

2010

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DEVELOPMENT OF THE FINANCIAL SECTOR

Policy measures to develop the financial sector in 2010 remained supportive of macroeconomic stability and growth momentum of the economy, while advancing longer-term initiatives to enhance the potential capacity and resilience of the Malaysian financial sector. Malaysia's inter-linkages with the global economy and position as an international centre for Islamic finance were further strengthened. This was achieved with a continued focus on elevating financial inclusion levels and ensuring a strong foundation for financial stability. Going forward, the financial sector is also being positioned to take on an enhanced role in supporting Malaysia's transition to a high value-added and high-income economy, underpinned by growth that is both sustainable and inclusive.

PRESERVING SOUNDNESS AND CONFIDENCE IN THE FINANCIAL SECTOR

Over the years, banking institutions in Malaysia have built up strong capital and provisioning buffers, with improvements in underwriting and risk management practices as well as strengthened governance structures. In 2010, the preconditions for further growth were considerably enhanced and the enabling environment continued to improve in support of productive competition and innovation.

The financial safety net was significantly strengthened with the coming into force of the new Malaysia Deposit Insurance Corporation (PIDM) Act 2011 on 31 December 2010, incorporating substantial enhancements to the consumer protection framework. The new legislation widens the existing coverage under the deposit insurance system with an increased coverage limit of up to RM250,000 per depositor per member institution (from RM60,000). Coverage is also now extended to foreign currency-denominated deposits. PIDM's powers to minimise risk in the financial system have also been enhanced to support its role in safeguarding public confidence in the Malaysian financial system and the intervention and resolution of non-viable financial institutions.

Specifically, the new legislation empowers PIDM to utilise a wider range of tools and measures, including enhancing protection limits, extending coverage to a non-member institution and designating a bridge institution to temporarily assume the commitments of a non-viable institution as a resolution option.

The Bank continued in parallel to pursue initiatives to enhance the resilience of Malaysia's insurance industry. These initiatives focused in particular on enhancing the capacity of insurance companies to provide protection to consumers, addressing structural weaknesses in the industry, and strengthening the financial safety net to safeguard the interests of policyholders.

The financial safety net was significantly strengthened with the coming into force of the new Malaysia Deposit Insurance Corporation (PIDM) Act 2011

In the general insurance industry, fragmentation and the lack of scale among the general insurers remained a key challenge to realising the long-term growth potential of the sector and its ability to support the growing needs of the economy for risk protection solutions. Out of the 30 insurers represented in the general insurance industry, 20 of the smaller players account for a combined share of only 38% of total gross premiums. Moving forward, demand for increasingly sophisticated insurance products and protection mechanisms will rise as the economy advances to become a high-income nation and new economic growth sectors assume a more important role in the economy. With this in view, the Bank continues to promote consolidation and rationalisation within the industry with the objective of developing strong general insurers with sufficient capacity and scale to contribute meaningfully to the broader economy. Notable progress has been made thus far; where in addition to the successful rationalisation schemes of three general insurers approved by the Bank

in 2010, a number of promising negotiations are in the pipeline. The impetus for continued consolidation and rationalisation is further driven by the more liberal foreign equity participation limits, strengthened capital requirements and enhanced supervisory expectations on the insurers.

Efforts to address structural weaknesses in the motor insurance sector were taken forward during the year. This has been key to putting the general insurance and takaful industry on a firmer foundation to support the requirements of Malaysian households and businesses given that more than 47.5% of total general premiums and contributions are concentrated in the motor sector. Motor insurance business represents the dominant portfolio for 18 general insurers, with shares ranging from 24.3% to 87.3% of total premiums underwritten by these insurers. In recent years, it has become increasingly difficult for the general insurance and takaful industry to continue supporting motor insurance and takaful business on a commercially sustainable basis, leading to a significant withdrawal by insurers from underwriting motor policies (especially Third Party policies). The holistic review of the existing motor insurance framework focusing on coverage for third party bodily injury aims to preserve access to affordable motor insurance cover for the public, while ensuring its sustainability over the longer term. A more detailed description of the underlying issues, challenges and the outcome of this review is provided in the box article "Towards a More Effective and Efficient Motor Cover Framework".

The safety net for insurance policyholders was significantly strengthened with the implementation of the Takaful and Insurance Benefits Protection System (TIPS) on 31 December 2010. The TIPS replaces the Insurance Guarantee Scheme Fund (IGSF) for the insurance industry which has been in place since the 1970s to meet the claims of policyholders of failed insurance companies using funds pooled from the insurance industry. Since its establishment, the IGSF has been utilised to facilitate the payouts of three failed general insurance companies. Moving forward, TIPS will assume this role, with an improved level of protection to insurance policyholders and takaful participants and the broader mandate under the administration of PIDM to resolve insurance companies or takaful operators that have ceased to be viable or which the Bank considers likely to become non-viable, in a manner that minimises

cost to the financial system. A more detailed explanation of this system is provided in the box article "Introduction of Takaful and Insurance Benefits Protection System in Malaysia".

ENSURING CONTINUED ACCESS TO FINANCING

The prompt policy measures undertaken by the Bank in 2008 and 2009 to ease the strains faced by the business and household sectors and to support continued credit flows to the economy have enabled financial intermediation to function smoothly and efficiently. As at end-2010, total outstanding banking system financing increased by 12.7% from the previous year to RM883.3 billion or 115.3% of gross domestic product (GDP). Total outstanding financing to both businesses and households recorded robust growth of 9.4% and 13.4% respectively.

The improved environment for financing to SMEs is attributed to the development of a comprehensive institutional framework including support and advisory services, and pre-emptive measures by financial institutions to assist viable SMEs

As a key engine of growth in the economy, the small and medium enterprises (SMEs) continue to draw support from the financial sector to meet their financing needs, with outstanding financing to SMEs from banking institutions and development financial institutions (DFIs) reaching RM141.1 billion or 37.6% of total business loans as at end-2010. The number of SME cases received by the Bank's Integrated Contact Centre in relation to access to financing issues reduced significantly by 38% from 2009 to 327 cases. This reflects an improved environment for financing to SMEs, attributed in large part to the development of a more comprehensive institutional framework including support and advisory services for SMEs as well as pre-emptive measures by financial institutions to assist viable SMEs facing temporary financial difficulties and expedite the approval and disbursement of loans. These include

Towards a More Effective and Efficient Motor Cover Framework

Challenges facing the insurance and takaful industry in motor underwriting and impact on motor vehicle owners

Under the Malaysian road transport legislation, it is a mandatory requirement for all Malaysian motor vehicle owners to purchase an insurance policy or takaful certificate (collectively referred to as insurance policies) to cover against liabilities arising from bodily injury including death, to any third party. This is to provide for compensation to members of the public who suffer injury or loss of life arising from a road accident caused by a vehicle owner.

In Malaysia, motor insurance premiums (including contributions in the context of takaful) and the scope of coverage under motor insurance policies are determined by the Malaysian motor tariff (Tariff). The Tariff has not been revised since 1978 to take into account the changing profile of risks associated with motor insurance and takaful coverage (subsequent reference to insurance cover includes takaful cover), including the increased frequency and escalating costs of motor accidents.

