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MAY 2017

THE MALAYSIA DEVELOPMENT EXPERIENCE SERIES

Financial Inclusion in Malaysia

Distilling Lessons for Other Countries



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WORLD BANK GROUP
Global Knowledge & Research Hub
in Malaysia

FINANCE & MARKETS GLOBAL PRACTICE

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The Malaysia Development Experience Series captures key lessons from Malaysia relevant for emerging economies in Asia, Africa and elsewhere that are transitioning out of poverty and into shared prosperity.

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List of Acronyms

AB	Agent Banking
AIM	Amanah Ikhtiar Malaysia
AKPK	Credit Counseling and Debt Management Agency (Agensi Kaunseling dan Pengurusan Kredit)
AML/CFT	Anti-money Laundering and Combating the Financing of Terrorism
ASEAN	Association of Southeast Asian Nations
ATM	Automatic Teller Machine
BAFIA	Banking and Financial Institutions Act
BNM	Bank Negara Malaysia
BSN	National Savings Bank (Bank Simpanan Nasional)
CCRIS	Central Credit Reference Information System
CDD	Customer Due Diligence
DFI	Development Finance Institution
DFIA	Development Financial Institutions Act
EPF	Employees Provident Fund
FCIDSS	Financial Capabilities and Inclusion Demand-side Survey (2015)
FIDSS	Financial Inclusion Demand-side Survey (2011)
FII	Financial Inclusion Index
FSB	Financial Sector Blueprint
FSMP	Financial Sector Master Plan
GDP	Gross Domestic Product
GNI	Gross National Income
ICU	Implementation Coordination Unit
JKM	Department of Social Welfare
KPWKM	Ministry of Women, Family and Community Development
KYC	Know Your Customer
MFI	Microfinance Institution
MSME	Micro, Small, and Medium Enterprises
MyKad	National Identification Card
OECD	Organisation for Economic Co-operation and Development
p.p.	Percentage Points
PIDM	Malaysia Deposit Insurance Corporation (Perbadanan Insurans Deposit Malaysia)
PIN	Personal Identification Number
PNB	Permodalan Nasional Berhad
POS	Point of Sale
ROA	Return on Assets
ROE	Return on Equity
SKM	Cooperatives Commission of Malaysia
SME	Small and Medium Enterprise

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Executive Summary

Among middle-income countries, Malaysia has achieved one of the highest levels of financial inclusion in the world. At the end of 2015, 92 percent of Malaysia's adult population had an active deposit account at a financial institution, enabling accountholders to save, withdraw money, access automated teller machines (ATMs), and carry out payments through electronic means nationwide. Most households in Malaysia have access to a wide range of conventional and Islamic finance products and services. It is estimated that more than 70 percent of Malaysian adults in the labor force are accountholders of unit trusts (mutual funds), which enable them to invest their savings in the local stock market.

Recent data reveal that the remaining segments of the population with limited or no access to financial services – low-income households, people living in rural areas, and workers with few years of formal school education – are rapidly gaining access to financial services through innovative financial products provided by financial institutions, such as mobile phone applications and agent banking, which leverage technology and enable financial institutions to reach out to customers in remote areas in a secure and cost effective manner.

Malaysia's journey in financial inclusion has been unique in various aspects. Unlike many other emerging market economies that have experienced systemic banking crises after liberalizing, deregulating and privatizing their financial systems, Malaysia did not experience a systemic banking crisis. Malaysia has been able to achieve sustainable growth of its financial system over a long period of time, reconciling two policy objectives; namely, "financial stability" and "financial inclusion", in a successful manner so far.

How has Malaysia achieved its success in financial inclusion? What specific actions, programs, and strategies have contributed to enhance financial inclusion? What has (or has not) worked well and why? What could low- and middle-income countries learn from Malaysia's experience? To what extent could those experiences be replicated in other jurisdictions?

There is no single factor or silver bullet that can explain Malaysia's success in financial inclusion. The progress that Malaysia has achieved is the result of efforts undertaken by authorities and the financial sector industry over the past 20 years. Following a process of banking sector consolidation in the aftermath of the Asian financial crisis, authorities formulated a ten-year Financial Sector Masterplan (FSMP) in 2000, which provided not only a comprehensive diagnostic of problems preventing financial inclusion and overall financial sector development, but also prescribed a set of specific policy actions to address them. Building on the success of the FSMP, in 2011 a second ten-year strategy, the Financial Sector Blueprint (FSB) was adopted for the period 2011-2020, and is being executed under a robust monitoring and evaluation framework that tracks progress on financial inclusion, quality and usage of financial services, and customer satisfaction.

As part of the execution of the FSMP and FSB, a wide range of initiatives have been carried out to accelerate financial inclusion. For example, the mandate of Malaysia's central bank was amended to grant it the legal authority to proactively advance financial inclusion. In this regard, Malaysia's central bank was a pioneer among central banks around the world in recognizing and formalizing the important role that they can play to advance financial inclusion.

Other major reforms included reforming development finance institutions (DFIs), the establishment of a credit bureau, issuing a new regulation requiring banks to provide financial services to the poor at affordable fees, and launching the agent banking model to enable financial institutions to reach out new customers in remote locations in a safe and cost-effective manner. Moreover, Malaysia has made significant investments in the modernization of the national payment system infrastructure, accelerating the adoption of electronic means of payments nationwide.

The journey that Malaysia has followed has delivered positive results in terms of increasing the percentage of the population with access to basic financial services. However, the journey has not been exempted from obstacles and still several challenges will need to be tackled in the future.

Looking forward, Malaysia faces various challenges in terms of financial inclusion. Firstly, Malaysia will need to reach out to the remaining unserved population. Covering the last mile in financial inclusion might not be as easy as it seems. A large part of the unserved population is composed of foreign workers and their families, some of whom are undocumented workers. Secondly, a major challenge is how to ensure that the people with access to financial services actually make active use of their accounts. The report shows that many people still use cash to settle day-to-day payments despite the availability of a modern payment system infrastructure in Malaysia. Moreover, a large number of employers pay their workers' salaries in cash as opposed to direct deposits into the workers' bank accounts. Finally, another challenge is to ensure that efforts to promote financial inclusion remain sustainable. In particular, the high level of household debt, which in 2016 amounted to 82 percent of GDP, is an important alert signal that should be monitored carefully.

There are several lessons from Malaysia's experience in financial inclusion that could be useful for other countries, especially for low- and middle-income countries that are still in early stages of financial sector development and wish to make progress on financial inclusion. They include the following:

1. Adopting a long term strategy for financial inclusion
2. Setting up a robust monitoring system to track progress
3. Finding a champion institution for financial inclusion
4. Carrying out large investments in the modernization of the payment system infrastructure
5. Building and strengthening institutions to support financial inclusion
6. Encouraging financial innovation
7. Adopting regulations that promote financial inclusion without compromising financial stability
8. Advancing consumer protection and financial literacy
9. Maintaining a sound financial system, and
10. Involving the private sector in any effort to advance financial inclusion



Introduction

Every year, financial sector authorities from many countries around the world visit Malaysia to learn more about Malaysia's experience on a wide range of topics related to financial inclusion, such as: financial inclusion strategies, innovations in payment systems, national identification cards, data and statistical tools to monitor and evaluate financial inclusion policies, agent banking, digital finance, FinTech and regulatory sandboxing, unit trusts (mutual funds), Islamic finance, the role of development finance institutions, financial education and literacy programs etc.

Despite the enormous interest of policy makers from various parts of the world in Malaysia's financial inclusion experience, so far little has been written to document this experience in a comprehensive manner. This report constitutes one of the first attempts to analyze and distill Malaysia's experience of financial inclusion over the past 20 years. The report focuses exclusively on the provision of basic financial services to households. The provision of financial services to micro, small and medium enterprises (MSMEs) and large firms will remain outside the focus of this report.

The report is divided into five sections. The first one examines current levels of financial inclusion in Malaysia from an international perspective. The report uses the data provided by BNM as well as the data collected by the World Bank through the Global Findex Survey in 2014. The second section identifies the specific reforms and actions undertaken by Malaysia to expand financial inclusion since the Asian financial crisis of 1997-98. It groups the wide range of policy actions, initiatives, and strategies undertaken in the past 20 years during three different periods: a) Consolidation of the Banking system, b) Financial Sector Development Masterplan 2001-2010, and c) Financial Sector Blueprint 2011-2020.

The third section reviews Malaysia's experience with "agent banking", which is a hallmark initiative that leverages technology to provide financial services to under-served population, particularly in rural areas. The fourth section discusses challenges faced by authorities in further advancing financial inclusion. It looks not only at the remaining unbanked population, but also at recent patterns in terms of the actual "usage" of financial services by adults who already have accounts. Finally, the last section presents the report's conclusions and distills valuable lessons from Malaysia's experience for other countries which are considering advancing their levels of financial inclusion.



CHAPTER 1

Where Does Malaysia Stand in Terms of Financial Inclusion?

Among middle-income countries, Malaysia has achieved one of the highest levels of financial inclusion. According to data from BNM, 92 percent of the adult population (total adult population in Malaysia is 22 million) had a bank account in 2015, with 59 percent of the adult population having an account at a single institution and the remaining 33 percent having accounts at multiple banking institutions.¹

¹ Data are based on the Financial Capability and Inclusion Demand Side Survey 2015. Malaysia's total adult population is defined as those aged 15 and above.

Malaysia's banking system has grown an average rate of 6.8 percent p.a. in terms of assets since 2011. This trend is expected to continue in the upcoming years. Given the positive outlook for the banking system in the upcoming years, Malaysia is likely to reach universal access in the provision of financial services to its adult population by 2020.

Currently, Malaysia has 1.4 bank branches per 10,000 adults, 4.7 ATMs per 10,000 adults, and 10.7 point-of-sale (POS) terminals per 1,000 inhabitants, which are among the highest ratios in South East Asia. Data from BNM show that financial institutions provide services in 97 percent of all sub-districts in Malaysia either through bank branches or agent banks.

The Global Findex Database of the World Bank, which collects data on financial inclusion in countries around the world every three years, revealed that 81 percent of Malaysia's adults had an account at a licensed financial institution in 2014. Differences in financial inclusion data between Findex and BNM are mainly due to methodological issues and coverage. An important difference between the two databases is that BNM's data cover only Malaysian citizens, whereas Findex makes no distinction between Malaysian and non-Malaysian adults. BNM's data cover savings accounts at a wide range of financial institutions, whereas Findex 2014 did not include savings at some specialized institutions, such as the Pilgrim Fund and Permodalan Nasional Berhad (PNB), which are popular for long-term savings among the Malaysian population. In addition, Findex data were collected in 2014, whereas BNM's data were collected a year later (2015).

Findex data shows that around the world, the percentage of adults with an account at a financial institution increased from 51 percent to 61 percent between 2011 and 2014. Malaysia recorded one of the highest increased levels of financial inclusion among middle-income countries, moving from 66 percent to 81 percent between 2011 and 2014, as shown in the following table.

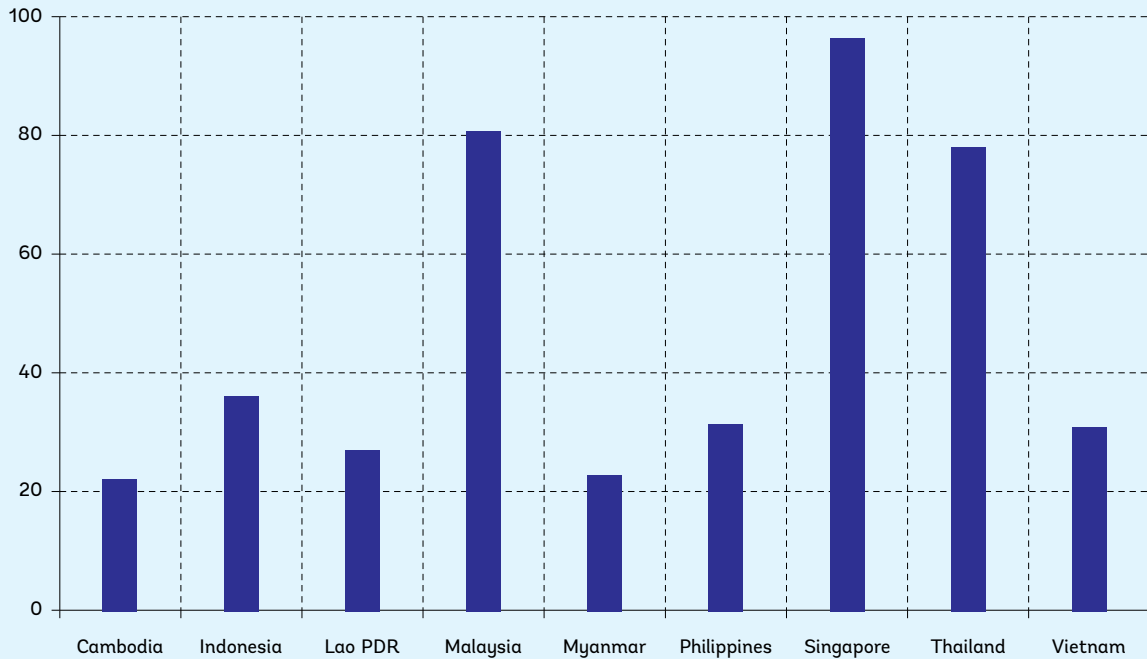
TABLE 1. Adults with an Account in Select Middle Income Countries (%)

Country	GNI per capita (US\$)	2011	2014	Difference 2014-2011 (p.p.)
Brazil	11,690	56	68	12
Costa Rica	9,550	50	65	15
Croatia	13,420	88	86	(-)2
Hungary	13,260	73	72	(-)1
Malaysia	10,430	66	81	15
Mexico	9,940	27	39	12
Kazakhstan	11,550	42	54	12
Panama	10,700	25	43	18
Poland	13,240	70	78	8
Russia	13,850	48	67	19
Turkey	10,970	58	57	(-)1
World	10,683	51	61	10

Source: Global Findex database. (p.p.) = percentage points. GNI = gross national income.

Among the ten member countries of the Association of South East Asian Nations (ASEAN), Malaysia has the second-highest rate of adults with a bank account, only surpassed by Singapore, as illustrated in the following figure.

FIGURE 1. Adults with an Account in ASEAN (% of adults)



Source: Global Findex database. *The Association of Southeast Asian Nations (ASEAN) comprises Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. Data for Brunei are not available. Data for Lao PDR and Myanmar come from national sources.



Eco-system of financial institutions

Underpinning the high rate of financial inclusion achieved by Malaysia is a large eco-system of banking institutions providing a wide range of conventional and Islamic financial services to the population. The banking system serving households is currently composed of 27 commercial banks, 16 Islamic banks, and six development finance institutions (DFIs) with a combined network of 3,264 branches and 11,308 ATMs.

TABLE 2. Top 10 Commercial Banks by Assets in Malaysia in 2016 (US\$ Million)

Ranking	Financial Institution	Assets	Loans	Deposits
1	Maybank	121,843	67,957	82,524
2	Public Bank	76,468	56,542	61,289
3	CIMB Bank	74,347	42,600	48,918
4	RHB Bank	44,921	27,151	31,782
5	Hong Leong Bank	40,333	24,875	31,384
6	UOB	24,666	18,064	19,560
7	OCBC Bank	21,015	14,547	15,873
8	AmBank	20,939	14,556	14,953
9	HSBC	17,481	8,674	12,588
10	Alliance Bank	13,543	9,481	11,167
	Total	455,556	284,447	330,038

Source: BNM, banks' financial statements, and World Bank staff estimates.

Commercial banks are the largest intermediaries in Malaysia's banking system. They account for 70 percent of total assets in the banking system and operate 62 percent of all bank branches nationwide. They are the largest type of provider of financial services to households in Malaysia, including deposits, credit, payments, money transfers, insurance products, and so on.

Opening a savings account at a conventional or Islamic bank is a simple procedure in Malaysia. Malaysian citizens only need to present their national identity card, which incorporates various biometric features, and sign the required documentation. Accounts can be opened with as little as RM20 (US\$4.40), or even less in some banks, and there are no annual fees for maintaining an account. As discussed in the next chapter, customers in rural areas can also initiate the opening of an account at a bank agent, and subsequently complete their account opening at a bank branch, where bank officers complete required anti-money laundering and combating the financing of terrorism (AML/CFT) checks.

