Zamani Abdul Ghani: Developments in electronic money management

Welcome address by Mr Zamani Abdul Ghani, Deputy Governor of the Central Bank of Malaysia, at the Official Monetary and Financial Institutions Forum (OMFIF) and Lafferty Group – World Roundtable on Electronic Money Management "From Practice to Policy", Kuala Lumpur, 15 May 2010.

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On behalf of Bank Negara Malaysia, I am most pleased to welcome all of you to this gathering on "World Roundtable on Electronic Money Management" – "From Practice to Policy". This event is jointly organised by Bank Negara Malaysia, the OMFIF and the Lafferty Group. As you may be aware, Bank Negara will also be hosting the first ever Asia OMFIF Meeting, which will take place at Bank Negara's Lanai Kijang over the next two days. This World Roundtable on Electronic Money Management, thus precedes the Asia OMFIF Meeting. It provides an excellent opportunity for the industry to have an interactive dialogue with regulators and practitioners from around the world to exchange ideas, experience and perspectives on developments in the area of electronic money and electronic payments.

Economic efficiency and cost savings

Rapid technological advancements and innovation in the last two decades had revolutionised the payment landscape. In the retail payments area, electronic money in the form of stored value cards and other access devices has grown rapidly. Businesses around the world are also intensifying their efforts to cut operating costs and increase efficiency to improve their long-term competitiveness and sustainability. These developments, among others, have intensified the demand for electronic payment. As electronic payment facilitates the automation of payables and receivables, costs associated with paper and labour intensive processes, including potential errors in processing, would be sharply reduced or eliminated. Apart from lowering costs, electronic payment allows for better resource allocation, thus raising productivity and profitability of businesses. Electronic payment also improves cash flow forecasting, thereby resulting in more efficient liquidity management. Furthermore, customer service quality would also be enhanced with the provision of faster and more convenient means of payment. Businesses that respond to these opportunities and are effective in delivering their services will generate greater value for their customers and achieve competitiveness differentiation.

The faster electronic payment displaces the use of cash, the less would be the need for the costly printing and supply of currency notes and coins. The same is also true for physical cheques. The strategic management of currency is an increasingly challenging task faced by most central banks. Apart from ensuring cost effective and high quality currency notes and coins, it also requires accurate forecasts of the demand for currency notes and coins, which varies seasonally and with economic activity. The higher acceptance of electronic payment not only improves the economic efficiency of a country, but also allows substantial cost savings to be gained. Studies have shown that widespread utilisation of electronic payment systems has the potential of contributing to at least 1% of a country's GDP annually. Indeed, there are important potential benefits and scale effects that can be reaped from the realisation of the electronic payment agenda for individuals and businesses, as well as for the economy as a whole. Thus, it is for all these reasons that Bank Negara Malaysia has made the migration to electronic payments as one of its strategic results.

While the acceptance of electronic payment is on the rise in Malaysia, with electronic payment per capita doubling from 23 in 2005 to 41 in 2009, cash and cheques are still largely popular. Hence, resource intensive and time consuming processes continue to exist in the payment value chain. As electronic payments are more economical for the society and, as part of the broader efforts to enhance Malaysia's long term national competitiveness, it is essential that costs arising from these inefficiencies are eliminated. An area that requires more attention moving forward, is the change in customers' behaviour and mindset. Undoubtedly, it takes time and energy to withdraw cash, deposit cheques and reconcile cheque payments. However, there are segments of society who still prefer paper as they are so accustomed to paper and have always trusted paper instruments. Thus, one of the greatest hurdles to accelerate the adoption of electronic payments is breaking longstanding habits and changing the behaviour of people.

Another important aspect in promoting greater adoption of electronic payments is the need to strengthen consumer confidence in the safety and security of the payment mechanism. Recognising the important role of payment cards in the Malaysian payment system and in the electronic payment agenda, Bank Negara Malaysia spearheaded the migration from magnetic stripe to the chip-based card infrastructure on a national scale for both the ATM and credit cards. This migration is also to counter fraud due to cloning, skimming or counterfeiting. We began with the ATM card migration and by 2005, Malaysia became the first country to fully migrate to the EMV chip-based credit card infrastructure on a national scale.

Financial inclusion

Efforts and emphasis on accelerating the adoption of electronic payments would also contribute towards Bank Negara Malaysia's objective of building a progressive and inclusive financial system. Financial inclusion is a high priority in our national agenda and the Bank's commitment in enhancing financial inclusion is explicitly mentioned in our new Central Bank of Malaysia Act 2009. Malaysia has one of the highest penetration of deposit and loan accounts in the world. Based on the study conducted by the World Bank in 2008, more than 80% of the Malaysian population has access to at least a deposit account. In 2009, the penetration of deposit accounts and loan accounts in Malaysia are 3,300 deposit accounts per 1,000 adults and 1,100 loan accounts per 1,000 adults, respectively. The World Bank has also ranked Malaysia number one for three years (2008–2010) in terms of getting credit. Much of this success in achieving a high level of financial inclusion is due to the strategies and policy initiatives undertaken by the Bank over the years.

Going forward, efforts would also be geared towards leveraging on the high penetration of mobile phones in Malaysia, even amongst the lower income groups. Thus, the convergence of electronic money and mobile phone hold immense potential to reach the unbanked and underserved segments of the population, particularly in the rural or non-urban areas. The mobile channel and electronic money instruments can, not only allow mobile payment and remittance services to be offered to these communities, but can also act as the gateway to extend further financial products and services including credit, savings and insurance. These would bring more from these communities into the formal financial system and economic mainstream and would transform the livelihood of the poorer segments of society. The development of a more inclusive financial system is one of the focus areas, apart from electronic payment in the new financial sector blueprint that Bank Negara is in the midst of formulating.