Among the motor accident-related expenses borne by the insurers and takaful operators, costs relating to bodily injury and death constitute the largest component. Over the years, the claims experience of the Third Party Bodily Injury and Death component of motor insurance policies has progressively deteriorated with claims ratios exceeding 200% since 2006. In 2010, for every ringgit of Third Party Bodily Injury and Death premiums received, insurers and takaful operators paid out RM2.82 and RM2.25 respectively in claims, before factoring in other related costs such as management and acquisition expenses.

The growing gap between premiums collected and claims paid out by the industry has contributed to the displacement of Third Party motor insurance covers as more insurers and takaful operators are not able to sustain such business on a financially viable basis. As a result, some motor vehicle owners have had to purchase their motor policies from the Malaysian Motor Insurance Pool (MMIP), which was originally set up by the general insurance industry in 1992 to act as an insurer of last resort for high motor risks such as buses as well as vehicles carrying hazardous materials. This led to a sharp increase in the number of motor policies issued by the MMIP which increased from 5,897 in 2007 to 128,058 in 2009. Policies insured by the MMIP are subject to additional premium surcharges and stricter underwriting rules to reflect the higher risk of the policies covered. The increased displacement of motor policies into the MMIP has, however, disproportionately affected these vehicle owners through substantially increased insurance-related costs and reduced access to motor insurance protection. While the vehicles underwritten by MMIP account for only 2% of the total number of vehicles insured in Malaysia, immediate review of the rules of MMIP will be undertaken to ensure that these motor vehicle owners that are not deemed as high risk will have greater access to motor protection at a lower premium.

Holistic review of the motor cover framework

Recognising the difficulties faced by vehicle owners with respect to motor insurance, the Bank initiated a holistic review of the motor insurance framework with the primary aim of addressing the issue of access to affordable motor insurance protection. The goal is to ensure that the public is afforded easy access to adequate insurance and takaful protection at a reasonable premium at all times, and that such protection is provided in a commercially sustainable manner over the longer term. In undertaking the review, the Bank was mindful that while a review in the premium rates would address the pricing misalignment in the short term, this must be accompanied by more fundamental structural adjustments to the entire motor claims value chain to arrest the continuing trend of escalating claims costs in the longer term. The resulting proposed new motor cover framework therefore significantly improves on the existing tort-based unlimited liability system through pervasive efficiency enhancements to contain the cost of claims that result from leakages, misaligned incentives and claims fraud.

Feedback from public engagements

Engagements with key stakeholder groups and the public at large have indicated broad support for motor insurance protection to continue to be provided by the existing insurers and takaful operators due to the

ease of access and better service levels that would be promoted as a result of competition. The majority of respondents also supported maintaining the existing scope of coverage for various types of bodily injury claims with a reasonable overall limit on compensation paid out. Feedback received further suggested a high degree of acceptance by the public to a reasonable and gradual premium adjustment to address the pricing misalignment in view that the Tariff has not been revised for more than 30 years. However, the expectation was for this to be accompanied by a significantly more efficient claims settlement process that would also effectively control cost leakages along the entire claims settlement chain. Preserving the role of the court system as an avenue for redress was also favoured to ensure the adequate protection of claimants' interests.

Towards a new motor cover framework

Taking into consideration the feedback obtained from the public engagement process, the new framework focuses on two areas, namely enhancing efficiency in the claims settlement process and the introduction of a gradual premium adjustment to bring premiums more in line with the general motor claims experience.

The formulation of efficiency enhancement measures has been achieved in close consultation and collaboration with the relevant government agencies as well as selected private institutions involved in the claims settlement chain. These include the Royal Malaysian Police, the Ministry of Health (hospitals), the Judiciary, the Attorney General's Chambers, the Malaysian Bar Council, and the insurance and takaful industry, which have provided their commitment to support the realisation of more efficient, fair and transparent claims settlements that most importantly safeguard the interests of motor vehicle accident victims. The identified efficiency initiatives include:

- the establishment of a call centre to provide immediate support assistance to road accident victims;
- enabling hospitals to assist road accident victims in submitting claims notifications to insurers;
- shorter timelines to produce police and medical reports to facilitate early processing of claims;
- a more simplified claims notification process; and
- a review of lawyers' fees for bodily injury and death cases.

Steps by various parties to implement the identified efficiency measures will commence immediately. The effective implementation of these measures is expected to reduce the time taken to settle motor insurance and takaful claims significantly from the current average duration of one to five years to six to 18 months moving forward. The improvement measures are overseen by a joint working committee chaired by Bank Negara Malaysia, and comprising representatives from the Ministry of Finance, the Ministry of Health, the Judiciary, the Attorney General's Chambers, the Malaysian Bar Council, the Royal Malaysian Police, the insurance and takaful industry and the consumer and transport associations. The committee's mandate is to drive and ensure the successful implementation of the various efficiency enhancement measures which the relevant agencies and private institutions have committed to undertake. The first meeting of the committee will be held in April 2011.

In parallel with the efficiency improvement measures, reasonable premium adjustments will be introduced gradually over a period of four years beginning 1 January 2012. The premium adjustments are guided by the following key principles:

- The adjustment will be gradually phased in to mitigate its impact and coincide with enhancements to the Malaysian transportation system;
- The premium adjustment will not have a material impact on the lower income group; and
- Premium adjustments will be more closely aligned with the risk profile of vehicle categories, so that those with good claims experience will benefit from a lower adjustment or a premium reduction consistent with risk-based pricing.

The new motor cover framework strives to converge the long-term interests of both the insuring public and the insurance and takaful industry as well as promote a good and safe driving culture. Its effective and timely implementation is critical to secure the long-term availability of reasonably priced motor insurance protection offered by insurers and takaful operators, with competitive and efficient service levels that will deliver better outcomes for consumers.

Introduction of Takaful and Insurance Benefits Protection System in Malaysia

The recent financial crisis has prompted regulators around the world to reassess the robustness and adequacy of the safety net arrangements in their own countries to safeguard the public when failures of financial institutions occur. The initiatives taken include a review of the scope and level of coverage of existing arrangements as well as the consideration of new arrangements to provide effective protection for the broad range of financial consumers.

In Malaysia, the safety net arrangement within the financial sector was further strengthened with the introduction of the Takaful and Insurance Benefits Protection System (TIPS) by the Malaysia Deposit Insurance Corporation (PIDM) on 31 December 2010, to complement the existing deposit insurance system (DIS) introduced in 2005 for the banking system. TIPS, which replaces the existing Insurance Guarantee Scheme Fund (IGSF) administered pursuant to the Insurance Act 1996, operates as an **explicit compensation scheme** to protect consumers of the insurance and takaful industry in the event of a failure of an insurer or takaful operator (hereinafter collectively referred to as institutions). By alleviating the potential financial loss to policyholders (including participants in the context of takaful) in the unlikely event of the failure of an institution, TIPS will further strengthen the consumer protection framework in Malaysia, thereby promoting public confidence in the industry.

