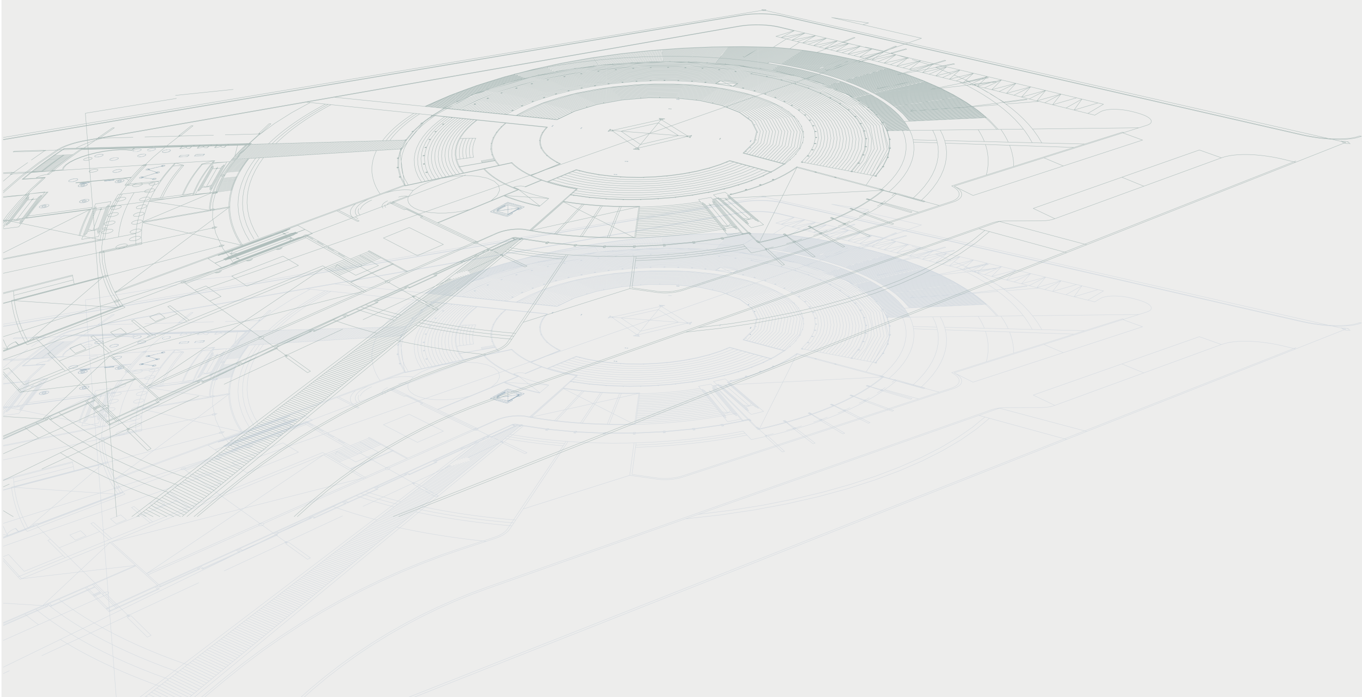
CHAPTER 2

POSITIONING AHEAD



CHAPTER SUMMARY

1

The new wave of climate action

Growing movement to mainstream the transition to net-zero economy, catalysed by the pandemic and renewed global push

2

The rise of the stakeholder economy

Growing calls for businesses to create value for society and environment besides serving their shareholders – a meaningful reset of shareholder capitalism

3

The changing dynamics of globalisation

Geo-political dynamics and trade conflicts have increased complexities for global supply chain and emphasised the need for countries to raise the bar on competitiveness

4

The ageing global population

Fast ageing global population brings about implications to retirement savings, catalysing greater need for the younger generation to invest for their future

5

The great technology and digital acceleration

Proliferation of data and technology as well as dominance of big technology (BigTech) led to greater emphasis on regulating technology and digital services

2.1 GLOBAL MEGATRENDS

The IMF estimated that the global economy shrunk by an estimated 3.3% in 2020, the steepest peacetime economic contraction since the Great Depression of the 1930s, triggered by a global public health emergency. The COVID-19 pandemic has upended prior growth trajectories of all economies, adversely affecting households and companies across a broad range of economic sectors. Socioeconomic vulnerabilities were also exacerbated during the pandemic and development gains of the previous decades were reversed. The World Bank estimated that per capita income had fallen in more than 90% of emerging markets and developing economies (EMDEs) due to the pandemic, with losses of at least 10 years of per capita income gains expected for more than 25% of the EMDEs.

With the successes on vaccine development, moving forward, most economies are expecting a recovery in economic growth. The IMF projects the global economy to grow at an average rate of 4.0% p.a. between 2021 and 2026, with a higher average rate of 5.0% p.a. for EMDEs. In particular, ASEAN-5[1] is expected to remain one of the fastest growing regions in the global economy, with an average annual growth of 5.5% over the next six years[2]. Nevertheless, significant uncertainties remain, with the extent of the economic recovery depending in part on governments' abilities to keep the pandemic under control, avoid pre-mature withdrawals of policy supports and minimise long-term economic scars.

Looking ahead, several relevant megatrends are expected to shape the recovery and growth of the global and Malaysian economies – some of which are pre-existing trends, which have been accelerated by the pandemic.

2.1.1 THE NEW WAVE OF CLIMATE ACTION

In 2020, the urgency for climate action was pushed to the forefront, precipitated in part by the collective global action towards combating the COVID-19 pandemic, resulting in a marked decline in worldwide emission levels during lockdowns[3]. Coupled with growing evidence of climate change and more in-depth research into its imminent risks, global policymakers are ever more aware of the critical need to address the immediate and longer-term systemic implications to the physical world, societies and economies.

