed the pilot issuance of RM50 million three-month Islamic Monetary Notes based on the globally accepted profit sharing concept of *Mudarabah*. This issuance is expected to widen the investor base and increase the depth and vibrancy of Malaysia's Islamic financial markets.

The Bank remains active in promoting the sustainable development of Islamic finance at the global level, drawing on its considerable experience. In April 2015, the International Monetary Fund (IMF) and the G-20 economies co-organised an Islamic finance seminar in conjunction with the annual Spring Meetings of the IMF and the World Bank, the first time that Islamic finance has been featured at an event at this level. The Bank supported the event as an expert resource, helping to promote the recognition of Islamic finance as a viable form of financing for infrastructure investment and reinforce its importance in supporting economic growth. Islamic finance has additionally gained further acceptance among ASEAN member states with the adoption of a resolution by the ASEAN Inter-Parliamentary Assembly during the year to promote diverse sources of funding, including Islamic finance, to boost inter- and intra-regional trade.

DEVELOPING TALENT TO DRIVE GROWTH AND DYNAMISM IN THE FINANCIAL SECTOR

Ensuring relevant skills, competencies and a strong ethical foundation for the financial sector workforce remained a key priority of the Bank. This continued to be pursued in close collaboration with key institutions and bodies established and supported by the Bank.

Following its establishment in July 2014, the Financial Services Talent Council (the Council) completed the groundwork to strengthen talent development for the financial industry. The insights and perspectives obtained from extensive engagement and consultation with key stakeholders provided rich input to the Council's formulation of strategies to meet the future talent demands of the industry. The Council is currently in the advanced stages of developing its recommendations and aims to publish the same in 2016. The recommendations are expected to complement the work of existing talent organisations in the industry, with a view towards strengthening the overall talent development ecosystem that produces a sustainable and high quality talent pipeline for the financial sector.







The Financial Services Professional Board (FSPB), an industry-led initiative to drive the development and advocacy of professional and ethical standards, published a voluntary code of ethics (CoE) for the industry in January 2016. Incorporating perspectives from leading practitioners and influential experts, the CoE outlines a set of five fundamental principles, focusing on competence, integrity, fairness, confidentiality and objectivity, the adoption of which will set a high bar for professionalism and ethics in the financial services industry.

The voluntary code of ethics published by the Financial Services Professional Board sets a high bar for professionalism and ethics in the financial services industry

Efforts towards elevating professional standards in the industry were also advanced, as elaborated in Diagram 2.1.

Diagram 2.1

Raising the Professional Standards in the Financial Services Industry through Strategic Transformation of Professional Associations with High Impact Mandate

Formerly known as	Strategic transformation into	Current role and function
 Institute of Bankers Malaysia	 Asian Institute of Chartered Bankers (AICB)  Asian Banking School (ABS)	<p>AICB, the professional body for the banking industry championing professional development, qualifications and thought leadership in collaboration with ABS, the industry provider specialising in professional banking education</p> <ul style="list-style-type: none"> Introduced the final level of Chartered Banker programme in February 2016, following the successive introduction of the first two levels, the Executive Banker (2013) and Professional Banker (2015) Offered specialised certification programmes (e.g. regulatory compliance and risk management) to meet the industry's demand
 Association of Chartered Islamic Finance Professionals	 Chartered Institute of Islamic Finance Professionals (CIIF)	<p>Promote global standards of professionalism amongst Islamic finance practitioners</p> <ul style="list-style-type: none"> Released inaugural standards on Chartered Professional qualification and authorised training financial institutions, in conjunction with the launch of CIIF in November 2015
 Association of Shariah Advisors in Islamic Finance	Association of Certified Shariah Advisors (ACSA)	<p>A leading professional body committed to enhancing the level of knowledge and standing of Shariah practitioners</p> <ul style="list-style-type: none"> Developing programs to certify Shariah advisors in the financial services industry Developing continuous professional enhancement programs for its members

The International Centre for Education in Islamic Finance (INCEIF) has continued to play an instrumental role in the education of Islamic finance professionals, supplying core talent to Islamic financial institutions across the globe. The number of enrolled students has increased over threefold since the first intake of 600 students from 21 countries in 2006 to 2,212 students representing 79 nationalities. The number of graduates has correspondingly increased, with 248 students graduating in 2015. With the launch of the INCEIF Endowment Fund in November 2015, the private sector can now contribute towards INCEIF's aspirations, particularly in research and development of programme offerings. INCEIF is concurrently embarking on the development of a ten-year blueprint that will establish its strategic priorities to ensure that it remains responsive to the evolving talent development needs of the Islamic finance industry.