Mandate of PIDM

The Malaysia Deposit Insurance Corporation Act 2011 provides that PIDM's mandate shall include administering TIPS. This will further enhance PIDM's role as an important component of the financial safety net, while leveraging on PIDM's capacity, competencies and institutional framework which have been developed and strengthened to manage financial sector resolutions. Similar to the DIS, PIDM is required to carry out its mandates under TIPS in a manner that minimises cost to the financial system.

Public policy objectives of TIPS

The primary objective of TIPS is to protect the interests of policyholders and preserve public confidence in the insurance and takaful industry. Most individual and small policyholders would find it difficult to ascertain the financial soundness of institutions given the significant information asymmetries that exist between policyholders and institutions. This is further compounded by the technical complexity and long term nature of insurance and takaful business. The vast majority of policyholders would have neither the resources nor incentives to monitor the performance of institutions and exercise informed consumer choices. Under these circumstances, the reasonable protection of policyholders serves not only to safeguard the interests of policyholders of an institution that may become insolvent, but it is also important to avert a widespread erosion of confidence in the industry at large which could have detrimental consequences for economic activity, individual welfare and the development of the industry.

A key feature of TIPS, in comparison with the IGSF, is the explicit level of protection provided under TIPS. The IGSF previously provided compensation up to 90% of the benefits in the event of a failure of an institution. This level in practice has varied between 55% and 70% of the benefits depending on the availability of the fund. In contrast, under TIPS, the maximum level of protection is predetermined to provide greater certainty, assurance and importantly, full protection to the vast majority of insured individuals and small businesses. The explicit protection under TIPS, which has existed under the DIS since 2005, will also provide for the consistent treatment between savings instruments offered in the banking and insurance/takaful industry to reflect the growing convergence of products within the financial sector and provide equivalent protection for depositors and policyholders.

The protection of policyholders will also be further enhanced under TIPS with broad powers provided for PIDM to be able to intervene and resolve troubled institutions which have ceased to be viable or which the Bank considers likely to become non-viable, in the best interest of policyholders. PIDM's intervention and resolution powers include arrangements to transfer policies/certificates to another institution in order to preserve the continuity and value of investments and protection afforded under existing insurance policies and takaful certificates.

A further objective of TIPS is promoting and strengthening incentives for sound risk management by institutions. This will be achieved through the implementation of a differentiated premium structure which will reflect the risks posed by individual institutions to the compensation fund. Under this structure, institutions with strong financial standing and risk management will contribute a lower rate of premium to the fund. This will complement and reinforce the supervisory role of the Bank through strengthened incentives for institutions to adopt and implement sound risk management practices commensurate with their risk profiles. This contrasts with the IGSF where all institutions contribute the same rate of premium to the IGSF regardless of their risk profiles.

Membership

Membership in TIPS is compulsory for insurers licensed under the Insurance Act 1996 and takaful operators registered under the Takaful Act 1984. Reinsurance companies, retakaful operators, international takaful operators, Danajamin Nasional Berhad and intermediaries such as insurance/takaful agents, brokers and adjusters are excluded from membership.

Funding

TIPS will be funded from annual premiums assessed against member institutions based on the level of coverage for each individual institution. PIDM maintains and administers separate funds under TIPS respectively for:

- conventional life policies;
- conventional general policies;
- family takaful certificates; and
- general takaful certificates.

The clear segregation of funds promotes equity, transparency and accountability in the management and usage of the funds, as each fund is built up from premium funded from the respective types of insurance/takaful business for the benefit of its respective policyholders. The segregation between conventional and takaful TIPS funds also ensures compliance with Shariah principles.

Coverage

TIPS provides coverage for ringgit-denominated policies issued in Malaysia. Where a member institution is unable to meet its obligations to its policyholders, PIDM is required to reimburse the policyholders in respect of the covered benefits up to the specified maximum limits provided under TIPS. The maximum coverage limits vary for the different types of protected benefits, ranging from up to RM10,000 per month for disability or annuity income benefits, to an amount of up to RM500,000 on death or property damage claims. Any premiums paid in advance will also be refunded in full. The limits are generally adequate to protect the vast majority of policyholders in full, while retaining sufficient incentives for policyholders of high-value policies with substantial benefit levels to be more vigilant in selecting the institutions from which coverage is obtained. Further details on the coverage provided by TIPS can be accessed at www.pidm.gov.my.

Collaboration and coordination

Bank Negara Malaysia remains responsible for the regulation and supervision of insurers and takaful operators as part of its mandate for maintaining overall stability of the Malaysian financial system, while PIDM administers both the DIS and TIPS in a manner that contributes towards promoting public confidence in the financial system. The close collaboration and coordination between the Bank and PIDM ensures the effectiveness and efficiency of the financial safety net.

This is achieved through a strategic alliance agreement (SAA) between the Bank and PIDM, which was established during the inception of the DIS and which has now been expanded to include TIPS. The SAA clearly sets out how the two organisations will collaborate and coordinate their activities to preserve the integrity of the financial safety net and minimise duplicative regulatory costs and burdens on the industry. In particular, the arrangements provide for the coordination of risk assessments, resolutions of member institutions as well as requirements on regulatory reporting. It also establishes protocols for regular consultation and exchange of information concerning developments in the industry to promote optimal financial stability outcomes.

collaborative efforts in 2010 to establish SME Financing Help Desks that are well-equipped to provide advisory services at SME associations and business chambers nationwide, as well as the Association of Banks in Malaysia's (ABM) "PARTNER" initiative to streamline and simplify loan application procedures for SMEs. Such efforts over the years have contributed towards the advancement and transformation of SMEs which saw more than 4,600 SME accounts with a combined financing value of RM14.9 billion upgraded to become large enterprises during the year.

While financing remains largely ample to support the present needs of the Malaysian economy, proactive measures were taken to cater to the new financing requirements of the economy. Three special funds were established by the Government in 2010, namely the RM200 million Creative Industry Fund and RM1.5 billion Green Technology Financing Scheme in support of the development of new growth areas, and the RM20 billion Facilitation Fund to support the financing of large-scale and high-impact development projects by the private sector. The Creative Industry Fund aims to spur commercialisation activities in the creative field, including assistance to companies that export high-tech multimedia content and that contribute to economic activity through the promotion of the nation's rich heritage of arts and culture. An important area for further growth is the adoption of environmentally-friendly technological solutions, including renewable energy and energy efficiency enhancements, to promote and sustain the competitiveness of Malaysian companies in the face of rising energy costs and greater social awareness of the critical need to preserve the environment. This is also consistent with the broader goal of achieving long-term growth that is economically and environmentally sustainable. The RM1.5 billion Green Technology Financing Scheme is targeted at companies which are producers and users of green technology in the energy, building, water and waste management, and transportation sectors. The Facilitation Fund represents the Government's continued commitment towards supporting public-private partnerships as a means of effective risk-sharing and in providing a long-term sustainable solution to the financing of large-scale and high-impact development projects. In ensuring that the three special funds meet their objectives and benefit the respective industries and the economy at large, proactive measures were undertaken to

improve the utilisation of these funds, including promoting awareness and understanding, enhancing the fund disbursement framework such as certification requirements, and conducting training programmes for relevant stakeholders.

