The financial sector that best serves the Malaysian economy
inclusive

2.1 Effective intermediation for a high value-added and high-income economy

2.2 Developing deep and dynamic financial markets

2.3 Financial inclusion for greater shared prosperity
The Malaysian financial system’s ability to allocate financial resources effectively and efficiently will be crucial to support Malaysia’s transformation to become a high value-added, high-income economy. Amid greater regional economic and financial integration, the financial sector will also have a more prominent role in intermediating funds in the region and other emerging economies. A more diversified, efficient, competitive and stable financial system is therefore a necessary precondition for Malaysia’s economic transformation.
The financial system must be able to mobilise savings effectively from domestic and cross-border sources, towards meeting the large and diverse financing and investment needs of the domestic economy and across borders, particularly in the Asian region and other emerging economies.

The financial sector today is well positioned to advance and benefit from the opportunities emanating from a more competitive and integrated environment. In the recent decade, the Malaysian financial system has performed its intermediation function without disruption even during the height of the recent global financial crisis. This achievement reflects the resilience of the financial system during periods of increased volatility and turmoil or economic downturn. The significance of the bond market has also increased with a broader spectrum of financial instruments to meet the long-term funding needs of large businesses and projects with long gestation periods. Reliance on the capital market by the Malaysian corporate sector for funding has therefore increased, with the corporate debt securities and sukuk market now accounting for 58.5% of total corporate financing as at end-2010, compared with 46.4% in 2001. In this regard, financing activity for the corporate sector has transitioned towards becoming more market-based from being predominantly bank-based in the early 2000s.

The lending structure of the banking sector has hence evolved from predominantly corporate loans towards more retail-based loans to household consumers, and business loans to small and medium enterprises (SMEs). The share of outstanding loans to the household sector has increased from 34.4% of total outstanding loans as at end-2000 to 55.4% as at end-2010, while SME financing has increased from 31.1% to 38.5% of total outstanding business financing during the same period. The enhanced financing environment for SMEs followed the implementation of a comprehensive set of initiatives to support the financial requirements of SMEs, improve processes and procedures within financial institutions, and facilitate the availability of advisory services, including redress mechanisms, by the industry and other agencies such as those provided by the Bank and SME Corporation Malaysia established in 2009. Overall, the strengthening of risk management processes and corporate governance in the financial industry has enabled financial institutions to perform their intermediation function more prudently and effectively.

Moving forward, a number of key broad economic trends will affect the intermediation function performed by the financial sector:
• Increased diversification in Malaysia's economic structure, where the manufacturing and services sectors will increasingly advance up the value chain towards higher value-added activities. Economic growth will be increasingly driven by knowledge-intensive and more innovative industries, and a larger pool of more advanced SMEs, with improved processes, product innovation and market outreach.

• Development of more advanced and extensive infrastructure in the domestic economy, as well as in the region. In Malaysia alone, an estimated RM1.3 trillion of investments in knowledge-intensive as well as large and long-term infrastructure projects is required under the Economic Transformation Programme over the course of the next ten years. Of significance, 92% of this funding requirement is expected to be sourced from the domestic financial system. Meanwhile, the financing requirements to support the massive infrastructure development needed in the Asia Pacific region are also expected to be sizeable, estimated to be at USD8 trillion over the next decade (Asian Development Bank: Infrastructure for a Seamless Asia – 2010).

• Greater international and regional economic and financial integration will provide new opportunities and markets for the Malaysian corporate and financial sectors.

• Changing demography in Malaysia, with a larger pool of more affluent middle-income consumers, a more mature population, and more financially-savvy consumers.

The financial sector today is well positioned to advance and benefit from the opportunities emanating from a more competitive and integrated environment.
To support a more diverse range of enhanced demands for financial services, the financial sector will need to improve and expand its role to effectively and efficiently mobilise larger volumes of funds from a broad range of sources – from households in the form of traditional retail deposits and insurance premiums, to more sophisticated sources such as pension funds and institutional investors – within Malaysia and also the region. There will therefore need to be more effective matching of sources of funds with the diverse financing needs of the economy. The financial markets are also expected to grow in significance, functioning as an important intermediary for fund-raising and for investors seeking market returns for wealth creation, accumulation and preservation. To respond to these expected trends, financial institutions will need to strengthen their capacity and capability to offer a wider range of financial products and services that can cater for the whole spectrum of risk, liquidity and maturity preferences of borrowers and investors. This trend will gain greater significance as regional financial integration intensifies.

The Malaysian financial system, which includes the presence of foreign financial institutions and a more developed financial market, is well positioned to effectively mobilise regional savings to be channeled to regional investment activities. This would also involve the effective and efficient intermediation in multiple currencies. In terms of financing, it is envisaged that commercial banks and development financial institutions (DFIs) will continue to be the main providers of traditional forms of financing to households and SMEs. Investment banks will also be key players in arranging financing and other financial solutions for firms, with a greater focus on large investment activities across borders and in multiple currencies. To support the demands of innovation-driven economic activities and start-up ventures, a vibrant risk capital ecosystem will be required to provide financing avenues beyond traditional bank financing. In tandem with the larger pool of funds mobilised from investment-related products, opportunities exist for financial institutions to expand their scope of financing beyond traditional financing, towards more equity-based and risk capital funding. Towards this end, there will be a greater shift towards a more balanced risk-taking culture among
financiers that will facilitate new ventures by entrepreneurs while recognising the possibility of bona fide failures among new start-ups. In support of this development, the enabling infrastructures will be developed to reduce information asymmetries and increase the volume of information flow which is critical to facilitate better credit assessments and to promote the more efficient pricing of risks. Going forward, the financial markets are also expected to have a more meaningful role in financial intermediation, expanding the breadth and depth of financial instruments to facilitate the better matching of long-term savings and investments. This will be complemented by creating an enabling environment to support large-scale financing.

