Capital Markets Reform: Malaysia’s Experience

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Securities Commission of Malaysia
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Washington D.C.
AGENDA

• Introduction
• Approach and consultation process
• Overview of Capital Market Master Plan
• Implementation of Capital Market Master Plan
• Performance Measures
CHANGING FINANCIAL LANDSCAPE DEMANDED RE-ASSESSMENT OF BROAD STRATEGIC FRAMEWORK FOR THE MALAYSIAN CAPITAL MARKET

<table>
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<th>Internationalisation of financial activity</th>
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<tbody>
<tr>
<td>• Growth in global investment activity</td>
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<tr>
<td>• Increased international fund-raising</td>
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<tr>
<td>• Greater cross-border M&amp;A</td>
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<table>
<thead>
<tr>
<th>Deregulation of financial markets</th>
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<tbody>
<tr>
<td>• Reform of pension and mutual funds industries</td>
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<td>• Removal of barriers to cross-border activities</td>
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<td>• Removal of market segmentation</td>
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<tr>
<th>Rapid advances In technology</th>
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<tr>
<td>• Rise of alternative platforms for market activity</td>
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<td>• New intermediation channels and processes</td>
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THERE WAS AN URGENT NEED TO ALLEVIATE FINANCING BURDEN ON BANKING SECTOR...

Higher investment spending requirements going forward

- Total investment spending expected to double over next 10 years
- Capital market expected to play major role in mobilising cost-effective financing for high-growth and k-economy sectors
... THEREFORE REQUIRING MORE EFFECTIVE MOBILISATION AND ALLOCATION OF FUNDS

- Need to increase role of capital markets in meeting nation’s financing needs
- Need to further diversify holdings of financial assets within financial system
CONCENTRATION OF FUNDS WITHIN THE PENSIONS AND PROVIDENT FUND INDUSTRY

- Malaysian investment management funds by category as at end-1999

- General Insurance Funds: 4.81%
- Unit Trust Funds: 14.65%
- Life Insurance Funds: 10.93%
- Asset Management Companies: 2.91%
- Provident and Pension Funds: 66.70%
CONCEPTION OF THE CAPITAL MARKET MASTER PLAN ("CMP")

• Minister of Finance announced CMP initiative in August 1999

• Capital Market Strategic Committee ("CMSC") comprising high level SC’s & private sector representatives was set up

• CMSC’s role was to provide views on strategic issues & future direction of Malaysian capital markets

• Chairman of SC appointed as Chair of CMSC
EFFORTS TAKEN TO FACILITATE DIRECT CONSULTATION & WIDE REPRESENTATION OF VIEWS IN FORMULATION OF CMP

• CMP website was launched in October 1999 to disseminate information & garner public feedback

• Formal requests made by CMSC to solicit views from market intermediaries, market institutions & relevant industry and professional bodies

• Robust consultations with industry participants & professional bodies held over entire course of formulation of CMP
EFFORTS TAKEN TO FACILITATE DIRECT CONSULTATION & WIDE REPRESENTATION OF VIEWS IN FORMULATION OF CMP

- Meetings with Ministry of Finance, other government agencies & regulatory bodies including Central Bank of Malaysia, capital market reform experts from other jurisdictions, academics & foreign and domestic users throughout consultation process
- Private consultants retained to provide research & independent assessment
- SC’s own pool of research, analysis and assessment
- By end of 2000, several hundred meetings with market participants, stakeholder groups, independent consultants and experts had been conducted
CAPITAL MARKET MASTER PLAN HAS AN IMPORTANT ROLE TO PLAY ……

Develop capital market that has ability to nurture competitive environment and create value-added opportunities

Chart strategic positioning & future direction of capital market

Provide strategic clarity of vision & objectives for capital market
THE VISION FOR THE CAPITAL MARKET IS FOR IT TO BE ...