The coverage of the Corporate Debt Restructuring Committee (CDRC), which recommenced operations in July 2009, was expanded in 2010 to enhance CDRC's role in assisting distressed corporations. The eligibility criteria were revised to allow a larger pool of companies to benefit from CDRC's assistance where there are prospects for companies to remain viable post-restructuring. With improved economic conditions and pre-emptive measures by financial institutions in the restructuring and rescheduling of credit facilities, Malaysian corporates were largely well-supported to continue remaining in business without the need to avail of CDRC's assistance. In 2010, CDRC received only 13 applications for assistance from distressed corporations with a total debt value amounting to RM2.2 billion.

Since its establishment in 2009, Danajamin Nasional Berhad (Danajamin) has continued to play an important role in assisting corporations to raise funds from the bond market at a reasonable cost, particularly in an environment of more cautious investor sentiment. As at end-2010, Danajamin has approved RM4.6 billion worth of guarantees. Danajamin's longer-term objective is to support sustainable access to the bond market for a diverse range of issuers, thus contributing to the further development of a vibrant and comprehensive domestic capital market. In this effort, Danajamin also participates in risk-sharing arrangements under syndicated facilities with banking institutions, with Danajamin guaranteeing instruments with longer tenures whilst the banks address the medium-term funding requirements. Credit enhancements provided by Danajamin in 2010 have benefited a diverse set of issuers covering a wide range of industries and sectors, including the property, infrastructure, plantation, oil and gas, construction, manufacturing, aviation and energy sectors.

DEVELOPING THE FINANCIAL MARKET

The deep and vibrant Malaysian bond market remains an important source of funding for corporations, with the bond market growing

significantly from an outstanding value of RM306.8 billion in 2001 to RM782.4 billion or 102.1% of GDP in 2010. This has contributed towards more diversified sources of financing for the Malaysian economy, with the corporate debt securities and sukuk market now accounting for 58.5% of total corporate financing as at end-2010. In 2001, the corporate debt securities and sukuk market supported 46.4% of total corporate financing. Wide-ranging initiatives to develop the bond market since the 1980s, coupled with measures taken in the aftermath of the 1997 Asian financial crisis, have established Malaysia's bond market as the largest in South-East Asia.

In complementing the bond market, greater focus has been directed at the development of a comprehensive and well-functioning money and foreign exchange market. Being a highly open economy with aspirations for deeper regional integration and expansion, prospects for further growth and development in the Malaysian foreign exchange market, in particular, are promising to promote trade, support more effective and efficient risk management, and enhance the contribution of the financial sector to economic growth.

The average daily turnover including swap transactions in the foreign exchange market grew by 49.6% since 2007 to reach USD6.9 billion in 2010. The increased breadth and liquidity of the foreign exchange market can be attributed to the development of new financial instruments, the gradual liberalisation of foreign exchange administration rules to promote greater efficiency in the conduct of international trade and to facilitate the use of domestic currency in the settlement of trade, and the admission of new entrants into the market with the capacity to contribute towards further developing the foreign exchange market. During the year, flexibility was given for foreign electronic brokers to establish electronic broking platforms for wholesale interbank trading in Malaysia as part of efforts to increase the diversity, dynamism and competitiveness of the foreign exchange market. Electronic broking platforms will enhance transparency, improve market efficiency and lower transaction costs for market participants. This flexibility, coupled with the entry of new global financial market players established as commercial banks in Malaysia will contribute towards the development of a more vibrant and dynamic foreign exchange market to support Malaysia's economic transformation.

On the international front, Malaysia remained the global leader in sukuk issuances, capturing 66% or USD94 billion of total global sukuk outstanding as at end-2010. Bursa Malaysia is currently the largest sukuk listing exchange in the world with a value of USD27.7 billion as at end-2010, exceeding that of any other leading international financial centre. The global dimension of Malaysia's sukuk market is reinforced by the continued presence and interest of foreign issuers and investors, which saw four successful issuances of foreign currency-denominated sukuk amounting to USD1.85 billion and SGD1.50 billion in 2010.

The global inter-linkages of Malaysia's Islamic financial markets were further boosted by the establishment of the Bloomberg-AIBIM-Bursa Malaysia Sovereign Shariah Index (BMSSI) in February 2011 as a benchmark to measure the performance of ringgit-denominated Shariah-compliant government securities. Jointly developed by the Association of Islamic Banks in Malaysia (AIBIM), Bursa Malaysia and Bloomberg, the index will promote more efficient price discovery for investors seeking exposure to Shariah-compliant financial instruments, thereby stimulating product innovation and the further development of the Islamic financial markets.

ENHANCING CONTRIBUTION OF ISLAMIC FINANCE AND MALAYSIA AS AN INTERNATIONAL ISLAMIC FINANCIAL CENTRE

Islamic finance in Malaysia continued to register strong growth during the year. Total assets of the Islamic banking sector (including DFIs) amounted to RM350.8 billion as at end-2010, increasing by 15.7% from end-2009. The Islamic banking sector now accounts for over 20% of the overall banking system in terms of assets, financing and deposits. In the takaful sector, assets increased by 17.8% from 2009 to reach RM14.7 billion as at end-2010. Takaful assets now account for 8.7% of the total assets in the insurance and takaful industry.

Strategies to spur the development of Malaysia's Islamic finance industry continued to focus on developing the players, infrastructure and expertise required to meet the needs of the growing economy, and reinforcing Malaysia's position as a leading international centre for Islamic finance.

During the year, the Bank granted four new family takaful licences to joint ventures between global and regional players and strong domestic entities. This was an increase from the earlier announced issuance of two new family takaful licences in 2009. The decision to increase the number of licences took into account the overwhelming interest received in the new licences offered and the large untapped growth potential within the takaful sector. Given Malaysia's demographic profile, the realisation of this potential is especially important to enhance the insurance and takaful penetration rate. All four new family takaful operators offer strong value propositions that are expected to significantly grow the family takaful industry and further entrench Malaysia's position as the global hub for Islamic finance.

The formation of a high-level Law Harmonisation Committee in 2010 to review, harmonise and further strengthen the legal infrastructure to facilitate the conduct of Islamic finance reinforces Malaysia's leadership role in building and maintaining a solid foundation for the development of Islamic finance. The committee is headed by Tun Abdul Hamid Mohamad, the former Chief Justice of Malaysia, and has a diverse membership drawn from the Government, regulatory authorities, experienced Islamic finance practitioners and Islamic finance scholars. The committee has a mandate to recommend legal reforms that will advance the development of Islamic finance and achieve greater certainty and enforceability of Islamic finance contracts domestically. It is expected that this in turn will position Malaysia's laws as the law of choice for international Islamic finance transactions and settlement of disputes relating to cross-border Islamic financial transactions.

