Adnan Zaylani Mohamad Zahid: Charting the next financial sector blueprint – digitisation, climate change and resilience

Speech by Mr Adnan Zaylani Mohamad Zahid, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Financial Market Association of Malaysia's Annual Dinner, Kuala Lumpur, 22 November 2019.

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It is an honour and a great pleasure to be here and see many familiar faces at tonight’s Financial Market Association of Malaysia’s annual dinner. The last time I attended this dinner was three years ago, when I was the Assistant Governor overseeing the financial markets and the Financial Market Committee chair. I left this role in September of 2017, unable to resist the offer and allure of pursuing a public policy degree. Though we had done much by then to deal with the many challenges following the financial market development measures put in place at the end of 2016, I have to admit that I left with a sense of regret and uncertainty. The regret was from not being able to be part of the team to see things through, and uncertainty from the fact that the stakes were high and any measure of success then was fleeting. These concerns proved to be unwarranted.

The FMC continued to play a key role in mobilising the industry and providing a much needed reality check and feedback from the market in terms of intelligence and insight, which helped the Bank navigate through those challenging times. FMC members became the bridge between the regulator and the industry at large in the implementation of the many initiatives that have seen us through to this day. I see quite a few of the FMC members tonight and I understand that many have continued to contribute and help Bank Negara Malaysia further shape the development of our financial markets. Thank you to all, and especially to Dato’ Lee Kok Kwan for previously leading FMAM to become the success it is today.

The fact is, three years on, we have not only weathered the volatility and challenges then. The financial markets have actually moved from strength to strength. Amidst heightened global volatility, not to mention the many domestic political upheavals and uncertainty of the recent years, it is a wonder that the Malaysian financial market has continued to grow consistently. The onshore foreign exchange market has expanded from an average daily trading volume of USD8.1 billion in 2016 to USD 12.3 billion today. This is mirrored by the growth of the ringgit bond market which stood at RM1.2 trillion in 2016 to reach RM1.5 trillion now. Despite our markets growing larger, stability has been a key feature as witnessed by a moderate level of volatility in the onshore markets. The 1-month USDMYR implied volatility hovers around 3 to 4 percent compared to a high of 12 percent in 2016, supported by a much less disconcerting level of non-resident holdings of government bonds at 22% compared to 34% back then. In so far as financial markets are concerned, these recent times have seen us avoid major and abrupt market movements or disruptions. Besides the 2016 measures that stabilised our markets, this growth is also the result of the many initiatives implemented since then.

One key fundamental strategy has been our steps to enhance market transparency and visibility, which provides us with information and data for targeted development efforts. The operationalisation of the RENTAS Segregated Securities Account which enables us to observe the activity in the Malaysian bond market has also provided investors with improved efficiency and a reduced reporting burden, lowering the cost of investing in this area. On this topic, I am pleased to share that on Monday this week, Clearstream launched their revamped solution which will provide an internal settlement link to facilitate greater access to the Malaysian market. They now rejoin a host of International Central Securities Depositories and Global Custodians that provide such access. This is yet another positive development for our financial markets.

With greater oversight capabilities, we were able to introduce the dynamic hedging programme in 2016, which successfully enabled institutional investors’ active management of their foreign exchange exposures in the onshore market. The programme currently records participation of 104 registered institutional investors managing USD37 billion total asset under management, and has led to the migration of these investors' former offshore strategies to the onshore market which has increased the level of transparency and orderliness of the ringgit market.

Similarly, the Appointed Overseas Office framework which was expanded in 2017 has facilitated wider access to the Malaysian market. The launch of the AOO pilot programme in August this year has further enhanced market liquidity and reduced transaction costs for larger volume transactions by allowing inter-AOO squaring of positions for more efficient price discovery. With 168 AOOs from 22 banking groups operating in 36 countries, market access to the onshore Malaysian markets continues to grow.

To meet the need for continuous communications with investors, market participants and intermediaries alike, the Bank developed dedicated webpages for investors interested in the developments of the Malaysian financial market. There are continuous updates on what is new in our markets, and important updates on Foreign Exchange Administration rules that market participants may use as a point of reference in their ringgit dealings.

Many of these initiatives focus on increasing efficiency, access and transparency. However, the reality is that markets will always be imperfect. In the 1970s through to the 1990s, we were told that financial markets can be relied upon to be efficient, that prices will reflect all available public information and hence appropriately reflect the fundamentals of an instrument or asset. Regulators were asked to leave markets alone. Liberalisation and deregulation were the two key themes and policy push on emerging markets that would enable the development of liquid financial markets. Then in the 1990s, the Asian Financial Crisis happened. Together with liberalisation and deregulation came excessive speculation and destabilising capital flows. The costs of adopting developed market policy approaches to developing and emerging markets proved high. In dealing with the crisis, we rolled back selected liberalisation initiatives and de-internationalised the ringgit. The latter enabled ringgit trading to be brought back onshore and protected it from the laissez faire offshore markets that were prone to such volatility and risks. This non-internationalisation policy remained intact through the years. Yet markets found a way to circumvent it through the non-deliverable forward market. The 2016 enforcement reaffirmed the ringgit non-internationalisation and remains a strong prudential safeguard against excessive volatility and external risks.