The launch of the INCEIF Endowment Fund in November 2015 allows the private sector to contribute towards INCEIF's aspirations, particularly in research and development of programme offerings

Another key development during the year was the establishment of the Asia School of Business (ASB) in April 2015. The ASB, which will be based in Kuala Lumpur, is the result of a strategic partnership between the Bank and the Massachusetts Institute of Technology Sloan School of Management in support of broader efforts to provide world-class education that will produce transformative and principled leaders who can contribute to the development of the emerging world, particularly in Asia.

DEEPENING OF INTERNATIONAL FINANCIAL AND ECONOMIC LINKAGES

Efforts to foster greater financial and economic integration in the region intensified under Malaysia's Chairmanship of ASEAN. During the year, the ASEAN Community was successfully established, paving the way for the creation of

a single market envisioned under the ASEAN Economic Community (AEC). A well-developed and regionally-connected financial system that facilitates economic activity represents a critical prerequisite to achieve the AEC.

The launch of the ASEAN Banking Integration Framework (ABIF) in March 2015 was an important milestone towards achieving greater regional financial integration. Through ABIF, Qualified ASEAN Banks will gain greater market access and operational flexibilities based on mutually agreed commitments between home and host countries in the region. To support the participation of newer ASEAN members in ABIF, the Bank contributed to the development of ABIF's capacity building roadmap, which aims to provide a cohesive and coordinated approach for capacity building initiatives in the region. This was developed in collaboration with the South East Asian Central Banks, the Asian Development Bank and other ASEAN member countries.

The Memorandum of Understanding with the Bank of Thailand serves as a pilot scheme in the use of ASEAN currencies for trade settlement

Looking ahead, the ASEAN Finance Ministers and Central Bank Governors also endorsed a broad framework for further ASEAN financial integration beyond 2015. The framework sets out a ten-year plan based on the three pillars of financial integration, financial stability and financial inclusion. This will guide the priorities of the various ASEAN working committees that have been established to pursue further integration opportunities, including in the areas of financial sector liberalisation, capital market development as well as payment and settlement systems.

Under the mutual recognition framework developed by the ASEAN Capital Market Forum to facilitate cross-border offerings of collective investment scheme (CIS) products within ASEAN, the Bank accorded several foreign exchange administration flexibilities. This will broaden opportunities for authorised fund managers under the ASEAN CIS framework to establish

ringgit-denominated unit funds outside Malaysia and to invest ASEAN CIS funds raised in Malaysia abroad without having to seek for prior approval. The ASEAN CIS framework is expected to encourage the development of wider investment product offerings to harness and channel surplus funds within the region in support of regional growth and development.

As part of ongoing efforts to promote the use of local currencies in trade and investment, the Bank entered into a Memorandum of Understanding with the Bank of Thailand in August 2015 to