BOX 1

National Identity Card as Pillar for Financial Inclusion

The Malaysian identity card is the compulsory identity card for Malaysian citizens aged 12 and above. The current identity card, known as MyKad, was introduced by the National Registration Department of Malaysia in September 2001. Malaysia became the first country in the world to develop and use an identification card that incorporates both photo identification and fingerprint biometric data on a built-in computer chip embedded in a piece of plastic.

MyKad is the first smartcard in the world designed with six main functions: identification, driver's license, passport information, health information, and an e-cash function. Today, thanks to MyKad, opening bank accounts is a simple procedure, as new customers are quickly validated upon the presentation of their MyKad. Moreover, they can also activate MyKad to have additional payment functions linked to their bank account and use it as an ATM card or an electronic means of payment nationwide.

MyKad security features include authentication using symmetric-key cryptography, multi-layered operating systems with firewalls, and a secure chip platform. MyKad incorporates two types of biometric technology for identification purposes; namely, a colour photograph of the card holder and the Digital Certificate.



Source: Malaysia National Registration Department, Ministry of Home Affairs. <http://www.jpn.gov.my/en/informasi/>

In addition to large private commercial banks, three development financial institutions (DFIs) play an important role in financial inclusion in Malaysia: Bank Simpanan Nasional (BSN), Agrobank and Bank Rakyat. Although these institutions are small in terms of assets (they account for less than 5 percent of the banking system's assets), together they have one third of the total number of deposit accounts in Malaysia's banking system. Moreover, these DFIs operate 23 percent of all branches in Malaysia. BSN has the largest branch network (403), followed by Agrobank (188), and Bank Rakyat (148).

BSN's mandate includes the promotion and mobilization of savings, especially to small savers. It has USD\$6.6 billion in assets and nine million customers. BSN offers traditional banking products, including Islamic banking products and micro finance. BSN focuses on provision of microfinance and agent banking, and promotes savings and opening of accounts among school children.²

Agrobank, formerly known as Bank Pertanian Malaysia (BPM), was established in 1969 as a DFI with a mandate to meet the financial needs of the agriculture sector. Being a full-fledged Islamic Bank since 2015, the Bank has developed Shariah compliant financing packages for the entrepreneurs throughout the agriculture value chain (i.e. from production, processing, marketing and support services). In support of the financial inclusion agenda, Agrobank has broadened its rural branches and agents network and expanded utilization of its electronic banking platform. It currently operates in 70 percent of rural communities in Malaysia.

Bank Rakyat is the biggest Islamic bank in Malaysia. It has a large branch network, and its services and products include savings accounts for children, teenagers and adults, as well as investment accounts for adults and senior citizens. On the consumer financing front, Bank Rakyat offers personal financing, housing financing, education financing, car financing, credit cards etc. Bank Rakyat's main lending product is personal financing. The bank offers financing to government employees, a product with low risk and high return. In the global ratings Bank Rakyat appeared not only as the tenth largest Islamic bank, but also as the second-most profitable Islamic banking institution in the world in 2011.

Malaysia also has a few unique government-owned institutions dedicated to mobilize savings from low-income households, including Permodalan Nasional Berhad (PNB) and the Pilgrim Fund. PNB mobilizes savings from Malaysian nationals (especially the Bumiputra ethnic group) and invests resources in corporate entities to generate returns that are higher than the deposit interest rates offered by banks. As of 2016, PNB had more than 10 million customer accounts and had consistently provided attractive returns to its customers (unit holders). Moreover, PNB has become the largest asset management company in Malaysia in terms of total assets.

The Pilgrim Fund Board (Lembaga Tabung Haji) was established in 1963 to provide a savings scheme for the Muslim population. The government provides a blanket guarantee on all its deposits, making it an attractive investment vehicle not just for small but also for large individual Muslim investors in Malaysia. Currently, it serves more than seven million individual clients through its 119 branches, making it the second largest deposit-taking DFI after BSN, in terms of number of clients.

² National primary and secondary school students are encouraged to open and have a bank account under the scheme called Skim Galakan Simpanan Pelajar (SGSP). See <http://www.mybsn.com.my/content.xhtml?contentId=262> (last accessed at May 8th 2017).

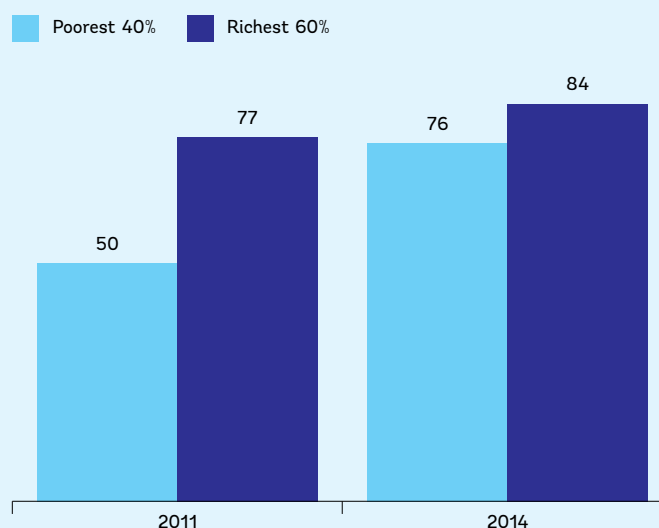
Levels of financial inclusion across different segments of the population

The data collected by the World Bank Findex Survey reveal that levels of financial inclusion are relatively homogeneous across different segments of the population in Malaysia. In particular, when the population is divided by age groups, income levels, place of residence (rural vs. urban areas), and gender, the rates of financial inclusion, measured as the number of adults with an account at a financial institution, remain relatively homogeneous. However, some significant disparities in terms of financial inclusion are observed when the population is grouped according to their education level.

Income

According to the Findex database, between 2011 and 2014 Malaysia made significant progress in granting access to an account to the poorest 40 percent of the adult population. During this period, the percentage of adults in the low-income bracket with an account at a financial institution increased from 50 percent to 76 percent. As a result, the gap on account ownership between the richest and the poorest significantly declined.

FIGURE 2. Account Holders by Income in Malaysia (% of adults)



Source: Global Findex database.

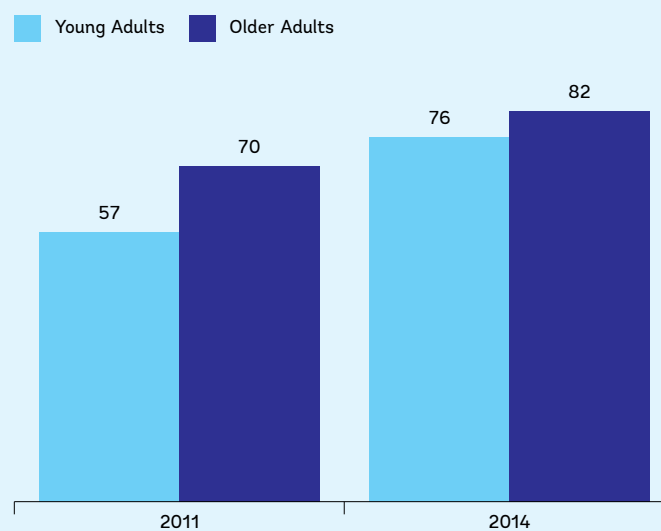
In 2011, the gap between the richest 60 percent and poorest 40 percent was 27 p.p., within the average of the East Asia and Pacific region, and at similar levels to other middle-income countries such as Brazil and Mexico. In 2014, the gap in Malaysia decreased to nine p.p., one of the biggest improvements in the provision of financial services to the poor recorded by Findex in this timeframe.

Age

In 2014, 82 percent of older adults (25 years and older) in Malaysia reported having an account at a financial institution while the figure for the group of young adults (younger than 25) was 76 percent. While in 2011 the gap between older adults and younger adults was 13 p.p., in 2014 it declined to six p.p.

In the East Asia and Pacific region, the age gap has broadened in past years; while in 2011 the gap was six p.p. (56 percent of older adults and 50 percent of young adults), in 2014, the gap increased to 10 p.p. In contrast to Malaysia's case, the age gap in the East Asia and Pacific region has increased due to the lower take-up of younger adults compared to that of older adults. Income disparities among these groups might be one of the explanations for the lower growth rates of the younger group in the East Asia Pacific region.

FIGURE 3. Account Holders by Age in Malaysia (% of adults)

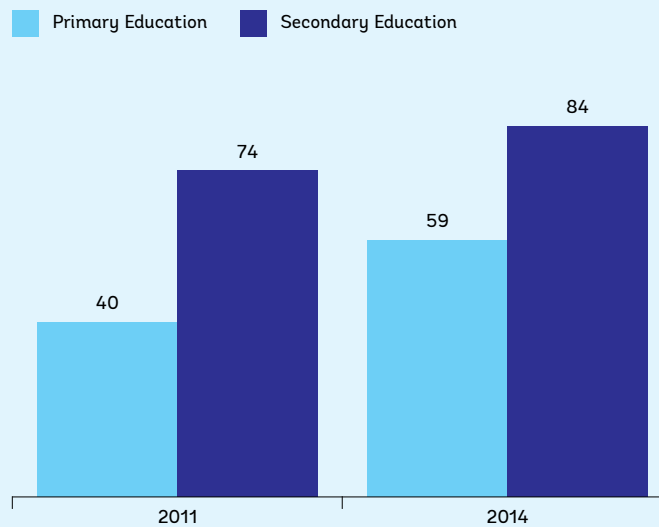


Source: Global Findex database.

Education

In Malaysia, adults with more years of formal education are more likely to have an account than adults with fewer years of school. The education gap between these two groups declined from 34 p.p. in 2011 to 25 p.p. in 2014, but still remains significant. In 2014, the financial inclusion rate stood at 59 percent for adults with less than six years of education and at 84 percent for adults with more than six years of education. In the East Asia and Pacific region, levels of financial inclusion related to education levels are improving at faster rates than the ones shown in Malaysia. While in 2011 the education gap in East Asia and Pacific was 15 p.p., in 2014 it decreased to 13 p.p. Thus, the education gap in the country is twice the reported figure in the region.

FIGURE 4. Account Holders by Level of Education in Malaysia (% of adults)

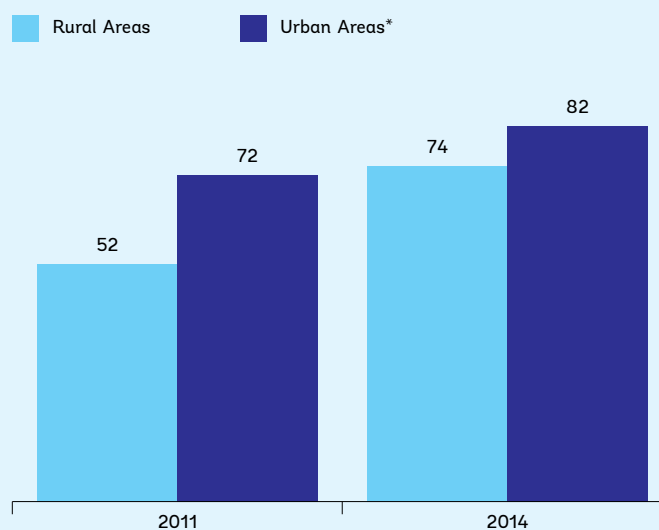


Source: Global Findex database.

Urban vs Rural

Globally, adults in rural areas have traditionally faced difficulties in having an account at a financial institution, due to the high cost faced by banks in opening branches in small villages and remote areas. In 2014, 74 percent of adults in rural areas in Malaysia had an account (versus 82 percent in urban areas), an improvement of 22 p.p. with respect to 2011. In the East Asia and Pacific region, 64 percent of adults living in rural areas did so.

FIGURE 5. Account Holders in Rural and Urban Areas in Malaysia (% of adults)

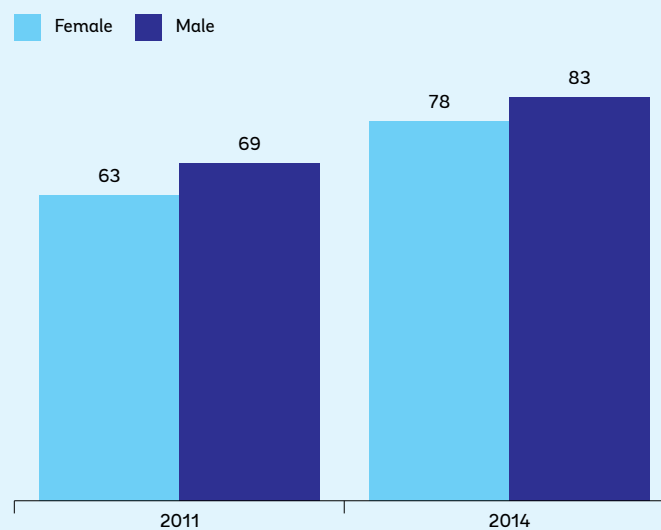


Source: Global Findex database. *Proxy by the average of account ownership of richest 60% and all adults in the country.

Gender

Around the world, the gender gap in financial inclusion is seven p.p., with 64 percent of male adults having an account vs. 57 percent of female adults, according to Findex. In Malaysia, the gap between men (83 percent) and women (78 percent) stood at five p.p. in 2014, an improvement of one p.p. from the figure reported in 2011. Malaysia's female account ownership is also comparable to the East Asia and Pacific average (which is 67 percent).

FIGURE 6. Women and Men with an Account in Malaysia (% of adults)



Source: Global Findex database.

So, who does not have access to financial services in Malaysia? The answer will depend on which database is used. BNM's data indicate that around 1.7 million people (8 percent of Malaysia's adult population) do not have a bank account yet. They are mostly composed of low-income households living in rural areas. But this figure only includes Malaysian citizens.

If we use Findex, we can conclude that there are approximately 3.9 million adults (regardless of nationality) in Malaysia that still do not have a bank account. This means that one out of five adults does not have the initial entry point to formal financial services. According to Findex data, the population more likely to be unbanked comprises adults living in rural areas with low education levels. Moreover, they are likely to be foreign workers. Malaysia hosts a large number of foreign workers many of whom come from neighboring countries such as Bangladesh, Indonesia, Myanmar, and Nepal, among other countries.³

³ According to the Human Resources Ministry, there are around 2.1 million registered foreign workers in Malaysia. However, the estimated number of undocumented workers varies a lot depending on the source of information.



CHAPTER 2

How has Malaysia Achieved a High Financial Inclusion Rate?

There are various actions and initiatives that have contributed to Malaysia's success in financial inclusion. In this section, we examine the journey that Malaysia has followed during the past 20 years to broaden access to financial services to its population.

We start with the actions put in place in the aftermath of the Asian financial crisis of 1997-98, which marked a milestone in the international financial system, and prompted authorities in Malaysia and other countries in Asia to put in place measures to protect their financial systems from volatility in financial markets, large capital outflows, and economic recession in the region.

In this report, we do not analyze what happened before the Asian financial crisis in terms of financial inclusion. That could be the subject of a separate report that properly investigates how financial institutions were created since Malaysia was formed in 1957, how they evolved, and how financial instruments, markets and regulations have developed since then.

Since the Asian financial crisis of 1997-98, Malaysia has undertaken a wide range of reforms to modernize, strengthen and expand its financial system, ensuring that financial institutions serve the poor by offering convenient products and services to them at reduced fees; while some services are provided on a commission-free basis.

The most relevant actions undertaken by authorities in the past two decades to expand financial inclusion include, among others, the following:

- i. Reducing the number of banks in order to have fewer but larger and stronger institutions that are better equipped to compete with regional peers in ASEAN,
- ii. Amending the mandate of Malaysia's central bank to grant it the legal authority to proactively advance financial inclusion,
- iii. Reducing the use of cash and checks in the economy through the modernization and expansion of the national payment system infrastructure;
- iv. Reforming and strengthening existing DFIs (such as BSN, Agrobank, and Bank Rakyat) by refocusing their policy mandates and enhancing their corporate governance;
- v. Issuing the Guideline for Basic Banking Services requiring banks to serve low-income households and limiting the fees that bank can charge for basic services to customers;⁴

- vi. Encouraging higher competition in the marketplace
- vii. Strengthening the regulatory and supervisory standards for the banking sector in line with international standards;
- viii. Introducing new financial products and expand the outreach of Islamic finance;
- ix. Leveraging technology to develop new instruments and innovative solutions to serve low-income households (e.g. agent banking model) in a cost-effective manner; and
- x. Strengthening consumer protection and financial literacy.

The reforms undertaken by Malaysian authorities have had a positive impact on financial inclusion by building a sound and increasingly market-oriented banking system.