An important breakthrough in meeting the global liquidity management requirements of Islamic financial institutions was achieved with the establishment of the International Islamic Liquidity Management Corporation (IILM). This initiative marked the successful collaboration of 12 central banks and regulatory agencies, and two multilateral institutions to form a corporation that would be part of an international Islamic infrastructure to issue high quality instruments to support the liquidity needs of the global Islamic financial system. IILM was established in October 2010 during the second Global Islamic Finance Forum (GIFF) hosted by the Bank, which has become a key

international event in the calendar of Islamic finance, bringing together regulators, Shariah scholars and financial market participants who are key drivers in shaping Islamic finance globally. A more detailed explanation of IILM is provided in the box article "International Islamic Liquidity Management Corporation (IILM): Enhancing Global Islamic Liquidity Management".

Strategies continued to focus on developing the players, infrastructure and expertise required to meet the economy's needs, and reinforcing Malaysia as a leading international centre for Islamic finance

Over the years, the Bank has pursued various initiatives to deepen the industry's Shariah understanding as well as address issues in the application of Shariah in Islamic finance. This includes the establishment of the Fund for Shariah Scholars in Islamic Finance amounting to RM200 million in June 2005. In 2010, the fund supported talent enrichment, research and Islamic finance knowledge enhancement activities, which included the provision of scholarships for furthering Islamic finance studies. The fund also supported efforts to translate selected papers and international *fiqh muamalat* publications with the aim of deepening knowledge and expertise in the field of Islamic finance. During the year, the Islamic Banking and Finance Institute of Malaysia (IBFIM), with the support of the fund, published the English translation of *Qawa'id al-Ahkam fi Islah al-Anam* (Rules of the Derivation of Laws for Reforming the People) which serves as one of the main references in Shariah jurisprudence. The issuance of Shariah Parameters continued to serve as guidance and reference in Shariah best practices for various Islamic finance transactions. In 2010, two concept papers for *mudharabah* and *musharakah* contracts were issued as part of this initiative. The second edition of Shariah Resolutions in Islamic Finance, which documents all Shariah rulings made by the Shariah Advisory Council between 1997 and 2010, was published as part of the Bank's efforts to promote deeper understanding of the Shariah rulings. It is envisaged that all these initiatives will

International Islamic Liquidity Management Corporation (IILM): Enhancing Global Islamic Liquidity Management

Current challenges in Islamic liquidity management

The recent global financial crisis has underscored the critical importance of robust liquidity risk management practices by financial institutions and a sound financial market structure that is able to support the aggregate liquidity needs of the financial system.

For institutions offering Islamic financial services (IIFS), the limited availability of Shariah-compliant instruments in many jurisdictions continues to present substantial challenges for efficient and robust liquidity management. As demand for these instruments continues to outstrip supply, both at the national and global levels, the secondary market trading of the instruments involves high transaction costs and wide bid-ask spreads, while the trading has remained shallow. Even standard instruments for liquidity management such as that based on commodity *murabahah* are considered illiquid given the difficulty of converting the underlying commodity trade into cash before the maturity of the instruments. This has resulted in additional commodity brokerage costs associated with short-term liquidity transactions. In most markets where IIFS operate, the supply of tradable and sovereign instruments that can be held for liquidity purposes has also been limited. The combination of supply and cost considerations has resulted in unnecessarily large holdings of cash by most IIFS to meet their short-term liquidity needs and mitigate liquidity mismatch risks. As Islamic finance grows to become a more significant component of the global financial system, addressing the limitations that constrain effective liquidity management practices will be critical not only to support the further development of Islamic finance, but more importantly to promote global financial stability.

The establishment of Bursa Suq Al-Sila` in Kuala Lumpur in August 2009 as an international commodity *murabahah* platform was a key initiative to strengthen the Islamic liquidity management infrastructure. It is the world's first, end-to-end Shariah-compliant multi-currency commodity trading platform specifically dedicated to facilitating commodity-based Islamic financing and investment transactions in the Islamic money market. This will ultimately enhance the liquidity and risk management capacity of participants in the international Islamic financial markets.

Besides mitigating relevant legal, market and counterparty risks, the Bursa Suq Al-Sila` provides industry players with additional instruments to manage their assets and liabilities as well as to facilitate the development of new financing and investment products that are globally accepted.

Establishment of the International Islamic Liquidity Management Corporation

At the global level, the development of Islamic liquidity management infrastructure has been further strengthened with the setting up of the International Islamic Liquidity Management Corporation (IILM). This arose from the recommendation of the High Level Task Force on Liquidity Management that was established by the Islamic Financial Services Board Council in March 2009.

The formal establishment of the IILM on 25 October 2010 represents a major breakthrough in the development of global Islamic finance industry given its pivotal role in facilitating cross-border Islamic liquidity management. Its significance in the global Islamic financial landscape is further underscored by the close collaboration among central banks behind the operations of the IILM to address key fundamental issues facing the industry namely the lack of short-term liquid instruments for IIFS and the absence of a robust liquidity management infrastructure. The current members of the IILM comprise 12 central banks and regulatory authorities, and two multilateral development institutions. Membership in the IILM is open to central banks, monetary authorities, financial regulatory authorities, government ministries or agencies that have regulatory oversight on finance, and relevant multilateral organisations.

The IILM will enhance cross-border liquidity management among IIFS through the regular issuances of short-term high quality Shariah-compliant financial instruments in major reserve currencies in a cost efficient manner. The ultimate objective is to facilitate greater international integration of the Islamic money and capital markets, while improving the efficiency of the cross-border intermediation of funds. A range of high-grade Shariah-compliant interbank instruments and the supporting liquidity management platform will be established to facilitate the domestic and global development of Islamic liquidity management in the different jurisdictions. The IILM will also be equipped to render technical advice and support in the development of Islamic liquidity management capabilities among IIFS and member countries, and thus enhance the ability of IIFS to participate in international liquidity management operations.

Backed by the strength of the IILM's shareholders, instruments issued by the IILM will also contribute towards expanding the pool of eligible collateral for interbank transactions and/or central bank financing; as well as for secondary market trading among IIFS within and across different jurisdictions. Over the medium term, this is expected to catalyse the development of infrastructure at the international level for collateralised borrowing and lending, and the development of standardised documentation to facilitate trading of these instruments. Furthermore, with the enhanced capacity of IIFS to manage liquidity shocks over time, the significant potential reduction in cash holdings by IIFS would also contribute towards improving returns to investors.

In addition to encouraging more efficient cross-border intermediation of funds and improved liquidity risk management practices among IIFS, the IILM will provide a platform for interaction and engagement among central banks and regulatory authorities on developments and evolving practices in Islamic liquidity management. This will in turn foster greater regional and international cooperation in supporting further development of the Islamic financial markets.

Malaysia, as the host country for the IILM, has enacted a dedicated legislation for the establishment of the IILM that accords the entity with privileges and immunities granted to supranational organisations. This stature strengthens the prospects for the IILM to assume a key role in the development of Islamic finance as an important and viable component of the international financial system. The IILM will have an important role in shaping the future landscape of the global Islamic finance industry through its contribution to the development of more efficient and vibrant Islamic financial markets across borders, and overall financial stability.

contribute towards reinforcing Malaysia's role as a global Shariah reference point in Islamic finance in defining the practices of Islamic financial transactions internationally.

