

Muhammad bin Ibrahim: Migration to electronic payments

Keynote address by Mr Muhammad bin Ibrahim, Deputy Governor of the Central Bank of Malaysia, at the Payment System Forum 2013 "Migration to electronic payments", Kuala Lumpur, 9 December 2013.

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It is my pleasure to welcome all of you to the Payment System Forum 2013 organized by Bank Negara Malaysia in collaboration with the Association of Banks in Malaysia (ABM) and the Association of Islamic Banking Institutions Malaysia (AIBIM).

Overview of the payment system forum

The objectives of the Payment System Forum are:

- Firstly, to build greater awareness amongst the business community on the wide range of electronic payment solutions available in the market; and
- Secondly, to showcase experiences by businesses who have successfully migrated to, and are reaping the benefits of, electronic payments.

Besides featuring presentations by banks and payment system professionals, and the sharing of experiences by businesses, I am pleased to announce that the Payment System Forum has also brought together 27 exhibitors.

The exhibitors comprise representatives of banks, payment service providers and government agencies who will showcase their electronic payment solutions. Members of the business community are encouraged to visit the exhibition booths located outside of this Auditorium and sign-up to the latest offers.

Enhancing Malaysia's payment system infrastructure

An efficient, reliable and secure payment system is critical to the stability of a country's financial system, besides contributing to a country's economic growth and competitive position. In this regard, Bank Negara Malaysia has constantly strived to improve the payment system infrastructure in this country. Payment system efficiency has contributed towards making Malaysia a competitive and efficient economy.

Cheque truncation

Bank Negara's effort in improving the payment infrastructure has been continuous. A significant milestone was achieved in 2009 when the e-SPICK system, an image-based cheque-clearing system was introduced. This modernized cheque processing in Malaysia. In essence, e-SPICK is a cheque truncation system which converted paper-based processing to electronic processing of cheques. Physical cheques are no longer sent to the issuing bank and the cheque clearing center for processing. Instead, images of cheques are sent electronically.

Cheques which previously took up to 8 business days to clear (or T+8) can now be cleared within 2 business days (or T+2). This was done at a time when the country's broadband penetration rate was low at 32% compared to 67% today. The move to transmit cheques electronically not only shortened the clearing times for cheques, but also contributed to a significant reduction in the banks' cheque processing cost from RM6 to about RM3 per

cheque¹ today. With the lower cheque processing cost, the cost savings for the banking industry is estimated at about RM600 million² per year.

Migration to chip payment cards

Another notable achievement in the country's payment system infrastructure is in the migration from magnetic stripe payment cards to chip payment cards, where Malaysia was the first country in the Asia Pacific region to do so.

With the completion of the industry-wide migration to secure chip-based payment cards in 2005, the fraudulent skimming or counterfeiting of payment cards was eradicated. Whilst the migration costs the banks about RM200 million, this industry move proved to be a beneficial one as the pay-back to the banks in terms of potential fraud avoidance was in 2 and a half years. The efficiency and business opportunities to build applications on the chips are enormous.

With a safer payment card infrastructure, tourists have increased their spending via credit cards in Malaysia, from RM4.7 billion in 2006 to RM7.7 billion in 2012, recording an average annual growth of 9% per annum. Malaysia as a tourist destination has benefited from the greater trust placed in its payment card platform, which allows Malaysian businesses here to earn more from tourists through their use of payment cards. For the tourists, it is not only efficient but safe, without the need to carry large amount of cash.

Apart from these two (2) key achievements, Bank Negara Malaysia has been planning ahead to continuously improve the country's payment infrastructure in search for greater efficiency gains and cost savings for the country to remain competitive.

Migration to electronic payments and its benefits

With the rapid technological advancements and increasing demands for more efficient payment services, migration to electronic payment systems and channels has become imperative. Research has suggested that a successful migration to electronic payments has the potential to drive further efficiency gains and cost savings of about 1% of GDP annually. But to realize these benefits, we require more enhancements in payment infrastructure and a change of behaviour from users of payment systems.

Global trend

Globally, cheque numbers are falling. Based on the World Payments Report 2013, cheque usage in the mature Asia Pacific countries³ has registered the biggest decline. Over the period from 2010 to 2012, the average annual rate of decline was 10%. In Australia, cheque usage had declined by 60% in the past decade and at the current rate of decline, it is expected to reach near zero by 2018. In some European countries, like Norway and Sweden, cheques barely exist. Even in the US, which is sometimes referred to as the "Promised Land of the Cheque," cheque usage has been declining at an average annual rate of 7% since 2003.

¹ The cost saving is achieved mainly in the transportation cost to send the physical cheques to and from the clearing centres.

² Refers to the average cost savings per year from 2010 to 2012, calculated based on the difference between the total cheque processing costs before and after the introduction of eSPICK.

³ Japan, Singapore, Australia and South Korea.

Malaysia

Malaysia however, remains a high user of cheques and cash despite the progress that has been achieved in the electronic payment infrastructure and the increasing sophistication of the Malaysian economy. Malaysia's usage of cheques per capita is 6.9 compared to 0.2 in advanced countries⁴. Likewise, Malaysia's currency in circulation (CIC) over GDP of 6.1% is much higher than 3.8% on average in these countries. Over the past three years (2010 – 2012), cheque volume has declined only marginally at an average rate of 0.2% annually and the CIC over GDP remained at 6%.