At the same time, it is important to highlight that the process under which these reforms were conceived and implemented has been equally important for Malaysia's success in financial inclusion.

Specifically, major reforms have been formulated and executed under the umbrella of two long-term strategies for financial sector development: the Financial Sector Masterplan 2001-2010 and the Financial Sector Blueprint 2011-2020. Each of these two long-term plans provided a comprehensive diagnostic of the factors preventing financial inclusion, set specific objectives and goals to be pursued by authorities in a 10-year timeframe, and formulated a well-sequenced set of actions and reforms to fulfill their stipulated goals and objectives. Moreover, the execution of these 10-year strategies has been closely monitored by authorities on a regular basis using the extensive data collected by BNM on financial inclusion, and the tools and indexes developed by authorities to track progress in financial inclusion.

⁴ See Guidelines on Basic Banking Services by BNM at: http://www.bnm.gov.my/index.php?rp=gl_001_5_basic_banking_services. (last accessed at May 8th 2017).

Banking sector consolidation

In the aftermath of the Asian financial crisis of 1997-98, financial sector authorities came to the conclusion that the banking system was highly fragmented into a large number of small institutions (more than 77 banks before 1997) that on an individual basis were unable to compete with some of their regional peers in ASEAN. The small size of Malaysian banks undermined their ability to reach the efficiency and profitability levels of their peers. Moreover, it prevented them from offering the wide range of products and services that large regional universal banks do. Furthermore, some institutions were facing a large volume of non-performing loans and capital shortfalls that prevented them from growing and serving new clients.

Financial sector authorities concluded that in order to become more competitive, the banking system needed to enter a process of consolidation that would serve to build capacity, strengthen resilience and increase efficiency for the purpose of facilitating Malaysia's economic transformation.

The first round of consolidations in the banking sector was launched by BNM in the wake of the 1997-98 Asian financial crisis. This accelerated merger program resulted in the establishment of 10 so-called anchor banking groups (i.e., well-capitalized domestic commercial banking conglomerates providing a wide range of conventional and Islamic financial products) by 2003.

As a result of efforts to consolidate financial institutions, the number of domestic banks declined from 77 in 1997 to only 34 in 2010. From 2000 to 2010, the capitalization ratio for domestic banks increased from 11.7 to 14.2 percent. Moreover, the ratio of non-performing loans in the banking system declined from 9.2 to 2.6 percent. The profitability ratios also improved during this timeframe; return on assets (ROA) increased from 1.1 to 1.6 while the return on equity (ROE) increased from 13.3 to 16.7 percent. Malaysia now has two institutions that have succeeded in becoming large regional banks in the ASEAN region, Maybank and CIMB Bank, with US \$121 and US\$74 billion dollars in assets, respectively, as of end 2016.

SELECTED FINANCIAL SECTOR INDICATORS IN MALAYSIA

FIGURE 7. Bank Deposits (% of GDP)

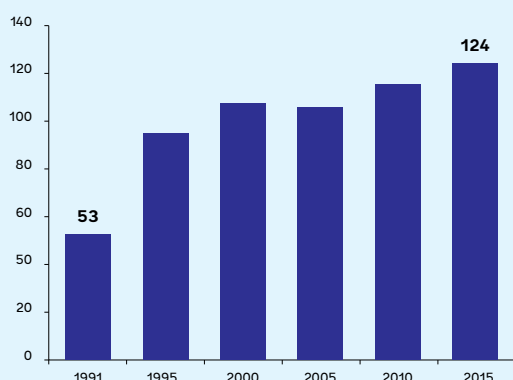


FIGURE 8. Domestic Credit to Private Sector (% of GDP)

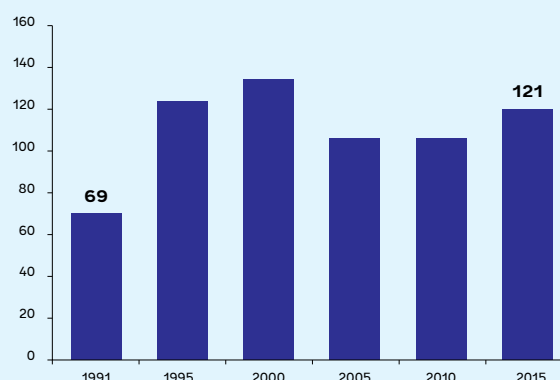
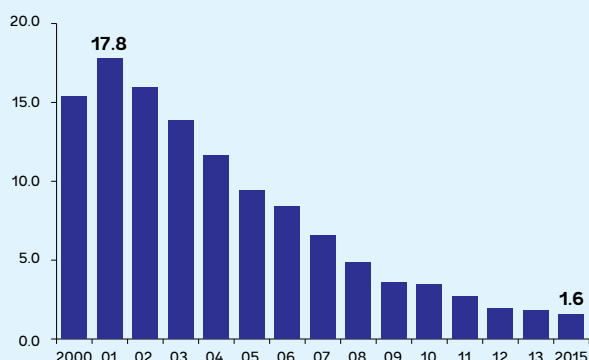
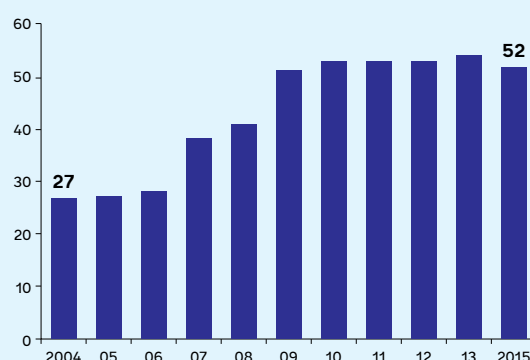


FIGURE 9. Non-Performing Loans Ratio (%)**FIGURE 10. ATMs (per 100,000 adults)**

Source: Global Financial Development Database, World Bank.

In addition to the need to strengthen the solvency of banking institutions, Malaysia also identified the need to strengthen the skills of the workforce in the financial services industry and develop a new generation of local bankers with strong skills to better serve the evolving marketplace in Malaysia and ASEAN. As a result of this, BNM in collaboration with financial sector industry associations has actively supported the establishment of various institutions to build capacity and develop the skills and talents of the working force, currently composed of 128,000 people in the banking industry alone.

TABLE 3. Eco-system of Institutions for Talent Development for the Financial Sector in Malaysia

Institution	Training Focus
Financial Sector Talent Enrichment Program	Training for top graduates to provide practical exposure and soft skills development in preparation for entry into the financial services workforce
Asian Institute of Finance	Enhance human capital development in the financial sector
Asian Institute of Chartered Bankers	Professional and educational body for the banking and financial services industry
Malaysian Insurance Institute	Education and training provider focusing on insurance
Islamic Banking and Finance Institute Malaysia	Islamic finance reference center for the industry and academia
International Centre for Education in Islamic Finance	Graduate Islamic Finance Programs for practitioners (i.e. Chartered Islamic Finance Professionals)
International Shariah Research Academy	Promote applied research in Sharia and Islamic finance
Securities Industry Development Corporation	Capital markets education, training and information resource provider
ICLIF leadership and Governance Center	Training for senior management and Board of Directors in strategic and leadership management and to strengthen oversight functions
Finance Accreditation Agency	Responsible for quality assurance of learning initiatives, including program, individual and institutional accreditation

Source: BNM.

Financial Sector Masterplan (2001-2010)

The FSMP for the period 2001-2010 was the first long-term plan launched by Malaysia for the development of the sector. The FSMP included more than 100 recommendations to address vulnerabilities and build a strong and resilient financial system that is responsive to changing economic requirements. In the particular case of the banking sector, the Masterplan included 39 recommendations that had the objective of improving efficiency, resilience, and dynamism in the banking system. The primary focus was to build the capabilities of domestic banking institutions to enhance their competitiveness and promote the development of a more robust banking system.

The FSMP had three phases. During the first one, the focus was on building the domestic capacity of the financial sector and enhancing their efficiency through mergers among institutions. The second phase was aimed to gradually deregulate the domestic financial market, with the main objective being to foster competition among participants. The last phase included measures to accelerate the pace for integration of the financial system with international markets.

Key actions under FSMP to scale up financial inclusion

In the timeframe 2001 to 2010, several major reforms in the financial sector were formulated and put in place by Malaysian authorities. They included the following:

Strengthening DFIs. Malaysia has six DFIs, which are expected to provide financial services in sectors not sufficiently covered by banking institutions. Before 2002, DFIs were not adequately supervised and faced recurrent financial problems. In 2002, a major reform was initiated with the enactment of the Development Financial Institutions Act 2002 (DFIA), which empowered BNM as the regulatory and supervisory authority of these institutions. The main objective of DFIA is to ensure that the DFIs perform their mandates in a safe and sound manner. Since the enactment of DFIA in 2002, a total of six DFIs⁵ fall under the purview of BNM with mandates to serve identified strategic sectors of the economy including agriculture, SMEs, infrastructure, maritime and the export-import sector.

DFIs also contribute significantly to financial inclusion initiatives, with Bank Simpanan Nasional (BSN), Agrobank and Bank Rakyat as the main drivers of financial inclusion. After more than a decade, the Act was further strengthened to allow DFIs to better serve its respective mandates and at the same time reflects the challenges arising from the new financial landscape. The amended DFIA came into effect on 31 January 2016, comprising enhancements in areas of governance, business activities of DFIs and regulatory oversight as well as inclusion of new areas on Shariah, business conduct and consumer protection, and the regulatory enforcement framework.

Making the access and cost of basic banking services affordable to the population. Through the Guideline for Basic Banking Services issued by BNM in 2005 all banks were required to provide basic banking services and ensure that all segments of the population had access to deposit and transaction services at low

⁵ The six DFIs are: Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat), Bank Pembangunan Malaysia Berhad (Bank Pembangunan), Bank Pertanian Malaysia Berhad (Agrobank), Bank Simpanan Nasional (BSN), Export-Import Bank of Malaysia Berhad (EXIM Bank) and Small Medium Enterprise Development Bank Malaysia Berhad (SME Bank). With the exception of Bank Rakyat, which is a cooperative bank, DFIs are owned by the government of Malaysia.

costs, and receive reasonable savings rates. Specifically, the Guideline prescribed the following measured to be observed by banks:

- a) All Malaysian citizens and permanent residents shall be entitled to have one Basic Savings Account (BSA) and one Basic Current Account (BCA) per institution.
- b) The initial deposit to open a BSA shall not exceed RM20 (US\$4.40).
- c) A BSA should earn interest irrespective of account balance. The minimum level of interest rate to be offered shall not be lower than 0.25 percent per annum.
- d) No service or maintenance charge shall be imposed on the account.

The following table describes the restriction on fees of basic banking services that need to be observed by banks in Malaysia.

TABLE 4. Fees of Basic Banking Services in Malaysia

Type	Nature of transaction	Services without any fee per month
Over the counter visit	Account enquiries, deposits, withdrawals, funds transfer within the same bank and bill payments	Up to 6 transactions
ATMs	Balance enquiries	No limit
	Withdrawal	Up to 8 transactions
	Funds transfer within the same bank	No limit
Deposit machines	Cheque deposits	No limit
	Cash deposits	No limit
Interbank Giro	Interbank funds transfer	2 transactions
Internet banking	Account enquiries	No limit
	Bill payments	No limit
	Funds transfer	No limit

Source: Elaborated by the authors based on BNM's Guidelines on Basic Banking Services, available at: http://www.bnm.gov.my/index.php?rp=gl_001_5_basic_banking_services

BNM's mandate on financial inclusion. Traditionally, central banks have not had an explicit mandate to promote financial inclusion. In 2009, the Central Bank of Malaysia Act was amended to grant the central bank with the legal authority to proactively promote financial inclusion. This was a key milestone that empowered BNM to promote financial inclusion. Moreover, from an international perspective, Malaysia had been one of the pioneers in granting the central bank the explicit mandate to advance financial inclusion.

Deposit Insurance. In 2005, Malaysia established the Malaysia Deposit Insurance Corporation (PIDM). PIDM was mandated to insure both deposits and benefit payments under insurance and *takaful*⁶ in the case of banks' and insurance companies' failing. PIDM covers deposits up to US\$62,500 per depositor (per bank) and up to US\$125,000 per policyholder in insurance and *takaful* benefits. The safety net is provided with no charge to users and is activated automatically.

6 Shariah-compliant insurance.



Collection of Credit Information. One of the challenges that Malaysia faced in the aftermath of the Asian financial crisis was that there was no reliable credit history of individual borrowers. Given that lack of credit information could be a major barrier to accessing formal financial services, BNM led the initiative to establish a credit bureau. In 2001, the Central Credit Reference Information System (CCRIS) was established to collect credit information from all regulated financial institutions. As at end-2016, the CCRIS captured credit information on nine million active borrowers.

Disputes' Resolution Mechanism. The Financial Mediation Bureau was established in 2005 to ensure that all financial services consumers had access to an independent, and impartial dispute resolution scheme.⁷ Not only did the population have an agency to deal with complaints on the services or products of the financial institutions, but a Credit Counseling and Debt Management Agency (AKPK)⁸ was also established in 2006 to provide counseling on financial and debt management and assist indebted individuals to work on loan repayment schemes.

BNM also established the Consumer and Market Conduct Department in 2006, which is in charge of formulating and implementing policies that promote fair and responsible treatment of consumers by financial institutions. This Department also monitors financial institutions' compliance with standards on complaints handling, debt collection, financing, imposition of fees and charges, and provision of credit cards. BNMLINK⁹ was established as a centralized point of contact for the public to address any type of inquiry related to the provision of services or products of the financial sector.

Consumer education. An important component of the strategy to promote financial inclusion was the strengthening of the consumer education and protection framework. Financial institutions in Malaysia are required to comply with a set of disclosure requirements that aim to ensure that information disseminated to financial services users is not only timely, but easy to understand and accurate. Consumers are empowered with both the knowledge and the skills to make good financial decisions through financial education. The programs were developed by BNM, AKPK, and the financial sector. These programs¹⁰ provide awareness to consumers of the risks involved in using various financial products, as well as the benefits. One distinctive component of the protection framework is that the financial institutions are responsible to assess the suitability of a product for a potential user.

7 In October 2016, the Financial Mediation Bureau was replaced by the Ombudsman for Financial Services.

8 Agensi Kaunseling dan Pengurusan Kredit.

9 BNMLINK provides face-to-face customer service to walk-in visitors on general enquiries and public complaints. Bank Negara established TELELINK, which allows the public to access these advisory services by telephone. MobileLINK extends BNMLINK's advisory services in Malaysia using a mobile customer service bus equipped with supporting facilities and technologies.

10 Within these programs, POWER!, introduced in 2011, targets young individuals and new borrowers with the aim of providing them with the skills to effectively manage their finances.

TABLE 5. Evolution of the Malaysian Financial Sector

Pre-Asian Financial Crisis (1997)	After Implementation of FSMP (2010)
Fragmented banking system with 77 domestic banks, and 55 domestic insurance companies.	Consolidation and rationalization of the banking industry with 34 domestic banks, and 37 domestic insurance companies.
Less-developed bond market and over-reliance by corporations on banking system financing.	Diversified financial sector with deep and liquid debt securities market. Strategic alliances with foreign institutions.
Rigid and prescriptive rules-based regulation and supervision.	Robust surveillance, regulatory and supervisory framework. Strengthened corporate governance and risk management practices.
Limited prominence of Islamic finance.	Malaysia as an international Islamic financial hub.
Rigid prices mechanisms, gaps in access to finance with limited consumer protection mechanisms.	Efficient delivery channels for financial products and services. Comprehensive consumer protection framework.

Source: Adapted from BNM.

The transformation of the Malaysian financial sector through the implementation of the recommendations of the first FSMP delivered important results. During this period, the banking system grew at an annual rate of 7.3 percent. Moreover, the banking system emerged with fewer but stronger and larger domestic institutions, some of which have become leading players in retail banking in South East Asia (Maybank and CIMB).

In terms of financial inclusion, the number of bank branches per 100,000 adults increased from 11.3 to 14.6 between 2000 and 2010, according to BNM. The total number of deposit accounts per 1,000 adults increased from 1,975 to 2,954 in the same period. During this timeframe, Malaysia registered a substantial increase in the number of loans per 1,000 adults, which increased from 310 to 858.