Efforts were also made to strengthen the Shariah advisory profession during the year. The International Shariah Research Academy for Islamic Finance (ISRA) is in the midst of setting up the Association of Shariah Advisors (ASAS), which will be the body that regulates the conduct and establishes the ethical code for Shariah advisors. ASAS is also expected to take on the role of accrediting Shariah advisors and enhancing public confidence in the qualification and professionalism of Shariah advisors. ISRA also continues to pursue initiatives to enhance collaboration amongst Shariah advisors and scholars beyond national borders, towards mutual recognition of Shariah opinions so that international Islamic finance activities can be harnessed further.

The International Centre for Education in Islamic Finance (INCEIF), Malaysia's global university of Islamic finance, continued to supply qualified Islamic finance professionals during the year 2010 with 74 students from 10 countries including Afghanistan, India and the United Kingdom obtaining the Chartered Islamic Finance Professional (CIFP) qualification, and seven students from countries including India, Indonesia and Nigeria receiving the inaugural Masters in Islamic Finance degree. Given the global nature of Islamic finance, INCEIF has over the years strengthened its collaboration with foreign and domestic institutions, including entering into memorandums of understanding (MoUs) with four institutions of higher learning from Jordan and Indonesia in 2010. With INCEIF having sealed over 50 collaboration arrangements with various institutions globally, the enhanced collaboration and cross-leveraging of respective areas of strengths among education and training providers at the domestic and international levels are expected to enhance the supply of high quality researchers and practitioners in Islamic finance across jurisdictions. These human capital development efforts were complemented by initiatives taken to encourage the entry of expatriates that have sound knowledge of Islamic finance to contribute to the development of the Islamic financial industry. Through the collaboration by the Bank, Ministry of Home Affairs and Immigration Department of Malaysia,

a special employment pass for Islamic finance expatriates was introduced in September 2010, providing longer tenures and distinct flexibilities with the two-pronged objective of attracting foreign Islamic finance talent into Malaysia and enabling the Malaysian Islamic finance industry to better utilise such talent.

ENHANCING MALAYSIA'S INTER-LINKAGES WITH REGIONAL AND INTERNATIONAL ECONOMIES

Malaysian financial institutions continued to expand their regional footprint in 2010. Six domestic banking groups currently have operations in 19 countries worldwide, contributing RM250 billion in total assets and almost RM2 billion in profits as at end-2010. The recent years have also seen nine Malaysian stand-alone investment banks, insurance and reinsurance companies and takaful operators expand abroad through acquisition or the establishment of subsidiaries or joint ventures as part of longer-term growth strategies to diversify their sources of income and tap new business opportunities. Several Malaysian financial institutions have successfully emerged as leading regional players with an important role in contributing to the overall development of the countries in which they are present. In line with the more significant presence of Malaysian banks within the region, the Bank further strengthened its bilateral relationships with central banks around the region. New MoUs with Bank Indonesia, National Bank of Cambodia and State Bank of Vietnam were signed during the year. The Bank also entered into bilateral MoUs with the Australian Treasury, Banque de France, Central Bank of Nigeria and Bank of Mauritius to foster long-term strategic developments in both conventional and Islamic finance between Malaysia and these economies. These bilateral arrangements reinforce the Bank's expanding framework of cooperation with the regional and other foreign regulatory authorities which spans cooperation in cross-border banking supervision, regional financial integration, development of financial market infrastructure, capacity building and human capital development. Moving forward, as Malaysian banks enhance their presence in regional markets and global advancements in Islamic finance become more pronounced, such cooperation is expected to continue to strengthen.

A key development in 2010 was the implementation of the liberalisation plan that was announced in April 2009 which offered new commercial banking and family takaful licences to qualified players. Following a rigorous evaluation process, five new commercial banking licences were accorded to foreign financial institutions with the expertise, global network and strong business capacity to contribute to the future growth and diversity of Malaysia's financial system, support new areas of economic growth and facilitate international trade and investment flows. Of the 20 foreign commercial banks including the new entrants in Malaysia, over half now originate from Asia, signifying the growing importance of Asia in the global economic landscape. Existing locally-incorporated foreign banks also benefited from the increased operational flexibility granted to establish new branches in Malaysia, with four foreign banking institutions obtaining approval to establish 12 new branches nationwide thus far. These developments have contributed towards further expanding the breadth and depth, and enhancing the competitiveness of the Malaysian financial sector.

Several Malaysian financial institutions have successfully emerged as leading regional players with an important role in contributing to the overall development of the countries in the region

As the region becomes increasingly integrated, strong regional frameworks for cooperation in the areas of surveillance, supervision, policy and crisis management have become more important. The Chiang Mai Initiative Multilateralisation Agreement, a multilateral currency swap arrangement which covers all ASEAN member states, the People's Republic of China, Japan, Korea and Hong Kong SAR came into effect on 24 March 2010 with the aim of providing financial support to address balance of payment and short-term liquidity difficulties in the region through prompt and simultaneous currency swap transactions among

the participants. The agreement is supported by an independent regional surveillance unit that will be established, demonstrating the strong commitment of its members to further enhance the region's capacity to respond to downside risks and challenges in the global economy while preserving financial stability.

CONTINUED DEVELOPMENT OF HUMAN CAPITAL

Promoting strong institutional arrangements to meet the human capital development needs of the financial sector remained a key priority in 2010.

Since its establishment in 2007, the Financial Sector Talent Enrichment Programme (FSTEP) has played an important role in supplying the financial services industry with graduates who are equipped with the necessary competencies and skill sets to perform within the industry through a combination of classroom teaching and practical training in financial institutions. To ensure that the programme remains relevant and takes into account the evolving nature of the financial services industry, FSTEP's revised syllabus and programme design and delivery was launched in July 2010. The enhanced programme will enable participants to have a deeper practical understanding of the financial industry and its operations, thus enhancing their ability to assume meaningful roles in the industry. To date, 784 participants have benefited from FSTEP, with an employment success rate of over 99%.

The Asian Institute of Finance (AIF) made further advancements in 2010. Established in 2009, AIF aims to complement and enhance the capacity of the financial sector training institutes in elevating the competency and skills of professionals in the banking, insurance, securities and Islamic financial services industries to meet the demands of the more challenging and complex operating environment. During the past year, AIF's efforts were focused on providing key capacity building support systems, executing capacity building initiatives, facilitating the adoption of higher standards for learning programmes, establishing shared learning infrastructure, and promoting AIF and the training institutes as leading providers of comprehensive training solutions for the financial services industry. Continuous improvements to programme quality and design

were promoted through the development of a learning programme assessment and accreditation framework and implementation of quality assurance processes. The positioning of AIF as a leading human capital development institute in the region was further enhanced through strengthened collaboration with domestic and international institutes and research centres.

For directors, the Financial Institutions Directors' Education (FIDE) programme continued to provide a strong foundation for building more effective boards and promoting better governance practices across the financial industry. Further information on this programme is provided in the box article "Financial Institutions Directors' Education under the ICLIF Leadership and Governance Centre" in Chapter 3.