To support the demands of innovation-driven economic activities and start-up ventures, a vibrant risk capital ecosystem will be required to provide financing avenues beyond traditional bank financing.
for projects with long gestation periods, in particular for infrastructure financing.

As Malaysia enhances its trade and investment linkages with the region and other parts of the world, the financial sector has a crucial role in supporting the expansion of Malaysian corporations, intermediating surplus funds from the region to productive investments, and facilitating cross-border capital flows. Increasing consumer demand from a larger middle-income population in the region will also be a key impetus for a more sophisticated and comprehensive range of financial services. The presence of Malaysian banks in the region is expected to continue to expand and become more entrenched, while the financial markets is expected to deepen with expanded international outreach, especially in Islamic finance. In the process, the mobilisation of cross-border funds to meet the financing and investment needs of domestic, regional and international businesses will contribute significantly to the deepening of the financial system in Malaysia.

The aim is therefore to develop a vibrant and sustainable financial system that will facilitate economic activities moving up the value chain, meet domestic and regional financing needs of all firms across the risk-reward spectrum, and support financing of large and long-term projects. The capacity of the financial system will also be enhanced to better support the

**The financial sector as an enabler of growth**

**Enabler of Growth**

The financial sector should effectively & efficiently allocate resources to the relevant activities that facilitate the transformation of Malaysia towards a high value-added, high-income economy

- **Businesses**
  - 1. Financing new areas of growth
  - 2. Financing innovation & entrepreneurship
  - 3. Financing modern infrastructures
  - 4. Financing internationalisation of businesses

- **Households**
  - 5. Education, retirement & healthcare products
  - 6. Providing greater sophistication in wealth management
internationalisation of Malaysian businesses as well as provide a comprehensive range of solutions for mitigation of business and financial risks.

In terms of the provision of financial products and services to households, as Malaysia transitions to become a high-income economy, the expansion of the middle class and rising income levels will require more diversified and differentiated risk-return savings and investment products, and financing options for education, wealth creation, accumulation and preservation, and financial planning. Consumers will also demand for a more diverse range of high-quality financial products and services that are cost-effective and reliable, and offered through more accessible, convenient and cost-effective delivery channels.

In tandem with the gradually maturing population, greater emphasis will also be accorded to develop products and services that cater for retirement and long-term medical demands of consumers. The development of a robust and efficient pension framework will also contribute as an important source of long-term funding for large major projects required to facilitate the economic transformation process.

The mobilisation of cross-border funds to meet the financing and investment needs of domestic, regional and international businesses will contribute significantly to the deepening of the financial system in Malaysia.
Going forward, the vision is for the financial sector to serve as the foundation from which Malaysia’s transformation into a high value-added, high-income economy can be achieved through effective and efficient domestic and regional financial intermediation that will comprehensively mobilise diverse savings towards a wide spectrum of investment activities in Malaysia and across borders. The financial sector will be able to channel funds from surplus to deficit entities, through a complete range of intermediaries, markets and instruments, and perform the intermediation function to the highest value creation at a competitive cost. This process will be driven primarily by productive competition and sustainable practices, thereby contributing towards the preservation of financial stability. This will be achieved by having the following:

- A vibrant and sustainable ecosystem comprising diversified, strong and competitive financial institutions and diversified financial markets, supported by effective and efficient financial infrastructure, as well as a conducive operating environment;
- An appropriate balance between regulatory and market-based mechanisms to ensure the continued development of the financial sector in providing financial products and services that meet the demands of businesses and individuals; and
- Greater regionalisation and internationalisation of the Malaysian financial system.
Recommendation 2.1.1

Enhance the financial sector’s capability to support high value-added activities. This includes supporting the financial needs of innovative enterprises throughout the lifecycle, which will encompass the transition to the growth and expansion stages, and facilitating efficient exit for early stage investors, by:

i. Enhancing the role of financial institutions in developing profit- and risk-sharing investment and financing facilities, such as equity- and quasi-equity-based financing. This will be complemented by sufficient safeguards to ensure that such activities are not funded by retail deposits in these financial institutions.

ii. Promoting the offering of factoring and leasing by financial institutions and DFIs to meet the needs of small businesses and start-ups. This would also include international factoring to finance exporters, given Malaysia’s high trade openness.

iii. Promoting the full range of financing by DFIs to targeted strategic sectors, particularly in the agriculture, cooperative and SME sectors.

iv. Promoting market-based alternatives, such as a receivables exchange which allows

Financing innovation and entrepreneurship

A financial system that efficiently provides financing to support innovation & entrepreneurship

1. Growth of innovative firms & entrepreneurship at all stages of development requires different sources of financing

Different stages of innovative firms require different forms of financing

<table>
<thead>
<tr>
<th>Stage</th>
<th>Source</th>
<th>Business</th>
<th>Govt &amp; others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seed</td>
<td></td>
<td>0%</td>
<td>20%</td>
</tr>
<tr>
<td>Start-up</td>
<td></td>
<td>20%</td>
<td>40%</td>
</tr>
<tr>
<td>Early growth</td>
<td></td>
<td>40%</td>
<td>60%</td>
</tr>
<tr>
<td>Expansion</td>
<td></td>
<td>60%</td>
<td>80%</td>
</tr>
<tr>
<td>Valley of death</td>
<td></td>
<td>80%</td>
<td>100%</td>
</tr>
</tbody>
</table>