Notwithstanding this progress, at the end of 2010, financial inclusion indicators were still not fully satisfactory for authorities in Malaysia. Specifically, physical outreach of banks was considered low. In 2010, Malaysia had 15 branches per 100,000 adults versus 32 in high-income countries. In terms of ATMs, Malaysia had 52 ATMs per 100,000 adults vs. 94 in high-income countries. Moreover, 54 percent of sub-districts (*mukims*) with a population of more than 2,000 adults (where 17 percent of the total population live) did not have any financial inclusion access point. For low-income households, data revealed that they were lagging behind the rest of the population in terms of financial services. For example, for low-income households the take-up rate of insurance products was only 10 percent vs. 41 percent for general households.

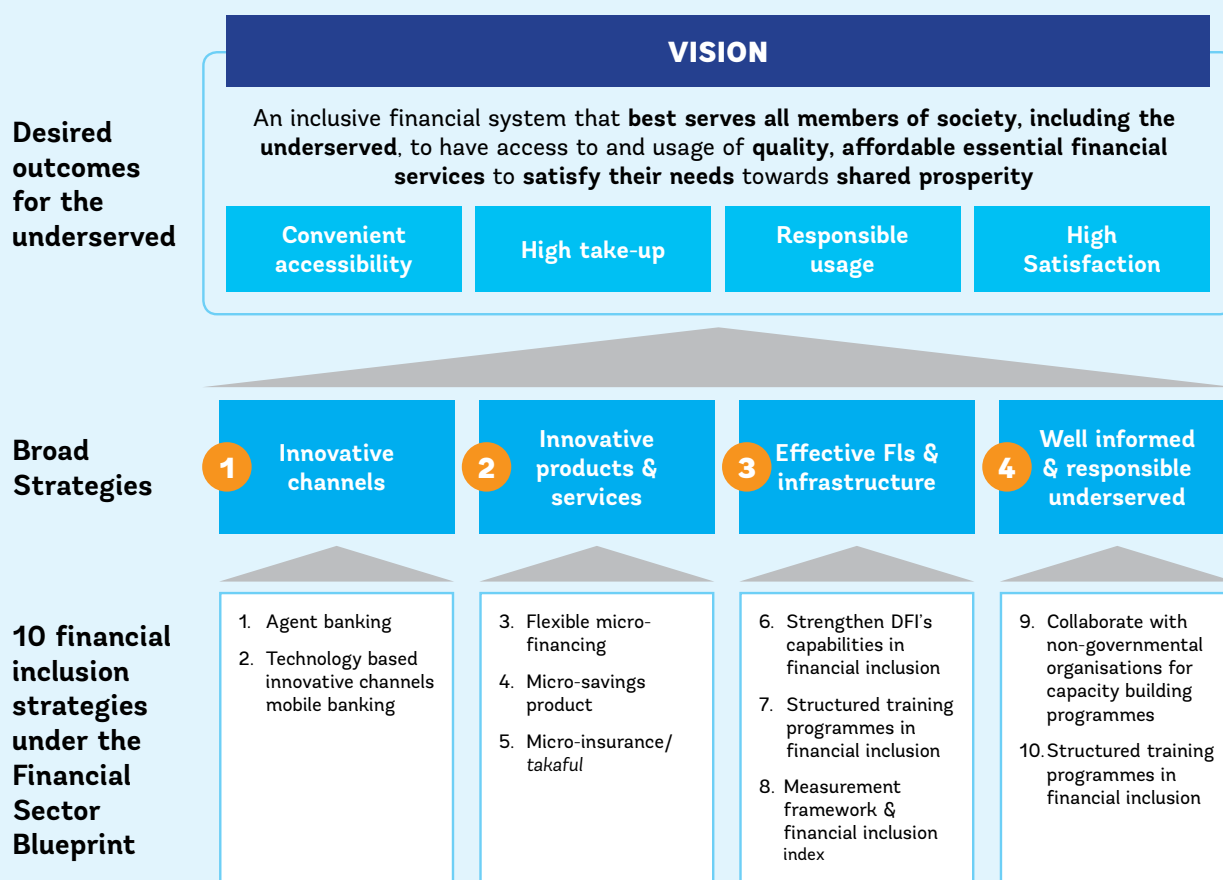
Financial Sector Blueprint (2011-2020)

The FSB, launched in 2011, changed its focus from a sector-based approach adopted during the previous decade to one that reflected a more integrated financial sector with increased interlinkages with different economic sectors with many jurisdictions. In the FSB, the role of the financial sector includes not only meeting the financing needs of the country, but also playing an important role in meeting the growing financial needs of an emerging Asia. An important part of this strategy was the internationalization of Islamic finance, as well as development of the country's international Islamic financial center.

In the development of the FSB, BNM designed a comprehensive Financial Inclusion Framework in 2010, setting specific and measurable outcomes, strategies and actions to advance financial inclusion. To formulate this framework, a cross-departmental working group was established within BNM. The group generated over 100 ideas to advance financial inclusion, which translated into 10 high-impact strategies, as illustrated in the next figure. For the formulation of this Framework, engagements and consultations with a wide range of stakeholders were carried out, including poverty experts, bankers, NGOs, as well as institutions such as SKM, ICU, JKM & KPWKM.

FIGURE 11. Malaysia's Financial Inclusion Framework

A framework under the Financial Sector Blueprint (2011-2020) to enhance financial inclusion

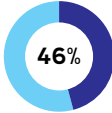
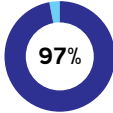
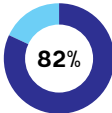
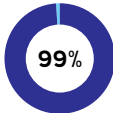
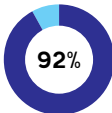
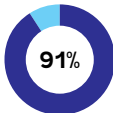
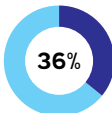
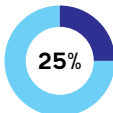
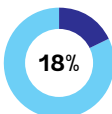
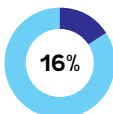
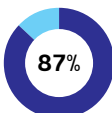
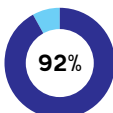
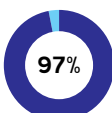
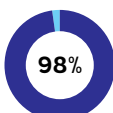
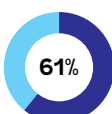
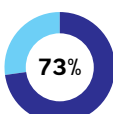


Source: Financial Stability and Payment Systems Report 2015, BNM.

Moreover, BNM formulated a Financial Inclusion Index to monitor its own progress on a systematic and regular basis. As shown in the following figure, the Financial Inclusion Index (FII) adopted in Malaysia has four dimensions (Convenient accessibility, Take-up rate, Responsible usage, and Satisfaction levels) and eight monitoring indicators. The FII is constructed from both supply-side and demand-side data collected by BNM on a regular basis. The index ranges from a score of 0 to 1, where higher numbers denote progress towards reaching the financial inclusion goals in the country.

The index assesses progress against a previously established target for each indicator. This means that data for each indicator is divided by the target and once this result is obtained, it is multiplied by its weight. Each dimension has the same weight. The indicators' goals are set from 40 percent in the case of adults with insurance/*takaful* to 95 percent for the population living in sub-districts with at least one access point.

FIGURE 12. Malaysia's Financial Inclusion Index

Dimension	Indicator	2011	2015
1. Convenient accessibility	% of sub-districts with at least 2,000 population with at least one access point	 46%	 97%
	% of population living in sub-districts with at least one access point	 82%	 99%
2. Take-up rate (% of adults)	Deposit accounts	 92%	 91%
	Financing accounts	 36%	 25%
	Life insurance	 18%	 16%
3. Responsible usage (% of customers)	Active deposits	 87%	 92%
	Performing financing accounts	 97%	 98%
4. Satisfaction level (% of customers)	Satisfied with financial services	 61%	 73%

Source: BNM

The results of the FII show that in 2011 it reached a level of 0.77 and in 2015 it improved to 0.90. The improvements in financial inclusion were mainly explained by the increase of 51 p.p. on the percentage of sub-districts (with at least 2,000 population) with at least one access point. The second component that experienced major progress was the percentage of population living in sub-districts with at least one access point, which improved 17 p.p. to 99 percent of the population reporting at least one of such access points. The third major driver of the growth of the index was an increase of 12 p.p. in the level of satisfaction with overall financial services. Active deposits accounts showed an increase of five p.p. to 92 percent of customers reporting activity in their bank accounts.

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

Following the example of Malaysia's Financial Inclusion Index, a growing number of countries have started to develop their own indexes to measure their progress in the area of financial inclusion. There is also an effort in ASEAN member countries to track progress on a set of indicators that not only cover financial inclusion topics, but also, financial sector development, and enabling environment.

Under the FSBP 2011-2020, major initiatives to increase financial inclusion have been launched in Malaysia. They include the launching of the agent banking initiative (discussed in detail in the next Chapter) and the modernization of the payment system infrastructure (discussed in Chapter 4) to reduce the use of cash and checks, and encourage the use of debit cards and other electronic means of payments.

Overall, Malaysia's experience shows that there has been no "silver bullet" to scale up financial inclusion. Ultimately, the success experienced by Malaysia has been the result of efforts undertaken by authorities and the financial sector industry over the past 20 years. Key ingredients for Malaysia's success have been a long term vision clearly articulated in the two financial sector strategies, detailed action plans, and strong commitment by authorities to implement them, efforts to strengthen DFIs, leadership by BNM and other agencies, large investments in payment systems, strengthening of DFIs, ability to execute and pass legal reforms through Parliament, actions to encourage financial innovations and leverage technology, and strong investments in data on financial inclusion, among other ingredients.



CHAPTER 3

Leveraging Technology: The Case of Agent Banking in Malaysia

As part of the 10 high-impact initiatives under the FSBP 2011-2020 to reach out to the remaining segments of the population with no access to financial services, especially the population living in rural areas in which there is no bank branch, BNM launched the agent banking initiative in 2012.

Through this initiative, licensed financial institutions are allowed to partner with an existing business to offer financial services such as retail outlets (e.g. grocery stores, coffee shops, restaurants, gas stations, etc.) and post offices that are located in sub-districts not served by any bank branch.

Each of the selected retail stores or agents receive a POS device/terminal that is connected online-real time with the back-end system of the financial institution. This terminal allows agents to offer basic financial services to their customers on behalf of the financial institution, such as opening savings accounts, deposit or withdraw money, making bill and loan payments, making domestic fund transfers, etc.

The use of agent banking provides attractive benefits for participating financial institutions and their agents. For financial institutions, it allows them to provide basic financial services to customers in remote areas in a cost-effective manner, thus reducing customers' travelling time to the nearest financial service access point. Agent banking represents a significantly lower-cost alternative to traditional bank branches and automatic teller machines (ATMs).

For appointed agent banks, this mechanism enables them to get additional income from the commissions they earn for the financial transactions conducted on behalf of the financial institutions. Moreover they attract more customers to their premises and thus generate higher sales or revenues for their core business activity.

Agent banking guidelines

BNM published the Agent Banking (AB) Guidelines in 2012 in order to facilitate the implementation of this initiative while at the same time protecting the interest of consumers.

The AB Guidelines set the minimum level of responsibility and accountability that participating financial institutions should have in order to manage appropriately all the associated risks that dependence on third parties' financial service provision imply.

Under the AB Guidelines the provision of financial services is restricted only to unserved and underserved¹¹ areas for Malaysian citizens.

During the initial phase of AB, only a limited number of financial services were allowed, such as accepting deposits, facilitating withdrawals, fund transfers, loan repayments, and bill payments.¹² Agents were not authorized to issue an ATM card, or conduct money services business or loan appraisals. In 2015 BNM broadened the range of financial transactions

that ABs could do in response to a clear demand of customers and agents. Since then, agents can facilitate the opening of savings accounts.

Under the AB Guidelines, the decision to approve the customers' application for the opening of savings accounts and issuance of ATM/debit cards must be made by financial institutions.

The minimum initial deposit for opening this type of account is less than US\$5 (RM20) and a "Know Your Customer" verification procedure must be completed by the financial institution within the next two months of receiving the opening request.

Agent banks are also required to facilitate a standardized preliminary Know-Your-Customer (KYC) procedure that consists of collecting customers' KYC information via an online-real time system of the financial institution and verification of customers' identities via the national identification card (MyKad) and a biometric authentication.¹³ The

11 Underserved areas in Malaysia are identified based on sub-districts (*mukims*) with a population of more than 2,000 or in the case of Sabah, Dewan Undangan Negeri (DUNs), which have no more than five access points.

12 It is the financial institution's responsibility to ensure that their agents at least provide two basic services, accepting deposits and funds withdrawals.

13 For debit card transactions a third verification takes place with the entering of the personal identification number (PIN).



customers' information is screened against several databases in order to comply with the AML/CFT requirements. Under the AB initiative, the agent is only the touch point, the information is channeled to banks' back-end and banks perform the customer due diligence (CDD) against their own database.

To appropriately manage liquidity risks, the Guidelines established a maximum daily cash withdrawal limit of US\$ 250 (RM1,000) per customer account at independent sole proprietor agents (stand-alone convenience and grocery stores, bookstores, telecommunication agents, restaurants and stationery shops) and maximum daily cash withdrawal of US\$1,250 (RM5,000) per customer account at agents other than sole proprietor agents (such as post offices and petrol stations).

Financial institutions are accountable for all services that agent banks perform on their behalf. Agents must receive training from the financial institutions on areas such as products, services, protection of customer information,¹⁴ fraud detection mechanism, AML/CFT, equipment

operation and complaints handling. The selected agents must have a valid business license, and pass a thorough due diligence process in order to assess their credit profile, business owner reputation, and capability and competency to conduct agent-banking services.

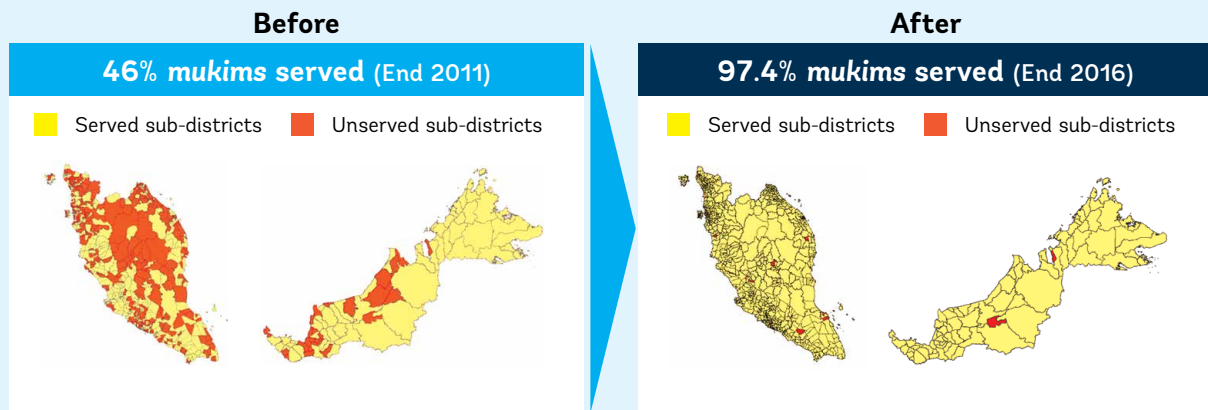
A comprehensive monitoring process was established in order to ensure that the services were provided as expected and that associated risks were managed effectively. In order to track progress on savings account transactions, BNM requires all participating financial institutions to submit a monthly report that includes the number of agents opened, and total amount of transactions. Furthermore, the institutions are required to send an active accounts report in order to monitor the level of usage and new savings accounts opened. The information of appointed agents and other transactions such as deposits, withdrawals, and payments are also filed to BNM. Within the reports that are sent to the regulatory body there is one that updates the status on agents that were reported to the police for inappropriate business practices.

¹⁴ The agent has a commitment not to disclose clients' personal information to any relevant authority or person according to the Personal Data Protection Act 2010. Other measures imply providing proof of transactions, facilitating channeling of complaints, disclosing agents information on the term of the appointment, list of services that they provide, a client's charter, and the fees and daily transaction limits.

Performance of agent banking in Malaysia

Since its inception in 2012, the agent banking initiative has become an effective vehicle to advance financial inclusion in Malaysia, in particular in locations that have no bank branches. In 2011, before the AB initiative was operational, only 46 percent of the sub-districts¹⁵ in Malaysia had access to financial services. In 2015, three years after it was implemented, 97 percent of the country's sub-districts¹⁶ had access to basic financial services thanks to agent banks. Agent banking provides a vehicle for people in Malaysia's rural areas to perform basic financial transactions in a convenient and safe manner and at no additional cost.