- Internationally competitive
- Highly efficient
- Supported by a strong and facilitative regulatory framework
A comprehensive blueprint for the longer-term strategic Development of the Malaysian capital market

152 recommendations covering 11 categories:
• Equity market
• Bond market
• Derivatives market
• Stock broking industry
• Market institutions
• Investment management
• Regulatory framework
• Corporate governance
• Islamic capital market
• Technology & e-commerce
• Training & education
REALISATION OF CMP WILL ULTIMATELY DEPEND ON EFFECTIVE IMPLEMENTATION

Implementation of CMP involved…

✓ prescribing mechanisms for co-ordinating implementation
✓ highlighting skills, capacity and resources
✓ establishing guidelines for monitoring and reporting
✓ formulating communication programme

… through an explicit framework
... ACCORDING TO AN EXPLICIT PROCESS …

Implementation process

1. Approval of CMP
   - Minister of Finance

2. Implement Recommendations
   - SC
   - Other relevant Government agencies & regulatory bodies
   - Relevant market institutions and other market participants

3. Monitor Progress

4. Update CMP

5. Report Progress
... INVOLVING VARIOUS PARTIES HAVING A STAKE IN THE PROCESS

Implementation structure

Minister of Finance

- Advisory Council
- Securities Commission
- Treasury
- Bank Negara Malaysia and other agencies

Other Government Organisations

- Foreign Investment Committee
- Ministry of International Trade & Industry
- Registrar of Companies
- Attorney General’s Chambers
- Employees Provident Fund etc.

Implementation Task Force

Various Working Committees

- Exchange
- Clearing Houses & Depository
- Other market participants
IDENTIFYING ENABLERS TO ASSIST IMPLEMENTATION

**Facilitative regulation**
- Industry to take greater responsibility
- Further deregulation
- Focus on market-based solutions

**Technology**
- To enhance connectivity and increase yields from information

**Education**
- Focus on increasing intellectual capital
- Focus on enhancing skill-sets to support innovation
THE CMP IS TO BE IMPLEMENTED IN THREE PHASES …

PHASE 1

- Strengthen domestic capacity and develop strategic and nascent sectors

2001 → 2003

PHASE 2

- Further strengthen key sectors and gradually liberalise market access

2004 → 2005

PHASE 3

- Further expansion and strengthening of market processes and infrastructure towards becoming fully-developed capital market
- Enhance international positioning in areas of comparative and competitive advantage

2006 → 2010
ROBUST ENGAGEMENT AND DIALOGUE PROCESSES TO ENSURE RELEVANCE OF CMP’S OBJECTIVES & RECOMMENDATIONS

- **Phase I**: Overall review by Capital Market Advisory Council
- **Phase 2**: Industry workshops on key/selected areas + Sector/country analysis
- **Phase 3**: CMP Dialogues

Feedback from CMAC on Implementation Review
Phase 1:

- Addressed weaknesses that had emerged during the 1997 financial crisis
- Strengthened domestic capacity for future expansion
- Enhanced microstructure efficiency including enhancement of the Securities Commission’s overall efficiency and effectiveness
AREAS OF FOCUS FOR PHASE 2 IMPLEMENTATION

- **ENHANCE LIQUIDITY**
  - Address structural impediments to enhance liquidity

- **VALUE CREATION**
  - Assist market intermediaries and institutions to create value for their customers

- **GLOBAL NETWORKS**
  - Focus upon enhancing the position of Malaysia’s capital market within a global network
IMPLEMENTATION SCORECARD AS AT 31 DECEMBER 2005

• 65% or 99 recommendations completed

• 35% or 53 recommendations are in progress

• Strong CG framework
• Surveillance & enforcement
• Education

• Diversified sources of financing
• Strengthened institutional structures

• Efficient capital-raising process
• Lower cost for investors
• Repositioning of market institutions
• Deregulation

• Liquidity lab initiatives
• Pension reform
• Risk Management
• Strategic alliance
KLCI HAS BEEN A MEDIUM PERFORMER IN THE REGION

