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PERSPECTIVE

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Malaysia's Regulatory Framework: A Catalyst for FinTech Adoption

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The regulatory sandbox of Bank Negara Malaysia, the Financial Technology Enabler Group (FTEG) and Malaysia Digital Economy Corporation (MDEC) FinTech Booster Programme have acted as catalysts for the FinTech growth. Much of the credit goes to Bank Negara Malaysia's initiative to regulate and facilitate the development and adoption of FinTech solutions by introducing this regulatory sandbox framework in 2016. Photo: Mohd Rasfan, AFP.

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EXECUTIVE SUMMARY

- Measures to fight the Covid19 pandemic have accelerated Financial Technology (FinTech) adoption in Malaysia. More than 75% of Malaysia-based businesses are now using at least one FinTech-related product or service since the past year.

- Bank Negara Malaysia's regulatory sandbox, the Financial Technology Enabler Group (FTEG) and Malaysia Digital Economy Corporation (MDEC) FinTech Booster Programme, have acted as catalysts for FinTech growth.

- FinTech Booster is further driving the digitalisation of SMEs by developing innovative products and services as well as by enhancing FinTech startups' understanding of market, compliance and regulation requirements.

- The issuance of the Digital Banking Framework by BNM signals an increased focus on democratising access to finance for the unserved and underserved markets.

- The Securities Commission (SC) has allowed alternative finance platforms to operationalise secondary trading, and this is further accelerating the FinTech adoption in the country, mainly amongst the SMEs.

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INTRODUCTION

Financial Technology (FinTech) refers to technology, solution or software that enhance, automate, and improve the delivery of financial products and services. FinTech comprises of five major segments, namely, payments, wealth management, insurance, alternative finance and regulation.

The Asia Pacific region has been at the forefront of FinTech growth in the world. According to data from Statista, Asia Pacific (APAC) is the third biggest region for FinTech platforms after North America and EMEA (Europe, Middle East, Africa). In 2020 alone, APAC contributed 4,765 new FinTech startups, a whopping 66 percent jump since 2018.

Apart from regional giants such as India and China, the Southeast Asian (SEA) market has shown a huge potential in FinTech growth. In 2020 alone the combined value of FinTech startups in the SEA was US$150 billion.[1] The region also witnessed a seven-fold increase in investment in FinTech startups since 2015, mainly driven by foreign investors. In 2020 total investment in the region stood at US$1.6 billion.[2]

In Malaysia, national lockdowns due to Covid19 acted as a catalyst for the adoption of FinTech. The Malaysian government's Movement Control Order (MCO) during the height of the pandemic helped to add 3 million new mobile banking service subscribers in 2020 as well as pushed e-wallet usage and adoption to new highs. Merchants were quick to embrace the trend, with over 400,000 new businesses registering for QR code payment acceptance, a 164% jump from the previous year. Capital raised on Equity-based Crowdfunding platforms jumped more than 457% to RM 127.7 million (USD30.4 million), while P2P/Marketplace Lending value rose over 20% to RM 503.3 million (USD119.8 million).[3]

This essay provides an outline and explains how far Malaysia has come from a humble start (in the FinTech ecosystem) and how the regulatory framework is acting as a catalyst for this leap.

FINTECH ADOPTION WITHIN GOVERNMENT INITIATIVES

Malaysia's digital shift has been ongoing for the past decade but Covid19 has further accelerated FinTech adoption in the country. Much of the credit goes to Bank Negara Malaysia's (BNM) initiative to regulate and facilitate the development and adoption of FinTech solutions by introducing a regulatory sandbox framework in 2016.[4] This sandbox has provided a flexible regulatory environment that allows FinTech companies to experiment in a production environment. In fostering technological innovations in financial services, it has contributed to the growth and development of Malaysia's financial sector. Participation in the sandbox also affected the ability of FinTech to raise capital. One of the graduates of BNM's sandbox MoneyMatch successfully closed a Series A fundraising[5] round totalling MYR 18.5 million (USD 4.4 million) over two tranches, initially led by Cradle Seed Ventures in 2019 and more recently by KAF Investment Bank, and is now eyeing a digital banking license. Before establishing the regulatory sandbox, in June 2016, BNM established a Financial Technology Enabler Group (FTEG)[6] whose responsibilities included formulating and enhancing regulatory policies to facilitate technological

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innovations. The FTEG also served as BNM's dedicated contact point for FinTech-related queries including the adoption of FinTech in the financial services industry.