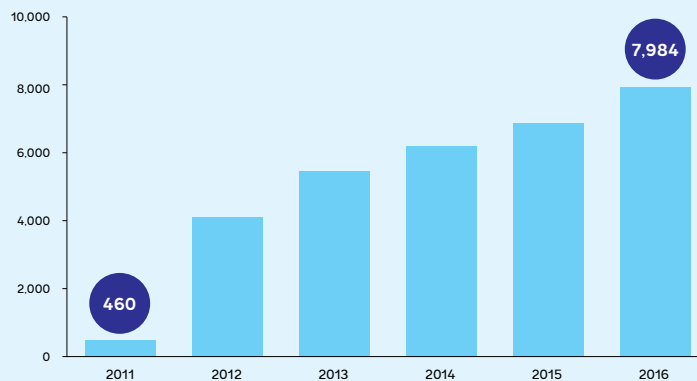
FIGURE 13. Increase in Number of Sub-districts (Mukims) with Access to Financial Services through Agent Banking



Source: BNM

The network of bank agents providing financial services has grown rapidly in the past years. At the end of 2016, the AB network had 7,984 agents from the 460 that were already established at the end of 2011. In its first five years, the number of agents increased more than 17 fold.

FIGURE 14. Banking Agents in Malaysia

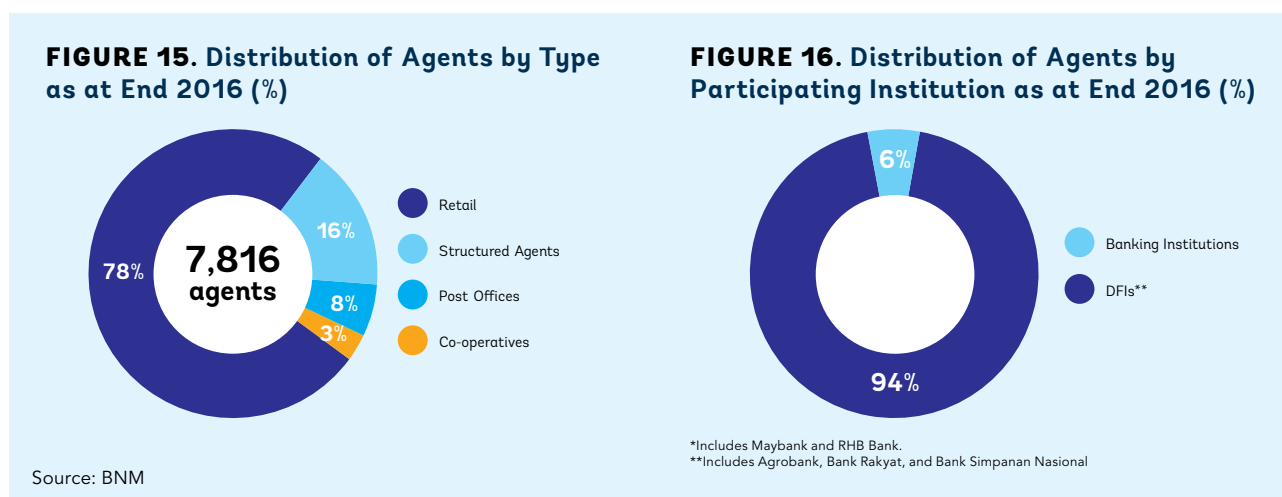


Source: BNM

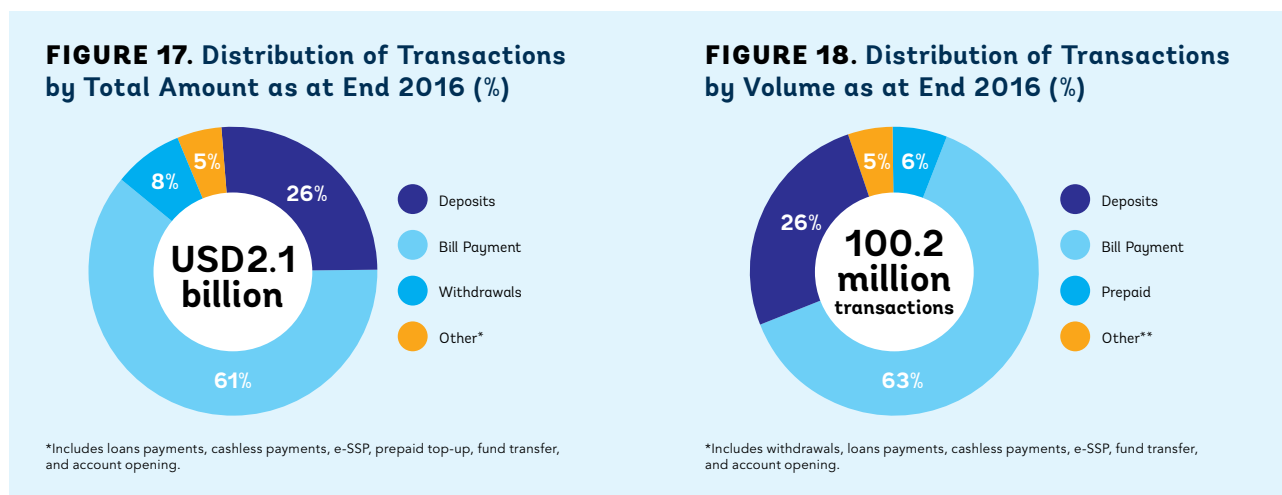
¹⁵ With a population greater than 2,000 people.

¹⁶ Of the 886 sub districts in the country, 863 are served and the 23 unserved are distributed among 11 States in Malaysia.

As illustrated in the following figure, three DFIs (BSN, Bank Rakyat, and Agrobank) have appointed 94 percent of all agent banks in the country,¹⁷ and the remaining six percent have been appointed by banking institutions.



During the first five years of AB in Malaysia, AB has facilitated 100 million transactions for a total amount of US\$ 2.1 billion. Since inception to end-December 2016, the most frequent transaction by volume has been bill payments with 63 million records, representing 63 percent of total number of transactions, and contributing with 61 percent of the value. The second most frequently used service is prepaid top-up with 26 million transactions or 26 percent of the total, and with a share of three percent of the total amount. Deposits and withdrawals each represent six and five percent, respectively, of the total number of transactions, and 26 percent and eight percent of the total amount.



Thus, AB has become an important channel to provide payments, deposits and withdrawals services to the population not previously served by branches of financial institutions in Malaysia. In 2015, according to the Financial Capabilities and Inclusion Demand side Survey (FCIDSS), only 38 percent of adults in the country answered that they were aware of AB and from those people that reported being aware of the initiative, only a third were current users of such services. As more people become familiarized with this product, AB has vast potential to not only enhance access in rural areas, but also deepen financial inclusion through more active use of accounts.

17 Agrobank and Bank Rakyat introduced agent banking in 2014 to serve the agriculture sector and cooperatives, respectively.

BSN's experience in agent banking

BSN is one of the agent-banking pioneers in Malaysia. Leveraging mostly on retail outlets, BSN's agents have grown rapidly, offering banking services to areas which were previously unserved. Since the launch of the AB initiative in December 2016, BSN's number of transactions has reached more than 99 million with a value of US\$1.6 billion.

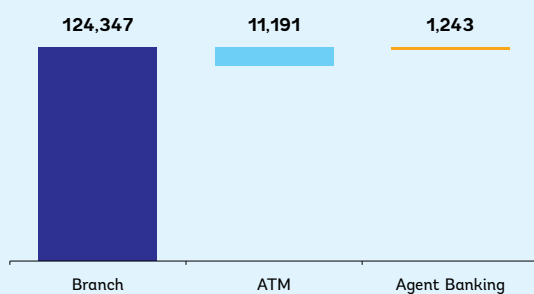
BSN introduced the use of point-of-sales (POS) terminals at the agents' premises, equipped with wireless GPRS, a reader for citizens' identity cards (MyKad) and a thumbprint biometric reader to verify the identity of persons transacting at the AB premises. In the early days, BSN staff were on site, handholding and educating the ABs on the use of the POS terminal and creating awareness of this new banking channel among members of the local community. BSN AB started off with only five basic transactions, all of which were online and real-time through the POS terminal. These included cash deposits and withdrawals, bill payments (mainly for utilities), purchase of BSN's savings certificates (SSP) and cashless purchases.

In other countries, agents are hard to source, as they are required to pay and invest in their own

infrastructure and equipment. To encourage agents' participation, BSN provides agents with – and covers the cost for – all the equipment and support they require (e.g. POS terminals, GPRS connection, continuous training etc.) which acts as an incentive to register. The selection of BSN AB goes through a rigorous process to ensure the suitability of the agent. Among the basic requirements are (1) local registered companies with a minimum of 12 months operational period; (2) has GPRS coverage or fixed land line; (3) has secure and suitable building infrastructure with a permanent mailing address; (4) must own/register a BSN account under the business entity; and (5) must have an account balance of at least RM1,500.

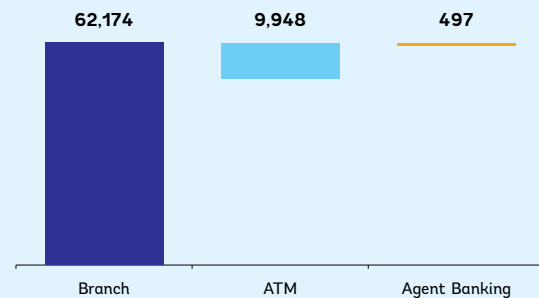
In comparison to opening and operating brick and mortar bank branches, the setup of AB channels has represented a substantially lower investment for BSN. While a bank like BSN requires more than US\$124,000 to set up a branch, AB requires less than one percent of this investment amount. Furthermore, the annual operating cost of a traditional branch is 125 times the cost of agent banks.

FIGURE 19.
Agent Banking Set Up Cost (USD)



Source: BSN, and World Bank staff estimates.

FIGURE 20.
Agent Banking Annual Operating Cost (USD)



BOX 2

Benefits of Agent-Banking: BSN's Experience

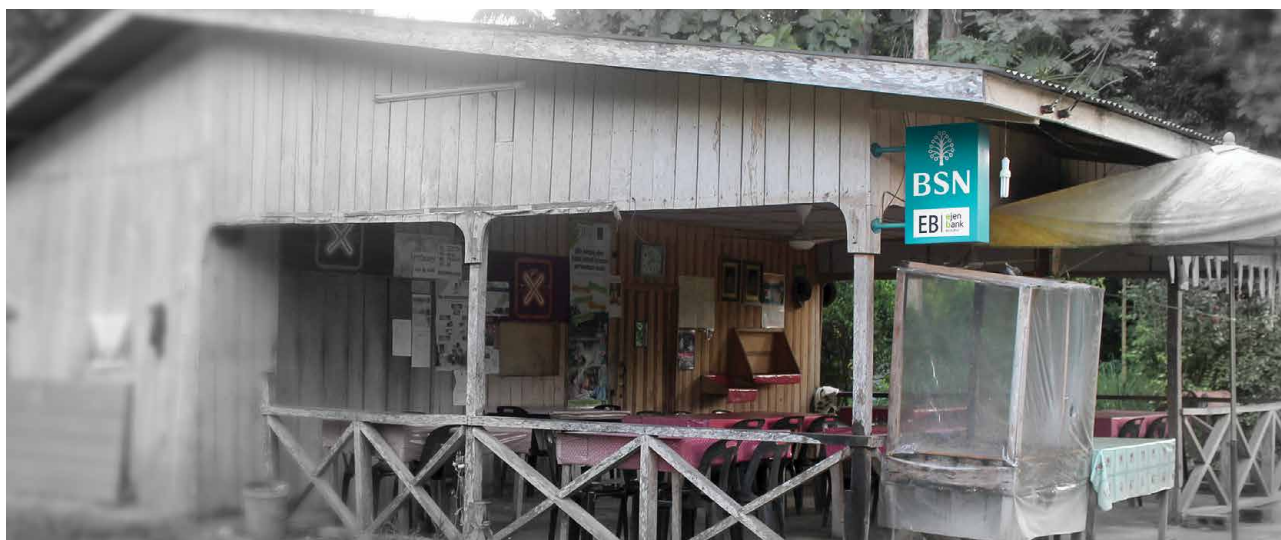
Since the launch of the AB initiative in December 2012, BSN's number of transactions has reached more than 90 million with a value of US\$1.6 bn. The rapid growth of agent banking services in rural communities in Malaysia shows that there is a need for financial services in under-served areas that did not have a convenient access point. To illustrate this point, prior to the introduction of agent banking by BSN in 2012, the people in Felda Chini, Pahang, had to travel up to two hours (120 kilometers round trip) to access financial services in the town of Bandar Muadzam Shah. This travel implied a cost of time and transportation. Also, given the cash nature of the transactions, people faced a risk of potential loss of their money.

BSN AB has changed the way people perceive banking; instead of walking into a typical banking hall to perform banking transactions, customers now have the option to bank while performing cashless purchases at their local grocery stores or at any BSN AB premise located all over Malaysia. Furthermore, customers have the peace of mind of performing cash withdrawals and deposits safely outside a bank's automated banking lobby and after banking hours at BSN AB premises, which typically open between 8am and 10pm daily. For city folk, this also means that they save precious time queuing at the counter and searching for parking.

In rural areas where there is generally poorer exposure to sophisticated IT, BSN AB has helped to increase the knowledge of appointed agents of the use of technology via the POS terminal. Therefore, agents who now appreciate the convenience and security of online banking are educating their fellow neighbors in the community on the benefits of savings and the security of cashless purchases using their BSN ATM/debit cards.



Source: Adapted from BSN.



BSN has benefited from the use of AB with deposits increasing via opening of new accounts as well as deposits received from existing customers. As at the end of 2016 BSN recorded a total surplus of deposits (including SSP) over withdrawals of RM80 million in its agent banking operations. Moreover, between 2012 and 2016 the amount of deposits raised through AB by BSN increased nearly five-fold from RM44 million to RM215 million. BSN has opened more than 25,000 savings accounts for new clients through agent banks, a modest figure that has the potential to increase in the future.

Overall, agent banking has been a successful tool in enabling financial institutions to reach out to new customers in rural areas and provide basic financial services to them in a safe and convenient manner, especially retail payment transactions. The number of sub-districts without access to financial services has drastically declined in Malaysia thanks to agent banking. Agent banks are the only financial services providers in 53 percent of sub-districts in Malaysia. When compared to the cost of setting up traditional brick and mortar branches or ATMs, the cost of setting up agent banks is substantially lower, allowing banks to reach out to new customers in a cost-effective manner.

Looking forward, the agent banking initiative faces some challenges. First, there is the challenge of attracting more financial institutions into this scheme. So far, a single financial institution (BSN) conducts around 80 percent of all transactions

under agent banking. Major private banks have signed up for agent banking, as well as other DFIs. The challenge is to increase the participation of more retail banks.

Second, agent banking could gradually expand the services provided under this platform while maintaining its strong AML/CFT features. So far, most transactions executed through agent banks are bill payments, while figures of the opening of new savings accounts remain modest. As people become more familiar with agent banking, this product has the potential to promote active use of accounts and to become the distribution channel of a wider variety of financial services such as microfinancing and micro-insurance among the population in rural areas.

Third, as the market continues to grow, adjusted commission structures and a higher volume of transactions through the agent banking platform would be required to enable the agent banking business to be sustainable. Similar to other countries, agent banking has not become a profitable line of business for BSN yet as they have been investing in infrastructure, training and creating awareness to increase usage of this channel. Adjustments to the fee structure charged by BSN to end-customers could be considered to make it a profitable line of business. In addition, BSN could explore developing a mechanism to quantify and take into account indirect income contributed by agent banking to other businesses in its profitability analysis.



CHAPTER 4

How Adults in Malaysia Use Financial Services

In light of the existing high rates of account ownership among the adult population in Malaysia and the large eco-system of financial institutions serving the needs of households, what are the challenges that Malaysia still faces in terms of financial inclusion?

Is the high ratio of account ownership being translated into active account usage in Malaysia? Do adults with accounts at financial institutions actively use their accounts to save, purchase goods and services, receive their salaries, pay utility bills and make other types of payments, and remit money to other households within Malaysia? In this section we examine how Malaysians save, borrow, make payments, transfer money, and make deposits using publicly available data from Findex, FIDSS and BNM.

Overall, the data shows that high account ownership is not being proportionately translated into an active usage of accounts in Malaysia yet. Cash is still being used extensively despite the availability of a modern, large, and secure payment system network. Looking forward, current efforts to promote greater use of financial services among the adult population should continue. In particular, efforts to channel a larger volume of government transfers to households through e-payments should continue.

