

2014

DEVELOPMENT OF THE FINANCIAL SECTOR

- 63 Ensuring Effective and Efficient Intermediation
- 64 Strengthening the Insurance and Takaful Industry
- 66 Developing Deep and Vibrant Financial Markets
- 69 Advancing the Financial Inclusion Agenda
- 70 Malaysia as an International Islamic Finance Marketplace
- 71 Regional and International Developments
- 72 *Box Article: Investment Accounts under IFSA*
- 78 Continued Development of Human Capital

DEVELOPMENT OF THE FINANCIAL SECTOR

During the year, the financial sector continued to make progress on several fronts towards fulfilling the vision and strategies outlined in the Financial Sector Blueprint 2011-2020. While the intermediation process has continued to support the financing needs of the economy, there remains scope for financial institutions to capture opportunities from supporting new growth sectors. The package of reforms to the life insurance and family takaful sector will be implemented beginning 2015 in a phased manner to ensure that the preconditions are in place for transitioning to a more competitive and innovative marketplace. The implementation of measures to improve the efficiency and sustainability of the motor insurance sector, including a third round of premium adjustments, has also paved the way for the gradual abolishing of tariffs to proceed in 2016.

The process of financial integration in the region advanced further with the conclusion of the Sixth Package of Financial Sector Commitments under the ASEAN Framework Agreement on Services and the ASEAN Banking Integration Framework. Several landmark foreign currency sukuk and debt issuances, along with initiatives to facilitate wider use of regional currencies and securing Malaysia's status as a 'netting-friendly jurisdiction', also enhanced the international complexion of the Malaysian financial system. The Bank continued to advocate for inclusive financial development on a regional and global level, while measures introduced domestically to monitor and assess the effectiveness of financial inclusion initiatives will drive policies to increase not only access to, but also the effective use of financial services. Several high-level arrangements were also established to raise the supply and quality of financial professionals with the aim of ensuring that the financial sector remains well-resourced to achieve its mandates.

ENSURING EFFECTIVE AND EFFICIENT INTERMEDIATION

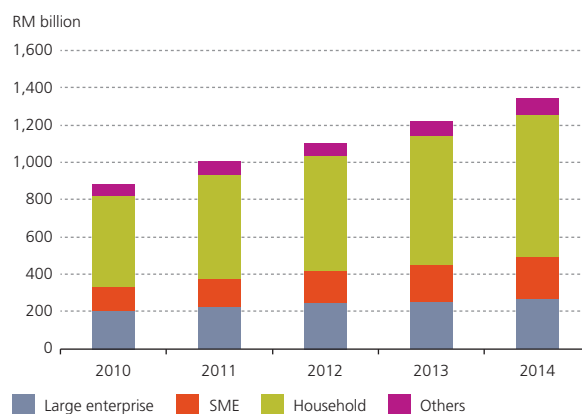
During the year, the financial sector continued to mobilise savings and investments towards meeting the diverse financing needs of the

economy. Total new loans disbursed by the banking system continued to grow by 13.3%. More than 70% of the total loans disbursed were channeled to businesses, with the remaining to households. Financing to small and medium enterprises (SMEs) was also sustained, accounting for 30.4% of total business loans disbursed in 2014. In the debt securities market, corporate fund raising activities remained robust despite the challenging external environment. The nominal value of total private debt securities (inclusive of short-term trust certificates) issued during the year amounted to RM137.5 billion, reflecting an annual growth of 10.7% (2013: RM124.2 billion).

The financial sector has an important role in enabling the Malaysian economy's transition towards higher value-added activities. This role is not limited to direct bank financing. The development of innovative financial structures, including Islamic investment accounts, and the provision of other forms of non-credit financial services, have expanded the potential for financial institutions to play a larger role in supporting the funding needs of new growth industries such as green technology, biotechnology and other innovative industries. These sectors present significant growth opportunities for the financial sector as the transformation of the Malaysian economy towards becoming a developed nation gains traction.

Chart 2.1

Outstanding Banking System Financing



Source: Bank Negara Malaysia

According to a recent survey of banking institutions conducted by the Bank, new financing to businesses remained largely focused on the traditional economic sectors while the share of total financing to these new areas of growth accounted for less than 5% despite strong demand, particularly from start-ups. Given the nascent nature of the venture, bank financing to these start-ups may inappropriately put depositors' funds at substantial risk, particularly where survival of the start-ups is wholly dependent on the success of an untested venture. Nonetheless, there is scope for banks to capture opportunities in different stages of the growth cycle of innovative companies that would not undermine necessary prudence. These opportunities remain largely unexploited due to the following factors:

- Lack of expertise within financial institutions with relevant knowledge and experience in the new growth areas to support risk assessments;
- Lack of market information on the commercial potential of the new growth areas;
- Inability of businesses to pledge collateral typically required by banks;
- Prohibitive costs of financing; and
- Further support required by the companies to improve business and financial management practices.

In addition to the above factors, financing by banks to new growth areas could also be constrained by other factors such as:

- Limited credit history and track record of the business venture, rendering it difficult to ascertain business viability;
- Lack of robust business plans and incomplete record keeping; and
- Low level of awareness among smaller and newer businesses on alternative financing instruments such as private equity and leasing.

In an effort to address these issues and enhance the capability of financial institutions to support the financing needs of new growth industries, the Bank facilitated various strategic collaborations between the financial services industry and key stakeholders during the year. This included the Malaysia Green Technology Corporation, Intellectual Property Corporation of Malaysia and Multimedia Development Corporation. The collaborations served to increase awareness among the financial institutions on the growth potential in innovative industries and helped to bridge important information gaps,

including on valuation methodologies, that are hindering the extension of credit to viable companies. Conferences and business matching sessions were also held to connect financial institutions with the industry players. A number of financial institutions on their part have also embarked on capacity building initiatives through in-house training programmes and partnering with businesses involved in the industry, such as solar panel producers, in engaging potential clients.

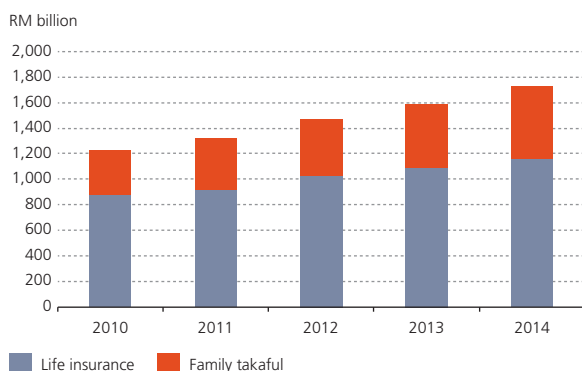
Beyond capacity building, changes are also needed in how financial institutions approach the provision of financing to the new growth areas. Credit decisions that are based on a deeper understanding of the borrower's business prospects and value beyond tangible assets would better facilitate access to financing for borrowers in these new growth areas. For businesses with incomplete credit histories or delayed income streams, alternative forms of financing such as factoring and leasing, and structured trade financing could be pursued. The establishment of dedicated advisory units to provide research and development services in the targeted sectors would also support the long-term growth of financial institutions in these new areas of growth.

