Adnan Zaylani Mohamad Zahid: Re-inventing payments - the future of financial services

Keynote address by Mr Adnan Zaylani Mohamad Zahid, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Malaysian E-Payments Excellence Awards (MEEA) 2019, Kuala Lumpur, 31 July 2019.

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It is my pleasure to be speaking here today, at such an exciting time for our payments landscape.

Malaysia's progress in migrating to e-payments has been promising. In less than a decade since 2011, we have reduced cheque usage by half to 101 million in 2018. E-payment acceptance points such as point-of-sale (POS) terminals have more than doubled to 16 terminals per thousand inhabitants in 2018. More merchants are also accepting QR payments with over 400,000 registrations recorded to-date. Meanwhile, e-payment transactions have almost tripled to 125 transactions per capita in 2018.

At the same time, new business models are emerging. We estimate that 40% of fintechs in Malaysia are in payments or payment-related services – making it the largest segment. The e-wallet space has been particularly vibrant, contributing to rapid growth in mobile payments. From 2017 to 2018, mobile payment transaction volume had increased twenty-fold from just below two million transactions to over 34 million transactions within a year.

Keeping these developments in mind, allow me to share three broad priorities in taking Malaysia's payments journey to greater heights.

Greater scope to enhance inclusivity and quality of e-payment adoption

The first priority is to improve the quality of our e-payment migration to be more inclusive, broad-based and sustainable. The good progress so far means that Malaysia has a solid foundation for more widespread adoption of e-payments. E-payments are increasingly prevalent, with adoption picking up across a wide range of use cases. A wider network of merchants is also increasingly open to accepting e-payments as a possible driver of efficiency gains and revenue growth. Importantly, these encouraging developments have been contributed, in part, by the market reforms and incentive structures implemented since 2013. These measures have corrected market distortions and facilitated the pooling of industry resources to continuously enhance the payment infrastructure and services.

Nonetheless, there are opportunities for more inclusive and broad-based adoption. Studies have shown that cash usage is still prevalent with more than 80% of Malaysians reportedly using cash in a majority of their everyday spend such as F&B, groceries and fuel. E-payment adoption is also uneven across geolocation and is largely concentrated in the urban centres. This calls for greater efforts in two key areas to address such market gaps.

The first key area is to significantly expand merchant acceptance, with a focus on lower-tier merchants. E-payment acceptance points are not yet ubiquitous, especially among micro-enterprises that are frequented by many Malaysians, such as wet markets, night markets and hawker stalls.

In this regard, solutions that are 'infrastructure-light' could go a long way in boosting e-payment acceptance among micro-enterprises who are cost-sensitive. New, cost-effective solutions such as QR payments and "Tap-on-Phone", which leverage on the already high penetration of smartphones in Malaysia, may be preferred over traditional POS terminals. Indeed, we are encouraged to see that industry players are starting to roll out interoperable solutions. Notably, these include several pilot initiatives ahead of the nationwide roll-out of PayNet's Interoperable

QR payment solution. Such solution has the potential to become a game-changer by facilitating merchants to accept payments from customers of different participating banks and non-banks by using only a unified QR code.

Beyond that, we should accelerate the digitisation of the value chain for both users and merchants. This could include digitising salary payments, and payments to suppliers, wholesalers and distributors. These developments would make it more compelling for consumers and businesses to maintain funds digitally, thereby providing a natural incentive to keep using and accepting e-payments.

The second key area is on strengthening public confidence. Some segments of the population may still lack awareness and confidence in e-payments, despite fraud levels being relatively low in Malaysia. Some consumers are also concerned about overspending, as they are used to relying on cash withdrawals as a way to budget and control expenses. These are cognitive barriers that can be overcome with concerted efforts.

Banks and non-banks alike should intensify efforts on awareness-building and education campaigns. These could focus on use cases that are central to day-to-day life, such as paying for fuel, groceries and F&B. Done well, this can have a long-lasting effect on behavioural change towards greater adoption of e-payments.

To strengthen this proposition to customers, financial institutions should continuously enhance their security features, and put in place while actively promoting their product arrangements that will give customers the peace of mind. This may include strengthening the effectiveness of fraud detection and prevention engine using the latest technology such as artificial intelligence and machine learning. Additionally, offering liability protection programs and a commitment to resolve disputes within a stipulated timeframe would go a long way in providing assurance to customers.

Supporting this, financial institutions' mobile applications and Internet banking channels must provide seamless ways for users to track their expenses. This would include budgeting features, instant notifications and possibly smart money management tools. Some of these enhancements may be small tweaks with a potentially big impact to get users to be more comfortable with e-payments.

Going beyond payments to enhance value proposition to end-users

This brings me to second key priority – the need to go beyond payments in response to certain "new normals" in the payments landscape. Today, customers increasingly expect payments to be fast, frictionless and free. Competition has also heightened. Non-traditional players such as fintechs and bigtechs are increasingly relying on payments as entry point into financial services.

Against this backdrop, payment service providers must rethink their strategies to remain relevant and be sustainable in the long run. Today, going cashless is more than just e-payments. Instead, it should be about putting customers at the core of innovation to address real pain points and drive greater value creation. This means delivering integrated solutions to enhance the value proposition to end-users.

