

Nor Shamsiah Mohd Yunus: Shifting tides - future of finance

Opening remarks by Ms Nor Shamsiah Mohd Yunus, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the MyFintech Week 2019 "Shifting Tides: Future of Finance", Kuala Lumpur, 17 June 2019.

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I would like to welcome all of you to the inaugural MyFintech Week and Financial Industry Conference hosted by Bank Negara Malaysia. This event is being held at a time that brings together two important mileposts for the Malaysian financial services industry - the beginnings of an exciting era of digitalisation and a new chapter in the development of the financial sector as the current Financial Sector Blueprint approaches the end of its horizon in 2020.

"Shifting tides: Future of finance" was deliberately chosen as the theme of the event for a reason. For much of history, human civilisation could not reasonably explain how ocean tides occurred. It was only through the discovery by Sir Issac Newton and the dedication of scientists over many centuries that we are able to understand it today.

Like ocean tides, the future of finance may be hard to fathom at the beginning. Yet it offers many opportunities and risks. Perhaps most importantly, it also underscores the heavy responsibility and ownership that we collectively bear to build a financial system that is safe, reliable and truly serves the needs of the people.

In my remarks today, I will discuss what this entails in order to develop a financial system for all Malaysians.

The world is undergoing dynamic shifts

The world around us is shifting dramatically. To understand this shift, we should pay attention to five megatrends.

The first is the shift in global economic order with the rise of Asia, including the rising prominence of ASEAN. The gravity of the global economy is moving to the East. Being the sixth largest economy and home to around 650 million people, there is an abundance of opportunity, hope and dynamism in this region. The financial sector will no doubt, be a key player in further catalysing the growth of ASEAN countries.

The second is the risks brought about by climate change. Tackling climate change may be one of the biggest challenges for humanity in building a sustainable and prosperous future. It could lead to devastating, wide ranging and irreversible damage to our economy, society and the way we live. Economic losses in itself could be very significant, as high as USD20 trillion. Insured losses from effects of climate change have already increased five-fold in the past 30 years.

The third is the rising income inequality that can threaten the fabric of our society. Consider this. The top 1% of the population has captured twice the global income growth of the bottom 50% since 1980. Worse still, inequality has persisted despite large transfers of public to private wealth in many countries.

The fourth is the rising populism and protectionist policies. This can be seen in inward looking policies and anti-establishment views that have become more entrenched in parts of the world. Slow growth, lack of economic mobility and erosion of trust in public and private institutions are among the factors that are likely to have contributed to this. Like undercurrents before a storm, these trends have far reaching implications for political, economic and social systems.

Last but not least, the fifth shift is the advancement of technology. This has and will continue to

dramatically alter the way we behave, interact and transact. Much has been said about the benefits, but an increasing reliance on technology presents risks that we cannot ignore. This includes issues of data privacy, discrimination or biases and also displacement of certain segments within society. In the digital age, higher order risks of cyber-attacks and operational disruptions are magnified in ways that we have yet to fully comprehend.

Calling for a financial system that is relevant, safe and socially responsible

These five megatrends and finance are deeply intertwined. While undoubtedly finance has helped to power the economic rise of ASEAN, its role in contributing to an increase in climate risk and inequality cannot be denied.

Therefore, as we consider the future of finance, we need to contemplate not only how these megatrends may impact finance, but how finance itself can respond to and shape these trends in more positive ways moving forward.

In my mind, this calls for a financial system that is **relevant, safe and socially responsible**.

Finance must be relevant to the needs of the economy. This means that it must offer suitable, cost-effective and quality financial products and services for all segments of society. It must also respond to the changing demographics and structure of the economy. For example, as we move towards becoming a digital economy, the financial sector must accord adequate support to innovative SMEs, such as those involved in e-commerce. Equally important, we must remember that this imperative is not only for banks, but extends to the other parts of the financial sector. Non-banks such as venture capital and private equity firms, as well as alternative financiers such as factoring and leasing companies, have an equal stake in this and should also play a more active role in financing the needs of businesses. The need to bridge the gaps between 20th century finance and the 21st century economy is both compelling and urgent for the whole financial sector as conditions remain challenging for the economy domestically and abroad. This is also certainly not the only time that we will face such challenges.

To be **safe**, finance must not sow the seeds of its own destruction and not serve as an amplifier of risk to the economy. The ability of finance to mobilise capital, create leverage and distribute risk allows it to be a powerful force for good. But excessive and unbridled risk taking creates instability which is harmful not only for the particular firm, but the economy and society at large.

There is also a greater need for finance to be **socially responsible**. Financial institutions can and must assert the much needed leadership in a world where the continued neglect of equitable development and a rapidly deteriorating environment is displacing communities, raising social and political tensions, and putting future generations at grave risk. Finance still holds the trust of society and substantial influence over economic agents. But this is a privilege earned, and demands that financial institutions behave ethically, and act in the best interest of the communities they serve.

The role of technology to revolutionise finance

There is no question that technology will lie at the very heart of these imperatives for the financial system. This has been true for decades, only the order of its impact is now, arguably much greater.

After all, the world's first ATM in 1967 transformed the relationship between people and money and making finance more accessible. Today, fintech signals the next phase in the transformation of finance.

Fintech holds enormous potential to enhance competition, increase productivity, address unfulfilled consumer demand and fundamentally change the way institutions provide financial

services – in ways we may not even have fully discovered.

