Jessica Chew Cheng Lian: Digital developments in Malaysia's financial sector and the broader economy

Opening address by Ms Jessica Chew Cheng Lian, Deputy Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Asian Banker Digital Finance Convention 2018, Kuala Lumpur, 22 March 2018.

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It is my great pleasure to be here today at the 2018 Asian Banker Digital Finance Convention.

Many of us here would remember what a “Kodak moment” is. I believe the term for that these days is “Insta-worthy”.

Kodak’s story is a familiar one, now infamous as a classic case of digital disruption. At the turn of the century, film was still very much the technology of choice. But within years, the digital camera quickly took over the mass market, eventually putting Kodak out of business. And the story does not end there, as we all know. Very soon, most people were taking pictures with their phones instead.

This may be an old cautionary tale, but its message continues to be relevant. The digital revolution is real. It is inevitable. And it is pervasive in ways that change the way we live today, and in ways we cannot yet imagine.

At its most fundamental level, perhaps the most significant change brought about by the digital revolution has been the change in paradigm. By this, I mean the basic assumptions that shape our thinking – whether in a business, social or political context.

In the world of finance, some of the questions being asked today are: What makes a bank a bank? Will digital currency ever replace central-bank issued money? Or more likely, will central banks issue their own versions of digital currency and in the process, disintermediate banks? Are banks selling financial products, or are they offering a lifestyle, opportunity and the freedom to pursue a new and different path in life? What business are banks really in?

When everyone stopped using film in cameras, one wonders if Kodak realised that it was actually in the business of capturing memories. Or when smartphones burst into the mobile handset market, did Nokia realise that their business was not selling mobile handsets, but connecting people with the world around them?

Three years ago, McKinsey predicted that technological advancements will redefine the landscape of finance, and then went on to argue that incumbents had – at most – a brief window of five years to adapt or risk becoming obsolete. You may or may not agree with this, but I think it would be hard to deny that a shake-up of the industry is already present.

To some extent, the finance industry has been responding. Total IT spending is estimated at over $200 billion every year across the regions of North America, Europe, Asia Pacific and Latin America. In 2016, a single global bank spent $9.5 billion, or 16% of its expenses on technology. The impact of these investments are becoming increasingly visible – banking without branches, investing without brokers, paying without paper.

Technological advancements are also redefining the landscape of finance in ways that we are only beginning to understand. Distributed ledger technology offers the potential to transform longstanding practices in areas such as correspondent banking, trade finance and remittances. Big data analytics continues to uncover new ways to understand and access untapped markets. Innovations in mobile technology are also challenging the status quo, particularly in the area of payments. Alipay and Tenpay quickly come to mind as examples of companies that took a single mobile app and went on to build an international ecosystem from scratch.

These trends are now increasingly commonplace across the globe, driven by a multitude of factors – from the drive to improve efficiencies, deliver a superior customer experience, break into new markets, or combat fraud.

In the face of these tectonic shifts, most of us are finding ourselves in unchartered waters. Within the central bank, we are doing work across a range of issues that we believe will be important to inform our thinking on digital developments, both in the financial sector and the broader economy. Within your own institutions, I trust this is also the case. In that sense, we share a common interest – to keep our sights fixed on the future so that we can step forward confidently.

With that in mind, today I would like to touch on four areas of particular relevance as we navigate this digital world:

- First, the role of digital leadership;
- Second, ensuring the quality of growth in the financial sector;
- Third, future-proofing the workforce; and
- Fourth, preparing our society for digital finance

Digital leadership in the face of changing market dynamics

Let me turn first to digital leadership. Strong digital leadership starts with an acceptance of a new normal. Historically, finance has been a close-knit community. But the barriers to entry are being lifted by technology. As I alluded to earlier, this has blurred the boundaries of what it means to be a bank, or a financial services provider.

As a result, banks are no longer just competing with other banks. Non-traditional players – such as fintech firms and platform-based companies – are increasingly well-positioned to offer financial services. Digital disruptors want to not only gain market share, but to transform the market itself. This is reflected in the willingness to take loss-leading positions when entering a market.