% performance of selected benchmark indices (1 Jan – 19 Sept ‘06)

- China Shanghai B: 57.6%
- Indonesia Jakarta: 27.8%
- India Sensex: 27.4%
- Malaysia Mesdaq: 23.6%
- Philippines Pcomp: 22.3%
- Hong Kong Hang Seng: 16.6%
- Germany DAX 30: 8.6%
- France CAC 40: 8.5%
- Singapore STI: 8.1%
- US DJIA: 7.7%
- Malaysia KLCI: 7.0%
- Australia ASX All Ord: 6.5%
- S&P Composite Index: 5.6%
- Taiwan TWSE: 5.1%
- UK FTSE 100: 3.8%
- Malaysia 2nd Board: 3.8%
- US Nasdaq Comp: 0.8%
- Korea KOSPI: -0.4%
- Japan Nikkei 225: -1.5%
- Thailand SET: -1.6%

Source: Thomson Financial DataStream
MALAYSIA’S RECOMMENDED WEIGHTINGS HAS FALLEN SINCE END-05

Recommended weightings for Asia ex-Japan and Malaysian equities

Source: Dow Jones Newswire Asia Fund Poll
PRIMARY EQUITY ISSUANCE HAS DECLINED

Funds raised via initial public offering (Jan 2005 – July 2006)

Source: Bank Negara Malaysia
NONETHELESS CAPITAL MARKET CONTINUES TO BE IMPORTANT SOURCE OF FUNDING FOR PRIVATE SECTOR

Graph 9.13
Funds Raised by the Private Sector In the Capital Market

<table>
<thead>
<tr>
<th>Year</th>
<th>Bond Market</th>
<th>Equity Market</th>
</tr>
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<tbody>
<tr>
<td>2001</td>
<td></td>
<td></td>
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<tr>
<td>2002</td>
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<td>2003</td>
<td></td>
<td></td>
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<tr>
<td>2004</td>
<td></td>
<td></td>
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<tr>
<td>2005</td>
<td></td>
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</tbody>
</table>
DESPITE LACKLUSTRE MARKET PERFORMANCE, EQUITY FINANCING REMAINS IMPORTANT SOURCE OF FUNDING FOR SMEs

Funds raised via initial public offering (Jan 2005 – July 2006)

Source: Bank Negara Malaysia
DIVIDEND YIELDS OF PUBLIC LISTED COMPANIES HAS BEEN RISING

- Malaysia’s dividend yield (4.0%) is higher than region’s average (approx. 3.2%) and is among the region’s highest.

Source: I/B/E/S Global Aggregates
AVERAGE M&A DEAL SIZE HAS BEEN INCREASING

Number of announced M&A deals and total announced value for Malaysia*

Source: Bloomberg
Note: *Data captures announced deals among public companies
**For period 1 Jan – 19 Sept 2006
PRIVATE SECTOR DEBT MARKET HAS GROWN DRAMATICALLY

Issuance of debt securities by the private sector*

Source: Bank Negara Malaysia

*Includes issuance of Cagamas bonds
WIDENING RANGE OF BOND PRODUCTS

Range of products in 2005

Some new products in 2006

- Public Bank’s RM1b hybrid debt securities
- ADB’s USD10b Asian currency note programme
- Khazanah’s USD750m Islamic exchangeable bond

Source: BNM
TURNOVER OF DEBT SECURITIES (JAN-DEC 2005)

- Listed: 0.10%
- ABS: 2.30%
- Cagamas Bonds: 5.10%
- KH: 5.70%
- GII: 12.10%
- PDS: 24.20%
- MGS: 50.40%
## PERFORMANCE OF DERIVATIVES MARKET AS AT DEC 2005