R&D by sources of funding

EU: Business sources of funding for R&D

<table>
<thead>
<tr>
<th>Source</th>
<th>Own financing</th>
<th>Bank borrowings</th>
<th>Market financing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Equity</td>
<td>Bond</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>81.4%</td>
<td>5.0%</td>
<td>1.1%</td>
</tr>
<tr>
<td>Korea</td>
<td>64.4%</td>
<td>20.0%</td>
<td>15.6%</td>
</tr>
<tr>
<td>EC</td>
<td>81.4%</td>
<td>5.0%</td>
<td>3.6%</td>
</tr>
<tr>
<td>PR China</td>
<td>64.4%</td>
<td>20.0%</td>
<td>15.6%</td>
</tr>
<tr>
<td>US</td>
<td>81.4%</td>
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</tr>
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<td>Canada</td>
<td>64.4%</td>
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</tr>
<tr>
<td>UK</td>
<td>81.4%</td>
<td>5.0%</td>
<td>15.6%</td>
</tr>
<tr>
<td>EU</td>
<td>65.4%</td>
<td>20.0%</td>
<td>15.6%</td>
</tr>
</tbody>
</table>

businesses to sell receivables to institutional investors in a real-time auction, for more effective access to funding.

v. Promote the development of expertise to support new growth areas such as green technology and the adoption of socially and environmentally sustainable financing practices which are consistent with international standards.

**Recommendation 2.1.2**

Increase the supply of a broad range of private risk capital funding across all stages of financing by collaborating with the Government and other agencies to:

i. Promote the establishment of funds of funds that invest in the venture capital industry both domestically and regionally, and provide incentives for investments in innovative local start-ups. The sources of financing could potentially originate from domestic and foreign business angels, private equity and venture capital funds, as well as institutional investors.

ii. Facilitate the establishment of new institutions with specialised expertise to provide risk capital financing, complementing the private equity and venture capital industries. The capacity and capability of DFIs to have a greater role in providing risk capital financing to support targeted strategic sectors will also be enhanced.

**Recommendation 2.1.3**

Enhance the capacity of the financial sector to support the financing needs of domestic and regional large-scale projects with long gestation periods, including infrastructure development. The provision of products with longer maturities will meet the longer-term investment demand of insurance companies and institutional investors, including pension funds. Towards this end, the following measures will be pursued:

i. Encourage strategic partnerships between domestic financial institutions and foreign financial institutions specialising in long-term project financing to strengthen domestic capabilities.

ii. Promote the regionalisation of Malaysian financial institutions to participate in the effective mobilisation and allocation of regional capital in addition to domestic savings, towards both local and regional projects.

iii. Support the establishment of new institutions with specialised expertise in structuring large and long-term financing, in particular infrastructure funds to capitalise on economies of scale by pooling funds from a diverse range of investors, as well as mobilise regional savings to be invested in domestic and regional projects.

iv. Strengthen the risk assessment and management capabilities of insurance companies and institutional investors,
including pension funds, to better ascertain the prospects and financial viability of long-term projects, instead of relying solely on the credit ratings of such instruments.

**Recommendation 2.1.4**

Support the regionalisation and internationalisation of Malaysian businesses by strengthening Malaysian financial institutions’ knowledge of the different markets to overcome the key challenge of information asymmetries. This includes:

i. Establishing strategic partnerships with foreign counterparts to facilitate greater information exchange, counterparty risk assessments and market information.

ii. Collaborating with Government agencies, industry specialists, DFIs, financiers, and industry and business associations to establish a common platform for information exchange on financial products and services and other relevant information. International linkages will be established with global entities such as foreign financial institutions, foreign trade promotion agencies and multinationals to facilitate greater synergies.

iii. Facilitating more significant presence and participation of qualified Malaysian financial institutions abroad, supported by cross-border coordination and cooperation in financial regulation, supervision, surveillance, and crisis prevention and resolution mechanisms to preserve financial stability.

**Financing for greater internationalisation of businesses**

<table>
<thead>
<tr>
<th><strong>A financial system that effectively facilitates the internationalisation of Malaysian firms</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Expansion of firms abroad requires a myriad of financial services</td>
</tr>
<tr>
<td>2. Private financial institutions to meet financing needs that support the internationalisation of firms</td>
</tr>
</tbody>
</table>

**Necessary financial services for successful internationalised firms**

- Increasing need for cross-border financing as overseas business opportunities for companies expand
- Particularly, funding will be required for three major purposes:

**Trade Finance**
- Trade finance for exports & imports
- Credit insurance to mitigate default risk

**International Finance**
- Funding of overseas plants & operations
- Includes small, shorter tenure loans as working capital

**Project Finance**
- Large, long tenure loans with limited recourse to the project sponsor
- Requires credit assessment capability to guarantee against risks

- To be complemented by additional end-to-end advisory services

- Need for specialist financial institutions (e.g. export credit agencies & export-import banks) to complement private financial institutions
- Market-based solutions

- Structural limitations potentially inhibit the local market’s capacity to lend
Recommendation 2.1.5

Promote a conducive environment for financial institutions to develop more products and enhance services for businesses to better manage business risks, by:

i. Promoting the development and offering of a wide range of foreign currency products and services to meet the demands of businesses for foreign currency financing, hedging of foreign currency receipts and payments, as well as other foreign currency exposures.