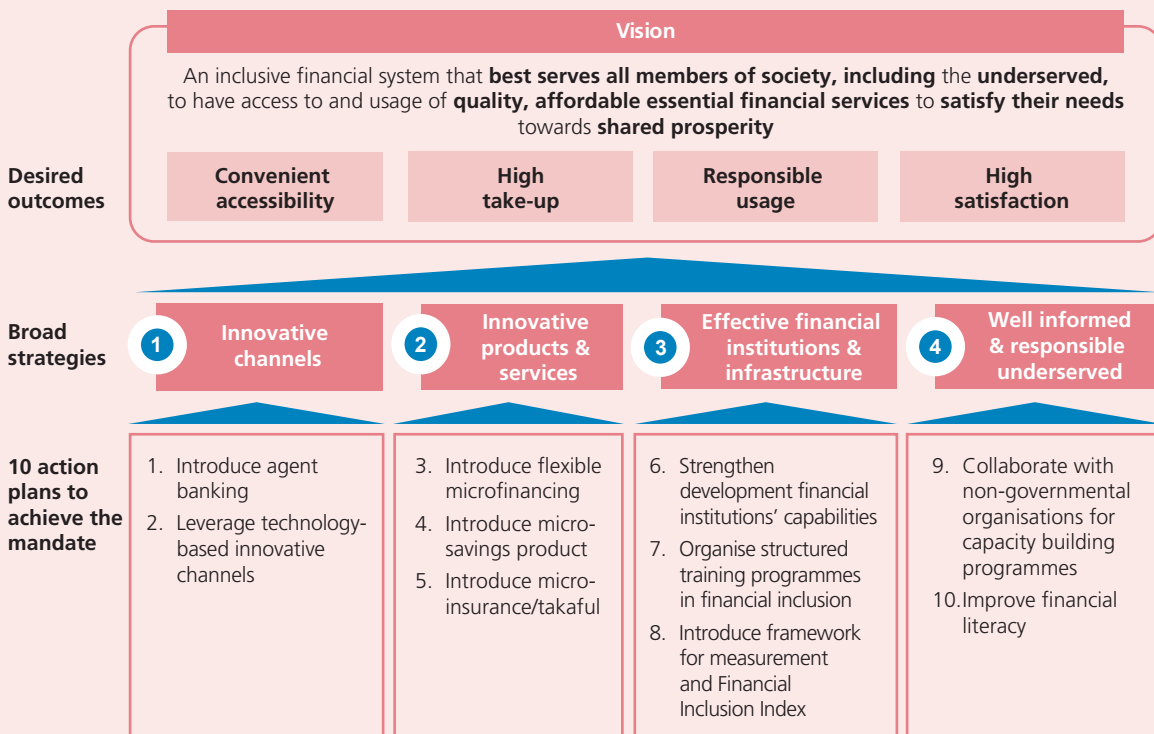
promote the use of the ringgit and Thai baht for settlement activities. This collaboration will serve as a pilot scheme in the use of ASEAN currencies for trade settlement, which is expected to lower the cost of doing business and reduce exposure to foreign exchange volatility. The Bank also renewed its bilateral currency swap arrangement with The People's Bank of China for the third time after its initiation in 2009. The three-year term arrangement was maintained at RMB180 billion or RM90 billion and will further strengthen the existing economic and financial linkages between Malaysia and PR China.

Unlocking Shared Benefits for All through Inclusive Finance

Promoting inclusive finance, where all segments of society have access to suitable and affordable formal financial services, is a key focus and specific mandate of the Bank in contributing towards equitable and sustainable growth. Essential financial services provide opportunities for Malaysians, including the lower income segments of society, to safely save and invest, borrow for productive activities and buffer themselves against unforeseen shocks. In advancing the financial inclusion mandate, the Bank in 2011 introduced the Financial Inclusion Framework, a comprehensive plan outlining the strategies for an inclusive financial system over the coming decade. Subsequently, the Financial Inclusion Index was developed to track the progress and impact of the Bank's financial inclusion policies. This article reports on the progress of financial inclusion in Malaysia since 2011 when the first Financial Inclusion Demand-Side Survey was conducted.

Diagram 1

Financial Inclusion Framework



Source: Bank Negara Malaysia

Significant Achievements in Financial Inclusion

The Financial Inclusion Index score for the general population in Malaysia improved significantly to 0.90 in 2015 from 0.77 in 2011 (where 1.00 reflects full inclusion). These improvements were largely driven by increased accessibility to financial access points across the country, more responsible usage of products and higher levels of satisfaction among financial consumers. Meanwhile, gaps continue to be observed in the utilisation of financial products and services, particularly among low-income households.