<table>
<thead>
<tr>
<th>Products</th>
<th>2005 Average daily volume</th>
<th>Share of total volume in Bursa Malaysia Derivates in 2005 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPO Futures</td>
<td>4,709</td>
<td>47.1</td>
</tr>
<tr>
<td>Open interest position</td>
<td></td>
<td></td>
</tr>
<tr>
<td>KLCU Futures</td>
<td>4,519</td>
<td>45.2</td>
</tr>
<tr>
<td>Open interest position</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-months KLIBOR Futures</td>
<td>661</td>
<td>6.6</td>
</tr>
<tr>
<td>Open interest position</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-year MGS Futures</td>
<td>40</td>
<td>0.4</td>
</tr>
<tr>
<td>Open interest position</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5-year MGS Futures</td>
<td>70</td>
<td>0.7</td>
</tr>
<tr>
<td>Open interest position</td>
<td></td>
<td></td>
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</tbody>
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Source: Bursa Malaysia Derivatives Berhad
### PHENOMENAL GROWTH IN ISLAMIC CAPITAL MARKET

<table>
<thead>
<tr>
<th>Shariah-based unit trust fund</th>
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<tbody>
<tr>
<td><strong>Number of approved funds</strong></td>
<td><strong>94</strong></td>
</tr>
<tr>
<td>Shariah-based</td>
<td><strong>392</strong></td>
</tr>
<tr>
<td>Total Industry</td>
<td></td>
</tr>
<tr>
<td><strong>NAV of approved funds</strong></td>
<td></td>
</tr>
<tr>
<td>Shariah-based</td>
<td><strong>RM8.91 billion</strong></td>
</tr>
<tr>
<td>Total Industry</td>
<td><strong>RM108.90 billion</strong></td>
</tr>
<tr>
<td>% of Shariah-based to total industry</td>
<td><strong>8.18%</strong></td>
</tr>
</tbody>
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As at end August 2006
### PHENOMENAL GROWTH IN ISLAMIC CAPITAL MARKET

#### Shariah-complaint securities on Bursa Malaysia

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<tbody>
<tr>
<td><strong>Number of Shariah-complaint securities – Oct 2006</strong></td>
<td>886</td>
</tr>
<tr>
<td><strong>% of Shariah-complaint securities to total listed securities</strong></td>
<td>86%</td>
</tr>
<tr>
<td><strong>Market capitalization (Oct. 2006)</strong></td>
<td></td>
</tr>
<tr>
<td>Shariah-complaint securities</td>
<td>RM 494.24 billion</td>
</tr>
<tr>
<td>Total market capitalization</td>
<td>RM769.08 billion</td>
</tr>
<tr>
<td><strong>% of Shariah-complaint securities to total market capitalization</strong></td>
<td>64.26%</td>
</tr>
</tbody>
</table>
## PHENOMENAL GROWTH IN ISLAMIC CAPITAL MARKET

### Sukuk

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
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<tbody>
<tr>
<td>Size of outstanding Sukuk</td>
<td>RM102.85 billion</td>
</tr>
<tr>
<td>% of outstanding Sukuk to total outstanding bonds</td>
<td>46.7%</td>
</tr>
<tr>
<td>Sukuk approved by SC in Q3 2006</td>
<td></td>
</tr>
<tr>
<td>Number of Sukuk</td>
<td>16 issues</td>
</tr>
<tr>
<td>Size of Sukuk</td>
<td>RM12.39 billion</td>
</tr>
<tr>
<td>Size of total bonds approved</td>
<td>RM20.69 billion</td>
</tr>
<tr>
<td>% of size of Sukuk to total bonds approved</td>
<td>28.8%</td>
</tr>
</tbody>
</table>
KEY MEASURES INTRODUCED AS AT 31 DECEMBER 2005

- Measures to enhance market liquidity in bond market
- Market access liberalised for intermediaries, issues and investors
- Institutional and regulatory reforms including demutualised securities exchange and corporate governance
- Deregulation in investment management industry
- Broad fiscal incentives
- Vast improvements in market infrastructure
THANK YOU