STRENGTHENING THE INSURANCE AND TAKAFUL INDUSTRY

The insurance and takaful industry continued to play an important role in meeting the savings and protection needs of Malaysian households and businesses. During the year, total payments made by the life insurance and family takaful sector for death, disability and medical claims increased by 16.6% to RM5.0 billion (2013: RM4.3 billion). The industry also paid RM10.2 billion (2013: RM9.8 billion) in maturity benefits and cash surrender values, representing an increase of 3.8% from 2013. As at end-2014, life insurers and family takaful operators provided coverage amounting to RM1.7 trillion (2013: RM1.6 trillion) in sum insured/sum participated for all policies, or 161.8% of gross domestic product (GDP). This translates to a sum insured/sum participated per capita of over RM56,995. While the insurance penetration rate, as measured by the number of policies per population, has increased significantly over the past decade to 55.5% (2004: 42.6%), there remains a significant gap in protection, with many Malaysians either not having any form of life insurance protection,

Chart 2.2

Life Insurance and Family Takaful: Sum Insured and Sum Participated in Force*



*Excludes reinsurance and retakaful

Source: Bank Negara Malaysia

or having less insurance than they actually need. According to a survey published by the Life Insurance Association of Malaysia and Universiti Kebangsaan Malaysia in 2013, the average protection gap ranges between RM553,000 for families whose primary wage earner has some form of life insurance, to RM723,000 for families without any form of life insurance taken by the primary wage earner. This underscores the opportunity for further growth of life insurance and family takaful in meeting this need. For the general insurance and takaful sector, a total of RM8.6 billion was paid by the industry in 2014 for claims related to bodily injury, loss and damage of property, business interruption and third party liability. This translates to an average of RM23.5 million in claims paid a day.

Life Insurance and Family Takaful Framework

In November 2013, the Bank published a concept paper on the Life Insurance and Family Takaful (LIFE) Framework, setting out a package of reforms aimed at raising the efficiency and effectiveness of delivery channels and promoting greater product innovation. Extensive engagements with the industry and other stakeholder groups followed during the year. The proposals were generally well-received but there were some concerns raised that the removal of operating limits on agency remuneration and management expenses could ultimately reduce competition in the market and the range of product advice that consumers receive as the largest companies aggressively bid up commissions to attract agents to sell their products. Some insurers also highlighted that

the proposed minimum allocation rates, designed to preserve value to policyholders, could render existing products difficult to sustain over the long term. While these are valid concerns, the Bank views that these are mainly transitioning issues that could be overcome. The implementation of the complete package of reforms will create the preconditions for market competition and for the evolution of new products with superior value propositions. As part of the transition process and to minimise potential disruptions to the provision of products and services to consumers, the Bank will be implementing the LIFE Framework in a phased manner beginning with the following measures in 2015:

- The implementation of direct channels and product aggregators to enable consumers to compare products across different providers and purchase life insurance or family takaful products through direct channels such as the Internet. This will be implemented along with safeguards that will be put in place to promote informed decision-making;
- Revision of the regulatory framework on financial advisers to accord greater operational flexibility and to enhance the list of recognised qualifications for financial advisers;
- Removal of agency financing scheme limits and aligning the cost structures between bancassurance/bancatakaful and corporate agents for non-investment linked products other than the pure protection products to widen the delivery channels for insurance and takaful products; and
- Introducing a balanced scorecard for all intermediaries to drive increased professionalism and service quality, and to ensure that consumer needs for advice and information are effectively met.

The Life Insurance and Family Takaful Framework will be implemented in a phased manner beginning 2015

These measures will be followed by the liberalisation of commission structures for investment-linked products, including the introduction of minimum allocation rates. This is expected to spur the innovation of a wider range of products and delivery channels that can better suit the diverse consumer needs based on individual risk appetites, financial goals and levels of financial literacy.

Transitioning towards a managed market-based pricing environment in 2016

The implementation of initiatives under the New Motor Cover Framework (the Framework) has seen marked improvements in the claims settlement process within the motor insurance sector. During the year, the Accident Assist Call Centre, a 24-hour hotline introduced in 2013 to aid the general public involved in road accidents, handled 6,248 calls relating to motor accidents and road emergencies. The widespread dissemination of leaflets and motor claims guides at hospitals, police stations and post offices have also guided vehicle owners and victims of motor accidents through important steps that should be taken to expedite claims and protect against unscrupulous parties seeking to take advantage of the circumstances faced. As a result of the initiatives under the Framework, the time taken to settle a third party bodily injury claim continued to improve significantly as at the first half of 2014, reducing further by an average of 39 days compared to the same period in 2013. Since its establishment in 2007, measures introduced by the Vehicle Theft Reduction Council of Malaysia have also contributed to a reduction in the incidence of vehicle thefts. The number of thefts in 2014 reduced by 19.9% compared to 2013, equivalent to an estimated lower claims paid for theft losses of about RM125 million.

Improvements in the motor claims settlement process as a result of the implementation of initiatives under the New Motor Cover Framework

To enhance insurers' and takaful operators' claims and underwriting processes, ISM Insurance Services Malaysia Berhad is working towards the establishment of the Fraud Intelligence System (FIS). This will be instrumental in delivering savings, and ultimately lower premiums, by reducing the losses incurred annually due to fraudulent claims, estimated at about RM760 million a year. The FIS will initially cover the motor sector before being extended to all lines of insurance and takaful business.

These developments pave the way for plans to gradually abolish tariffs in the motor sector to proceed in 2016. Such a move will result in premiums that are more reflective of risks, with policy owners who demonstrate better risk profiles enjoying lower premiums compared

to higher risk groups. To ensure that motor insurance cover remains affordable and to facilitate an orderly transition to a more liberalised environment, premiums will initially be allowed to adjust within specified bands. A detailed roadmap setting out the approach that will be taken towards full market-based pricing will be announced in 2015.

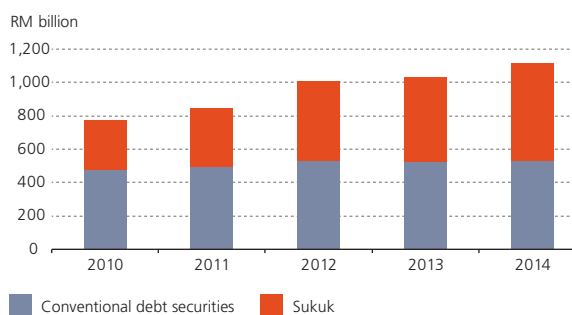
As part of this transition, a third round of motor premium adjustments was undertaken on 15 February 2014 under the Framework. Adjustments similar to the previous rounds were made to premiums for only three vehicle classes – private cars, motorcycles and express buses. Premium rates for other vehicle classes remain unchanged as prices already broadly reflect the claims experience. A final round of premium adjustments will take place in 2015.

DEVELOPING DEEP AND VIBRANT FINANCIAL MARKETS

The domestic financial markets continued to develop as an important avenue for fund raising, investment and risk management activities. In 2014, the total outstanding debt securities expanded by 8.2% to RM1,117.0 billion (2013: RM1,032.5 billion), with the nominal value of new issuances amounting to RM505.9 billion (2013: RM501.2 billion). The Malaysian debt securities market remained the largest in Southeast Asia, at 104.4% of GDP. A key highlight during the year was the issuance of a 3-year RMB1.5 billion bond by Cagamas Berhad in September 2014, which attracted a strong order with a bid-to-cover ratio of over three times and a fixed coupon rate of 3.7% per annum. The landmark issuance, which carries

Chart 2.3

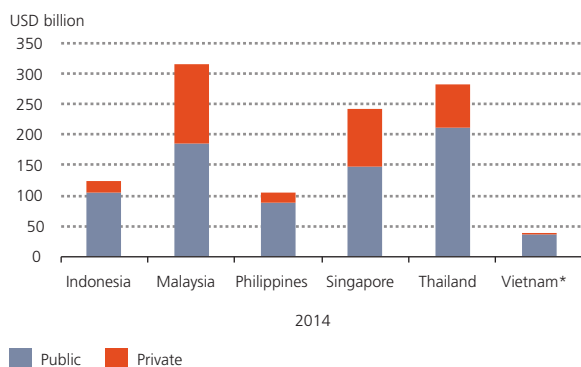
Outstanding Debt Securities (Public and Private)



Source: Bank Negara Malaysia

Chart 2.4

ASEAN Outstanding Local Currency Debt Securities Market



* As at September 2014

Source: Asian Bonds Online

the market name 'Tiger Emas Bond', represents the largest renminbi bond by a Malaysian issuer during the year. This was also the first renminbi and non-ringgit denominated bond to be settled via Malaysia's Real-time Electronic Transfer of Funds and Securities System (RENTAS), affirming the capacity of RENTAS in supporting the issuance and depository of foreign currency bonds in the international markets.