Whilst human capital development initiatives for the financial services industry are imperative, the continuous enhancement of the regulatory community's capabilities in keeping pace with advancements in the financial sector is equally crucial. The South-East Asian Central Banks (SEACEN) Research and Training Centre, located in Kuala Lumpur, plays a critical role in providing capacity building programmes that have practical applications in central banking, including programmes that are targeted at regulators. In line with the centre's vision of becoming the regional learning hub for central banks in the Asia Pacific region, the centre aims to promote the participation of central banks both within and beyond the region in its learning and networking platforms, and foster greater collaboration and deliberation on central banking issues to build regional views. In January 2011, the People's Bank of China became the 17th member of the SEACEN grouping, reinforcing the identity of SEACEN as the most inclusive central banking grouping in the region.

PRESERVING THE INTEGRITY OF THE FINANCIAL SYSTEM

Malaysia's anti-money laundering and counter financing of terrorism (AML/CFT) regime is characterised by a robust legal and regulatory framework that is consistent with international standards, preventive measures applied to financial institutions and designated non-financial businesses and professions, a comprehensive financial

intelligence infrastructure to support analysis and investigations, and strong domestic and international inter-agency cooperation arrangements to support capacity building, surveillance and enforcement.

Since the establishment of the AML/CFT framework in Malaysia, efforts have been ongoing to ensure that the framework remains effective against evolving money laundering and terrorism financing threats. During the year, initiatives were taken to further strengthen the implementation and strategic focus of AML/CFT efforts. This aims to support high impact outcomes, more optimal resource allocation and improved monitoring of AML/CFT measures. The National AML/CFT Strategic Plan 2010-2012 will serve as a strategic tool to promote focused implementation of AML/CFT efforts through outcome-based initiatives in six areas of focus: (i) effective implementation of preventive measures for reporting institutions, (ii) timely resolution of money laundering and terrorism financing investigations and prosecutions, (iii) strengthened legal framework, (iv) larger pool of specialist AML/CFT practitioners, (v) effective management of seized and forfeited assets, and (vi) increased visibility and awareness of AML/CFT initiatives domestically and regionally. The core thrust of the strategic plan is the mutual agreement of relevant stakeholders to support the areas of focus through well-coordinated efforts and alignment with the overarching objective of safeguarding the integrity of the financial system.

The National AML/CFT Strategic Plan 2010-2012 focuses on well-coordinated efforts among the relevant stakeholders and alignment with the overarching objective of safeguarding the integrity of the financial system

A major reform of the legal and regulatory regime governing the money changing and remittance services industry was also undertaken to promote the orderly development and modernisation of the industry and strengthen its defences against illicit activities. The proposed legislation, which

has been finalised, will be tabled to Parliament this year. More details on the reform and the envisioned new landscape of the money changing and remittance services industry can be found in the box article “Modernisation of the Money Changing and Remittance Industry”.

PROMOTING AN INCLUSIVE FINANCIAL SYSTEM

Financial sector development policies have facilitated the nation’s balanced growth by recognising the social and economic benefits of financial inclusion. This commitment to financial inclusion is embedded in the Central Bank of Malaysia Act 2009, which includes promoting a sound, progressive and inclusive financial system among the primary functions of Bank Negara Malaysia. The Bank’s financial inclusion agenda is delivered through five key components – extensive financial access and outreach, micro financing to enable participation in productive economic activities, financial tools to cope with daily necessities, financial protection mechanisms to cope with emergencies, and avenues for consumer information, education and assistance.

Improving the outreach of financial services nationwide by overcoming geographical barriers to financial access represents an important outcome of the Bank’s financial inclusion agenda. In particular, the wider presence of financial institutions in remote and non-urban locations is key to ensuring that all segments of society are able to participate in the formal financial system and conduct financial transactions in a safe, secure and convenient manner. Efforts were advanced during the year to provide banking services in every district in Malaysia, with commitments made by financial institutions to establish a presence in the remaining unserved districts in Sabah and Sarawak. These plans are in progress and will deliver essential financial services to all districts in Malaysia in 2011. Greater flexibility was also accorded for banking institutions to leverage on the outreach of third parties to provide basic financial services. To date, two banking groups have entered into strategic arrangements with Pos Malaysia Berhad to provide banking services, including cash deposits and withdrawals, loan repayments, opening of savings account and remittances, to the public through the extensive postal service network nationwide.

Over 300 locations have been targeted for the roll-out of such shared banking services over the course of 2011.

The *Pembiayaan Mikro* framework that was introduced in 2006 to provide micro entrepreneurs with access to financing without collateral has seen significant progress over the years. *Pembiayaan Mikro* is currently offered by 10 participating financial institutions with total outstanding micro financing amounting to RM775.9 million, benefiting more than 66,000 customers as at end-2010. Market research surveys conducted in 2010 will support more targeted and effective promotional efforts to heighten awareness among micro entrepreneurs to avail of financing facilities under *Pembiayaan Mikro*.

The Bank’s financial inclusion agenda is delivered through extensive financial outreach, micro financing, financial tools to cope with necessities and emergencies, and avenues for consumer information, education and assistance

To complement the *Pembiayaan Mikro* framework, the 1Malaysia Micro Protection Plan (1MMPP) is being finalised by the insurance and takaful industry to provide a financial safety net for micro enterprises and individuals operating small businesses against unexpected events, such as the death or disability of a breadwinner, and damage or loss of property due to accidents, floods and fires. As a start, the 1MMPP will provide insurance and takaful coverage for death and disability, personal accident, hospitalisation and protection of property against natural disasters. Accessibility to the scheme will be promoted through simple underwriting standards and processes, an extensive outreach via banks and DFIs, and affordable rates starting at less than RM20 per month.

Ensuring access to affordable housing has become increasingly challenging with the higher pace of urbanisation and higher cost of living in urban centres. The challenge is particularly acute for the urban poor segments who spend the greater part of their incomes on

Modernisation of the Money Changing and Remittance Industry

Aided by rapid technological advancements, the money changing and remittance industry globally has seen significant growth over the last decade in terms of size, sophistication and number of players with global linkages and advanced operations. Domestically, the volume of money changing and remittance transactions has similarly increased significantly in tandem with the expansion in economic activity. This in turn has driven demand for and access to money changing and remittance services while increasing the need for operators to ensure safety, security and integrity of these activities.

In line with these developments, Bank Negara Malaysia has initiated a comprehensive review of the legal and regulatory framework for the money changing and remittance services business in Malaysia, with the view to modernising and elevating the current status of the industry. The review is also aimed at ensuring that the necessary safeguards are in place and operating effectively to protect the integrity of the industry from the risk of money laundering, terrorist financing and illegal activities.

As an outcome of the review, a new industry landscape is envisaged to promote the orderly and professional development of the money changing and remittance industry in Malaysia under a more cohesive framework, while rationalising the regulatory regime applicable to the money changing, remittance and foreign currency wholesale businesses which is currently provided in three separate legislations, namely the Money Changing Act 1998, the Payment Systems Act 2003 and the Exchange Control Act 1953. This will pave the way for a more dynamic and effective industry to evolve with the following features:

- Greater business flexibilities for qualified players in the industry, including the ability to carry on multiple business activities within a single entity, thus promoting greater synergies between these activities and economies of scale;
- Differentiated regulatory requirements according to the nature, scale and complexity of an entity's business; and
- Strengthened safeguards to promote the professional and sound management of the industry.