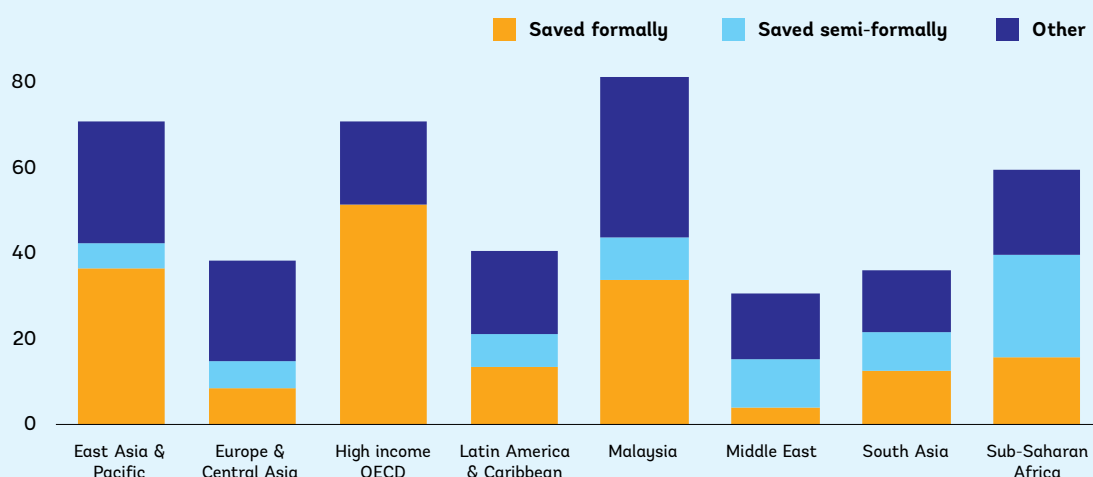
Also a growing volume of monthly salary payments from the private sector to workers should be executed through electronic transfers. Moreover, greater use of debit cards and expansion of electronic-payment-ready POS terminals will further encourage people to reduce the use of cash in favor of other electronic and more secure means of payment.

How people save

In the Findex survey, adults in Malaysia were asked whether they had saved any money (regardless of the institution or instrument) during the past year or not; 82 percent of adults reported having saved money in the past 12 months, an increase of 31 p.p. with respect to 2011's level. However, the share of adults who reported saving formally (at a bank) was only 34 percent, while the rest was saving through other instruments/institutions.

One reason why the number of people in Malaysia that save at bank institutions is low, despite the fact that 92 percent of adults already have a bank account, is because many adults prefer to put their “long-term” savings at other institutions which offer more attractive returns than conventional bank deposits. These institutions, such as the Pilgrim Fund Board or PNB, are quite popular in Malaysia because of their high returns and implicit government guarantee on their products. People also save and make voluntary contributions to the Employees Provident Fund (EPF) or purchase unit trusts (mutual funds). In 2016 the EPF reported US\$11.4 billion in gross investment income, which represented the highest level recorded since the establishment of the Fund in 1951. Also, the purchase of residential property is quite popular among the growing middle class as a means for long-term savings and creating wealth, given the historical appreciation of the value of real estate.

FIGURE 21. Savings Among Account Holders (% of adults)



Source: Global Findex database.

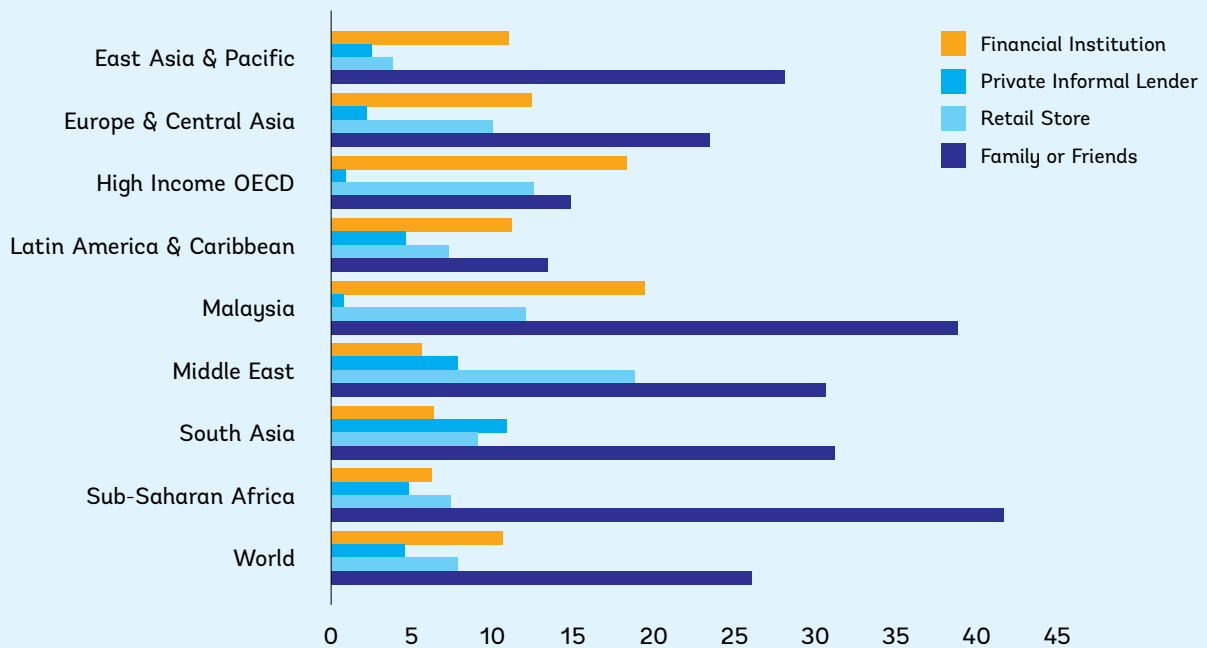
How people borrow

In Malaysia, 56 percent of adults reported borrowing money in the last 12 months in 2014. The most common source of borrowing was family or friends with 39 percent of adults doing so from this source. The second most frequent mode of borrowing was from financial institutions with 20 percent of adults. Less than one percent of adults in the country borrowed from a private informal lender.

The share of adults that reported formal borrowing increased from 11 percent of adults in 2011 to 20 percent in 2014. The expansion of credit in the country has translated into higher household indebtedness levels. While in 2011 the level was close to the 2009’s below 80 percent of the GDP, in 2014 the household debt represented 86.8 percent of GDP. Although the level of household indebtedness has grown rapidly, it is considered manageable by financial sector authorities. BNM recently issued a Responsible Lending Guideline which limits individuals’ ability to be over-leveraged.

Data reveal that access to formal credit by low-income families in Malaysia has increased. While in 2011 only three percent of the poorest 40 percent reported borrowing from a financial institution, in 2014 15 percent of them did so. In the case of the richest 60 percent, in 2011, 17 percent reported accessing formal credit markets and in 2014, 22 percent did so. So the income gap decreased from 14 p.p. (2011) to seven p.p. (2014).

FIGURE 22. Sources of New Loans (% of adults)

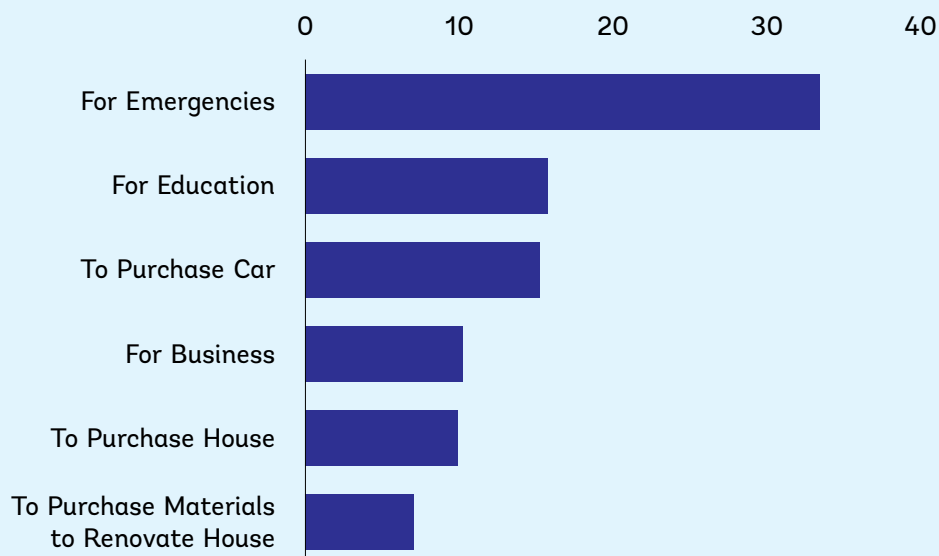


Note: Respondents could report borrowing from more than one source.
Source: Global Findex database.

To some extent, the adults' borrowing patterns observed in Malaysia are not different from patterns observed in other jurisdictions. For instance, for East Asia and the Pacific, borrowing from family members or friends is 1.5 times more likely than borrowing from banks. In Latin America and Caribbean adults borrowing money are 20 percent more likely to do so through these channels than doing so through financial institutions. In Malaysia the percentage of adults that reported borrowing from family or friends almost doubled from 20 percent in 2011 to 39 in 2014.

People that borrow from financial institutions in Malaysia do it for different purposes. Borrowing for emergencies, cover education expenditures, and purchasing a car are the main reasons for borrowing in Malaysia, as illustrated in the following figure.

FIGURE 23. Reasons for Loan Take-Up (% of loan borrowers)

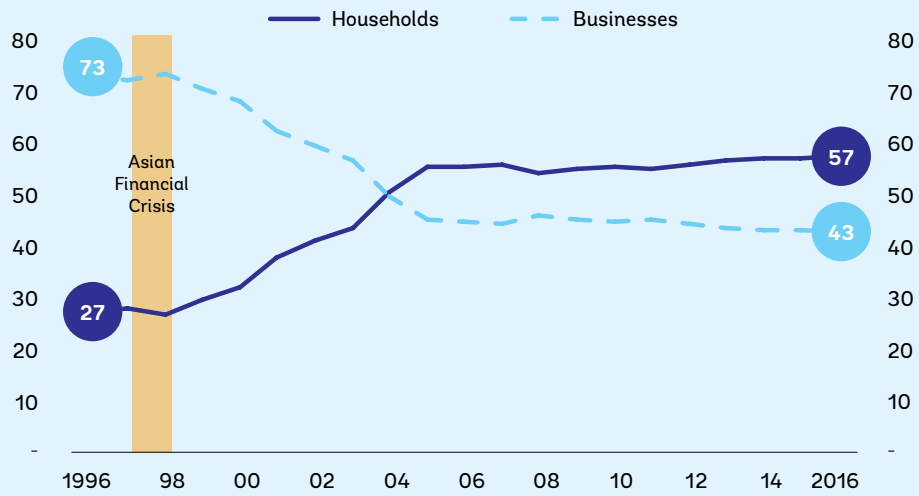


Source: FCIDSS 2015, BNM.

In the past 20 years, the Malaysian banking sector has experienced a shift in its lending focus, with the total credit portfolio shifting from businesses to households. The share of the latter has more than doubled in the last two decades to reach 57 percent of total financing in 2016.

Given the rapid expansion of the economy for the last 15 years, and increasing income at the household level, the banking sector has expanded. Since 2010 financing granted by banking institutions has increased in both corporate and household segments. The average annual credit growth for the period 2010-2015 was 11 percent. Bank credit has been financed mainly through customer deposits, and the loans/deposit ratio was 90 percent in 2015.

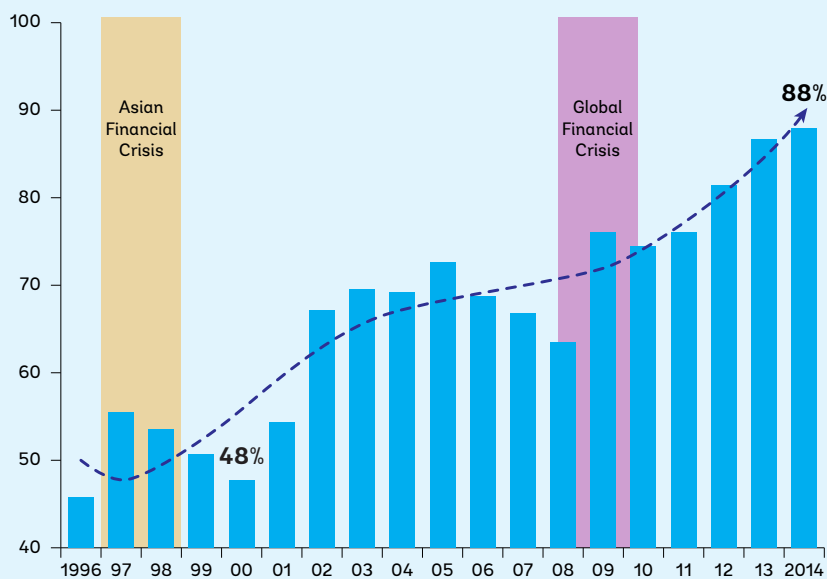
FIGURE 24. Malaysia’s Banking Financing by Sector (% of loans to households and businesses)



Source: BNM, and World Bank staff calculations.

With rapid consumer credit growth, household debt has increased significantly in the past years. While in 2000 household debt amounted to 48 percent of Malaysia’s GDP, in 2016 it reached 88.4 percent of GDP. By component, most household debt is composed of mortgages (55 percent), followed by auto loans, personal loans, and credit cards. Even though fewer people have mortgages as compared to personal loans, mortgages constitute the largest component of household debt on an aggregate basis, given the nature of these loans.

FIGURE 25. Household Debt in Malaysia (% of GDP)



Source: BNM, and World Bank staff calculations.

Use of debit and credit cards

In Malaysia, adults who open a bank account receive a debit card, which they can use to carry out a wide range of transactions at ATMs, pay for products and services at more than 323,000 points of sale nationwide, and do online transactions. Notwithstanding the large number of debit cards in Malaysia, data from BNM and Findex reveal that only half of the people with debit cards use them actively to make payments.

The high use of cash is not unique to Malaysia. In Latin America and the Caribbean, for example, 40 percent of account holders reported owning a debit card, but only 28 percent of them reported having made use of it in the last year, according to Findex.

Under the Financial Sector Blueprint 2011-2020, Malaysia is undertaking various initiatives to encourage people to reduce the use of cash and checks. Strategies focus on enhancing payment infrastructures in order to achieve greater coverage, faster settlements and more efficient payment services.

Efforts to displace checks are mainly centered on promoting the use of credit transfer services, while the key strategy to displace cash is by encouraging the use of debit cards as a convenient alternative to cash. The proliferation of mobile phones and mobile payment solutions also has significant potential to accelerate the migration to e-payments, especially among smaller traders that continue to transact mostly in cash.

TABLE 6. Progress Made in Achieving the Financial Sector Blueprint Targets

Payment Indicators	2011	2016	2020 Target
E-payments per capita	49	97	200
Cheques cleared (million)	205	133	100
Payment card terminals (per 1,000 inhabitants)	7	10	25
Debit card transactions per capita	1	3	30

Source: BNM 2016 Annual Report

As illustrated in the table above, the total number of e-payment transactions per capita in 2016 was 97 compared to 49 in 2011, driven primarily by an increase in credit transfers and payment card transactions. The use of checks is declining. In 2011, 205 million checks were cleared while in 2016 the figure dropped to 133 million. The target for 2020 is 100 million. In terms of payment card terminals (per 1,000 inhabitants), Malaysia has set an ambitious target of 25 for year 2020 from seven in 2011. Similarly, for debit card transactions per capita, Malaysia has set a target of 30 transactions per year, versus only one in 2011. As at end-2016, Malaysia had 10.2 payment card terminals per 1,000 inhabitants and 3.4 debit card transactions per capita in 2016.

According to Findex, in Malaysia 20 percent of adults reported owning a credit card in 2014, an increase of eight p.p. with respect to 2011's figure. However, those who own a credit card are more likely to use it than those who have a debit card. The share of credit card holders that reported having made use of it was 84 percent (in 2014). So in Malaysia credit card holders are twice as likely as debit cardholders to make use of their card to make payments.

BOX 3

Touch 'n Go Cards

The Touch 'n Go card is a popular payment product in Malaysia. Touch 'n Go is a prepaid smartcard that uses a contactless technology. The card is widely used in Malaysia as a means of payment for tolls at highways, public transportations, selected parking areas, theme parks, and retail outlets. The card costs less than US\$3 and can store up to US\$375.