The foreign exchange market also experienced robust growth in 2014, with the average daily turnover of

foreign exchange transactions increasing by 13.5% to USD11.8 billion (2013: USD10.4 billion). To further modernise the financial market infrastructure, the Bank granted approval to a foreign electronic money-broker to provide an electronic matching platform for the interbank foreign exchange market. The introduction of a foreign electronic money-broker forms part of Malaysia's ongoing liberalisation of the foreign exchange market and is expected to accelerate the development of electronic channels that will extend efficiency gains and opportunities beyond the interbank market to other intermediaries and end-users.

In tandem with the increase in intra-regional trade and investment activities, initiatives to facilitate the wider use of regional currencies were intensified. Among the key highlights during the year were:

(i) Operationalisation of a Renminbi Deposit and Investment Facility

The Renminbi Deposit and Investment Facility (RDIF) is part of the Renminbi Liquidity Facility offered by the Bank to enhance the liquidity of the renminbi in the domestic market. The RDIF provides an alternative avenue for financial institutions to place surplus renminbi funds with the Bank. As at end-2014, onshore financial institutions have placed a total of RMB3.5 billion with the Bank via RDIF. Opportunities exist for

Enhancement of Kuala Lumpur Interbank Offered Rate (KLIBOR) Standards

In light of the recent global reforms on financial benchmarks including the introduction of the International Organisation of Securities Commissions' (IOSCO) Principles of Financial Benchmarks, the Bank conducted a review of the KLIBOR Rate Setting Standards (the Standards) to further improve the effectiveness of KLIBOR in terms of governance, oversight, accountability and transparency. Arising from the review, the Bank introduced the following enhancements to the KLIBOR framework:

- Contingency procedures in the event of market or operational disruptions;
- Strengthened arrangements to be instituted on KLIBOR submitters to address conflicts of interest, training and whistle-blowing;
- Procedures for handling complaints addressed to the Bank by parties of interest;
- Establishment of a hierarchy of data input that guides the submissions;
- Periodical reporting by KLIBOR submitters for purposes of monitoring compliance with the Standards; and
- Establishment of a consultative committee to provide expert advice on the robustness of the rate-setting process.

These enhancements bring the Standards into alignment with the IOSCO Principles on Financial Benchmarks which represent an overarching framework for benchmark reforms as endorsed by the Financial Stability Board. The proposed enhancements were published in a concept paper issued by the Bank on 19 November 2014 and is expected to be finalised by the first quarter of 2015.

onshore financial institutions to further utilise the RDIF, particularly in managing their shorter-term liquidity. As such, this facility provides the catalyst to increase offerings of renminbi investment products such as renminbi deposits onshore.

(ii) Appointment of a designated renminbi clearing bank

Following the Memorandum of Understanding signed with the People's Bank of China on 10 November 2014, Bank of China Malaysia Berhad was subsequently appointed as the renminbi clearing bank for Malaysia on 5 January 2015. This marked another meaningful collaboration with the People's Bank of China in developing Malaysia's financial infrastructure to facilitate the use of local currencies for trade and investment flows between the two countries. With direct access to Chinese financial markets, the renminbi clearing bank will enable Malaysian financial institutions to source renminbi funds directly from the onshore Chinese financial market at competitive rates. With the majority of renminbi clearing banks currently located in advanced economies, the designation of a renminbi clearing bank for Malaysia – the first for an emerging economy in Asia outside China – is an important development in providing another viable option for firms and financial institutions in the ASEAN region to manage their renminbi transactions more effectively going forward.

Initiatives to facilitate the wider use of regional currencies were intensified

Another important development during the year was the enactment of the Netting of Financial Agreements Bill 2014 (NFA) in December 2014 which provides legal assurance for the enforceability of netting arrangements under the most commonly used financial agreements in Malaysia. The NFA, which comes into force in 2015, secures Malaysia's status as a 'netting-friendly jurisdiction' and reinforces the contractual rights and obligations of counterparties under qualified financial

agreements. These financial agreements include the International Swap and Derivatives Association (ISDA) Master Agreement, Global Master Repurchase Agreement and International Securities Lending Agreement that govern the over-the-counter derivatives, repurchase agreements, and securities sell-buy back as well as securities borrowing and lending transactions for unlisted debt securities.

Although close-out netting has a critical role in reducing systemic risks, it is recognised that in times of crises, the ability of resolution authorities to effectively implement resolution strategies can be substantially undermined by counterparty actions to enforce close-out netting. Consistent with the Key Attributes of Effective Resolution Regimes for Financial Institutions issued by the Financial Stability Board, the enforcement of netting arrangements under the NFA will therefore be subject to a temporary stay to facilitate the orderly resolution of financial institutions under such a stress scenario. This is also in line with the global efforts, led by ISDA, to incorporate a temporary stay within contractual arrangements to facilitate the cross-border application of resolution requirements. Under the NFA, the Minister is empowered to prescribe a period of temporary stay based on the recommendation of the relevant authorities responsible for the resolution of financial institutions to ensure consistent implementation across regulated institutions. The Minister also has the necessary powers to deal with future legislative or market developments that may give rise to uncertainty in the enforceability of netting arrangements.

Enactment of the Netting of Financial Agreements Bill 2014 secures Malaysia's status as a 'netting-friendly jurisdiction'

The enactment of the NFA and international recognition of Malaysia as a 'netting-friendly jurisdiction' will further contribute to the growth and development of the Malaysian derivatives market, by enhancing market liquidity and lowering costs for the introduction of a wider range of instruments for risk management.

ADVANCING THE FINANCIAL INCLUSION AGENDA

The Bank continued to accord high priority to advancing the financial inclusion agenda. In order to track the progress of financial inclusion initiatives, the Bank has implemented a systematic monitoring framework based on the following four broad dimensions:

- ‘Convenient accessibility’ measures the availability of financial access points in each sub-district in the country;
- ‘Take-up rate’ measures the population’s access to financial products and services;
- ‘Responsible usage’ measures the level of utilisation or activity of the financial products and services provided; and
- ‘Satisfaction level’ measures the quality and efficiency of financial products and services offered based on consumers’ satisfaction.

The implementation of the systematic financial inclusion monitoring framework is in line with the intended objectives of the Maya Declaration and Sasana Accord. The Maya Declaration, which was launched in 2011, is the first measurable set of commitments made by Alliance for Financial Inclusion (AFI) member countries to reach the world’s 2.5 billion unbanked people through greater financial inclusion. To further strengthen the effectiveness of the commitments, the AFI network adopted the Sasana Accord in 2013, under which AFI members will commit to quantifiable national goals and measure their progress through the AFI Core Set of Financial Inclusion Indicators.