Apart from BNM's initiatives, which is expected to provide regulatory guidelines and nurture new startups via regulatory sandbox, the Malaysia Digital Economy Corporation (MDEC) has also played an instrumental role in pushing FinTech adoption in the country by engaging with startups, investors and innovators from around the world. While BNM focused on regulation, MDEC provides investment opportunities, knowledge and awareness of the FinTech ecosystem, and an innovation lab for continuous development. MDEC has partnered with various stakeholders, and one of its initiative is The Orbit, a co-working space that serves local and foreign FinTech players, allowing startups to interact with industry leaders to ease solution development and encourage early market entry. To boost FinTech literacy and serve the ever-growing demand for FinTech talent, MDEC has collaborated with institutes of higher learning to deliver modules and programmes on FinTech. One such higher education provider, Asia Pacific University of Technology and Innovation (APU), became the first university in the country to offer a bachelor degree programme specialising in FinTech and a Master programme in FinTech.[7]

In partnership with the United Nations Capital Development Fund (UNCDF) and BNM, MDEC has also established the Financial Innovation Lab to accelerate innovative solutions in digital financial services that empower the daily lives of low and moderate-income people.[8] This initiative provides grant support ranging from USD10,000 to USD100,000 for new innovative FinTech startups. More recently, in August 2020, MDEC once again in collaboration with BNM, established a capacity-building programme called Fintech Booster.[9] This booster programme aims to assist FinTech startups, both local and foreign in developing their products and services via three strategically crafted modules: Legal & Compliance, Business Model, and Technology.

The Securities Commission (SC) has also been launched by the Malaysia Co-Investment Fund (MYCIF) of RM50 million (US$12.3 million) targeted at capital markets, including companies listed on the Leading Entrepreneur Accelerator Platform (LEAP) Market board (for SMEs).[10] Streamlining licensing requirements for Equity Crowdfunding (ECF), such as raising the funding limit on ECF platforms to RM10 million (US$2.4 million), and allowing ECF and Peer-to-Peer (P2P) platforms to operate secondary trading since last year, further boosted the growth of Fintech startups in the country.[11]

The SC has been spearheading its Digital Agenda for FinTech startups in Digital Investment Management (DIMs) and Digital Asset exchanges (DAX) space to increase the number of startups. In 2020, the SC approved three additional digital investment management (DIM) companies. They provide more value-added options for investors, such as spare change investing and differentiated investment strategies. By end-2020, the DIM companies had acquired 199,224 clients and RM466.20 million in total assets under management (AUM), a significant jump from 23,803 clients with RM74.7 million total AUM at end-2019.[12]

The various initiatives by different stakeholders described above have accelerated FinTech growth in the country. The number of FinTechs in the country increased from a mere 93 in 2017 to 233 in 2020, a whopping 150% jump in four years (Figure 1), while mobile banking

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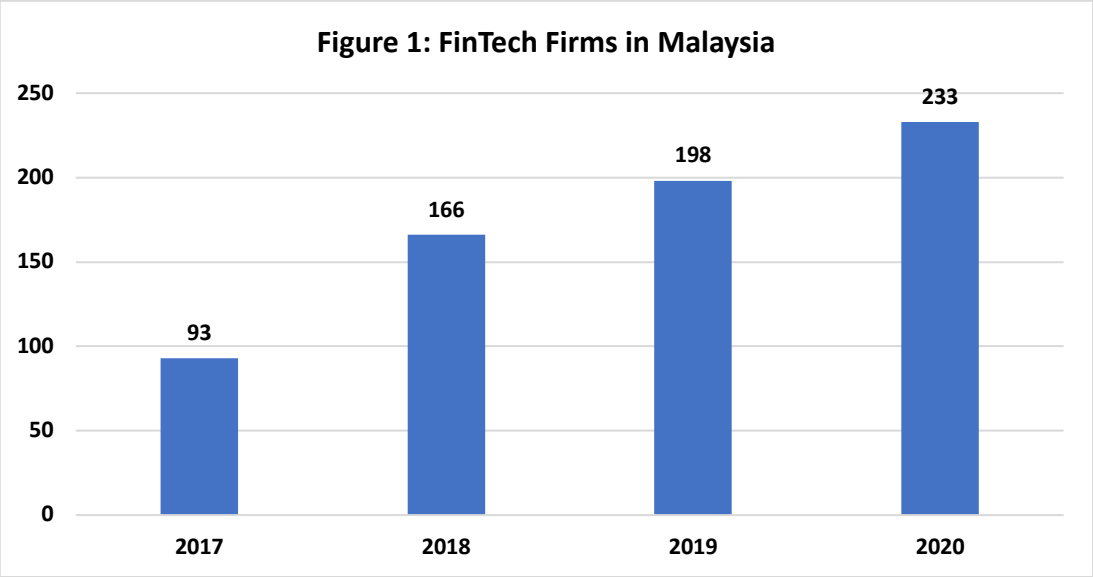
transactions more than doubled to MYR460 billion (USD 110Billion) in 2020 from MYR200 billion (USD 48.7 billion) in 2019 (Figure 2).