The card has been tested to last 64,000 transactions that could last up to 10-years. Each time the card is used the electronic card reader will deduct the exact fare from the value stored in the card. The users can reload the card in more than 9,000 points nationwide. At the end of 2016, it has been estimated that more than 11 million

Touch 'n Go cards were in circulation in the country. The first system was installed and used in 1997.

According to BNM, in 2016, 9 million credit cards, and 44 million debit cards were in circulation. The number of e-money accounts including prepaid cards is estimated at 61 million. The penetration rate of Internet banking and mobile banking to population is at 72 percent and 28 percent respectively. Given this trend of payment instruments and new channels, that offer services at low cost, more transactions are executed on a daily basis by electronic means within a more transparent and secure environment that are widely monitored by both market users and authorities.

Source: BNM, and Touch 'n Go.



How people pay or are paid

Malaysia has a modern payment system infrastructure that allows banks to conduct a high volume of transactions on a secure basis and low cost. However, data reveals that the existing infrastructure is not being used at its full capacity yet.

According to Findex, in 2014 only 55 percent of adults that received wages reported that they had received their wages into an account at a financial institution, and the remaining 45 percent were paid by their employer in cash. This latter figure illustrates the potential for advancing e-payments in Malaysia. A much higher percentage of workers could receive their monthly salaries and wages directly deposited into their bank accounts. This would not only be safer, but also more cost effective. Among adults receiving wage payments, adults in the bottom 40 percent (income level) were 17 p.p. more likely to receive their payments in cash.

In Malaysia, according to the Findex survey, 0.5 million people in the public sector and 3.7 million adults in the private sector receive wages in cash. However, a recent survey of 208 companies by BNM had found that 80 percent of the companies surveyed have fully adopted e-payments for salary payments. Nevertheless, certain sectors such as agriculture have a lower adoption rate, which may be due to factors such as remoteness, which hampers access to banking facilities, and the presence of undocumented migrant workers. Moving forward, the deployment of agent banks and payment card terminals and the increase in the adoption of mobile banking, mobile payments and e-remittance services would reduce the demand for cash in the rural areas. Moreover, a clear challenge is to convert the remaining volume of monthly salary payments that still take place in cash into regular deposits at the bank accounts of employees.

FIGURE 26.
How Wage Recipients in Malaysia are Paid
(% of adults receiving wages)

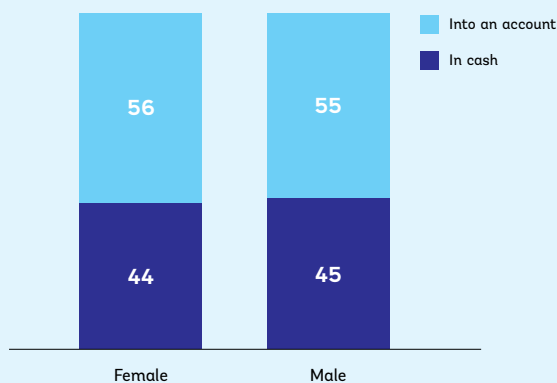
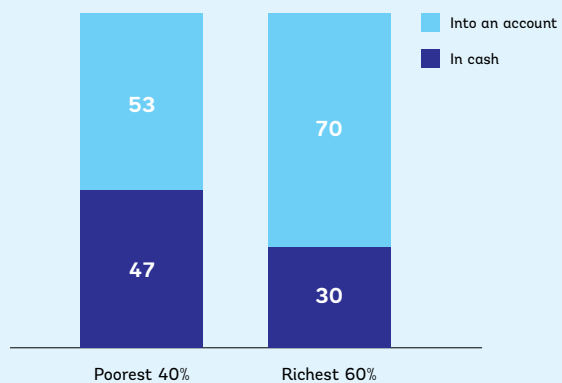


FIGURE 27.
How Wage Recipients are Paid in Malaysia
(% of adults receiving wages)



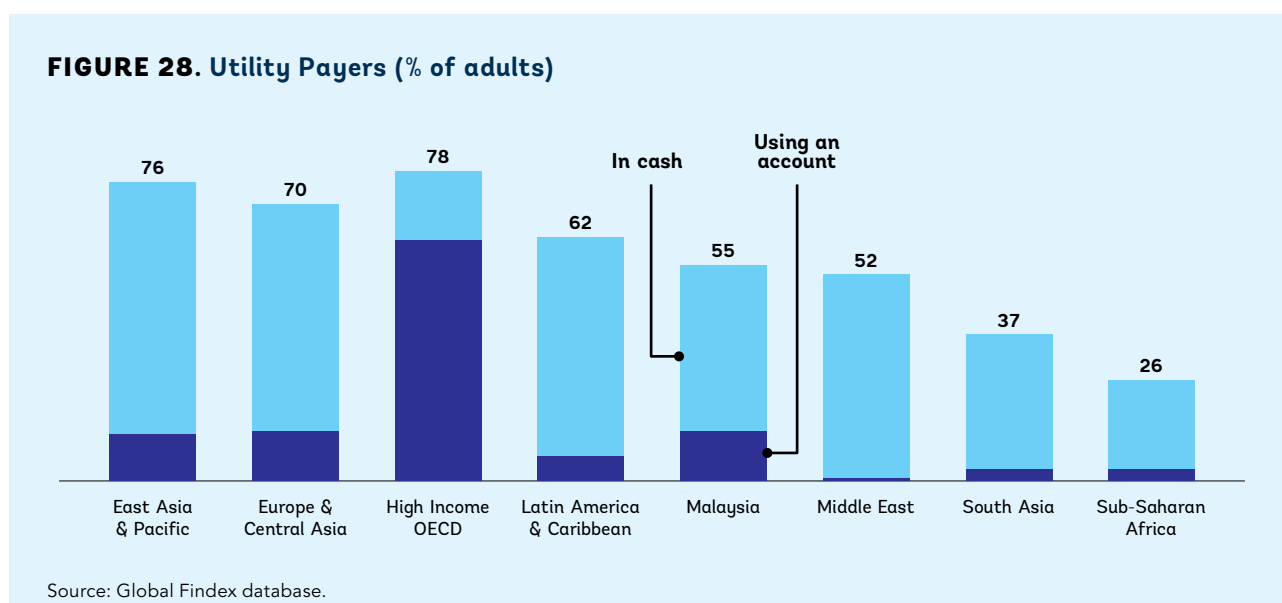
Source: Global Findex database.

Government payments and transfers

In Malaysia, 32 percent of adults in the Findex survey reported having received government transfers in the last year, such as pension payments, social transfers, agriculture subsidies, etc. According to Findex, only 60 percent of adults in Malaysia receiving government transfers reported receiving them into an account, while the remaining 40 percent did so in cash. However, based on data from the Federal and State Governments in Malaysia, in 2016, 99.8 percent of the payments made by the Federal Government and 93.2 percent of the payments made by the State Governments were made via e-payments and the remainder were paid via checks. In addition, 92 percent of the distribution of government aid via the Bantuan Rakyat 1Malaysia (BR1M) scheme were made via e-payments in 2016.¹⁸

Payment of utilities

While in high-income OECD countries 80 percent of those making utility payments reported doing so using a bank account, in East Asia and Pacific 91 percent of adults reported making these types of payments in cash. In Malaysia, 55 percent of the adult population reported making utility payments. Four out of five utility payers did so in cash, and the rest did so through a financial institution account.



According to Findex, the use of mobile phones to pay utility bills is still nascent in some regions, while globally three percent of utility payers reported doing so, more than 50 percent of payers in Kenya used these devices to make such payments. In Malaysia, six percent of adults who reported making utility bills payments did so through a mobile phone in 2014, according to Findex.

Although it is still at low levels, the adoption of electronic channels (e-channels) for bill payments is increasing rapidly in Malaysia. According to BNM data, in 2016, the total number of bill payment transactions conducted via online banking, mobile banking and ATMs increased by 41.5 percent to 116 million transactions (2015: 20.0 percent, 82 million). Notably, bill payment transactions performed via mobile

¹⁸ See <https://ebr1m.hasil.gov.my/manualPengguna/Pembayaran%20BR1M%202017.pdf> (last accessed date May 8th 2017).

banking grew more than twofold to 11.7 million transactions during the year (2015: 23.8 percent, 5.1 million), indicating the increasing appeal of mobile banking as a convenient channel for bill payments.

The national open electronic bill payment platform, JomPAY, recorded 3.9 million transactions valued at RM2.8 billion in 2016 (2015: 0.3 million, RM0.1 billion). The number of billers registered with JomPAY more than doubled from 472 billers in 2015 to 1,105 billers in 2016, enabling the public to make online payments to more billers from any banking account.

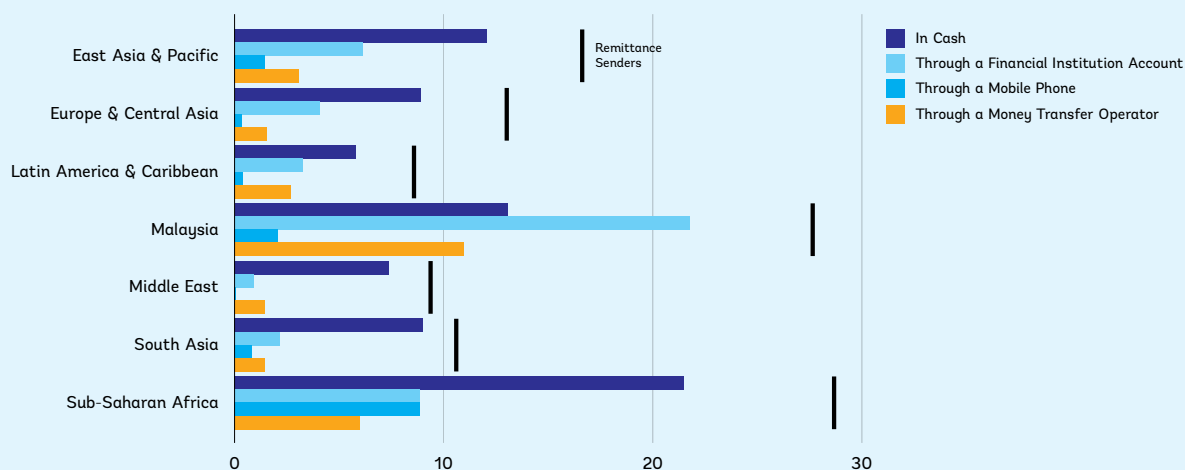
How people send or receive their domestic remittances

On average, 17 percent of adults in East Asia and Pacific reported having sent money to family or friends living in the country, and 21 percent received this type of payment. Domestic remittances are important in some regions of the world such as in Sub-Saharan Africa, where 29 percent of adults reported having sent them. In 2014 in Malaysia, 28 percent of its population (15 years +) reported sending domestic remittances and 25 percent reported receiving them in the last twelve months.

In Malaysia, the most common method to send domestic remittances is through a financial institution, almost four out of five senders reported doing so, and 65 percent of adults who received them did so through this channel. The second most frequent method to send money domestically is in cash; 47 percent of adults who sent remittances reported doing so. The third most common way is through a money transfer operator, 40 percent of remittances senders used this channel. The use of mobile phones to send money is still in early stages in Malaysia with less than two percent of adults having reported using this method.

According to Findex in 2014, the use of mobile phones to send money is still in early stages in Malaysia, with less than two percent of adults who reported having used this method. Based on BNM's data, in 2016, there were 8.9 million mobile banking subscribers for an adult population of about 23 million. BNM's data also show that the volume of funds transfers made using the mobile banking channel had almost doubled, from 17.1 million transactions valued at RM16.8 billion, to 33.7 million transactions valued at RM27.5 billion in 2016, signifying increasing adoption of mobile banking in Malaysia. Thus, Malaysia still has room to channel a larger volume of domestic remittances through cashless channels, given the widespread use of traditional cash-based methods.

FIGURE 29. Method to Send Remittances (% of adults)



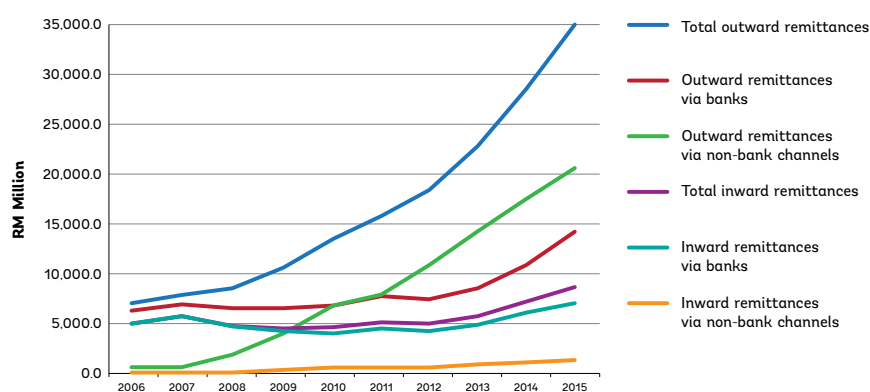
Note: Respondents could report using more than one method. Source: Global Findex database

BOX 4

Outflow of International Remittances in Malaysia

Migrants represent 15 percent of Malaysia's workforce, making Malaysia home to the fourth largest number of migrants in the East Asia and Pacific Region. The migrant population is diverse and includes workers from Indonesia, Bangladesh, Nepal, Myanmar, Vietnam, China and India, among other countries. They have become an integral part of Malaysia's economy, and on a yearly basis they remit substantial amounts of money to their dependents in their home countries through various channels. Remittance growth by migrants in Malaysia has been dramatic since 2006 (see graph below), with an increase in remittance outflows of more than 500 percent in the past 10 years.

FIGURE 30. International Remittance Statistics for Malaysia, 2006-2015



In 2016, BNM and the WB conducted a survey to explore the migrant workers' level of financial inclusion, and their prevalent practices and needs in remitting money to their origin countries. 401 migrants working in urbanized areas and remote plantations were surveyed to determine their specific remittance behavior. The main survey results entail the following:

First, the survey showed that among migrant workers the level of bank account ownership is low (22 percent for plantation workers and 55 percent for urban workers). Many workers cannot comply with the basic requirements to open a bank account, due to a lack of proper documentation. However, the factors that had the biggest impact are the habit among employers to pay wages in cash and the remoteness of plantations, making traveling to banks not only a hazardous (cash is carried on one's person) but also a time-consuming undertaking.

Second, word of mouth is the main source of information on remittance services among migrants. Two thirds of the migrant workers use non-bank remittance service providers (E.g Western Union, Moneygram etc). Banks are the second most preferred remittance option, while money exchangers and post offices are used by less than five percent of the surveyed migrant workers.

Third, 74 percent of the surveyed migrants own a smartphone and 90 percent of them access the internet via their smartphone. These numbers are high and present a tremendous business opportunity for technology-driven remittance services providers who invest in educating their consumer base and provide reliable and competitive remittance services.

Source: Endo, Isaku and Dieter J De Smet (2017): "Improving Remittances for Migrants". In: Development Digest. Kuala Lumpur. World Bank Group Global and Research Hub in Malaysia.

Use of mobile phones and FinTech

Globally, less than 10 percent of adults (with a financial institution account) reported accessing their accounts through a mobile phone (in the last 12 months) and performed a transaction. High-income OECD economies had the largest share of adults who reported doing so at 21 percent, followed by East Asia and the Pacific with 11 percent, and Sub-Saharan Africa with six percent.

In Malaysia, eight percent of adults reported making banking transactions through a mobile phone in 2014, according to Findex. However, the latest figures from BNM show that at the end of 2016, the total number of mobile banking subscribers reached the amount of 8.9 million people (or 40 percent of adults). Moreover, BNM also showed that the number of internet banking subscribers reached 22.8 million people (practically the equivalent of all the adult population with an existing bank account).

Mobile payments have significant potential to reduce the use of cash, with 43.9 million mobile phone subscriptions covering a population of 31.7 million individuals in Malaysia. It also complements initiatives to promote financial inclusion. The growth in financial transactions conducted via the mobile banking channel increased almost threefold from 35.6 percent in 2015 to 92.6 percent in 2016, representing 60.3 million transactions valued at RM33 billion (2015: 31.6 million transactions, RM20.6 billion).