The changing market dynamics raise some important strategic questions for banks – including how banks will choose to fundamentally approach competition, what this means for existing business models, and what outcomes this will entail both in the short and longer term.

One strategy has been to leverage opportunities for collaboration – whether among existing players or new entrants. We see this emerging as an increasingly important, if not inevitable, response globally on several fronts.

In the blockchain space, the industry in a number of jurisdictions has pooled resources to defray the cost of experimentation involved in developing scaleable use cases for the technology's application. In Malaysia, nine banks have done this by coming together to develop blockchain applications for trade finance.

Establishing shared networks, or opening up previously closed ones, is also gaining traction. This can be seen in the growing use of Open Application Programme Interfaces (or Open APIs). Over the last five years, publications of APIs in the financial sector have increased exponentially, with an estimated 200 new APIs published every year. In a survey that we conducted earlier this year, more than half of banks and insurers in Malaysia indicated plans to roll out open APIs in the near to medium term.

At the industry level, the Bank has established an open API implementation group with members drawn from the industry, fintech community and key stakeholders to develop open API standards for the financial sector as part of efforts to broaden access and promote innovation and competition.

On the risk management front, the World Economic Forum announced less than three weeks ago the creation of a consortium to facilitate more coordinated efforts in addressing cybersecurity risks. This entails developing common principles for risk assessments, guidance for implementation, and a scoring framework.

In the area of payments, the Bank has just last week issued the Interoperable Credit Transfer Framework (ICTF), which promotes collaborative competition or 'co-opetition' for mobile payments. Under this framework, banks and non-banks alike collaborate at the infrastructure level through a shared payment infrastructure, while individual players compete at the product level by developing innovative value-added features. This approach is envisioned to expand the network reach at a lower cost, while promoting competition in areas that advance financial inclusion, higher service levels and the delivery of a superior customer experience.

There are clear synergies to be gained from such collaborative efforts. They enable technological infrastructure to be shared across the industry. This shifts the competitive focus towards improving the value created for customers and the economy at large, rather than a race towards building proprietary networks that ultimately leads to market fragmentation.

However, the effect of this is also a sharp laser focus on bottlenecks within individual firms. By levelling the playing field, firms will face a greater urgency to address internal constraints that prevent them from capitalizing on opportunities for higher growth and productivity. This may well be the most important challenge for digital leaders.

Elevating the quality of financial sector growth

This brings me to the quality of financial sector growth.

There are two perspectives to this. First, digitisation offers enormous potential for the financial sector to achieve what was not possible before, at least not without prohibitive costs. And second, the transition to a digital economy itself calls for a re-orientation of the financial sector to meet the new business demands for financial services. On both counts, the financial industry can, and in fact ought to be, powerful agents of change.

With a little ingenuity, digital finance can unlock new growth opportunities that were previously deemed to be not commercially viable. Indeed, disruptive innovations – whether in banking or beyond – often begin at the fringes of the market, such as the underserved and unserved segments.

The much-lauded success of M-Pesa in Kenya is a shining example of this, where the humble mobile phone was transformed into a bank account for millions of people who were otherwise excluded by the financial system. We have our own success story in Malaysia with agent banks that were made possible with technology. Through the vastly expanded network of access points at a fraction of the cost involved to set up a branch, over 30,000 individuals who did not have bank accounts before now have access to banking services through agent banks.

This is just the tip of the iceberg, with considerable potential that remains untapped –

- to achieve full financial inclusion with access to bank accounts for all Malaysians;
- to make it easier, through psychometric and big data analysis, for businesses that have no track record or collateral to qualify for financing as Malaysia embraces an innovation-led growth model; and
- to practice and influence sustainable business practices that protect our future.

With digital finance, these are commercially viable possibilities. From Africa to London, technology and finance are being combined in unprecedented ways to deliver solar power to communities, drive investment decisions based on sustainability metrics and break down barriers to access.

With growing inequality, environmental degradation and more uncertain global developments, the stakes are high. If banks do not take up the mantle of leadership within the community, at risk is their legitimacy in the longer term as vehicles for the efficient allocation of economic resources.