(i) Convenient Accessibility

Convenient accessibility, which measures the availability of financial access points at the district (*daerah*) and sub-district (*mukim*) levels, recorded a marked improvement. All 144 districts and 97% (2011: 46%) of the 886 sub-districts with a population of at least 2,000 now have access to essential

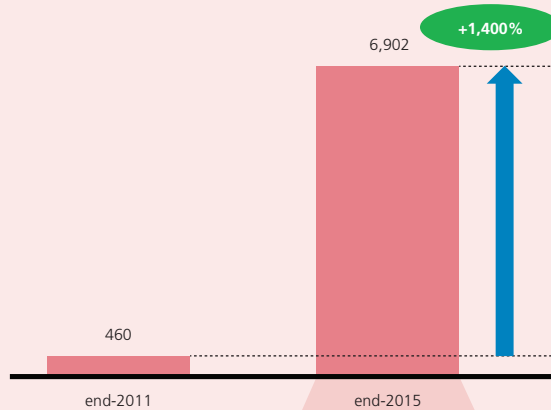
Agent Banking as Catalyst for Financial Inclusion

Agent banking enables consumers to obtain banking services by licensed financial institutions through third-party agents such as retail outlets and post offices. First introduced in 2012, the agent banking regulatory framework was further enhanced in April 2015 to allow agents to facilitate the opening of saving accounts¹ on behalf of financial institutions via online real-time systems and biometric identity verification.

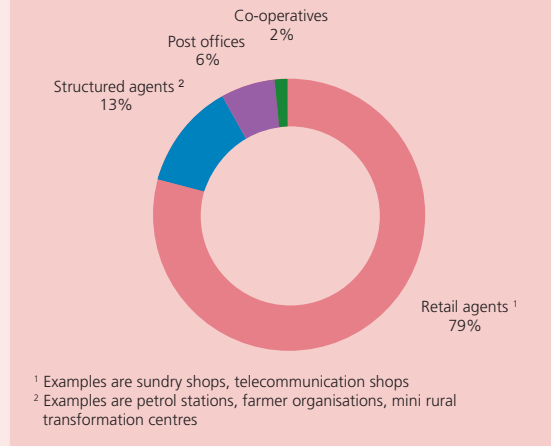
As at end-2015, 6,902 agent banks have been established nationwide, with over 13,600 new accounts opened and 63 million transactions amounting to RM5.7 billion facilitated by agent banks. Most of these transactions involved bill payments (59.2%; RM3.4 billion) and cash deposits (28.1%; RM1.6 billion).

Chart 1

Number of Agent Banks Had Increased



Mainly Supported by Retail Agents



Source: Bank Negara Malaysia

¹ In addition to allowable services under the Guidelines on Agent Banking (2012) namely accepting deposits, facilitating withdrawals, fund transfers, bill payments and financing repayments.

financial services. This expansion in the number of access points nationwide provides 99% (2011: 82%) of Malaysians with convenient access to safe, reliable and affordable financial services.

This achievement was in large part due to the establishment of agent banks, which had an important impact in increasing access to financial services particularly in the rural areas. Following the operation of agent banks, the volume of financial transactions conducted through agent banks has increased from three million transactions as at end-2012 to 63 million as at end-2015 (amounting to RM5.7 billion in value).

Another important development that has intensified since 2011 has been the expansion of Internet banking and mobile banking. As at end-2015, the number of Internet banking subscribers increased to 19.8 million (2011: 11.9 million) representing 63.7% of the total population, while the number of mobile banking subscribers increased to 7.3 million (2011: 1.6 million) representing 23.5% of the total population. These digital channels have had an important impact in increasing access to banking services, with greater convenience and flexibility for consumers to keep track of their personal finances.

Financial Inclusion Index

The Financial Inclusion Index measures the level of financial inclusion in Malaysia and the effectiveness in achieving the four desired outcomes of financial inclusion: (i) convenient accessibility; (ii) high take-up; (iii) responsible usage; and (iv) high satisfaction.

The Financial Inclusion Index is constructed from both supply-side data from financial institutions and demand-side data collected through the Financial Inclusion Demand-Side Survey, conducted periodically by the Bank.


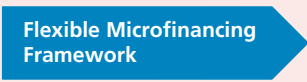


Financial Access Points in Malaysia

Access points per 10,000 adults:

- 4.5 branches and agent banks
- 5.1 Automated Teller Machines (ATMs)
- 2.3 Cash Deposit Machines (CDMs)

Diagram 2

Targeted Microfinancing Solutions

Microfinancing Initiatives	Purpose
Initiatives by the Financial Institutions:	
 Pembiayaan Mikro Scheme	Increase access to financing for micro enterprises
 Flexible Microfinancing Framework	Assist micro enterprises that have irregular or seasonal income streams
Complemented by schemes offered by the Microfinance Institutions:	
 Amanah Ikhtiar Malaysia (AIM) ¹	Provide microfinancing primarily to women for income-generating activities
 Tabung Ekonomi Kumpulan Usaha Niaga (TEKUN) ²	Provide financing facilities for entrepreneurs to kick-start and further expand their businesses

¹ AIM was established in 1987 with the objective of assisting the hard-core poor to rise out of the poverty trap. This is done through the provision of microfinancing through more than 130 branches nationwide.