The Bank also rolled out the second financial inclusion demand-side survey in January 2015 to assess the effectiveness of the initiatives launched since the first survey conducted in 2011. The outcome of the survey will continue to be used as important input in setting the Bank’s financial inclusion priorities moving forward. With deeper insights from the survey into the population’s evolving financial requirements and access to financial services, a more targeted approach in policy development and implementation can be achieved.

In widening the outreach of financial services, the Agent Banking Framework continued to be expanded. Several financial institutions launched agent banking initiatives during the year with the participation of retail outlets and

farmers’ organisations. The range of services offered through agent banking has also broadened, with a development financial institution now allowing customers to open bank accounts through its agents. As at end-2014, 95% of 872 sub-districts (*mukims*) that represent a population of more than 2,000 or State Legislative Assembly districts (*Dewan Undangan Negeri*, DUNs) in Sabah have a banking presence (2011: 46%). Agent banking represents the only bank presence in 53% of these *mukims*/DUNs. As a result, 99% of the population in Malaysia currently has access to banking services, either through a bank branch, an agent or both. At the same time, 92% of the adult population in Malaysia has at least one deposit account, of which 90% are active accounts with regular deposits and withdrawals. The benefits of the framework are also evident to financial consumers. Some communities, which previously had to travel up to 140 kilometres to the nearest bank branch, now enjoy access to financial services located within walking distance. In some instances, this has resulted in savings in terms of transportation costs of up to RM100 per trip to reach a bank branch, as well as travelling time of up to three hours. Rural communities also enjoy longer hours of access to financial services as the transactions are conducted during the agent’s operating hours, which typically extend beyond the normal operating hours of bank branches.

More agent banks launched with a broader range of services provided

Microfinancing schemes, through which the financial sector can provide financing support to micro enterprises, continued to grow albeit at a more moderate pace in recent years. Total outstanding financing extended under the *Skim Pembiayaan Mikro* was RM863.2 million as at end-2014, benefitting borrowers through more than 66,000 accounts. A total of RM2.7 billion had been approved to more than 168,000 micro-enterprise accounts since the scheme’s inception in 2006. The slower growth in financing extended under the *Skim Pembiayaan Mikro* in recent years has been mainly the result of an increase in alternative avenues provided by various government agencies for micro enterprises to obtain funding. A number of participating banks

and development financial institutions were also recording a higher incidence of impaired financing. Some participating financial institutions have taken proactive steps to review their existing monitoring mechanisms to allow for earlier interventions appropriate to the nature of these borrowers to avoid defaults. This has included providing advisory services to micro borrowers. During the year, a scheme with flexible repayment terms was also launched to meet the needs of micro enterprises with irregular or seasonal income streams. A pilot programme will be launched by a development financial institution in 2015 to promote prudent financial management among the lower income households. Under this programme, account holders will commit small amounts of savings over a certain period of time and enjoy favourable returns while continuing to have access to the funds in the event of emergencies. It is envisaged that such products will inculcate a regular savings habit and lead to an increase in standards of living among lower income segments. In addressing the protection needs of the low income and underserved segments, affordable insurance and takaful products are being piloted by several insurers and takaful operators. Banking agents and post offices are also being explored as potential avenues for distributing these products due to their wide outreach. The Bank will issue a framework on microinsurance and microtakaful products in 2015, taking into account the experience of these pilot schemes. The framework will seek to ensure a facilitative regulatory environment for affordable yet commercially sustainable microinsurance and microtakaful products.

On the international front, the Bank continued to be a strong advocate of inclusive financial development. In recognition of this role, Malaysia won the bid to host the headquarters of the AFI, a global network of policymakers from more than 100 countries. This will further expand opportunities for Malaysia to play a strategic role in deepening cross-border cooperation in the areas of central banking and finance. Work is also underway to establish the Global Financial Inclusion Knowledge Exchange as a central repository for policymakers involved in financial inclusion.

The Bank's active contribution to the global financial inclusion agenda includes the collaborative development of the Core Set Indicators (Indicators) and the Financial Inclusion Index (Index) under

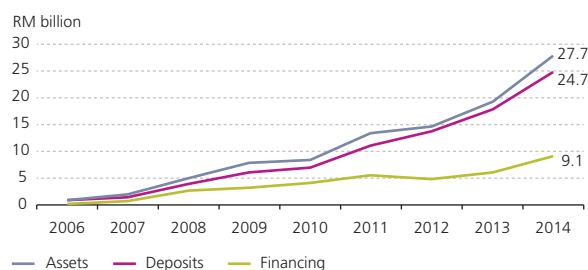
the AFI Financial Inclusion Data Working Group to track the progress of financial inclusion in different countries. The development of the Indicators and Index is based on the methodology and framework developed internally by the Bank to measure the level of financial inclusion domestically. The Bank also contributed towards the development of policy papers which were endorsed by international standard-setting bodies, including the Bank for International Settlements, on various financial inclusion issues such as the impact of global standards on financial inclusion, consumer empowerment and market conduct practices, public-private engagements as well as improving access to finance for SMEs. The Bank, in partnership with AFI, has also organised capacity building programmes which benefitted 132 policymakers from 46 countries in areas that support the financial inclusion agenda.

MALAYSIA AS AN INTERNATIONAL ISLAMIC FINANCE MARKETPLACE

The Islamic finance marketplace continued its growth momentum during the year supported by several new initiatives aimed at enhancing the vibrancy of the marketplace. The Islamic banking sector recorded a growth of 12.0% in 2014 to account for 25.6% of the total assets of the overall banking system. Foreign currency assets in the sector also increased to RM27.7 billion, reflecting the growing importance of cross-border transactions in Islamic finance (2013: RM19.3 billion). During the year, three conventional banks commenced their Islamic banking window and international currency business unit operations, increasing the diversity and competitiveness of the marketplace. The classification of investment accounts as distinct

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

from Islamic deposits under the Islamic Financial Services Act 2013 (IFSA) also further strengthened the growth potential of the sector through a wider range of products to meet the diverse needs of consumers. Following this, the Bank issued the Investment Account Framework to facilitate the orderly development and operationalisation of investment accounts as a new Shariah-compliant asset class and source of funding. Details of the investment accounts are further elaborated under the box article on 'Investment Accounts under IFSA'.

The Investment Account Framework will facilitate the orderly development and operationalisation of investment accounts as a new Shariah-compliant asset class and source of funding

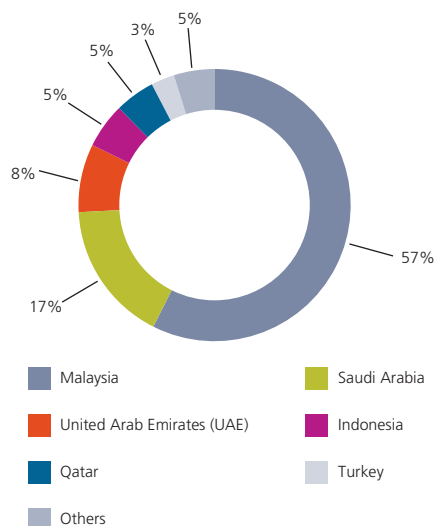
In the takaful sector, the total assets of takaful funds increased to RM22.7 billion as at end-2014 (2013: RM20.9 billion) while the total net takaful contributions accounted for 13.3% of the total net premiums and contributions in the insurance and takaful sectors.

Malaysia also continued to be the preferred destination for the issuance of sukuk by corporations and international organisations. In 2014, 65.6% of new global issuances of sukuk, amounting to USD77.9 billion, was originated in Malaysia. Latest available data places the share of all global outstanding sukuk which originated in Malaysia at just over 57%. Five foreign currency-denominated sukuk were accorded the 'Emas' status in 2014, bringing the total number of 'Emas' sukuk to 18 since 2009. Of significance, the year saw the first Japanese yen-denominated sukuk issued in Malaysia, further reinforcing Malaysia as the destination for multi-currency sukuk issuance.