Recognizing the enormous potential of technology to transform the financial sector industry in the upcoming years, Malaysia has taken proactive steps to facilitate innovation and the growth of the FinTech industry. In September 2016, BNM issued the Regulatory Sandbox for new companies to test their products in a safe regulatory environment. The “sandbox” provides a regulatory regime for new companies in the financial sector so that they can develop and test their products under more flexible regulatory requirements set by BNM for a period of up to six months. The sandbox is intended to protect consumers and contain risks, as some products and FinTech companies will not be able to survive in the marketplace.

To catalyze the development of a thriving FinTech ecosystem in Malaysia, BNM is currently embarking on several priority development areas, such as¹⁹:

- i) adopting an open application program interface (API) to enable data-sharing with third parties without compromising data privacy and security;
- ii) creating a common KYC utility to facilitate a more effective and efficient approach by financial institutions to manage compliance obligations. This also aims to reduce fraud and improve the delivery of personalized financial services;
- iii) developing guidelines for cloud computing to harness operational efficiencies while protecting data integrity in financial services;
- iv) examining applications of distributed ledger technology to evolve new infrastructure, arrangements, and processes that will transform the way financial services are delivered; and
- v) enhancing cybersecurity resilience within the financial services sector.

¹⁹ BNM (2017).

Conclusions

Malaysia constitutes a success story in financial inclusion. Malaysia's financial system has grown rapidly and uninterrupted over the past two decades providing a wide range of conventional and Islamic finance products to households at affordable fees. With more than 92 percent of its population having access to financial services, Malaysia is in the path of achieving universal financial inclusion in the near future.

A key merit of Malaysia's experience on financial inclusion is that it has not compromised financial sector stability. During the past 25 years, many emerging market economies around the world – Mexico, Turkey, Argentina, Indonesia, Thailand etc. – have faced large systemic banking crises after experiencing large credit booms. As a result of those crises, those countries have faced large fiscal costs that have hit the poor heavily. Malaysia's banking system has remained resilient and able to withstand various episodes of external turbulence in the past decades.

How has Malaysia achieved its success in financial inclusion? Underpinning Malaysia's success in financial inclusion is a unique path in financial sector development that involves strengthening banks and DFIs, broadening financial markets (especially Islamic finance), developing new financial instruments and delivery channels to reach out to the poor, upgrading prudential regulations, and modernizing financial sector infrastructure, especially the national payment system.

Financial inclusion has been a national priority in Malaysia for a long time, even before financial inclusion became a global goal for the international community at the end of the last decade. Malaysia's experience shows that there is no silver bullet to scale up financial inclusion. The progress in financial inclusion achieved by Malaysia has been the result of efforts undertaken

by authorities and the financial sector industry over the past 20 years.

In the aftermath of the Asian financial crisis of 1997-98, authorities took various actions to strengthen the domestic banking system by encouraging mergers among small institutions.

The mergers allowed the creation of much larger, more resilient, and more efficient institutions able to compete with their regional peers in ASEAN. Moreover, authorities introduced measures to strengthen banks' balance sheets and issued and enforced stricter regulatory standards.

The banking system consolidation process was followed by the formulation of a ten-year Financial Sector Masterplan in 2000, which provided not only a comprehensive diagnostic of problems preventing financial inclusion and overall financial sector development, but also prescribed a set of specific policy actions to address them. Building on the success of the FSMP, a second ten-year strategy, the Financial Sector Blueprint (2011-2020), was adopted in 2011 and is being executed under a robust monitoring and evaluation framework that tracks progress on financial inclusion, quality and usage of financial services, and customer satisfaction.

As part of the execution of the Financial Sector Masterplan (2001-2010), and Financial Sector Blueprint (2011-2020), a wide range of initiatives have been carried out in the past years to accelerate financial inclusion. The mandate of Malaysia's central bank was amended to grant it with the legal authority to proactively advance financial inclusion. In this regard, Malaysia's central bank was a pioneer among central banks around the world in recognizing and formalizing the important role that they can play to advance financial inclusion.



Other major reforms included the establishment of a credit bureau, reforming DFIs, requiring banks to provide financial services to the poor population at affordable fees, and launching the agent banking model to enable financial institutions to reach out new customers in remote locations in a safe and cost-effective manner. Moreover, Malaysia has made significant investments in the modernization of the national payment system infrastructure, accelerating the adoption of electronic means of payments nationwide.

In addition, strong institutional arrangements have been put in place to foster financial education and literacy, and to establish a financial sector ombudsman, and a deposit insurance agency has been created to protect small depositors in the event of a bank failure. All these initiatives have contributed to creating a large and increasingly sophisticated banking system that serves the needs of the population.

The journey that Malaysia has followed has delivered positive results in terms of increasing

the percentage of population with access to basic financial services. However, the journey has not been free from obstacles and several challenges still need to be tackled in the future.

Challenges Looking Forward

Looking forward, Malaysia faces two main challenges in terms of financial inclusion. First, Malaysia will need to reach out to the remaining under-served population. Covering the last mile in financial inclusion might not be as easy as it seems. A large part of the unserved population is composed by foreign workers and their families. This poses unique challenges given the legal status of foreign workers, some of whom are not legal residents, and global international standards that impose on financial institutions strict identification and “know your customer” rules. Solutions will have to be innovative to meet the particular features of the entire universe of migrant workers in Malaysia.

Secondly, a major challenge is how to ensure

that the people with access to financial services actually make active use of their accounts.

This report showed that a large percentage of the population continues to save money at home despite having an account at a financial institution. Many people still use cash to settle day-to-day payments despite the availability of a modern payment system infrastructure in Malaysia. Moreover, a large number of employers pay their workers' salaries in cash as opposed to bank accounts.

To address these challenges, numerous actions are needed.

For example, authorities could consider making mandatory for employers to pay salaries of workers directly into their bank accounts. Moreover, a larger share of government payments and transfers could be done directly through the banking system to the beneficiaries' accounts. New activities could be undertaken to discourage the use of cash in favor of debit cards. An increase in the number of electronic-payment-ready POS terminals, and further modernization of the payment system infrastructure, would help advance financial inclusion.

Malaysia's experience with agent banking has proven successful in reaching out to customers in remote locations where no bank branch exists.

Agent banking has enabled banking institutions to provide financial services to new customers in a cost-effective and secure manner. New initiatives leveraging technology could be considered to fully achieve universal financial inclusion in the near future.

Financial inclusion is not only measured by the number of people with an account at a banking institution.

People also need other types of services. Access to affordable mortgages, life and non-life insurance products, and private pension plans, are areas in which more progress is needed in Malaysia so that the country can reach the standards and aspirations of a high-income nation, as it aims to do by 2020.

Another challenge is to ensure that efforts to promote financial inclusion remain sustainable.

In particular, the high levels of household debt, which in 2016 amounted to 82 percent of GDP, provide an important alert signal that should be monitored carefully. So far, the high level of household debt has been contained and well-managed through appropriate macro-prudential policies adopted by BNM. The banking system as a whole remains well capitalized (16.5 percent capital adequacy ratio at the end of 2016) and has sufficient reserves to cover potential losses under adverse scenarios. Nonetheless the high stock of household debt is a topic that requires constant attention. Moreover, efforts to educate individual households about the risks of indebtedness need to continue.

Finally, a key challenge has to do with the role of DFIs.

As the gaps in financial inclusion narrow in the future, what will be the role of DFIs? Many of these institutions were created to provide financial services in sectors not sufficiently served by other financial institutions. With the further evolution of Malaysia's financial system, authorities will have to redefine the role of those DFIs directly involved in advancing the financial inclusion agenda.



Lessons from Malaysia's Experience

There are several lessons from Malaysia's experience in financial inclusion that could be useful for other countries, especially for low- and middle income countries that are still in early stages of financial sector development and wish to make progress on financial inclusion.

1. Long-term planning has been a key ingredient for Malaysia's success in financial inclusion.

The Financial Sector Masterplan 2001-2010 and the Financial Sector Blueprint 2011-2020 have been critical tools to advance financial inclusion. On the one hand, these strategic documents provided a clear and comprehensive diagnostic of the obstacles and bottlenecks, both of short- and long-term nature, that hindered financial inclusion in Malaysia. On the other hand, they also prescribed concrete guiding principles, goals, objectives, and specific actions that needed to be executed in order to advance financial inclusion. The long-term strategies provided a framework

for different stakeholders and institutions – such as BNM, the Securities Commission, Ministry of Finance, state-owned DFIs, etc – to collaborate and do their part to advance financial inclusion. Moreover, the strategies provided the platform for authorities to carefully plan the timing and sequence of reforms and reconcile two different policy objectives, namely “financial stability” and “financial inclusion”, in a successful manner.

2. A robust monitoring system to track progress has helped advance financial inclusion.

Malaysia has been a pioneer in the production of comprehensive data systems to track progress on financial inclusion. Every

three years, BNM carries out a comprehensive national survey among the population to collect data on account ownership, usage, customer satisfaction with financial products, costs and fees of financial services, etc. The collected data are actively used to monitor progress at national, regional and local level and take actions where progress is slower than expected. Data are also used to monitor progress on the implementation of the Financial Sector Blueprint. Moreover, BNM has created its own indexes and tools to set annual goals in financial inclusion and help in the formulation of financial sector policies.

3. A champion Institution for Financial Inclusion.

Traditionally the mandate of central banks did not include financial inclusion. BNM was one of the first central banks around the world to explicitly adopt a mandate on financial inclusion. In 2009, BNM's legal mandate was amended to provide it with sufficient legal powers to drive and execute the agenda of financial inclusion, as its original mandate did not explicitly cover it. Having an institutional champion for financial inclusion has helped advance the agenda rapidly in the past years.

4. Large investments in the modernization of the payment system infrastructure.

Malaysia's high rate of financial inclusion has been feasible thanks to the existence of a modern national payment system infrastructure that enables banks to conduct a high volume of transactions at low costs and on a secure basis. Over the past two decades, Malaysia has invested heavily on the modernization and expansion of its payment system network and infrastructure. The existing infrastructure supports a wide range of products such as agent banking, internet banking, the use of cards like "Touch 'n Go", credit cards, debit cards, ATMs, electronic-payment-ready POS terminals, etc. Without this modern infrastructure, it would be practically impossible for banks, utility companies, retailers, etc to roll out modern products and services for their customers.

5. Build and strengthen institutions to support financial inclusion.

Historically, the National Savings Bank (BSN), a government-owned DFI, has played a critical role to advance financial inclusion in Malaysia. Although small in terms of assets, in terms of number of clients it serves it is the largest banking institution. BSN has historically served low-income households through a large branch network that enables it to reach out customers across the country. BSN is an example of a solid institution that targets the excluded population through innovative products. BSN has been a clear innovator on agent banking, ATMs, accounts for children, special savings for low income groups, microfinance, etc. Similarly, other government-owned institutions, such as PNB and the Pilgrim Fund Board, have helped Malaysians access their long-term savings at affordable rates.

6. Encourage financial innovation.

BNM has encouraged and supported efforts by various institutions to adopt new products to target the financially excluded population. They include agent-banking, smart cards, ATMs, remittance services, mobile applications etc. Recently, with the emergence of the FinTech industry, Malaysia has adopted new regulatory approaches, such as the regulatory sandbox of BNM issued in October 2016, that enable new non-financial-sector firms to test their products and operate in the financial industry in an environment with sound safeguards.

7. Adopt regulations that promote financial inclusion without compromising financial stability.

The role of a conducive regulatory environment that encourages private-sector participants to lend to under-served markets has been crucial to give viability to the financial inclusion strategy of Malaysia. Malaysia has been successful in calibrating various prudential regulations in such a manner that they promote financial inclusion without compromising stability. An example of this type of regulation is the one applicable to agent banks, which allows third parties to provide basic financial

services to the public on behalf of the banks without compromising compliance with basic AML/CFT international standards. The recently issued FinTech regulatory sandbox is another example of a regulation that encourages financial innovation and allows non-financial sector firms to develop new products while preserving financial stability.

8. Consumer protection and financial literacy.

A key element for the success of financial inclusion in Malaysia has been the attention that authorities have put on consumer protection and financial literacy. In this area, Malaysia proactively takes steps to educate the population, helping them better manage their financial affairs, reduce the use of cash and adopt new technologies. At the same time, Malaysia provides an institutional framework to resolve consumer complaints rapidly. The institutions in charge of addressing financial services complaints are highly regarded by the Malaysian community and bankers. It is a good example that other institutions involved with the provision of services could consider in order to improve the quality of the products and services offered.

9. Maintain a sound financial system. Financial sector stability has been a prerequisite to the well-functioning credit and payments markets in Malaysia. The initial efforts to consolidate the domestic banking system laid the foundations to foster competition within a deregulated environment, which eventually translated into a gradual process of integration with regional markets. Moreover, BNM has taken adequate measures to ensure that DFIs involved in financial inclusion remain financially sound. In fact, the regulatory framework for DFIs involved in financial inclusion is similar to the one applicable to private banks. Furthermore, despite the rapid growth of credit and financial intermediation during the past two decades, the financial system has remained resilient so far.

10. Involve the private sector. Last but not least, active dialogue with the private-sector has been critical in advancing financial inclusion, especially in underserved communities where establishing brick-and-mortar bank branches is costly. Leveraging on private-sector infrastructure to offer affordable financial services tailored to the unbanked population was crucial in fostering the access and use of these types of products and services.

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Annex

TABLE 7. Malaysia's Selected Financial Inclusion Indicators

Indicator (% adults age 15+)	2011	2014	Variation (p.p.)
Population, adults age 15+ (millions)	20.9	22.0	N/A
Account			
All adults	66.2	80.7	14.5
Women	63.1	78.1	15.0
Men	69.2	83.0	13.8
Adults belonging to the poorest 40%	50.4	75.6	25.2
Adults belonging to the richest 60%	77.1	84.1	7.0
Young adults (15-24)	57.1	76.2	19.1
Older adults (older than 24)	70.5	82.0	11.5
Adults with primary education	39.7	58.6	18.9
Adults with secondary education	74.1	84.4	10.3
Borrowed from a Financial Institution			
All adults	11.2	19.5	8.3
Women	10.3	16.6	6.3
Men	12.1	22.2	10.1
Adults belonging to the poorest 40%	2.9	15.2	12.3
Adults belonging to the richest 60%	16.9	22.4	5.4
Young adults (15-24)	7.6	9.2	1.6
Older adults (older than 24)	12.8	22.9	10.1
Adults with primary education	4.2	9.5	5.2
Adults with secondary education	13.1	21.2	8.1
Borrowed from Family or Friends			
All adults	19.9	39.0	19.1
Women	16.8	29.9	13.0
Men	22.8	47.2	24.4
Adults belonging to the poorest 40%	22.9	45.6	22.7
Adults belonging to the richest 60%	17.8	34.5	16.8
Young adults (15-24)	28.4	49.1	20.6
Older adults (older than 24)	16.2	35.7	19.5
Adults with primary education	23.5	27.7	4.2
Adults with secondary education	19.0	41.1	22.1
Adults with secondary education	39.6	35.8	(3.8)

Source: Global Findex database.

Indicator (% adults age 15+)	2011	2014	Variation (p.p.)
Credit Card			
All adults	11.9	20.2	8.2
Women	9.9	15.5	5.6
Men	13.9	24.4	10.5
Adults belonging to the poorest 40%	3.4	10.5	7.1
Adults belonging to the richest 60%	17.8	26.6	8.8
Young adults (15-24)	3.2	7.5	4.3
Older adults (older than 24)	15.7	24.4	8.8
Adults with primary education	2.0	14.1	12.0
Adults with secondary education	14.6	21.1	6.5
Debit Card			
All adults	23.1	41.2	18.0
Women	20.6	38.4	17.8
Men	25.6	43.7	18.0
Adults belonging to the poorest 40%	7.6	32.5	24.9
Adults belonging to the richest 60%	33.9	46.9	13.1
Young adults (15-24)	15.6	36.0	20.4
Older adults (older than 24)	26.6	42.8	16.1
Adults with primary education	6.0	27.1	21.1
Adults with secondary education	28.7	43.7	15.0
Main mode of withdrawal: ATM	77.1	72.1	(5.0)
Saved at a Financial Institution			
All adults	35.4	33.8	(1.6)
Women	30.2	32.3	2.1
Men	40.6	35.1	(5.5)
Adults belonging to the poorest 40%	24.8	25.6	0.8
Adults belonging to the richest 60%	42.8	39.2	(3.5)
Young adults (15-24)	26.6	32.0	5.4
Older adults (older than 24)	39.1	34.4	(4.7)
Adults with primary education	19.8	22.3	2.5
Adults with secondary education	39.6	35.8	(3.8)



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