² TEKUN Nasional was established in 1998 and since then, there was a rebranding exercise in 2008. It has played a role that is beyond just being a financial provider but also provides entrepreneurship development and support services. TEKUN has more than 190 branches to-date.

Source: Bank Negara Malaysia, Amanah Ikhtiar Malaysia & Tabung Ekonomi Kumpulan Usaha Niaga

(ii) Take-up of Financial Products and Services

The take-up rate, which represents the population's usage of specific financial products namely deposit accounts, financing accounts and insurance policies, recorded a slight decline. While the percentage of adults with deposit accounts remained high at 91%, the percentage of adults with financing accounts (including credit cards) declined from 36% to 25%. This was due in part to heightened focus on better debt management and affordability of debt servicing following the introduction of measures such as the credit card services tax, the Credit Card Guidelines and the Guidelines on Responsible Financing. The percentage of adults surveyed who indicated that they purchased a life insurance or takaful policy moderated from 18% to 16%. These findings show that while financial inclusion has increased significantly since 2011, certain gaps remain, particularly among the low-income segment, where affordability remains a challenge.

Diagram 3**Pembiayaan Mikro Scheme**

Source: Bank Negara Malaysia

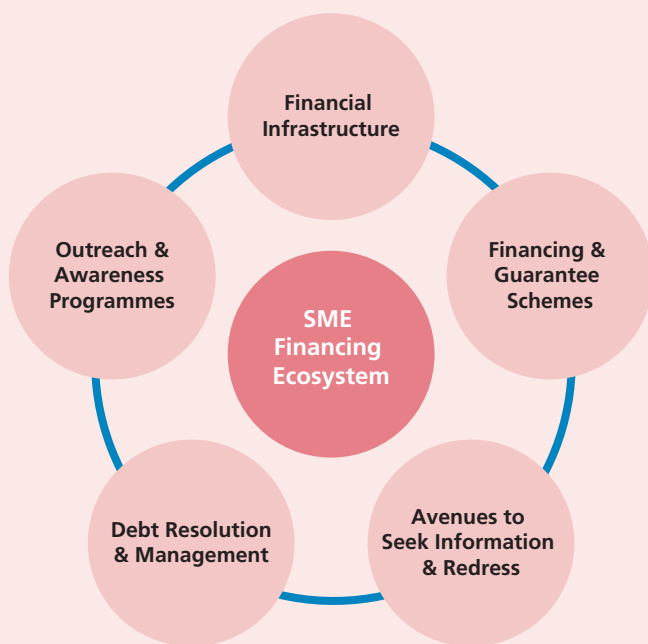
In recognition of these gaps and opportunities, the Bank has undertaken various initiatives to encourage the development of products and services that are targeted towards this segment. This has included encouraging financial institutions to offer microsavings products with low committed periodical savings to encourage and facilitate regular savings among the low-income population; offering affordable microinsurance/microtakaful products by insurance companies and takaful operators to provide financial protection against unexpected adverse events; and supporting the provision of tailored microfinancing solutions for micro, small and medium enterprises (SMEs).

The provision of financial services is also supported by a comprehensive financing ecosystem comprising: (i) an enabling financial infrastructure; (ii) financing and guarantee schemes; (iii) avenues to seek

information and redress; (iv) debt resolution and management arrangements; and (v) outreach and awareness programmes. These arrangements have been important to promote confidence and reduce anxiety in using financial services, in addition to supporting individuals and businesses to understand how the financial system can help them manage risks and improve their financial well-being.