During the year, several Malaysian banks were appointed as joint lead managers to facilitate the issuance of sukuk by international organisations and the governments of Hong Kong SAR, Indonesia, Turkey and the United Kingdom. Bursa Malaysia was also selected as one of the listing platforms for the trading of the sukuk issued by the Government of Hong Kong SAR. Reflecting the increased cross-border demand for sukuk,

Chart 2.6

Total Outstanding Sukuk Globally in 2014



Source: Islamic Finance Information Service, Zawya, Bloomberg, Kuwait Finance House Research

Malaysian Government Investment Issues (GII) will be included in the Barclays Global Aggregate, Asian Pacific Aggregate and EM Local Currency Government indices starting 31 March 2015. The inclusion would enable the GII to be marketed to a larger international investor base. To further widen the outreach of Islamic finance globally, the Bank launched the digital Global Conversations platform in September 2014. The digital platform comprised a series of Twitter hashtags and a MYIF mobile application that provides information on the latest developments, insights and deal flows emanating from Malaysia's Islamic finance marketplace and around the world. In particular, the hashtag #YnotIF (which stands for 'Why Not Islamic Finance') was introduced to raise awareness and promote Islamic finance to the global financial community.

REGIONAL AND INTERNATIONAL DEVELOPMENTS

Within the ASEAN region, significant strides in deepening financial integration have been achieved in realising the vision of a single market for goods and services under the ASEAN Economic Community. The conclusion of the Sixth Package of Financial Sector Commitments, expected in the first quarter of 2015, marks the most meaningful step in financial services liberalisation to date under the ASEAN Framework Agreement on Services. Under the Sixth Package, ASEAN

Investment Accounts under IFSA

Islamic finance, through its diverse spectrum of Shariah contracts, is well positioned to serve the real economy and fulfil the dynamic needs of customers. The introduction of investment accounts by Islamic banks is an important step forward in fulfilling this potential. These accounts offer new investment avenues that can cater to a wider range of investor risk-return preferences, thereby further contributing to the financing of entrepreneurship in the real economy. For Islamic banks, investment accounts will open up opportunities to tap new sources of funding that can be efficiently channelled to productive activities through the broader application of Shariah contracts such as equity-based contracts. This in turn will broaden the financial intermediary role of Islamic banks in promoting economic growth and development.

This article provides an overview of the key concepts and features of investment accounts, the implications for customers and Islamic banks, and steps taken by the Islamic banking industry to provide an efficient mechanism for delivering investment account products in the market.

Investment Account as a New Product Offering for Customers

The clear distinction between investment and deposit accounts under the Islamic Financial Services Act 2013 (IFSA) paves the way for the accelerated growth of investment accounts as a distinct Shariah-compliant asset class and source of funding for Islamic banks. Customers with higher risk appetites will have the option of placing their surplus funds in investment account. Unlike Islamic deposits which can be withdrawn on demand and guaranteed by Perbadanan Insurans Deposit Malaysia (PIDM), clients of investment accounts are able to retain funds for a longer period of time and enjoy the opportunity to earn more returns but with more restrictive withdrawal conditions.

Investment accounts can be structured with different risk and return profiles that vary in accordance with the characteristics of the underlying assets. The funds sourced for these accounts can be directed to diverse forms of financing that extend beyond debt-based to include equity-based financing, as well as funding to viable ventures under a broader set of credit criteria (e.g. higher concentration limits) that are aligned with the risk-absorbing features of investment accounts. In terms of asset types, the funds can be channelled to a targeted asset such as trade financing to an individual exporter, or a portfolio of assets such as financing for a group of small and medium enterprises.

Investment accounts are an additional avenue, complementing private equity and venture capital funds, for businesses to access financing. The level of returns generated depends on the performance of the underlying asset, with possible upside potential in returns to customers generated from equity-based financing structures as well as more efficient capital and liquidity management strategies by Islamic banks. The form of the returns on investment accounts is governed by the types of Shariah contract adopted. These contracts generally fall under the following categories:

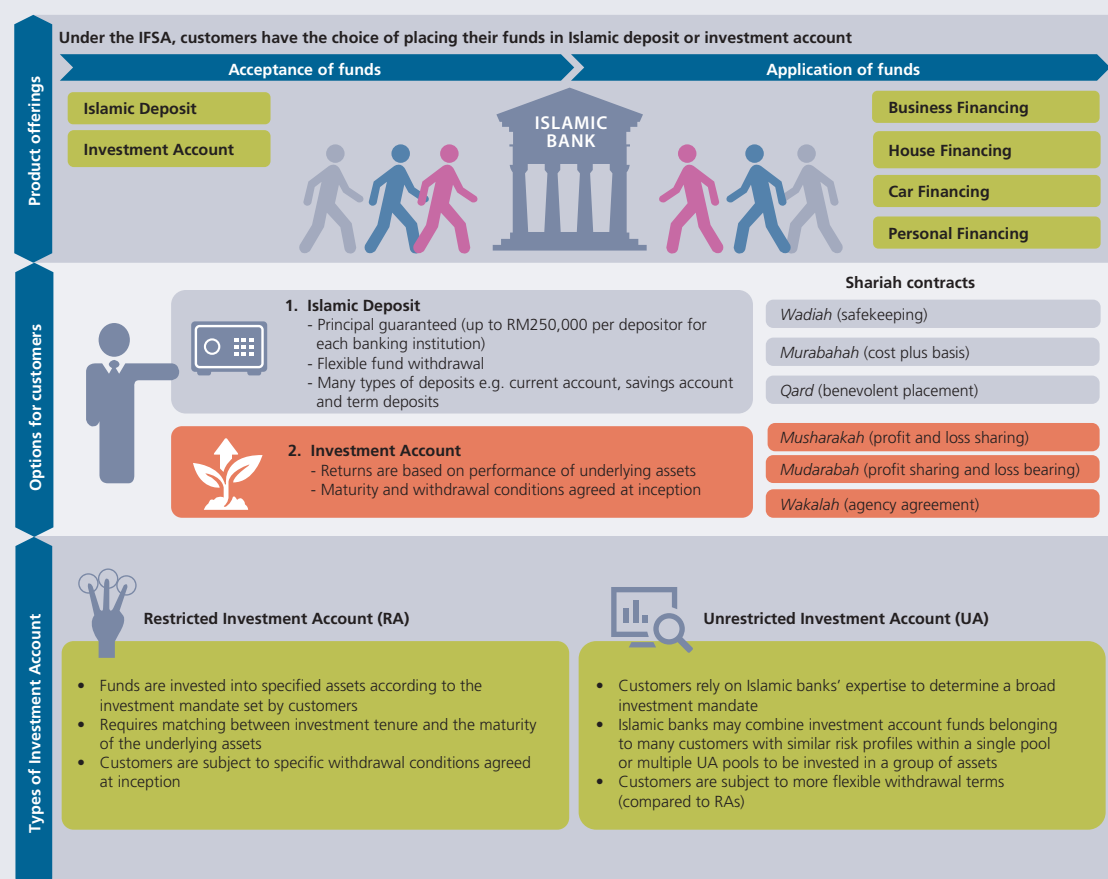
- *Musharakah* (profit and loss sharing) contracts - where profits are shared between the customer and the Islamic bank according to an agreed ratio and losses are borne based on proportion of capital contributed;
- *Mudarabah* (profit sharing and loss bearing) contracts - where profits are shared between the customer and the Islamic bank according to an agreed profit ratio and losses are fully borne by the customers as the sole capital providers; or
- *Wakalah* (agency) contracts - where profits are returned to the customers after payment of agency fees (imposed upon placement of principal or generation of returns) and performance fees when returns outperform an agreed benchmark.