ii. Promoting the development and offering of political risk insurance to ensure adequate protection for Malaysian businesses that expand abroad.

iii. According greater flexibility for qualified insurers and takaful operators to underwrite surety bonds and provide credit guarantee insurance. This will provide businesses with greater diversity of products that mitigate risks such as non-performance of contracts and non-payment by debtors. Existing caps on these insurance businesses will be gradually removed, subject to compliance with prudential requirements as well as the institutional capacity and financial soundness of the insurers and takaful operators.

iv. Facilitating greater injection of foreign expertise in the insurance and takaful broking and loss adjusting industries to better support insurance and takaful business, especially for the risk mitigation needs of firms engaged in high value-added activities.

Recommendation 2.1.6

Improve access to information to reduce information asymmetries and enhance the effectiveness and efficiency of financial intermediation. This includes:

i. Strengthening the credit information framework to facilitate more comprehensive financial assessments of borrowers, taking into account their repayment track records on other obligations which are not currently captured by the Central Credit Reference Information System (CCRIS).
ii. Establishing a technology advisory facility that pools the expertise of domestic and regional practitioners and academicians to strengthen the capability of financial institutions in assessing knowledge- and technology-based proposals. The feasibility and prospects of businesses will be assessed through a rating system. Such assessments should be available upon request by financial institutions or directly by the businesses.

iii. Collaborating with the Government to set up an integrated platform to allow both domestic and foreign investors to network with entrepreneurs for the purpose of exploring investment opportunities. This is also aimed to provide a one-stop centre for entrepreneurs to advertise business ideas and empower them with appropriate business and financial skills.

**Recommendation 2.1.7**

Develop a vibrant private pension industry to enhance Malaysians’ financial preparedness for retirement and old age. The voluntary private pension industry would effectively complement mandatory retirement saving schemes and old-age welfare safety nets. The private pension industry will also support the core objectives of the Government’s pension reform initiative, which includes protection against the risk of old-age poverty and consumption-smoothing in order to maintain reasonable living standards from work-life into retirement. The development of the pension industry is also expected to enhance the role of pension funds as a key source of funding, particularly for the longer-term and risk-based financing needs of the economy. Efforts will be focused on positioning insurance companies and banking institutions as significant intermediaries in the private pension industry to drive the outreach of retirement products by leveraging on their extensive distribution networks, as well as on enhancing consumer awareness by promoting the overall confidence of consumers in pension products and safeguarding the funds for retirement. This includes:

i. Developing a supporting infrastructure and regulatory framework for the development and offering of diversified and innovative pension products, such as annuities that mitigate longevity and inflation risks, “locked-in” savings that minimise pre-retirement
Financing old age & retirement and wealth management

A financial system that facilitates the adequate provision of retirement income including serving more affluent & sophisticated households

1. A well-developed financial sector can have an important role in retirement income provision that is financially sustainable, equitable from an inter-generational perspective and that provides adequate pension & social security benefits

2. Affluent and more sophisticated households would require and demand a wider range of financial services for more optimal wealth management

3. Facilitates the smoothening of household consumption patterns

Development of Pillar 3 is important for comprehensive retirement income provision

<table>
<thead>
<tr>
<th>Pillars</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pillar 0</td>
<td>Social assistance to provide a minimum level of protection</td>
</tr>
<tr>
<td>Pillar 1</td>
<td>Mandatory public pension plan (may be partially funded)</td>
</tr>
<tr>
<td>Pillar 2</td>
<td>Mandatory occupational / personal pension plan (fully funded)</td>
</tr>
<tr>
<td>Pillar 3</td>
<td>Voluntary occupational / personal pension plan (typically market-driven)</td>
</tr>
<tr>
<td>Pillar 4</td>
<td>Informal support (including family), other formal social programmes (including healthcare), other individual financial &amp; non-financial assets (including home ownership)</td>
</tr>
</tbody>
</table>


Wealth management landscape in Malaysia

As the pool of mass affluent grows in Malaysia as well as across the region, there will be greater demand for innovative and customised financial solutions to meet the varying demands of individuals
leakages and financial solutions for retirees such as reverse mortgages.

ii. Collaborating with the Government to develop incentives to spur the development of the private pension industry by the insurance companies and banking institutions.

iii. Promoting greater consumer education and the adoption of simple and comprehensible product disclosure and transparency standards.

iv. Strengthening the financial safety net for pension products to promote confidence and predictability of the expected retirement income levels.

v. Implementing appropriate regulatory parameters applicable to pension products to safeguard their ability to fulfill the financial needs at retirement.

Recommendation 2.1.8

Enhance the provision of wealth management products and services to better cater to the demands of the growing affluent segment of the community. As the pool of the affluent grows in Malaysia as well as across the region, there will be greater demand for innovative and customised financial solutions to meet the varying demands of individuals. Financial advisory services will become increasingly crucial in the planning and arrangement of the financial affairs of the affluent, ranging from estate management, asset allocation, tax planning to retirement planning.

