Muhammad bin Ibrahim: Fostering safe, efficient and reliable payment systems

Keynote address by Mr Muhammad bin Ibrahim, Deputy Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the SWIFT Business Forum Malaysia, Kuala Lumpur, 1 March 2016.

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As we transition into a high income and high value added economy, a resilient and efficient financial market infrastructure is an important enabler for economic growth and financial stability. Payment and Settlement Systems play a critical role in the smooth functioning of the economy. A fact sometimes underestimated. In a larger perspective, it can also be leveraged upon as a strategic tool to facilitate regional market integration, strengthen the country's competitiveness, and enhance the country's position as an international Islamic financial centre. Today's Business Forum organized by SWIFT offers a valuable platform for the financial community to exchange ideas and identify opportunities for collaboration to enhance the financial market infrastructure as an indispensable part of a vibrant financial ecosystem in Malaysia.

In my remarks today, I would like to discuss the importance of open and competitive Payment and Settlement Systems as a backbone for economic growth. I will also highlight the opportunities arising from greater standardization and interoperability and how banks can lead the way in facilitating greater straight through processing (STP) for greater efficiency and competitiveness. Lastly, I will outline the importance of keeping pace with innovation, with a focus on real-time payments.

Importance of open and competitive payment and settlement systems

To sustain improvements in the efficiency of payment services and lower barriers of entry, competition is vital in the payment landscape. Strategies adopted by Bank Negara Malaysia for payment system development in Malaysia are therefore aimed to foster effective competition among the market players as a key driver to lower costs, enhance quality and innovation, and provide greater choice to the public. An example of this is reflected in Bank Negara Malaysia's recent reform measures for the payment card market. These measures were introduced in response to inordinate market power to hike prices and the lack of transparency and information in how prices of products and services were being set.

The payment card market in Malaysia is sizeable with 453.9 million transactions valued at RM141.5 billion in 2015. The payment card market is dominated by two major international payment card networks which cumulatively controlled about 90% of market share in Malaysia. Prior to the implementation of the reform measures in mid-2015, the growth of payment card terminals from 2013 to 2014 had remained stagnant at 8 terminals per thousand inhabitants. Based on a report published by the World Bank and the IMF in 2013, the higher Merchant Discount Rate or MDR paid by merchants, averaging between 1.5% to 2.5% when accepting payment card transactions, had the impact of pricing out smaller merchants.

Lack of effective competition in the payment card industry had led to higher costs for payment card transactions, which would in turn raise costs for businesses and consumers. Over a period of 14 months from May 2013 to June 2014, interchange fee, that is the wholesale fee paid between banks in a payment card transaction, were hiked several times. As interchange fee is priced into the MDR, the hikes in interchange fee contributed towards an increase in the MDR for merchants. A lack of price transparency and the overall competition further weakened market pressure to lower interchange fee and MDR.

The highly concentrated market also discouraged merchants from switching to another payment card network given concerns over losing significant competitive advantage if they did. Clearly, left unchecked, such indiscriminate interchange fee hikes risked bringing about a broad-based increase in MDR which would in turn be passed on to consumers through higher retail prices of goods and services.

To curb indiscriminate increases in payment card acceptance cost and foster a competitive payment card market, Bank Negara Malaysia implemented the Payment Card Reform Framework in July 2015. Under the Framework, the interchange fees are subject to objectively-set ceilings, while a market incentive structure was instituted to strengthen the incentives for investments in payment card infrastructure. In addition, measures were also introduced to enhance transparency and competition by prohibiting restrictive trade practices. The results of such measures are very encouraging. These reforms have had an immediate and positive impact on the payment card landscape. The cost of payment card acceptance had started to moderate whilst the annual growth of payment card terminals had tripled from 5.4% in 2014 to 18.1% in 2015.

In addition to promoting effective competition within the payment industry, it is also important to preserve the neutrality of Payment and Settlement Systems. This includes neutrality among instruments and geo-political interests. This is especially true for global and critical market infrastructure providers such as SWIFT where the offer of services to all parts of the world should be guaranteed and reliable. The emergence of other service providers to fill any void should it happen, would be most unfortunate as it could diminish efficiencies gained from access to global market infrastructures. As a participant-owned institution, adequate safeguards to maintain SWIFT's neutrality and finality are essential to ensure it continues to serve its mandate as a trusted provider of secure financial messaging services to facilitate global connectivity.

Opportunities from greater standardization and interoperability

Let me now move on to the need for standardization and interoperability in Payment and Settlement Systems. Proprietary and legacy systems are costly and a source of much inefficiency as time and resources are needed to maintain different systems and facilitate interconnectivity. Hence, there is much value for the financial community to collaborate through greater standardization to facilitate interoperability and innovation to achieve greater economies of scale and network multiplier effects. For instance, in the area of retail payments, the collective industry efforts to adopt chip technology based on international standards in 2003 had succeeded in eradicating counterfeit fraud. The investment cost of about RM200 million was recovered through potential fraud cost avoidance in just less than two years. The migration to adopt the international chip standard on an industry scale has boosted public confidence collectively in the use of payment cards. Foreign cardholders including tourists had increased spending by about 77% in the past 10 years, from RM5.6 billion in 2005 to RM9.9 billion in 2015.