Under the 2021 Budget, the Malaysian government continues to nurture the P2P lending and ECF eco-system. A RM50 million (US$12.3 million) matching grant for P2P lending and RM30 million (US$7.3 million) matching grant for ECF have been allocated. The government also proposed an extension on stamp duty exemption for Exchange Traded Funds (ETF) which expires December 2020.[13] It is heartening to know that over the last four years, the government has allocated RM 200-250 million per year (USD 48-61 million) for the development of the FinTech ecosystem.



Source: Author's compilation. Data from Malaysia FinTech Report

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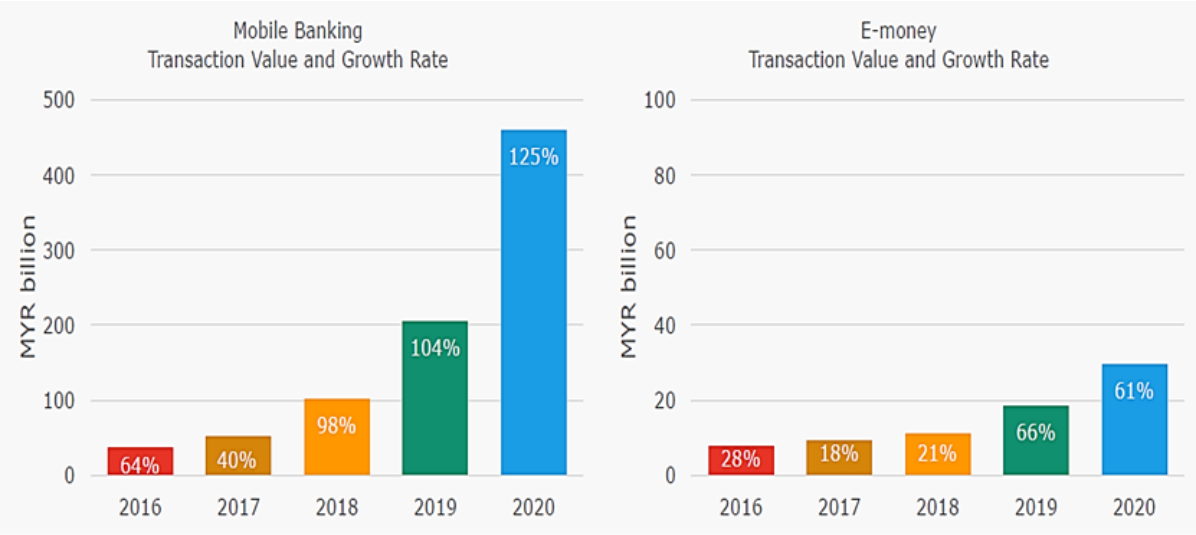
Figure 2: FinTech Transactions in Malaysia



Source: Malaysia FinTech Report 2021

MALAYSIA'S FINTECH REGULATORY FRAMEWORK

Currently, Malaysia does not have a specific regulatory regime applicable to FinTech participants, and the existing regulatory framework generally applicable to the traditional financial services industry applies equally to FinTech startups. The framework includes legislations such as the Financial Services Act 2013 (FSA); the Islamic Financial Services Act 2013 (IFSA); the Money Services Business Act 2011 (MSBA); the Capital Markets and Services Act 2009 (CMSA) as well as the various standards and guidelines issued by BNM and the Securities Commission (SC).