Moving forward, the institutional set-up and infrastructure to support a more effective provision of wealth management products and services will encompass the following measures:

i. Streamlining the current dual licensing regime for financial advisers and financial planners, including potential harmonisation and convergence of regulatory and operating requirements for financial planners and advisers.

ii. Encouraging the establishment of family offices to better accommodate the demands of ultra high net worth individuals and families, which will also contribute towards Malaysia’s aspirations to become a global centre for Islamic wealth management.

iii. Promoting Islamic fund and wealth management activities through the offering of innovative financial solutions to meet the more sophisticated investment demands of the increasingly affluent population, including households in Asia.

iv. Enhancing the development of important ancillary services that support the wealth management industry, such as legal services and real estate planning, in collaboration with relevant regulatory agencies and industry associations.

v. Facilitating the internationally-established financial institutions present in the Labuan International Business and Financial Centre (Labuan IBFC) to offer services through foundations and private trust companies to institutional investors and high net worth individuals.
**Recommendation 2.1.9**

Enhance the capacity and capability of the insurance and takaful industry to provide higher value-added medical and health insurance. This includes:

i. Encouraging insurers and takaful operators to offer higher-end and more sophisticated insurance and takaful products, complementing the basic protection to be provided under the oncoming national health financing scheme. This includes the provision of long-term care benefits, such as assisted-living and hospice care.

ii. Encouraging greater strategic alliances between domestic insurance companies and foreign financial institutions with specialised expertise in medical and health insurance and takaful.

**Recommendation 2.1.10**

Introduction of greater operational flexibility for financial institutions to introduce new products, expand the distribution network and widen their outreach to consumers subject to appropriate safeguards and meeting prudential requirements. Innovation in delivery channels over the years, particularly in the retail segment, has been catalysed by the advent of new technology and the drive by financial institutions to reduce costs, enhance revenues, increase customer satisfaction and widen outreach nationwide. Among the key initiatives that will be introduced under this broad strategy include:

i. Gradually removing restrictions for locally-incorporated foreign banking institutions to establish non-branch delivery channels, such as off-site electronic terminals and kiosks. This is in line with the objective to promote electronic means as a key delivery channel for financial services to accelerate the migration towards electronic payments (refer to the chapter Electronic Payments for Greater Economic Efficiency). Banking institutions are expected to leverage on this flexibility to introduce more cost-effective delivery channels for financial services to consumers.

ii. According greater flexibility for locally-incorporated foreign banking institutions to establish more physical branches in the medium term, with the aim of promoting greater outreach of financial services. These flexibilities will also be balanced with safeguards to ensure that banking institutions continue to fulfill their role in meeting the financial inclusion objectives (refer to the chapter Strengthening Regional and International Financial Integration).

iii. Encouraging insurers and takaful operators to enhance the offering of insurance and takaful products through non-branch delivery channels. This aims to expand the outreach of insurance and takaful services through more cost-effective means and contribute towards enhancing the insurance and takaful penetration rate in the country.
iv. Allowing locally-incorporated foreign banking institutions to conduct hire purchase business. This will be facilitated through appropriate legislative amendments.

**Recommendation 2.1.11**

Enhance service quality in the provision of financial services and the conduct of business by financial institutions through:

i. Collaborating with industry associations and training institutes to develop market-based mechanisms and training programmes aimed towards enhancing the level of service quality in the financial sector.

ii. Enhancing fair dealing in financial services through transparent service quality measurements.

The implementation of the initiatives identified in this chapter will commence immediately, with a particular focus on strategies to reinforce the financial infrastructure and create a conducive ecosystem for more effective intermediation of funds in the short to medium term. These include initiatives such as enhancing the credit information framework and establishing a technology advisory facility to support assessments of knowledge and technology-based proposals. Efforts to enhance the institutional structures will be made on an ongoing basis to continuously promote greater efficiency in the intermediation process, such as encouraging financial institutions to develop alternative forms of financing and promoting the offering of new financial products and services to meet demands of the changing demography.
Financial markets have an important role in the productive mobilisation of savings and allocation of capital. Efficient financial markets also support the effective transfer of risks and management of liquidity. As Malaysia transitions towards a high value-added, high-income economy, vibrant, competitive and resilient financial markets are necessary to meet the diverse and more complex demands of a more developed and internationally integrated economy.
Currently, the Malaysian financial markets are among the more developed markets in Asia. The size of the debt securities market has grown to RM867 billion or 105% of GDP in 2011, making it one of the larger debt securities markets in emerging Asia. The debt securities market has continued to develop with a growing presence of international issuers and investors.

The Islamic capital markets have also expanded both in terms of ringgit and foreign currency issuances and the range of new financial instruments. Issuers have responded to the demand for more innovative Islamic financial products and services. The progress has also culminated with the launchings of ringgit and foreign currency sukuk indices, developed in collaboration with the Association of Islamic Banking Institutions Malaysia, Bloomberg and Bank Negara Malaysia. These indices mark another significant milestone achieved in the internationalisation of Islamic finance in Malaysia.
The money market and the foreign exchange market have grown in depth and liquidity. The daily average volume traded in the money and foreign exchange markets in 2010 reached RM39 billion and USD7.3 billion respectively. Turnover in the foreign exchange market has increased significantly to 3.32 times the volume of trade in goods and services, higher than the 1.64 times registered in 2005. The size of the equity market has also expanded, with market capitalisation increasing from RM444 billion in 2000 to RM1.2 trillion in 2010.

Meanwhile, direct investment and portfolio capital flows have increased in both directions, with a rising trend of foreign and portfolio investment abroad by Malaysian corporations and institutions. These flows, and the continued expansion of regional and international trade, will cement the direction for greater integration of Malaysian financial markets with the international financial markets, in particular, those in Asia.