Malaysia has a banking population of 92% of which about 70% are internet banking subscribers. Moreover, the household broadband penetration rate in Malaysia has increased significantly from 32% in 2009 when we introduced the electronic processing of cheques, to 67% as at end-Sept 2013. With the necessary infrastructure in place, it is timely that all Malaysians migrate to electronic payments in our quest to become a high income, high value-added economy by 2020.

To nudge the systematic migration to electronic payments, Bank Negara Malaysia has set targets in its Financial Sector Blueprint to reduce the number of cheques processed per annum by half from 204 million in 2012 to 100 million by 2020. At the same time, there are also targets to increase the number of Point-of-Sale terminals from 9 in 2012 to 25 unit per 1,000 inhabitants and to increase electronic payment transactions per capita from 56 in 2012 to 200 by 2020. Only by migrating from cheques and cash to electronic payments, can the country anticipate to achieve further cost savings and efficiency gains.

Cost of cheques

Although significant improvement has been made in the cheque processing infrastructure, cheque remains an expensive payment instrument to process at about RM3 per cheque. The total cost is even higher when we take into account the cost incurred by the payer and payee in delivering and depositing cheques. It is estimated that cheque processing cost Malaysia about RM768 million⁵ per year. This amount is huge and a sheer wastage.

Correcting distortion between paper-based and electronic payments

Despite the cost incurred in processing cheques, cheques have not been priced directly to reflect its costs except for the stamp duty of 15 sen per cheque. On the contrary, electronic payment services such as the Interbank GIRO (IBG) are priced above cost at about RM2 per transaction. Such price distortion does not incentivize the adoption of the more efficient electronic payments on a mass scale. In advanced countries such as Australia, Norway and Sweden, electronic payment services are priced lower than cheques consistent with their respective cost of production. The correct price signals that reflect the real cost of cheques and electronic payments had facilitated a broad shift from the use of cheques to the use of electronic payments.

We need to correct this price distortion between cheques and electronic payment services, Bank Negara Malaysia has announced a new pricing strategy for payment services in March this year where the price of IBG and cheques are aligned closer to their cost of production.

With effect from 2 May 2013, the transaction fee for IBG conducted via internet and mobile banking was reduced to 10 sen from RM2 previously. In addition, a cheque processing fee of 50 sen per cheque leaf will be imposed 11 months later on 1 April 2014.

⁴ Norway, Sweden, Denmark, Finland.

⁵ RM636 million (banks) + RM19 million (MyClear) + RM113 million (businesses). RM113 million for businesses was computed based on the ECB study that businesses incur a cost amounting to 0.012% of GDP.

The 11-month grace period before the implementation of the cheque processing fee is intended to afford both the public and the businesses ample time to familiarize with, adjust and migrate to using electronic payments such as the IBG for their payment transactions.

Improving accessibility, security and convenience of electronic payments

Based on a recent survey conducted on businesses, we have identified 4 key hindrances to the adoption of electronic payments, namely:

- Concern of the security of electronic payments
- Difficulty to perform payment reconciliation
- Low limit of electronic payment transaction
- Lack of familiarity with electronic payments

In terms of security measures, banks have continued to invest significantly to ensure the safety of electronic payment transactions. Examples of security enhancements that have been undertaken include the migration to secure chip-based payment cards to address card counterfeiting fraud, the introduction of a second factor authentication to strengthen authorization of online banking transactions and the implementation of SMS alert to mitigate credit card fraud.

To provide ease of reconciliation, banks will facilitate payment references to be keyed in by the sender for IBG payments by April 2014 to enable reconciliation of payments by the beneficiary. In addition, banks have also committed to increase the daily limit for IBG and Instant Bank Fund Transfer (IBFT) transactions to RM10,000 with the necessary security and safety features.

In addition, ongoing initiatives to build awareness, educate and instill confidence in electronic payments are also carried out nationwide through a series of roadshows and media appearances.

Timely for businesses to migrate to electronic payments

Our country is at a turning point in the migration to electronic payments. Under the 2014 budget, RM1.8 billion has been allocated for the implementation of the second phase High-Speed Broadband (HSBB) project. This initiative will provide additional internet coverage which will benefit 2.8 million households nationwide. With this initiative, the household broadband penetration rate is expected to increase to its optimum level⁶. In addition, Bank Negara Malaysia has also called on the banks to widen the access points for the public to conduct electronic payments, including via the ATM network.

While Malaysia's population stands at 29.7 million, there are 41 million ATM cards which have a debit application that can be used to make purchases at merchant outlets. This provides an opportunity for banks and businesses to leverage on, to improve the coverage of Point-of-Sale Terminals to facilitate the use of the debit card as means to reduce the need for cash, as well as, to increase tourist spending at more merchant outlets.

With higher broadband and debit card penetration rate, coupled with increased payment innovation and strengthened security measures, businesses should consult their banks and take advantage of the various electronic payment solutions to reap the benefits of cost savings and productivity gains.

⁶ As at end-Sept 2013 – Total broadband subscriptions = 4.5 mil. With the additional 2.8 million household, total broadband subscriptions will increase to 7.3 million. Penetration rate = 7.3/6.7 mil household = 108%.

I hope you will continue to provide your support in making this national electronic payments campaign a success for the benefit of the country.

Conclusion

I hope that all of you will benefit from today's program. Please do take time to visit the exhibition booths to inquire about the latest promotional offers on electronic payment services and sign up to experience electronic payments at an affordable cost.

On this note, it gives me great pleasure to open the Payment System Forum 2013.