Based on our experience and understanding of the market and its imperfections, there will always thus be a need for rules, regulations and the regulator to see to that market imperfections are not exploited or lead to instability, and that markets continue to be 'fit for purpose' or serve their functions. In emerging markets, the industry also needs to come together to work for continued development. Only then will we be able to continue progressively growing in a stable and healthy environment.

Charting the upcoming Financial Sector Blueprint

While we see continued growth, a greater understanding of what is to come is key to maintain such momentum. The operating landscape we are entering is expected to be equally challenging and heightened with unknown risks. Global growth outlook is forecasted to remain subdued, with slow growth expected from advanced economies and this may inhibit advancement in emerging economies. Financial market conditions are expected to be increasingly complex with rapid changes in technological advancements. The ever-changing geopolitical positioning also continuously shifts investment priorities and risk appetite. Closer to home, while domestic growth is expected to remain sustainable, many uncertainties and challenges persist, and thus it is critical to ask ourselves, how do we respond?

With the current 10-year Financial Sector Blueprint approaching the end of its horizon in 2020, the time has come to chart our path for further development. At the Bank, we are in the midst of much research, analysis and formulating possible paths for our future. Based on this, we will be looking to engage financial markets stakeholders to set the framework for market development over the next five years. We have set a shorter horizon, acknowledging that in this era, changes occur rapidly and the longer horizon is rife with greater uncertainty than before. While these discussions are ongoing, I wish to share three main focus areas for the next plan as follows:

Firstly, given the active adoption of advanced technology in all aspects of our lives, the **digitisation of the financial markets** is not only an obvious step forward but an inevitable one. With evolving business practices and economic activities, there is urgency for us to adapt and elevate our infrastructure to ensure that our markets remain competitive and dynamic, while preserving an environment of financial and market stability. While rules and regulations will certainly be there to ensure orderliness, fair and ethical conduct, risks of a rapidly changing environment would require flexibility and agility in their design. This is both good and bad news.

The good news is that the design of rules could be more principle based, outlining key parameters and outcomes, leaving the 'how' to achieve them to the best practices of the industry. The bad news is that the industry will have to be independent in figuring out and ensuring compliance. Consequently, there is a need for the industry to further elevate its capacity and capability for the new environment. The goal is not only the greater adoption of digital technology in financial services which will undeniably reshape customer behaviour, business models and the traditional structure of financial intermediation for the better. It is also the push for the industry to adapt, innovate and change.

In the banking sphere, digital banking is just around the corner. The Bank will issue a discussion paper on this by year end and perhaps, a regulatory framework by next year. Digital insurers could be next. What about financial markets? I put this challenge to you ~ think about how your industry could change with these developments, how you should adapt and change, and what needs to be done. Tell us what you think and you can reach out to the FMC to share your thoughts and ideas.

Another area of focus that has captured wide attention is that of **climate change and sustainability.** Many of our banks have embraced sustainability goals while our Islamic Banks are striving actively to adopt Value-Based Intermediation; banking and financing based on Principles of Shariah that encompass not just sustainability but also the wider goals of Maqasid Shariah and social economic well-being. Financial markets should not be left behind. We should strive to work towards adopting sustainable and ethical practices where we can in the Malaysian financial markets. Extra support can be given to market activities that nudge the economy towards sustainable development, inclusivity and social welfare. Again, the industry can think of ways and means of how you can play a role in this.

Lastly, having experienced heightened uncertainties in recent years, we continue to need to **improve the financial market environment to ensure that markets are resilient** against any form of shock. A part of this is that market players themselves need to be agile. This has become a necessity in the landscape of the financial world today which has shorter visibility on what we can expect due to the ever changing nature of the financial markets. The ability to adapt and react immediately is a must to thrive in future years. Data science analytics and greater expertise will increase the agility of financial institutions to acclimatise to not only new demand but also new regulations or developments. Alongside that, the development of talent with forward-thinking capabilities would be instrumental in elevating the quality of financial services. This will contribute to the elevation of our job market as a whole and pave the way for an industry that will thrive.

Much could happen in the next five years. Technology, the environment, the economic and political landscape could change greatly. Thus, we must plan well. The financial sector will transform regardless but with proper planning and execution, we stand a chance to influence and improve the outcomes.

Financial market development will be a journey within this framework which requires effort and collaboration by both regulators and financial market participants. The spirit of teamwork and cooperation which has been developed over the years has paved the way for successful endeavours and should be nurtured further, through the sharing of information and feedback for the greater good of market development. Hence, let us take this dinner as an opportunity to strengthen our camaraderie, so we can also better achieve this common goal together. With that, I thank you and wish you an enjoyable night.