Much of the progress in the financial markets reflects the combined result of the Bank’s initiatives with other regulators and market players. The progressive liberalisation of the capital account and the opening up of the financial system and markets to a larger group of foreign institutions were also important contributing factors. In addition, the regulatory environment have facilitated financial market and real sector economic activities.

**Wholesale foreign exchange & interbank money market monthly volume**

![Graph showing monthly volume](https://via.placeholder.com/150)

Source: Bank Negara Malaysia
Moving forward, the Blueprint envisions that the Malaysian financial markets will grow in breadth and maturity, and become an important gateway to the ASEAN markets. In Islamic finance, it is envisaged that Malaysia will become a leading international Islamic financial centre. To fulfil these objectives, domestic financial markets will be geared to perform the following roles:

• Competitively meet the funding requirements of corporations, financial institutions and investors across the maturity spectrum and diversity of funding requirements;
• Address investment needs across a variety of institutional and retail investors through marketable or customised solutions in terms of choices of instruments and asset classes;
• Offer a variety of risk management solutions to meet the diverse demands of portfolio investors, financial institutions and corporations in investments, financing, and trade activities; and
• Intermediate competitively across domestic and regional markets and facilitate investment, financing, trade payment and settlement in the region.

The Malaysian financial markets will grow in breadth and maturity, and become an important gateway to the ASEAN markets; while in Islamic finance, Malaysia will position itself as the leading international Islamic financial centre.
Enabling Conditions

Vibrant financial markets rely on a holistic development of the money, foreign exchange, bond, equity and derivatives markets as well as the supporting infrastructures. Institutional capacity building and prudential safeguards that were put in place thus far have strengthened financial players’ capabilities and resilience and have better positioned the industry in a more integrated and competitive environment. Strong and highly rated financial institutions supported by globally integrated settlement and payment system will further increase the ability of the markets to provide competitive offerings and conduct cross-border financial activities. This includes leveraging on the strong and large international financial institutions in the Labuan International Business and Financial Centre (IBFC) to contribute to the vibrancy of the markets. Reinforced by a supportive regulatory framework, which will allow Malaysia to become a netting friendly jurisdiction, the costs in undertaking financial market transactions in Malaysia will be reduced considerably.

Progressive liberalisation of foreign exchange administration together with commitments to support financial market developments will further enhance the country’s regional and international linkages. With the preconditions in place, it paves the way for the full ‘internationalisation’ of the ringgit, where access to the ringgit market by non-residents for purposes beyond settlement of trade and investment will be fully liberalised. While such a move would further increase the efficiency in undertaking financial transactions in the ringgit market, it would also be accompanied by the risk of potentially destabilising speculative foreign exchange activities.

Preconditions therefore need to be met including having deep and vibrant domestic foreign exchange and money markets as well as ensuring sound risk management and corporate governance practices by financial market players. These preconditions will facilitate increasing two-way flows and the development of avenues and tools to manage risks. The surveillance framework and prudential safeguards will also need to be enhanced to mitigate or manage such risks, in particular to prevent excessive speculative activities that would undermine the overall macroeconomic and financial stability.

The recommendations in the Blueprint will focus on the money, foreign exchange and government securities markets. The recommendations outlined below will form the core of the Bank’s initiatives to develop these markets.
**Recommendation 2.2.1**

Promote an efficient and competitive money market with greater depth and liquidity by offering a wide range of liquid ringgit and multi-currency money market instruments, with participation by a wide variety of players. This includes:

i. Reducing counterparty risks and enhancing liquidity in money market transactions by promoting greater volume of securities and collateralised transactions. This will involve further development of the repurchase agreement (repo) market for domestic and cross-border transactions. The Bank aims to achieve a target of 70% of wholesale money market transactions to be in conventional and Islamic repo or any other form of collateralised transactions by promoting repo transactions for ringgit and foreign currencies funding including the use of cross-border collateral denominated in foreign currencies. In addition, it will be facilitated by conducting monetary operations with greater reliance on securities and collateralised transactions including accepting highly rated corporate short-term papers and qualified foreign currency securities.

ii. Widening participation in the wholesale money market to include qualified corporations to enhance liquidity. This includes allowing corporations that meet the qualifying criteria to participate directly in the wholesale money market and expanding the intermediary roles of money market brokers to provide services to the qualified corporations.

iii. Promoting deep and liquid interest rate derivatives for cost-effective hedging by financial institutions and corporations through the liberalisation of non-residents’ participation in the onshore interest rate derivatives market to enhance market liquidity and to raise the level of knowledge and skills to encourage greater use of interest rate derivatives by corporations, pension funds and insurers and takaful operators.

iv. Enlarging the size and range of Islamic money market instruments to cater for different market needs through innovative Shariah-compliant solutions by promoting equity-based (including hybrid) instruments. This would be achieved by using these instruments in the Bank’s market operations, and to collaborate with market participants to establish a mechanism/platform for Islamic banks to hedge their risk exposures.
Recommendation 2.2.2

Deepen liquidity in the government debt securities and sukuk markets by enhancing the benchmark yield curve, increasing product offerings and introducing government debt securities derivatives products. A liquid government debt securities market would contribute to minimising the cost and risk of financing to the Government and provide a reflective benchmark yield curve that facilitates market participants to appropriately price private debt securities. It will also enable the Government to better manage its public debt and for the private sector to more efficiently raise funding to finance long-term initiatives. Towards this end, the recommendations include:

i. Collaborating with the Government, to increase the issuance frequency of government benchmark securities across the yield curve and ensuring the issuance sizes are sufficient to support liquidity and benchmarking by the financial markets.

ii. Facilitating active buy-back or conversion of the off-the-run government securities to support liquidity and more transparent pricing of the entire yield curve.

iii. Enlarging the issuance size of government treasury bills to enhance the Government’s financial management and debt operation.

iv. Increasing the product dimension in the government securities market to create benchmark pricing for these instruments by introducing long-term and index-linked securities, promoting innovative Shariah-compliant government securities using equity and hybrid contracts and issuing securities in regional currencies to enhance the product offerings for the foreign currency debt securities and sukuk market in Malaysia. This may also include issuance of securities in regional currencies out of the Labuan IBFC.