In order for FinTech startups to apply for a regulatory license, an assessment of proposed FinTech activity has to be undertaken to determine whether or not the activity falls under the existing regulatory framework and, if so, what relevant legislation, standard and/or guideline then applies.

In a recent speech[14], Suhaimi Bin Ali, the director of the Financial Development and Innovation Department at BNM indicated that all FinTech startups will be either regulated by BNM or the SC and in some limited cases by joint regulations as shown in Figure 3 and regulated by the FSA, IFSA, MSBA or CMSA. BNM administers the FSA, IFSA and MSBA :

- The FSA sets out the regulatory framework for, among others, the conventional businesses of banking, investment banking, insurance, operating a payment system and issuance of payment instruments;

- The IFSA sets out the regulatory framework for, among others, the Islamic business of banking and takaful operators; and

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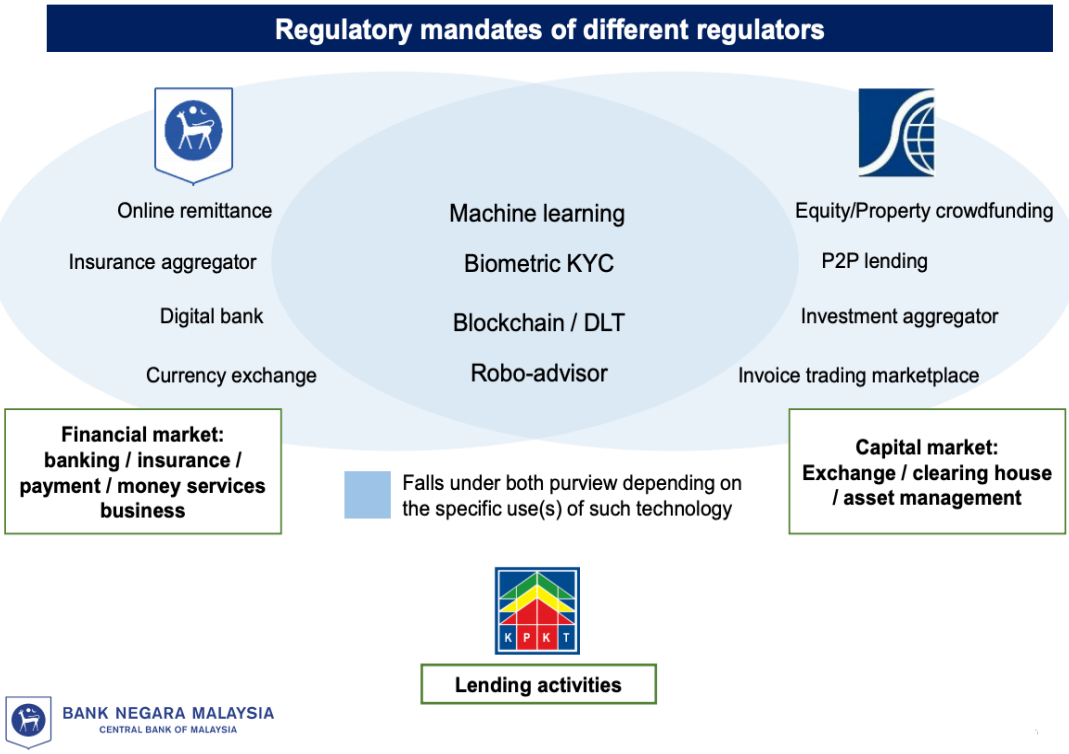
- The MSBA sets out the regulatory framework for the businesses of money-changing, remittance and wholesale currency.

The CMSA, in turn, is administered and enforced by the SC and regulates, among others, dealings in securities and derivatives, fund management, investment advice and financial planning.