Diagram 4

SME Financing Ecosystem



SME Financing in Malaysia

- SME financing approval rate exceeding 80%.
- 96% or RM274.5 billion were from financial institutions.
- Grew by 14% over the last three years.
- Share of financing to small-sized companies (41%), micro enterprises (31%) and medium-sized SMEs (28%).
- 44% of approvals were given to new customers*.

Source: Bank Negara Malaysia and *SME Corporation Malaysia Survey Third Quarter 2015

Development financial institutions (DFIs) also have an important role in contributing to a higher utilisation of financial services given the specific socio-economic objectives that they serve. This includes supporting the development of SMEs, the agricultural sector and co-operatives through the provision of inclusive financial services. The Bank provides oversight over six DFIs that are prescribed under the Development Financial Institutions Act 2002 with the aim of promoting their ability to perform their roles effectively and sustainably.

(iii) Responsible Usage

Responsible usage, which measures whether financial products are utilised appropriately, remained high. The percentage of banking customers with active deposit accounts, an indication that they are saving regularly, has increased to 92% from 87% in 2011 while the percentage of banking customers with performing financing accounts increased to 98% from 97% over the same period.

Financial education initiatives have had a key role in encouraging responsible usage by helping consumers make better financial decisions, thus promoting a positive experience from their participation in the financial system. The Bank continues to collaborate with the public and private sectors to organise and implement these financial capability programmes, while agencies such as the Financial Mediation Bureau, the Credit Counselling and Debt Management Agency and the Small Debt Resolution Scheme serve to ensure that financial consumers are able to get the help that they need to effectively manage their financial affairs.

Diagram 5

Financial Inclusion Initiatives

Dimensions	Initiatives (2011-2015)	Moving Forward												
<p>1 Convenient Accessibility</p> <p>2011 46% 2015 97%</p> <p>2011 82% 2015 99%</p> <p>sub-districts (<i>mukim</i>) with at least 2,000 population with at least one access point</p> <p>population living in sub-districts (<i>mukim</i>) with at least one access point</p>	<p> Agent Banking</p> <p> Mobile & Internet Banking</p> <p> Branching policy</p>	<ul style="list-style-type: none"> • Increase the number of access points in the underserved areas • Promote the opening of accounts via agent banking 												
<p>2 Take-up Rate % of adult population with financial products</p> <table border="1" data-bbox="276 735 755 966"> <thead> <tr> <th></th> <th>deposit accounts</th> <th>financing accounts</th> <th>life insurance/takaful policies</th> </tr> </thead> <tbody> <tr> <td>2011</td> <td>92%</td> <td>36%</td> <td>18%</td> </tr> <tr> <td>2015</td> <td>91%</td> <td>25%</td> <td>16%</td> </tr> </tbody> </table>		deposit accounts	financing accounts	life insurance/takaful policies	2011	92%	36%	18%	2015	91%	25%	16%	<p>Financial Products</p> <p> Basic savings</p> <p> Microfinancing</p> <p>CGC's direct financing scheme</p> <p>Enabling Infrastructure</p> <p> CREDIT BUREAU MALAYSIA</p> <p> CGC</p> <p> CCRIS</p> <p>Proportionate regulation (DFIA)</p>	<ul style="list-style-type: none"> • Microsavings & microinsurance/microtakaful for low income households • Savings product for youth • Accelerate migration to e-payment • Financing products for youth, women & persons with disabilities • ASEAN SME & Financial Inclusion Working Groups • Government-to-person payment (G2P) • Financing Guidebook for SMEs • Enhance regulatory framework on microfinance
	deposit accounts	financing accounts	life insurance/takaful policies											
2011	92%	36%	18%											
2015	91%	25%	16%											
<p>3 Responsible Usage</p> <p>2011 87% 2015 92%</p> <p>Customers with active deposit accounts</p> <p>2011 97% 2015 98%</p> <p>Customers with performing financing accounts</p>	<p>Regulations</p> <p> Responsible Financing Guidelines</p> <p> Credit Card Guidelines</p> <p>Financial Advisory, Education and Redress</p> <p> SME Promotion</p> <p> Small Debt Resolution Scheme</p> <p> FMB</p>	<ul style="list-style-type: none"> • Train-the-Trainers Programme on SME Financing • Financial literacy program for 1AZAM¹ participants and targeted segments (low income households, persons with disabilities, school children) • Enhance restructuring & rescheduling mechanism for SME financing <p>¹ 1AZAM (Akhiru Zaman Miskin) – Government's poverty eradication programme</p>												
<p>4 Satisfaction Level</p> <p>2011 61% Customers who are satisfied with overall financial services</p> <p>2015 73% </p>	<p>Consumer and Market Conduct</p> <ul style="list-style-type: none"> • Guidelines on Product Transparency and Disclosure • Guidelines on the Imposition of Fees and Charges on Financial Products and Services • ABM-PARTNER on client charter and standard documentations 	<ul style="list-style-type: none"> • Enhance advisory service by the DFIs • Digitalisation of delivery of products and services 												