Recommendation 2.2.3

Broaden the investor base for the government securities market, by:

i. Exploring cost-effective investment and distribution channels for direct retail participation in the debt securities and sukuk markets, especially in the government securities market.

Efforts will be concentrated on improving liquidity, depth and participation in the money, foreign exchange and government securities markets, and the foreign exchange administration rules will be progressively liberalised to further raise efficiency in financial market transactions.
ii. Collaborating with regional countries to develop a regional principal dealers’ framework to be the market makers for cross-border dealings of government securities.

**Recommendation 2.2.4**

Enhance avenues for risk management and instruments to manage risk exposures. Derivatives and other risk management instruments can be used to protect the value of investments, hedge liabilities and also enhance secondary market liquidity, through:

i. Providing further flexibilities to Principal Dealers in undertaking short-selling activities.

ii. Broadening the scope of Guidelines on Securities Borrowing and Lending Programme to allow non-Principal Dealers to borrow and lend securities.

iii. Enhancing the mechanism and infrastructure that facilitate securities-driven repo transactions such as central clearing for repo transactions.

iv. Structuring government securities issuances to support the design and specification of government securities futures contract.

**Recommendation 2.2.5**

Developments in the foreign exchange market in Malaysia have so far focused on meeting the growing needs of the real sector for trade and direct investment. As corporations expand their businesses overseas and more Malaysians invest internationally, there is a need to offer diversified products and services to meet such foreign currency financing for long-term investments, hedging of receipts and payment and for other risk management purposes. In this regard, the recommendation places emphasis on enhancing access and improving liquidity in the foreign exchange market and encouraging financial institutions to offer a wider range of foreign currency products and services. The recommendation is therefore to broaden the participation in the onshore foreign exchange market by:

i. Allowing corporations to actively manage foreign currency exposures arising from their overseas operations.

ii. Permitting institutional funds and retail investors to trade in foreign currencies, including margin trading, as a new investment class and avenue, subject to suitable safeguards.

iii. Allowing financial institutions to offer internet and electronic trading platforms for corporations and retail investors, subject to full disclosure of risks, and in compliance with prudential safeguards and investor protection requirements.

iv. Permitting participation by non-residents in the onshore foreign exchange derivatives market without underlying trades or investments, subject to prudential limits on funding and size of open positions.
Recommendation 2.2.6

Support the use of regional currencies for trade settlement and direct investment activities to reduce transaction costs and risks in regional cross-border transactions. This would lead to the creation of new asset classes in the Malaysian market, characterised by a broad range of investment products denominated in regional currencies, by:

i. Encouraging financial institutions to provide direct foreign exchange cross quotations with both onshore and offshore counterparties. The Bank will provide foreign currency liquidity in designated regional currencies to facilitate trade settlement.

ii. Allowing financial institutions to quote ringgit crosses to residents and non-residents with appropriate safeguards to enhance intermediation linkages.

iii. Promoting Malaysia as a centre for regional treasury operations for home-grown resident multinational companies and foreign multinational corporations.

Recommendation 2.2.7

Develop infrastructure and institutional arrangements that will support efficient and cost-effective foreign currency trading, payments and settlements onshore. This includes:

i. Promoting a common network infrastructure that includes establishing linkages between Real-time Electronic Transfer of Funds and Securities system and international securities depositories.

ii. Creating an electronic trading platform for regional currencies, to complement cost-effective offering of cross-border financial products and services.

iii. Collaborating with the financial market industry to establish a Self Regulatory Organisation to elevate professionalism in the foreign exchange market.

The implementation of the initiatives will commence immediately with a focus on widening product variety and access to financial markets and enhancing integration with the regional and global markets. Over the medium term, the implementation of the strategies will focus on strengthening the financial institutions’ capacity and widening access to financial markets for a larger number of participants. This will improve market liquidity and create more business opportunities as well as promote market activities. Concurrently, the market infrastructure will be enhanced to support the efficiency of financial transactions. In the medium to long-term, integration of the financial markets with the regional and global markets will be further enhanced by allowing greater access to non-residents. As the Malaysian financial markets develops with strengthened risk management capabilities and the necessary prudential safeguards and investor protection mechanism in place, Malaysia will become significantly internationally-integrated with strong linkages to other emerging economies and the traditional financial centres.
Pursuing the financial inclusion agenda, where all members of society have the opportunity to participate in the formal financial system, will continue to be a key component of Malaysia’s inclusive growth strategy. Financial inclusion will enable all citizens, including the low-income and rural residents, to have the opportunity to undertake financial transactions, generate income, accumulate assets and protect themselves financially against unexpected adverse events, thereby enabling them to benefit from economic progress. This will in turn contribute to balanced and sustainable economic growth and development.
Many initiatives implemented over this recent decade have significantly improved financial inclusion in Malaysia. These include the introduction of new financial products and services that meet the diverse requirements of all segments. This has been reinforced with the development of a consumer education and protection framework, as well as the strengthening of the enabling financial infrastructure. In addition, the role and capacity of development financial institutions (DFIs) have also been enhanced. As a result of these initiatives, the take-up of deposits has increased from 1,975 deposit accounts per 1,000 adults in 2000 to 2,954 deposit accounts per 1,000 adults in 2010. Meanwhile, the take-up of financing has increased from 310 financing accounts per 1,000 adults in 2000 to 858 financing accounts per 1,000 adults in 2010. These achievements have elevated Malaysia’s position in various global financial inclusion rankings. This includes Malaysia’s number one ranking since 2007 for “Getting Credit” in the “Ease of Doing Business” index by the World Bank and number eight out of 142 countries in 2011 for “Ease of Access to Loans” by the World Economic Forum.