In the e-wallet space, we have noticed the practice by some players in offering generous rewards including cashback to stimulate usage among users. While such practice may be effective in driving e-wallet adoption at the initial stage, it is questionable whether such practice is sustainable in the longer run. For instance, we have observed that the transaction volume of some players tend to fall significantly once the promotion period is over.

To achieve a more sustainable migration, the industry should strengthen the value proposition of e-payments. Greater focus should be placed on creating innovative and value-added solutions that go beyond payments. This may serve as a natural incentive for customers to adopt digital financial services.

To enhance the value proposition to end-users, Bank Negara Malaysia has also focused its efforts on evolving our regulations to facilitate new business models. The ongoing work on the digital banking framework is one example, amid growing interest among traditional and non-traditional players to enter this segment.

Of importance, the success of these new business models will depend on the industry players' ability to harness customer data to develop value-added services while ensuring compliance with data protection laws and regulations. This is key to enable greater customisation and offering of new services. For example, industry players that understand their clients' cash flow, turnover and supply chain can potentially identify new growth areas. These may include the provision of short-term credit, insurance and wealth management services to customers and businesses.

In harnessing customer data, there are clear synergies between existing and new players. Incumbents have vast amounts of data, but legacy systems and culture can pose challenges to turn such data into insights. On the contrary, new players could face the opposite challenge – with more agile technological capabilities built from the ground-up, but having little or no data to work with.

It is thus no surprise that more strategic partnerships between traditional and new players are emerging, in Malaysia and abroad. Such initiatives could foster vibrant ecosystems that could penetrate market segments that were previously underserved or unserved.

Similar opportunities are also possible on the cross-border payments sector amid increasing migration flows, global e-commerce and internationalisation of value chains. Concerted industry efforts are imperative to bring the cross-border payment experience up to par with that for domestic payments. Likewise, a customer-centric approach that goes beyond just payments can potentially be transformational.

In an increasingly globalised economy, Malaysian SMEs stand to gain significantly from cross-border payment innovation. Better integration of payment services with regional or global e-commerce networks could expand market access. Value-added features could also be embedded to eliminate existing frictions for cross-border trade. This may include digitising trade finance documentation and streamlining back-end processes of financial institutions and corporates to drive greater efficiency and expedite compliance process.

Future-proofing the payments landscape will be key moving forward

Finally, let me turn to the third key priority for payment infrastructures to be future-proofed. Payment systems of the future must be inclusive and able to accommodate the speed of change for implementing new solutions at scale.

In this regard, we have achieved a key milestone with the launch of the Real-time Retail Payments Platform (RPP) last year. It is designed to be more scalable, flexible and open to support new use cases such as Proxy Payments, Request-to-Pay, e-Mandates and services to support more seamless customer onboarding processes. The RPP represents the first step of a multi-year journey to future-proof our retail payment infrastructure. Additionally, the Bank is currently embarking on a study to identify possible opportunities to renew or enhance Malaysia's large value payment system, RENTAS, to support the emerging needs of the economy.

Across the board, four key elements will be important. The first is interoperability which can enhance competition and drive greater efficiency through wider network reach and economies of scale. Last year, we established the Interoperable Credit Transfer Framework that facilitates fair and open access for banks and non-banks to shared payment infrastructures such as the RPP.

The second element is standardisation, which can improve efficiency and foster the development of new services. For instance, adoption of ISO20022 may provide opportunities for innovations, enhanced fraud and financial crime detection, and improved straight-through processing. To harness the full benefits of ISO20022, Bank Negara Malaysia will undertake an industry-wide consultation to develop a holistic migration strategy covering both domestic and cross-border payments.

The third element is flexibility and openness. Open APIs can pave the way for businesses to scale and offer value-added products and services. They enable rich and diverse ecosystems that deliver more personalised and wider range of services to customers. While this may be a shift from banks' traditional approach of managing customer engagement through their own channels, it could be crucial to maintain long-term business agility.

In this area, Bank Negara Malaysia has supported the formation of the industry's Open API Implementation Group to identify and develop standardized open APIs for high-impact use cases. In this regard, the Implementation Group has developed standardized specifications for open APIs on product information of financial institutions. Moving forward, Bank Negara Malaysia will undertake further work on secure methods for allowing trusted third parties to access a broader range of banking information through open APIs, with the customer's consent.

Last but not least, is payment ecosystem resilience. While interoperable, standardised and open systems may facilitate enhanced efficiency and competition, it may also introduce new risks in such systems due to the increased interlinkages. All future-proofing efforts must therefore be anchored on enhancing operational resilience, including cyber resilience, in a rapidly evolving risk and threat landscape. To this end, the Bank had recently issued its policy on Risk Management in Technology (RMIT). This sets out baseline standards for financial institutions, and addresses key fundamentals of technology resilience including governance, cybersecurity risk management as well as capacity-building.

Conclusion

These are exciting times, where rapid technological innovations, evolving business models and shifting customer preferences, present new opportunities and challenges to the status quo. Such opportunities can bring about a positive and transformational impact to our society and economy. We should be bold to capitalize on these emerging trends, while remaining steadfast in managing the associated risks. Times are changing, and change is good. It takes us out of our comfort zones, and helps us reach new heights. Before I close, I would like to congratulate all the winners of today's ceremony and I wish you all a pleasant evening ahead.