Two main types of investment accounts are offered by Islamic banks in Malaysia: restricted and unrestricted investment accounts. Restricted investment accounts (RA) enable customers to specify the investment mandate and the underlying assets that their funds may be invested in. Consistent with the

more restrictive investment parameters, the maturity of a RA must match the tenure of the specified underlying assets with more restrictions imposed on the ability of account holders to withdraw their funds before maturity. Unrestricted investment accounts (UA), on the other hand, allow Islamic banks to determine the investment mandate and the structure of the investment account, which may include combining different UAs into pools of funds that invest in diversified portfolios of underlying assets, in exchange for more flexible withdrawal conditions. While investment accounts can be tailored to meet a diverse range of customer needs and preferences, they do not enjoy the guarantee of principal by PIDM. Under the IFSA, these important distinctions between UAs, RAs and deposit accounts must be reflected in an Islamic bank's operations as well as in its dealings with customers. Diagram 1 illustrates the key product offerings by Islamic banks.

Diagram 1

Main Product Offerings by Islamic Banks



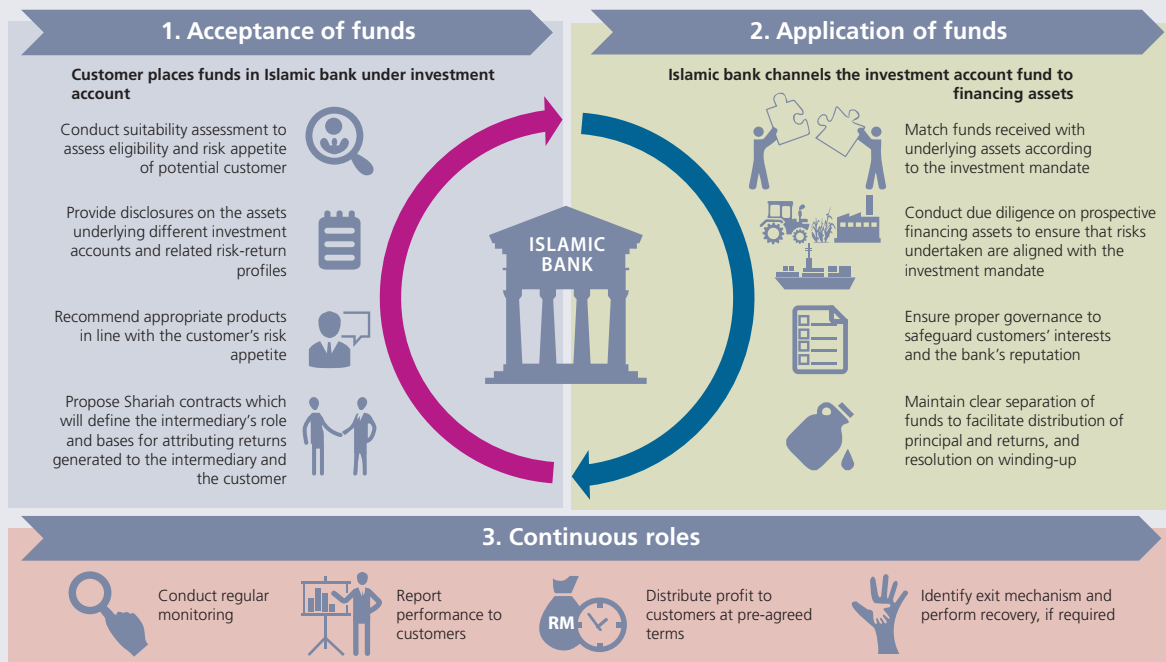
Operationalisation of Investment Accounts by Islamic Banks

The operationalisation of investment accounts is governed by the policy document on investment accounts which was issued by the Bank in March 2014. The document sets out the capital adequacy and liquidity requirements for investment accounts that reflect their risk-absorbing characteristics, additional disclosure requirements commensurate with the risks assumed by account holders, and responsibilities of Islamic banks to manage the investments in accordance with sound investment principles. The IFSA further safeguards the interests of investment account holders by according priority to the claims of account holders on the underlying assets funded

by investment accounts in the event of a winding-up procedure. Specifically, the Act provides that the assets underlying investment accounts shall be ring-fenced for the purpose of meeting the claims of investment account holders. An overview on the operationalisation of investment accounts is provided in Diagram 2.

Diagram 2

Intermediation Functions of Islamic Banks in Operationalising an Investment Account



Investment Account Platform to Enable the Efficient Delivery of Investment Account Offerings

A key strategy to achieve critical mass and provide the widest possible coverage of prospective investment ventures and sponsoring institutions is to leverage on shared infrastructure for the delivery of investment account offerings. This would significantly reduce initial investment costs that would otherwise be incurred by individual Islamic banks, while laying the groundwork for further efficiency gains to be reaped in future. The Investment Account Platform, which will be developed by the industry, will serve as a centralised multi-bank platform that will allow customers to view and choose from a wide range of ventures sponsored by different Islamic banks for the customers to invest and track their investments. The platform, which will operate on a secured infrastructure similar to internet and mobile banking, will have the following innovative features:

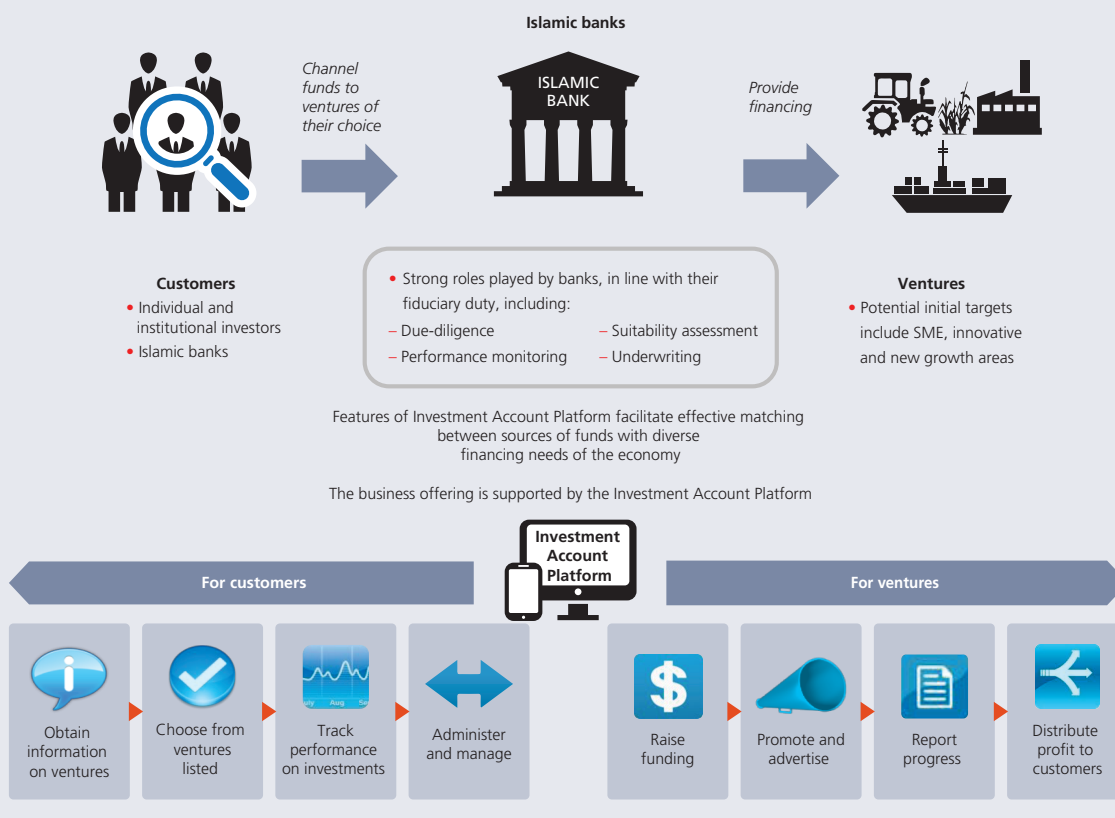
- Wide choice of viable ventures – The ventures listed on the platform will be subject to prior assessment and screening for viability by the sponsoring Islamic bank. All ventures listed will be Shariah-compliant.
- Control over the quality and coverage of important information for decision-making – Each venture listed will be accompanied by important information provided to customers which must comply with minimum disclosure standards covering the description of the venture, the terms of financing (such as the tenure and profit-sharing ratio), the estimated profit rate and the risk level of the venture as categorised by the sponsoring bank.
- Ease of transactions – Customers will be able to specify their preferences in relation to the types of ventures which they wish to invest in, based on factors such as the underlying industry, geographical location, risk level and tenure of financing. Customers can also filter investment ventures based on their selection of the sponsoring Islamic banks.