In the area of large value inter-bank payments, continuous efforts are also being made to modernize and enhance the RENTAS or the Real-Time Gross Settlement System to strengthen its resilience and elevate its efficiency and interoperability. In 2006, the RENTAS-USD CHATS link, an inter-bank Payment versus Payment (PvP) settlement link, was implemented to eliminate foreign exchange settlement risk. This was followed in 2007 with the implementation of a Delivery versus Payment (DvP) settlement service for USD securities issued, deposited and traded in Malaysia to eliminate settlement risk arising from trading of such securities. In 2012, Malaysia was among the first countries in the world to have its large value inter-bank payment system assessed by the IMF and the World Bank under the Financial Sector Assessment Program, to be in compliance with all applicable Principles of Financial Market Infrastructures (PFMI).

For 2015, the RENTAS daily average transactions totalled about 17,900 with a value of RM217.8 billion. This amounted to 4.4 million transactions valued at RM53.6 trillion throughout 2015. As part of the ongoing transformation of RENTAS, there is currently an exercise to transform RENTAS into a multi-currency system that adopts the SWIFT messaging standard. The adoption of SWIFT as an alternative access channel, which caters for multiple messaging standards including the ISO 20022, will facilitate the integration of RENTAS with other regional large value payment systems to facilitate seamless, safe and efficient cross-border financial transactions. The interconnectivity with other economies within the region will further enhance the integration of our trade and financial transactions.

Development and modernization of the payment system in any country will not be possible without the banking system. Therefore, banks should lead the way in facilitating straight through processing (STP) to enhance operational efficiency by promoting standardisation and interoperability. This can be achieved through the adoption of common standards such as the ISO 20022, for corporate and cross-border payments. In this regard, banks should leverage on the momentum created by the ongoing transformation of RENTAS to reach out to their customers by offering holistic, end-to-end, STP solutions. This would contribute towards enhanced safety and efficiency and facilitate economic growth through greater connection with global supply chains, as well as, enhance greater integration with regional markets.

Importance of keeping pace with innovation

Let me now turn to the importance of keeping pace with innovation. Over the past five years, significant efforts have been undertaken to modernise Malaysia's retail payment infrastructure and migrate away from inefficient paper based payment instruments such as cash and cheques. Good progress has since been made, especially in the displacement of cheques. The annual decline rate had accelerated from an average of –1.6% in 2011 to 2013 to –10.1% in 2014 and –16.5% in 2015.

Concurrently, there is also an increase in the uptake of electronic fund transfer services. The annual growth rate for the Interbank GIRO (IBG) had increased from an average of 18.8% prior to 2013 to 34.1% in 2014 and 2015. The Instant Interbank Funds Transfer (IBFT) service had also recorded encouraging growth where its annual growth rate of over 60% since 2011 had further increased from 67.8% in 2014 to 76.7% in 2015, signifying greater confidence in the use of e-payments.

However, we must not be complacent. As we move forward, there are two technology trends that hold immense promise to revolutionize the payments market. The first is the proliferation of mobile technology and ubiquitous communications. Increasingly, mobile devices are the preferred channel for consumers to make payments conveniently from anywhere and at any time. The second is the ability to process payments and move funds instantaneously around the clock.

Towards this end, Bank Negara Malaysia's wholly-owned subsidiary MyClear has initiated a multi-year program to modernise Malaysia's payment infrastructure. The key thrust of this plan is to develop a new real-time Retail Payments Platform that will serve as both a catalyst and enabler for innovative payments in Malaysia. This should meet the needs of consumers and businesses who increasingly expect payments on-demand where funds are available to the recipient immediately. In this regard, I would like to call upon the financial industry to jointly work with MyClear in the development of such new real-time Retail Payments Platform.

Conclusion

Payment and Settlement Systems are the foundation that underpin the financial market infrastructure and serve as a catalyst for economic growth. Hence, efforts to promote the resilience, interoperability and competition of such systems are of utmost importance. This has been and will continue to form the key thrust in Bank Negara Malaysia's policy work in delivering our mandate of fostering safe, efficient and reliable payment systems. There are immense opportunities and new sources of growth including expanding financial accessibility to the underserved that is made possible from greater standardization and interoperability of the payment systems, as well as, innovation. Hence, in today's rapidly evolving and highly competitive environment, the financial community should capitalise on such enabling environment, and collaborate through standardisation and interoperability, to lower costs, foster innovation and deliver better value proposition and choices to their customers.