Going green

Electronic payment also enables businesses to move towards eco-friendly work environment and practice social responsibility through "green" initiatives. Yes, we are conscious of the "Equator Principles" in finance and banking. The movement away from paper via online banking and electronic payment and the elimination of the need to drive to and from bank branch offices allow customers to reduce their carbon footprints. Statistics have shown that if

20% of households in the world switch to online payment modes, an estimated 1.8 million trees equaling to 100 million pounds of paper would have been saved.

Regulatory environment

The introduction and application of new technologies in the payments area have led to greater innovation, the introduction of new payment channels as well as new methods of delivering payment services more efficiently at lower costs to a wider spectrum of society and consumers. However, these have also brought on new risks. Regulators, providers and issuers have taken into consideration the risks that each of these various payment modes may have on the safety of the payment systems as a whole. Safeguards have to be put in place to instill public confidence in the usage of these innovative payment services or channels. In this regard, it is vital for regulators to impose prudential requirements on the providers and issuers of the electronic payment systems and instruments. The need for sound regulation and supervision is further exacerbated by the fact that criminals are constantly on the lookout to exploit the weakest link or point in the financial system.

The risk of the new and increasingly popular payment mechanisms being used as conduits for money laundering and combatting the financing of terrorism (AML/CFT) activities is also a growing concern for central banks and financial intelligence units around the world. The increasing use of electronic payment systems, particularly electronic money, for making cross-border payments makes them vulnerable to exploitation for criminal purposes. Therefore, all parties involved in the payment value chain have to be vigilant to ensure that they are not exploited for such purposes. Adherence to international standards on AML/CFT, including the ability to trace funds back to the source and to positively identify the beneficiaries of the funds, are indeed vital.

In Malaysia, electronic money is prescribed as a designated payment instrument in the Payment Systems Act 2003 (PSA) and the Act is under the purview of the Bank. As such, any person who wishes to issue electronic money would be required to obtain the prior approval of Bank Negara Malaysia and is subjected to the prudential requirements imposed by the Bank. In 2005, in line with the objective of reducing the use of cash in the domestic economy, we liberalised our policy by allowing non-banking institutions to issue electronic money. In 2008, the Bank issued the Guidelines on Electronic Money, which outlined the broad principles and minimum standards to be observed by electronic money issuers. As at end-March 2010, 26 issuers have been approved to issue electronic money comprising both card-based and network-based schemes. During the past five years, the use of electronic money recorded encouraging average annual growth of 21.5% and 24.9% in terms of volume and value respectively. With regard to the oversight of electronic money issuers, in particular the non-banking institutions, our objective is to ensure the safety and reliability of the issuers' systems and operations.

We acknowledge, nevertheless, that in this rapidly changing commercial and technological environment, it is becoming increasingly challenging for regulators to develop policies that are effective and appropriate to address the regulatory concerns while at the same time, promote innovation. Digital convergence of telecommunications, computers, and the media is fast conjoining many new products and services to replace the old ones. For these reasons, inflexible and highly prescriptive regulations and rules may be inhibitive to innovation. In addition, with the entrance of more non-bank players in the payments industry, overseeing these players could be more challenging as a different regulatory approach may have to be adopted. Regulators would need to be conversant with the business dynamics and operational arrangements of these new players while, at the same time, these players have to adapt quickly to the regulators' supervisory approach and requirements.

The regulators' dilemma in achieving a proportionate regulatory framework, in particular to promote the growth of electronic money, remains a challenge. This give rise to the need to balance trade-offs between impacting public confidence and promoting innovation and competition. Let's take the example of the provision of a more lenient regulatory regime. While this would promote the entry of new players in the market, it may also lead to the payment systems being used for illicit purposes. Regulators may as well get the major stakeholders to understand this dilemma. By doing this, hopefully the regulators will be able to apply a more stringent regulatory regime to protect public interest, but at the same time do not unduly affect the viability and growth of electronic payments.

Concluding remarks

Regulators play an important role in ensuring that effective regulations are in place to maintain the integrity of the payment system as well as to promote user confidence, particularly for new payment services. At the same time, it is also recognised that migration to electronic payment brings immense benefits to the country. Hence, a regulatory environment that would allow innovation to thrive has to be balanced against the objective of safeguarding public interest and confidence in the payments infrastructure. This balancing is required to ensure continued acceptance and usage of the various payment systems and instruments.

The emergence of payments processors, such as Spare Change, Boku, Paymo, to facilitate payments for virtual goods and services over online social networks, such as Facebook, Bebo and MySpace, as well as person-to-person transfers among users, are developments which regulators are monitoring very closely. If their operations involve virtual currencies that enable payment for virtual goods and services, do they pose a risk to the safety and reliable functioning of the payment system? Should they be regulated? At what stage should they be regulated? Are regulatory concerns in these new payment innovations warranted if they exist only in the virtual space? How should they be regulated as they operate without geographical boundaries? In addition, should virtual currencies be allowed to be used to purchase real good and services or be exchanged for real world currency? I or we do not have answers to these questions. But these are the issues that regulators and market players are grappling with. I will leave these to participants in this Roundtable to deliberate on.

I believe that the common purpose of today's Roundtable is to discuss on ways to speed up the migration to electronic payment with special focus on electronic money. This is indeed a good platform for all key stakeholders to provide their thoughts and highlight areas that require further improvement. In conclusion, therefore, I would like to thank OMFIF and the Lafferty Group for their involvement in this Roundtable event. I wish you all success in your deliberations and look forward to your views and suggestions in achieving our common goal. Lastly, I on behalf of Bank Negara Malaysia also wish to register our appreciation to all of you for taking time from your busy schedule to attend this event.