Similarly for Islamic finance, adoption of technology could present significant opportunities to reduce the cost of financial intermediation and expand access. For example, distributed ledger technology could enable automated execution of contracts through the use of digital protocols, or smart contracts, which can simplify complex Shariah contractual processes. In addition, fintech initiatives to integrate social finance tools, such as waqf, sadakah and zakat, to offer more affordable financial and protection solutions, will be instrumental to serve those who are currently financially underserved or excluded. The integration of social finance into Islamic financial services encourages wealth distribution among society to achieve greater balance between wealth creation and wealth sharing.

Ultimately, fintech in Malaysia should be harnessed to offer inclusive, sustainable and relevant financial products and services to serve the needs of all.

The responsibility to manage the attendant risks

This however means that we need to be cognisant of the potential risks associated with technology.

This will be especially important as fintech and bigtech firms become more prominent in the financial system. Such firms could pose system-wide vulnerabilities that can amplify shocks to the financial system and cause financial and economic instability. Increasing reliance and concentration on third party service providers, including those located offshore, to support critical functions, could also increase operational vulnerabilities in more unpredictable ways

The demands of society for speed, convenience and cost efficiency are at a point where substantial tensions already exist between pressures on financial institutions to accelerate the adoption of technology, and our capacity to manage those risks effectively. These tensions will only increase going forward.

Managing these tensions at an optimal level will be critical. It will call for changes to how financial institutions internally oversee and manage technology risks, both within and across their business activities, invest in hard and soft infrastructure and having much deeper collaboration across institutions and agencies.

Socially responsible finance will also require institutions to carefully consider how technological innovations may create new forms of financial exclusion or raise difficult ethical questions. Clear guidance on acceptable conduct by staff and relevant parties will be needed. This in turn, will require financial institutions to reflect on their core values and risk appetite.

In short, managing technology risks is not just an operational matter. It is a strategic one with high stakes for individual institutions, as well as the industry and the economy more broadly. Our response should be commensurate with these stakes.

Beyond measures taken at an institutional level, there is a pressing need for the financial industry, and indeed even the nation, to provide an enabling and secure framework for technological innovation; and educate and empower the public to take advantage of innovations. For example, the need to formulate a cohesive, coherent and comprehensive national strategy on cyber security is an urgent need. We can only play our intended role to support the broader economy if we are attentive to both strategic and operational considerations of risk.

Developing a safe, sound and vibrant financial system through innovation and technology

Bank Negara Malaysia is committed to play a facilitative role to enable innovation to flourish. Like

financial institutions, we need to balance the significant benefits of financial innovation with its risks. We are also mindful that the calls we make in regulating and supervising the industry can themselves sometimes, restrain innovation.

Our responses to new financial technologies will continue to be primarily concerned with the risks that they pose to financial stability and consumer protection. In finding the right balance in our overall regulatory and supervisory posture, we will continue to consult widely with the industry and experts in the field. A key priority for the Bank is to ensure that our regulatory and supervisory system is appropriately calibrated to encourage innovation, but also has the agility to shift gears when required to respond to new risks. This recognises that innovation without stability ultimately destroys value, confidence and undermines our future.

What does this mean in practice? There are at least three things, which are each a reflection of our ongoing efforts to build an enabling, yet safe environment for innovation:

- ♦ First, building interoperable infrastructures. This will start with open and fair access to a shared payment infrastructure for banks and non-banks alike. It is also important to recognise the need for other digital public infrastructures as key enablers to harness the full potential of fintech. These include having a national digital identity system, framework for open API and open banking, clear cloud policy and nationwide broadband connectivity.
- ♦ Second, further differentiating our regulatory and supervisory approach to capture new sources and transmission of risks while allowing room for experimentation and for firms to develop economies of scale. An important objective will be minimising regulatory arbitrage, which can lead to risks building up in parts of the financial system that may be subject to differentiated regulations. We anticipate that this will call for a much more dynamic approach to regulation and supervision as well as better communication of regulatory developments going forward.
- ♦ Third, strengthening platforms for collaboration. In this regard, the Bank, together with the financial industry, is in the process of establishing a Financial Threat Intelligence Platform. The platform will collate, analyse and disseminate real time information on cyber threats and trends to strengthen the detective capabilities of the industry against such threats. We expect to operationalise the platform before the year end. I am also pleased to announce the establishment of a dedicated innovation lab, right here in Sasana Kijang. The lab will provide a collaborative environment for the purpose of creating, elaborating, and prototyping innovative solutions to clearly defined problem statements.

Recall that ocean tides present us with both opportunities and risks. The fact that humanity today is better able to understand, predict and master ocean tides should give us encouragement for the future of finance. The goal of a relevant, safe and socially responsible financial system can be attained by focusing our energies toward this shared goal in which we all have a critical stake. Much like a “rising tide that lifts all boats”, the actions and choices that we make within the financial system do not just affect the provision of financial services, but have important implications for the well being of society and our economic prospects as a nation. We owe this not only to ourselves and others at this point in time, but especially to our future generations.

With that in mind, this event provides a valuable opportunity for us to reflect on a broad range of issues that can help us move forward with greater confidence. Let me leave you with three questions to ponder as you do so:

- ♦ First, what are the barriers preventing the industry from working together more closely to unlock the true potential of finance?
- ♦ Second, have firms in the industry achieved the right balance in their adoption of technology in finance and capacity to manage the attendant risks?
- ♦ Third, how can we scale financial innovation to create greater value for society, including

advancing inclusive and responsible finance as well as the sustainability agenda?

On that note, it gives me great pleasure to formally launch MyFintech Week and the Financial Industry Conference. I wish all of you an informative and productive week ahead.