Future-proofing the workforce for digital finance

One can hardly talk about the quality of growth without addressing the workforce. This brings me to the third area that I would like to touch on.

In a sense, the financial sector is arguably better positioned than most to transition its workforce as job profiles change in response to technological disruptions. For one thing, the financial sector has already been moving for a while in the direction of higher skilled jobs. Over the past three years, 91% of total jobs created in the financial sector were in high-skilled positions. As at the end of last year, high-skilled workers continued to comprise the majority of the workforce – representing 74% of the banking sector employees and 83% of the insurance/takaful sector employees.

That said, more substantive considerations of the implications of technological disruptions for the financial sector workforce have generally been lacking. Beyond talk of hiring more data scientists and cyber-security experts, or automating counter and customer services, most institutions have not fully examined how changes to workflows or business strategies under different digital scenarios will impact existing jobs. It is also not uncommon for institutions to chiefly focus on IT-related technical skills as a core competence for future workers. Yet we all recognise the speed at which technical knowledge becomes quickly obsolete. In reality, learning agility, creative thinking and behavioural insights may be far more important in future workers.

In responding to technological disruptions, the implications for the workforce therefore demand much more rigorous attention than the cursory acknowledgement that it is getting today.

We intend to work with financial institutions over the coming months to take this forward, beginning with a holistic assessment to better understand the dynamics of the financial sector workforce as a basis to forecast skill demand and supply under different scenarios. This in turn aims to support the formulation of strategies – both an the institution and industry level – to effectively transition the workforce.

For Malaysia, with a significant majority of jobs in the high-skilled category, technology is more likely to augment and redefine job roles in the financial sector, rather than eliminate occupations altogether over the next decade. Nevertheless, some segments will inevitably face the risk of displacement. We aim to work with the industry to establish appropriate mechanisms to re-skill workers and enhance their prospects for gainful employment in different roles. I should add that we will also expect individual financial institutions to design and implement appropriate programs for transitioning employees affected by digital disruptions, beyond compensation arrangements.

Preparing society for digital finance

My final point has to do with preparing society for digital finance. The consumer experience of financial services is changing dramatically. This is happening on several levels. Customer interfaces are shifting online. The basic commodity of finance – money – is being replaced by electronic forms. Financial products are offered as part of a seamless solution for customers buying property, subscribing to a mobile phone or data package, going on a holiday or enrolling in university. This in turn alters the relationships that a consumer develops, which can be several layers removed from the entity that is ultimately providing a financial product or service.

Frameworks and business practices designed to protect consumers have not fully kept up with these changes. This can increase risks to consumers – from a lack of transparency, misrepresentations, the inappropriate use of data to unfairly discriminate against consumer segments, legal loopholes, and financial fraud. Greater access to financial services itself through the entry of new and unconventional players can also contribute to over-indebtedness.

More needs to be done to better prepare society for digital finance. This must address the information needs of consumers in the context of digital financial services, clear parameters adopted by financial institutions for offering financial products through a new interface, and expanded arrangements for handling complaints which also cover the role of intermediaries through which financial services are offered. Most importantly, we need to increase efforts to educate consumers on how to protect themselves against fraud, and the implications of giving consent for their data to be collected and used.

Drawing on lessons from our engagements with financial service providers and fintech companies in the regulatory sandbox, the Bank intends to clarify and enhance existing standards expected of financial institutions in these areas to maintain confidence in the use of digital financial services.

Ultimately, what really matters is how effective your customer engagements are in addressing potential consumer risks. We look to financial institutions to preserve, if not further improve on, a positive consumer experience for your customers. At the industry level, financial institutions should also collaborate on public communication strategies to educate and raise awareness on digital financial services.

Conclusion

It has been said that not since the digital revolution in the 1990s has technology placed such a comprehensive burden on business, employees and individuals to reinvent themselves. In the process, a vast range of possibilities and challenges will open up for the world of finance to deliver stronger, higher quality and more inclusive growth. Individually and collectively, we will face stark choices that will shape the future of financial services in Malaysia. It is critical that we move forward thoughtfully to ensure a financial system for the ages and for all segments of society.