### Cross country comparison of selected financial inclusion indicators

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<th>Bangladesh</th>
<th>Indonesia</th>
<th>Thailand</th>
<th>Netherlands</th>
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<th>Japan</th>
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<tr>
<td><strong>Deposit Accounts</strong></td>
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<tr>
<td>Number of accounts per 1,000 adults</td>
<td>357</td>
<td>505</td>
<td>1,449</td>
<td>1,766</td>
<td>2,236</td>
<td>7,172</td>
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<tr>
<td><strong>Financing Accounts</strong></td>
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<tr>
<td>Number of accounts per 1,000 adults</td>
<td>80</td>
<td>197</td>
<td>272</td>
<td>1,085</td>
<td>915</td>
<td>178</td>
</tr>
</tbody>
</table>

Source: Consultative Group to Assist the Poor (CGAP) and Bank Negara Malaysia
Recommendation 2.3.1

Adopt innovative channels to enhance the outreach of quality and affordable financial services in a more cost-efficient manner. This includes:

i. Supporting the development of agent banking by developing a comprehensive agent banking framework to enable outreach of financial services at lower costs. Agent banking is the use of non-bank retail outlets (for example, post offices, petrol stations and other retail chains) by financial institutions to deliver financial services. By leveraging on technology, agent banking also contributes to the electronic payments agenda by facilitating an increase in the number of debit cards, point-of-sale terminals and mobile banking services.

ii. Accelerating the roll-out of innovative delivery channels, including mobile banking, by leveraging on technological advancements and strengthening collaboration.

Greater efforts are required to achieve the vision of an inclusive financial system that best serves all members of society, including the underserved, to have access to and usage of quality, affordable essential financial services to satisfy their needs, towards greater shared prosperity.
amongst relevant stakeholders, including telecommunication companies. This will provide users with the convenience to perform financial transactions at all times without the need to visit a physical access point.

A comprehensive agent banking framework will be developed to enable outreach of financial services at lower costs

**Recommendation 2.3.2**

Expand the range of products and services that will meet the distinct financial needs of all citizens, including the underserved. This includes:

i. Encouraging flexible micro financing products that enable prompt drawdown of financing in times of need and prepayment of financing during good times, to meet the needs of micro enterprises which have irregular or seasonal income streams.

ii. Enhancing provision of long-term contractual micro-savings products with low committed periodical savings and favourable returns to enable low-income households to inculcate the savings habit and fulfill long term goals such as starting a business, home ownership, education and to have a secure retirement.

iii. Facilitating the insurance and takaful industry to develop microinsurance and microtakaful products, which provide the underserved with adequate financial protection against unexpected adverse events in a cost-effective, accessible and easy-to-understand manner through a facilitative regulatory environment, strengthened delivery capacity, increased market awareness and enhanced consumer literacy.

**Recommendation 2.3.3**

Strengthen the institutional arrangements to provide financial services to all citizens, including the underserved and build capacity of practitioners in an effective and sustainable manner. This includes:

i. Strengthening the financial inclusion role of specialised DFIs which mobilise savings of small Malaysian savers and enhance micro financing to micro enterprises. This is achieved by having appropriate key performance indicators for financial inclusion, adequate representation on the board with expertise in financial inclusion, as well as improved potential for innovative product development.

ii. Encouraging financial training providers to offer structured and cost-effective financial inclusion training for professionals from financial institutions, cooperatives, microfinance institutions and...
non-governmental organisations (NGOs) in Malaysia, which can be extended to the region to draw on the sharing of experience from different jurisdictions.

iii. Enhancing the monitoring framework for the outcomes of financial inclusion initiatives, which are to achieve convenient outreach, high take-up, responsible usage and high consumer satisfaction, and a financial inclusion index to facilitate the tracking of the overall financial inclusion progress in Malaysia.

**Recommendation 2.3.4**

Enhance the knowledge and capacity of the underserved to utilise financial services responsibly. This includes:

i. Improving the provision of advisory services to increase the income generating capability of micro enterprises through greater participation of NGOs that have the capability to provide effective handholding and have strong relationships with the micro enterprise communities, to build skills and confidence of micro entrepreneurs.

ii. Enhancing the role and outreach of Mobile LINK (coach and mobile counter services) and the collaboration with consumer associations.

The implementation of all the initiatives will be conducted in phases over the immediate and medium term. In the first phase, efforts will be focused on adopting innovative channels to expand outreach of existing financial services to the underserved. In the second phase, the range and features of financial products and services will be further expanded to meet the diverse and distinct needs of the underserved. Finally, the capacity of financial service providers and the underserved are enhanced to intermediate funds more effectively.