- Suitability assessment – The sponsoring bank will assess the suitability of investment in a particular venture in relation to the risk appetite and financial position of the customer. However, the decision remains with the customer on whether to proceed with the investment. Customers who choose to pursue an investment that is inconsistent with the sponsoring bank’s suitability assessment will be appropriately warned of the risks.
- Regular monitoring – Customers will be provided with a performance report on the progress of the venture at least twice a year. The report will also include an assessment by the sponsoring bank on the potential emerging risks associated with the venture.

The Investment Account Platform will be administered by an entity established by the Islamic banking players. The entity will be responsible to coordinate and manage the listing of investment ventures and sponsoring Islamic banks on the platform. Individual sponsoring Islamic banks that leverage on the platform will retain all fiduciary responsibilities to investment account holders in connection with the ventures financed through investment accounts that are offered under the platform. Diagram 3 illustrates the broad mechanics of the Investment Account Platform.

Diagram 3

Broad Mechanics of Investment Account Platform



The platform will be integrated with the existing payment infrastructure and the I.T. systems of the Islamic banks to facilitate the transfer of funds from customers at the inception of the financing and the payment of principal and any profit generated at the end of the financing period. An important distinguishing feature of the platform compared with other platforms, such as crowd-sourced funding, is the involvement of banks as a financial intermediary in the transactions.

The platform is envisaged to expand opportunities for consumers to participate on a risk-sharing basis, with greater confidence in financing entrepreneurship and other economic activities. Over a longer duration, the success of the platform could entail inclusion of multi-currency financing for ventures outside Malaysia.

The effective implementation of investment accounts, supported by the Investment Account Platform, represents another strategic initiative to propel Islamic finance in supporting real economic activity. This is achieved through the wider expansion of innovative financing structures with a central role played by Islamic banks.

countries made market access offers across all modes of supply covering the banking, insurance and capital market sub-sectors. These include the areas of new licences, further sub-branching flexibilities for banks, higher foreign equity limits and greater movement of professional expatriates in the financial sector. Collectively, these offers will provide more access and certainty for the operations and investments of financial institutions in ASEAN. For Malaysia, the new offers are in line with Malaysia's current financial sector policies, particularly with respect to the insurance and capital market sectors. These include liberalising the entry requirements for direct insurers and reinsurers, fostering the development and integration of regional capital markets through the liberalisation of foreign equity limits in stockbroking companies and expanding the talent pool through the employment of expatriates in specialised areas.

Together with this Sixth Package, a significant milestone achieved is the conclusion of the ASEAN Banking Integration Framework (ABIF), a pragmatic approach that will enable deeper regional banking integration via mutually beneficial bilateral arrangements that take into account each member country's level of readiness. The immediate objective of ABIF is to achieve a more integrated banking market, spearheaded by Qualified ASEAN Banks (QABs) that have a meaningful presence across ASEAN countries. ABIF is built on principles which accord priority to the outcome of promoting greater regional economic growth, and emphasise inclusiveness, transparency and reciprocity taking into account the readiness of individual member countries to pursue greater liberalisation of their financial sectors.

Under ABIF, QABs that have the capacity and that are well-managed will serve as regional standard bearers. These QABs will be accorded greater access and flexibilities to expand into regional markets. Based on the assessment of reciprocal benefits to home and host countries, ABIF will accelerate opportunities for ASEAN banks to have a larger role in facilitating intra-regional trade and investment through the effective intermediation of cross-border financial flows in the region. With the implementation of ABIF, regulatory and supervisory arrangements will also be strengthened to ensure that regional financial stability is preserved.

On 31 December 2014, the Bank, Bank Indonesia and Otoritas Jasa Keuangan signed a Heads of Agreement as a precursor to the conclusion of ABIF. The Heads of Agreement identifies agreed measures between authorities in Indonesia and Malaysia on market access and operational flexibilities that will be accorded to the banking institutions that are established as QABs in the respective jurisdictions. In demonstrating the bilateral process which is an integral component of ABIF, the Heads of Agreement is expected to chart a path for the operationalisation of other future bilateral arrangements under ABIF.

The conclusion of the ASEAN Banking Integration Framework will pave the way for a more integrated banking market within the ASEAN region

Under Malaysia's Chairmanship of ASEAN in 2015, alongside deepening financial integration, promoting financial inclusion will also be a priority to enable ASEAN consumers to benefit from the fruits of financial integration. This will be done in collaboration with specialised agencies such as the AFI. The Bank will also continue to actively engage various national and regional stakeholders to further strengthen capacity building initiatives in the region to support the realisation of ASEAN's growth potential.

During the year, Malaysia underwent the Global Forum on Transparency and Exchange of Information for Tax Purposes Phase 2 Peer Review, which assesses the practical implementation of the global standard on exchange of information. Malaysia was given an overall rating of 'Largely Compliant'. Moving forward, Malaysia will adopt the global standard on automatic exchange of information for tax purposes by 2018, subject to the completion of necessary legislative procedures. This further signifies Malaysia's commitment to stronger international collaboration in combating tax evasion to ensure the integrity of the financial system is safeguarded.

CONTINUED DEVELOPMENT OF HUMAN CAPITAL

During the year, the Bank continued to collaborate with the financial services industry to evolve a holistic talent development infrastructure with the aim of securing a sustainable talent pipeline for the financial industry, with higher levels of professional standards.

Holistic talent development infrastructure to secure a sustainable talent pipeline for the financial industry with higher levels of professional standards

A number of key initiatives were undertaken in 2014:

(i) Establishment of the Financial Services Talent Council

To provide strategic direction on financial sector talent development, the Bank in July 2014 established the Financial Services Talent Council (Council). The establishment of the Council, which was identified under the Financial Sector Blueprint 2011-2020, brings together individuals with breadth and depth of experience from across the financial services industry and academia. Based on the future talent demands of the Malaysian financial sector, the Council aims to identify strategies to further develop, attract, retain and deploy domestic and international talent to meet these demands. The immediate focus of the Council is on:

- Identifying and mapping skills shortages, the underlying trends driving talent demand and the key sources of talent supply; and
- Assessing the effectiveness of all training and development providers that support the up-skilling of the industry talent pool.