Greater business flexibility

In line with the objective of fostering greater effectiveness and efficiency in the money changing and remittance business as well as to facilitate their orderly expansion, qualified players will be given greater flexibility to provide both money changing and remittance services within a single entity. This recognises the synergies between the money changing and remittance businesses and is expected to not only broaden the revenue base of operators, but also to encourage the use of formal channels for remittances by allowing existing money changers to also provide remittance services. Consideration is also being given to allow qualified wholesalers to conduct retail operations, thus enabling them to derive greater synergies from upstream and downstream activities. The existing foreign currency holding limit and remittance limits imposed on money changers and remitters respectively are also being reviewed to allow well-managed players to achieve greater scale and expand their product offerings. Such added flexibility to be accorded to eligible players that fulfill preconditions, will enhance the capacity of the industry to complement the banking sector in providing a broad range of comprehensive services to customers in the long run.

Differentiated regulatory requirements

The proposed new framework will provide flexibility under a more proportionate and differentiated regulatory and supervisory regime which provides for compliance with regulatory requirements according to the nature, scale and complexity of an entity's business. Consistent

with such a regime, wider enforcement powers are envisaged for the Bank to promote sound and responsible practices by players in the industry and to support early actions against non-compliances or breaches of regulatory requirements that may undermine the integrity and confidence in the industry.

Strengthened safeguards to promote sound and professional management

Central to an effective and dynamic industry will be enhanced oversight arrangements that are underpinned by effective governance, operational and control requirements for the sound conduct of the business. This is essential to provide a strong foundation for the modernised and more vibrant landscape for the money changing and remittance businesses. Consistent with other regulated industries within the financial sector, rigorous fit and proper requirements and assessments will be introduced for shareholders, directors and managers, to ensure that only people of high integrity, competency and experience are allowed to operate in the industry. A key focus will be on establishing the financial capacity and capability of players in the industry to put in place and effectively implement sound governance and operational arrangements, as well as internal control mechanisms, in particular for compliance with AML/CFT.

Conclusion

The new landscape for the money changing and remittance industry will provide a stronger foundation for the orderly growth and further development of the industry. Importantly, this will be supported by a more robust and responsive regulatory and supervisory framework that will safeguard the integrity of Malaysia's financial system from money laundering and terrorist financing threats, while improving the efficiency and quality of services provided to the public at large. The enabling legislation which will pave the way for these changes is expected to be put in place in 2011.

residential rent. In response to this challenge, the Government launched the My First Home Scheme under the 2011 Budget as a means of facilitating first-time home ownership among the young adult population. The scheme alleviates the financial strains faced by individuals in sourcing for funds to meet the down payment for a house. Under the scheme, first-time home buyers can obtain 100% financing from financial institutions, with the support of a guarantee granted by Cagamas Berhad (Cagamas) on 10% of the loan value. The guarantee granted by Cagamas is backed by the Government. The financial support provided under the scheme not only enables young Malaysians in urban centres to own a place of their own, but also contributes towards their asset accumulation, thus enhancing their welfare over time.

Ongoing efforts by the Bank to empower consumers through financial information, education and assistance have continued to pay off. Established by the Bank in 2006, the Credit Counselling and Debt Management Agency (AKPK) extended financial management advice and counselling services to over 30,000 consumers in 2010, of which over 15,000 consumers received assistance under AKPK's Debt Management Programme. The Bank's Integrated Contact Centre, established in 2008, also remained an important platform for consumers to source information and seek assistance on financial matters. In 2010, almost 300,000 individuals and businesses sought assistance from the centre, mainly to obtain information and financial advice. This represented a 15.6% increase in consumers seeking the centre's services compared to 2009 and is indicative of greater awareness and initiative on the part of consumers to avail of such platforms to seek assistance and enhance their knowledge on financial matters. To complement existing channels offered by the Bank's branches nationwide, mobile counter services were set up in November 2010, starting with Selangor, to enhance public accessibility to financial assistance in the non-urban areas. Public awareness was also enhanced through the Bank's strategic collaboration with consumer associations to conduct financial literacy programmes for communities and youths in both urban and non-urban areas nationwide. The multi-pronged approach taken by the Bank to promote consumer education and protection critically supports the development of a more competitive financial sector with enhanced access to a broad range of financial products and services reinforced by empowering consumers to make informed and responsible financial decisions.

KEY PRIORITIES MOVING FORWARD

The successful outcomes achieved over the years in financial sector development have largely been attributed to the comprehensive approach taken to develop the financial sector. Most segments of society today have broad access to financial services at reasonable cost. Moving forward, in order to support Malaysia's transition to a developed nation, the role of the financial sector will need to evolve further. Towards this end, the Bank is at the advanced stages of finalising a financial sector blueprint, which aims to enhance the capacity and capability of the Malaysian financial sector to best serve Malaysia's needs as a high value-added and high-income economy by 2020. It is envisioned that the structure of the Malaysian financial system will evolve to become more diverse in terms of institutions and arrangements to support an effective and efficient financial intermediation function in the new economy, with improved productivity, responsible innovation and greater support for the formation of businesses. The transformation of the financial sector will be accelerated by the continued process of financial integration and increased connectivity within the region, continued gradual and sequenced liberalisation of the financial sector, integration of payment and settlement systems, and greater cross-border cooperation in maintaining regional financial stability. This will be achieved with a continued focus on financial inclusion, and a strengthened surveillance, consumer protection and prudential regulatory framework which will provide the core foundations for sustainable growth with financial stability.

The financial sector blueprint aims to enhance the capacity and capability of the Malaysian financial sector to best serve Malaysia's needs as a high value-added and high-income economy by 2020

In the area of Islamic finance, Malaysia's position as the global hub for Islamic finance will continue to be reinforced, supported by a diverse set of institutions, deep, liquid and efficient financial markets, vibrant ancillary and support services

including consultancy and advisory services as well as a highly competent and skilled talent pool. This will also contribute to and complement identified strategies to promote the more efficient mobilisation of funds through the financial markets. The blueprint which will articulate the Bank's vision, strategies and recommendations will be released in 2011.

The Bank will continue to contribute actively to the holistic review of the pension and social security system spearheaded by the Government. The focus is to ensure that the pension and social security system is robust and sustainable in light of demographic and social trends in Malaysia. In addition to enhancements to the existing pension framework, an important outcome will be the development of a voluntary private pension industry to complement the mandatory retirement savings

scheme and old age welfare scheme. Banking institutions and insurance companies will have an important role in this development.

Efforts will also be enhanced to deepen Malaysia's inter-linkages with international economies. It is envisaged that as Malaysia becomes more integrated with the regional economies, cross-border cooperation in areas of financial sector development, financial regulation and supervision, and crisis management and resolution will become increasingly important. In this respect, the Bank will continue to proactively seek to open up opportunities abroad for Malaysian financial institutions through bilateral and multilateral agreements that provide optimal benefits to the economy at large, while ensuring the preconditions and safeguards are in place to mitigate any adverse effects to the financial sector and economy as a whole.