Source: Bank Negara Malaysia

(iv) Satisfaction Level

The index revealed a significant improvement in the level of satisfaction with financial services in Malaysia. The percentage of customers of financial institutions who are satisfied with overall financial services increased to 73% (2011: 61%), with higher satisfaction levels observed across

all segments of the population, including low-income households who also recorded an increase in satisfaction to 67% (2011: 60%). This in part reflects improvements in the conduct and services of financial institutions arising from various initiatives to promote a positive experience for all financial customers. Of note were substantially strengthened standards issued by the Bank to regulate product transparency and disclosures, and the imposition of fees and charges by banks. Also notable have been key private sector initiatives such as the PARTNER programme by the banking industry which simplifies documentation and improves the turnaround time for processing SME financing and housing loans. A similar initiative to introduce plain language in insurance contracts has also been pursued by the insurance industry.

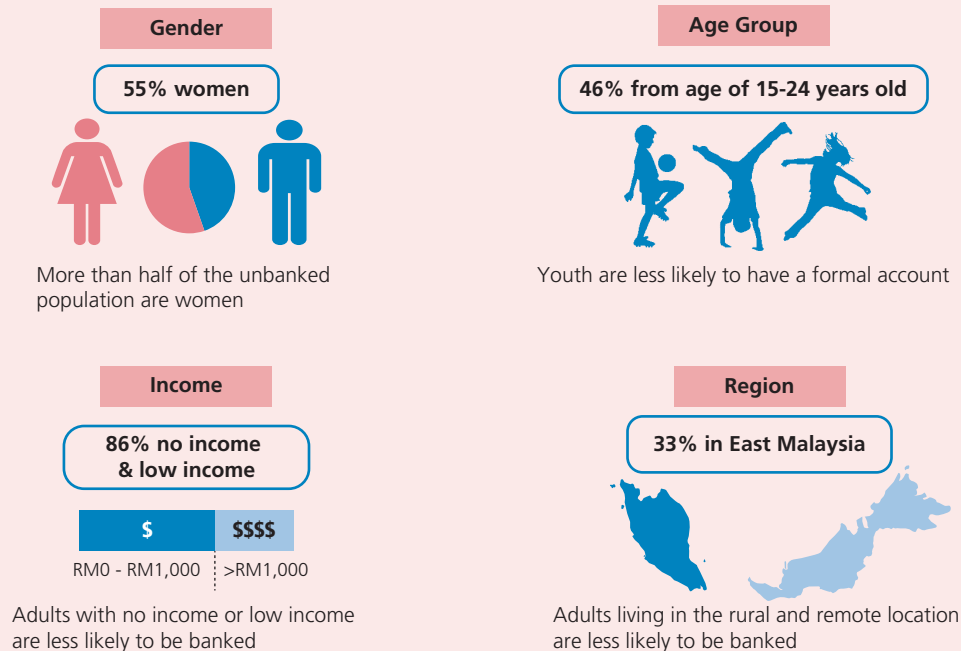
Elevating the Level of Financial Inclusion

The Bank remains committed to expand the level of financial inclusion. This will be supported by a sustained focus on encouraging the development of innovative delivery systems, products that are responsive to the needs of the underserved, and effective education, support and protection for financial consumers. With this focus, the Bank expects that the remaining 8% that constitutes the unbanked population in Malaysia will be further reduced to 5% by 2020.

Diagram 6

Who Are the 8% Unbanked Adult Population?

Gaps in financial inclusion across demographics, with women, youth and low income at the greatest disadvantage



Source: Bank Negara Malaysia