The Council's preliminary research and engagements have revealed some important observations as summarised in Table 2.1.

Moving forward, the Council will intensify its engagement with the industry, private sector and public sector, as well as education and training institutes. The feedback and assessment arising

from these sessions will form a basis for the Council's recommendations.

(ii) Establishment of the Financial Services Professional Board

The Financial Services Professional Board (Board) was formed by the industry in September 2014 with the support of the Bank and the Securities Commission to develop and advocate the adoption of high ethical and professional standards to strengthen confidence in the financial services industry domestically and internationally. The standards will extend across the banking, insurance, capital markets and Islamic finance sectors. The Board, which comprises prominent members with global experience in the financial services, law, accountancy and other related industries, will be able to offer valuable global perspectives that will lead to the formation of standards with universal applicability. With increasing focus on the practices in the financial industry globally, the Board's immediate focus is to develop a code of ethics for professionals in the industry.

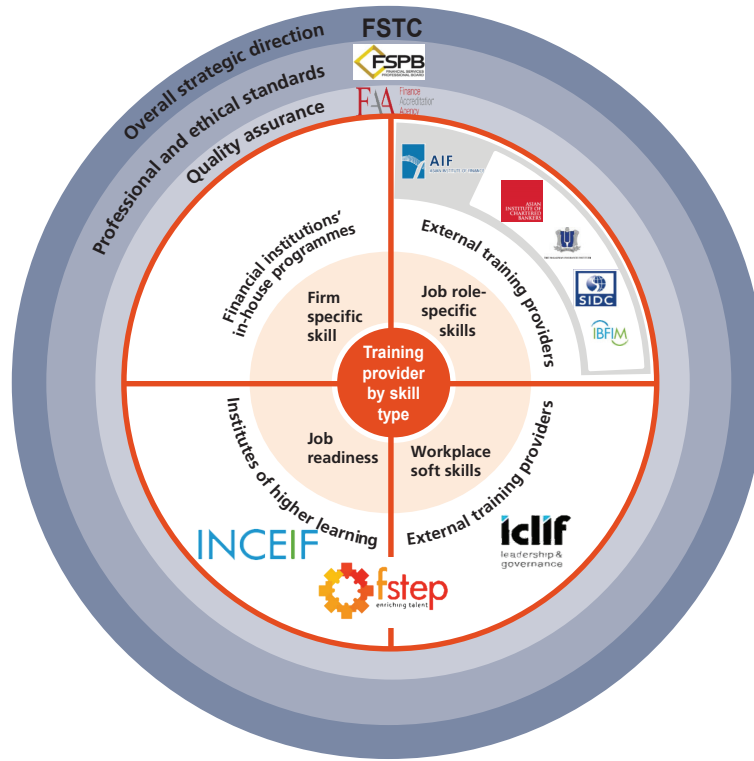
The Financial Services Professional Board was established to develop and advocate the adoption of high ethical and professional standards in the financial services industry

(iii) Finance Qualification Structure and FAA Learning Standards

The Finance Accreditation Agency (FAA) launched the Finance Qualification Structure (FQS) and FAA Learning Standards (FLS) in September 2014 to enhance the quality of talent and professional learning programmes in the financial services industry. The FQS seeks to harmonise and map professional qualifications relevant to financial practitioners into a single qualification framework, enabling comparability and mutual recognition of prior learning so that financial professionals can practice across jurisdictions through the use of one global set of standards. This is complemented by the FLS, which aims to promote minimum standards in designing, developing and delivering learning programmes, thereby raising

Diagram 2.1

Comprehensive Institutional Framework on Talent Development to Support Growth of the Financial Sector



	FSTC Financial Services Talent Council	Recommends strategies to develop, attract, retain and deploy domestic and international talent to meet the demand
	FSPB Financial Services Professional Board	Develops and advocates voluntary professional and ethical standards for the financial sector
	FA Finance Accreditation Agency	Responsible for quality assurance of learning initiatives, including programme, individual and institutional accreditation
	AIF Asian Institute of Finance	Enhances human capital development and talent management in the financial sector
	Asian Institute of Chartered Bankers	Professional educational body for the Malaysian banking and financial services industry
	The Malaysian Insurance Institute	Professional body and education institution for the Malaysian insurance and takaful industry
	SIDC Securities Industry Development Corporation	Provides capital markets education, training and information for ASEAN
	IBFIM	Islamic finance training and reference centre for industry and academia
	Iclif The Iclif Leadership and Governance Centre	Provides training for senior management in strategic and leadership management
	fstep Financial Sector Talent Enrichment Programme	Provides training for top graduates to acquire a foundation in the financial services industry
	INCEIF International Centre for Education in Islamic Finance	Builds Islamic finance talent and skills by offering both graduate and professional programmes

Source: Bank Negara Malaysia

Table 2.1

Key Observations

The job-readiness of graduates is important to the entry-level talent pipeline.

- A sizeable proportion of 65% of graduates hired into entry positions are not finance-related degree holders.
- Financial institutions are generally more concerned about job-readiness competencies than technical competencies at the entry level.

Financial institutions vary in the extent to which they rely on external training providers, in-house training or on-the-job experience.

- The financial institution's choice of combination between the types of training provider depends on the type and sophistication of the job skill that requires development.
- A majority of financial institutions indicate reliance on external training providers to provide basic training and required professional qualifications.
- Ongoing dialogue between external training providers and financial institutions is crucial to ensure that training programmes are up-to-date with up-skilling needs.

Job movements between financial institutions occurred primarily among relatively junior employees.

- Most of the resignations in 2013 involved employees with less than five years of experience moving within the domestic financial sector.
- Financial institutions face hiring cost pressures as a lack of experienced candidates is driving salary increases of 15-30% being offered to external hires, compared to internal yearly salary increases of about 5-6%.

The difficulty in hiring a suitable candidate increases from entry to senior level.

- The average time taken to fill vacancies across all levels is about 40 days, with responses ranging between five days to more than 100 days.
- The average time taken to fill vacancies is highest at the senior level followed by middle and entry level.
- Financial institutions need to ensure talent retention in critical skill areas. Institutions indicated that a key strategy employed is to continually engage employees on individual career development and succession planning.

Top 10 Areas Expected To Experience Shortage Over The Next Five Years

Banking

- Shariah Unit
- Treasury
- Corporate Banking
- Legal and Compliance
- Commercial Banking
- Transaction Banking
- Credit Risk
- Investment Banking
- Risk Management
- Information Technology

Insurance and Takaful

- Underwriting
- Appointed Actuary
- Business Development
- Risk Management
- Information Technology
- Claims
- Product Development
- Actuarial Services
- Legal and Compliance
- Sales and Marketing

Recurring gaps across functions

- Candidates with 6-10 years of applicable experience
- Candidates possessing both professional qualifications and market experience
- Niche and multi-product specialists
- Candidates with specialised technical skills
- Project managers
- Candidates with local and global market exposure and knowledge

the overall quality of learning programmes across the industry. Both initiatives are understood to be the first of its kind within the financial sector.

(iv) Financial Institutions Directors' Education in Islamic Finance and Shariah Leaders Education Programme

The Financial Institutions Directors' Education in Islamic Finance and Shariah Leaders Education Programme will be offered for the first time in 2015. These programmes

are specifically designed to broaden the perspectives of directors and Shariah scholars on emerging opportunities in Islamic finance as well as equip them with the necessary technical knowledge and skill sets in building a sustainable business model in accordance with Shariah principles. The programmes apply learning methodologies and approaches that have proven to be particularly effective in other successful leadership competency programmes offered by the Iclif Leadership and Governance Centre.