For those FinTechs which fall under BNM's supervisory scope, there are three broad categories: the License Regime, the Approval Regime and the Registration Regime, with each of these categories requiring FinTechs to follow more or less stringent regulations depending on the risks they may pose on financial and monetary stability, as well as customer protection. For example, startups that pose the highest risks to the financial system such as remittance and money exchange, are more regulated than money brokerage services or insurance adjusters. Regulators provide clear regulatory guidelines targetting customer protection and ensuring the integrity of the system. This is important especially from a customer compensation perspective (ie, how customers should be charged and the accompanying disclosures on the various new products and services). As the concept of freedom of contract is recognised in Malaysia, such compensation models are therefore a matter of contract between the FinTech provider and the customer.

Figure 3: Regulation of FinTech Services by BNM/SC or Joint Regulation



Source: BNM Presentation, Fintech Regulatory Bootcamp: Role of BNM in Facilitating Innovation, August 4, 2020

The key pillars and fundamentals behind BNM's approach to FinTech regulation are underpinned by the three principles of parity, proportionality and neutrality.[15] On parity, the

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end goal is to "provide a level-playing field for people playing in the same place doing the same thing," considering the special needs of new entrants and innovators in developing their ideas. On proportionality, regulations must be "proportionate to the benefits provided and the risks posed by the entrants." Finally, on neutrality, "BNM is committed to prioritizing the desirable outcomes and potential of emerging technologies within the FinTech space, rather than the technology itself."

To further boost the FinTech scene in the country, BNM has also issued a simplified regulatory framework for digital banks.[16] This framework aims to reduce the regulatory burden for new entrants that have strong value propositions for the development of the Malaysian economy, whilst safeguarding the integrity and stability of the financial system. Key features of the simplified regulatory framework include capital adequacy requirements. This involves the use of risk categories to calculate the credit and market risk components for risk-weighted assets under the Basel II capital framework. In addition, there is also a liquidity requirement: 25% of the digital bank's on-balance sheet liabilities must be held in high-quality liquid assets. Digital banks will be required to comply with all equivalent regulatory requirements applicable to incumbent banks after the foundational phase.

Following a six-month application period, which ended on 30 June 2021, BNM received 29 applications for a digital bank licence under the Financial Services Act 2013 and the Islamic Financial Services Act 2013.[17] The applications included interest from diverse parties ranging from banks, industry conglomerates, technology firms, e-commerce operators, FinTech players, cooperatives as well as state governments. It is expected that up to five licences may be issued and notification of successful applications will be made in the first quarter of 2022. Digital banks are being touted as the driver of Financial Inclusion in the country and the provider of more financing opportunities for Small and Medium Enterprises (SMEs).

CONCLUSION

Malaysia has come a long way in FinTech growth and much of the FinTech adoption in the country is owed to a well-thought strategy and encouraging regulations in support of the growth and adoption of FinTech across different verticals. Covid-19 acted as a catalyst for financial services in Southeast Asia and more specifically in Malaysia. The pamdemic drastically accelerated Malaysia's shift to a cashless world, with unprecedented growth in the number of wallets and e-payment transaction options.

Understanding the potential of FinTech in the national economy, regulators and government development authorities brought in numerous conducive regulatory changes to help digital finance thrive. As of the beginning of the year, Malaysia has been home to 233 FinTech startups, and many more will join soon. Even though it has been a success story so far, the country has yet to produce a homegrown FinTech unicorn. Malaysia needs to attract the best tech talents and create the technical prerequisites necessary for FinTech unicorns to grow.

[1] https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/2020-global-covid-19-fintech-market-rapid-assessment-study/
[2] https://dealroom.co/blog/the-future-of-fintech-in-southeast-asia
[3] Fintech Malaysia Report (2021) https://fintechnews.my/27070/malaysia/fintech-malaysia-report-2021/
[4] https://www.bnm.gov.my/-/financial-technology-regulatory-sandbox-framework
[5] https://www.dealstreetasia.com/stories/moneymatch-seriesa-250023/
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[9] https://fintechbooster.com.my/
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[13] https://www.treasury.gov.my
[14] https://www.bnm.gov.my/-/launch-of-the-fintech-booster-programme ; https://youtu.be/voKU1omK6Lo
[15] https://youtu.be/voKU1omK6Lo
[16] https://www.bnm.gov.my/-/regulatory-framework-for-digital-banks-update-
[17] https://www.bnm.gov.my/-/bnm-receives-29-applications-for-digital-bank-licenses

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