In 2020 itself, several countries unveiled legislations to achieve net-zero emissions by 2050, while many others announced their respective net-zero environmental policy targets as part of their recovery plans. To this end, Malaysia has pledged to reduce its carbon emission intensity by 45% by 2030[4], relative to its 2005 levels, with a number of policies and initiatives implemented to redirect the country towards further decarbonisation.

With the election of its new president in 2021, the US rejoined the *Paris Agreement*. Together with the 26th United Nations Climate Change Conference (COP26) which will take place later this year, 2021 could well become a key inflection point for global climate action.

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1 ASEAN-5 countries include Malaysia, Indonesia, Phillipines, Thailand and Vietnam.
2 *World Economic Outlook: Managing Divergent Recoveries,* IMF, April 2021.
3 *Global Energy Review: CO2 Emissions in 2020,* International Energy Agency, March 2021.
4 *Intended Nationally Determined Contribution of the Government of Malaysia*, United Nations Framework Convention On Climate Change, 2015.

The new wave of climate action is expected to reshape the fundamentals of finance, as climate risk is expected to become increasingly intertwined with investment risk[5]. Various parties have been calling for the mainstreaming of the transition to a net-zero economy, while others have advocated for a private financial system to support the re-engineering of economies for net-zero emissions under the COP26 Private Finance Hub. In this new era, the shift in capital allocation to sustainable businesses could see a renewed pace as climate risks are increasingly priced in by the markets, and investments into climate transition could become a key driver towards the achievement of net-zero emission commitments.

Financial regulators around the world, including Malaysia, have embarked on efforts around sustainable finance standards for investment products, taxonomies and disclosures as well as facilitative development policies to catalyse the growth in sustainable finance. It is expected that greater focus will be seen in the areas of transition finance, sustainability data, reporting standards and transparency.

2.1.2 THE RISE OF THE STAKEHOLDER ECONOMY

Besides climate change, the pandemic also brought attention to systemic inequalities, such as income, ethnic and gender inequalities as well as disparities between countries. At the same time, some businesses stepped up during this period of great social stress to contribute to the communities around them. During the pandemic, businesses were seen to repurpose manufacturing lines to produce personal protective equipment, redeploy airline crews to support the healthcare system and convert hotels into quarantine facilities.

Against this backdrop are growing calls for businesses to evolve from the traditional shareholder capitalism model of profit-making towards the more sustainable and socially inclusive stakeholder capitalism model – one which positions private corporations as trustees of society and the environment, instead of serving only their shareholders. Stakeholder capitalism is quickly gaining ground, due in large part to the realisation that shareholder capitalism is not sustainable and is in need of a meaningful reset to serve the needs of all stakeholders.

Central to the shift to a stakeholder economy is CG[6]. CG can be instrumental in defining the role of stakeholders within a corporation and to ensure that decision-making incorporates the best interests of all stakeholders – including customers, employees, regulators, local communities and shareholders. CG also involves establishing mechanisms to align the goals of a company's executive team with those of owners and other stakeholders. This, together with regulations, will shape businesses that deliver both profits and purpose in society.

> *"Malaysia has pledged to reduce its carbon emission intensity by **45%** by 2030, relative to its 2005 levels, with a number of policies and initiatives implemented to redirect the country towards further decarbonisation."*

[5] *Fundamental Reshaping of Finance*, Larry Fink's letter to CEOs, 2020.
[6] *Business Leaders: The Shift to Stakeholder Capitalism Is Up to Us,* World Economic Forum, January 2020.

2.1.3 THE CHANGING DYNAMICS OF GLOBALISATION AND THE NEED TO COMPETE BETTER

In recent years, the global supply chain has had to grapple with the changes brought about by evolving geo-political dynamics and various trade conflicts – most prominent being the US-China disputes on trade and technology. The pandemic has added further complexities, prompting most governments and businesses to rethink the interdependence of global supply chains, particularly in critical areas such as health, food, strategic technologies and other essential sectors.

This could possibly rewire the configuration of global manufacturing and trade as well as various other aspects of globalisation, including the bifurcation of technology, inward sourcing or reshoring aspects of supply chains and greater restrictions in human capital mobility. There are also calls to strengthen regional co-operation, diversify sources along the value chain to mitigate risks and enhance the resilience of supply chains with the greater use of technology. Overall, this trend emphasises the need for greater competitiveness, especially in emerging economies. This would require investment in both capabilities and productivity-driven technology, underpinned by a supportive financial system. Under these circumstances, market-based financing can emerge as a more suitable alternative to fund these companies. As such, economies which have more efficient markets, both public and private, will have a greater edge when it comes to cultivating more competitive businesses.

2.1.4 THE DEMOGRAPHIC CHANGE AND THE RETIREMENT DILEMMA

The global population, on average, is fast aging – people are living longer and birth rates are declining. While longevity has resulted in greater demand for healthcare, technology and biosciences, an aging population will contribute to a shrinking global workforce, productivity and pool of savings, while adding pressure on pension and welfare systems. Against a backdrop of other societal trends, including increasing income inequality, human capital pressures with the rise of technology, rising public sector debt burden and expectations of lower asset returns, the changing demography could result in profound implications on world politics, economic growth and the financial system.

While there are various complexities surrounding this subject, a key challenge that is in the spotlight for most governments is retirement savings, which, if left unaddressed, will lead to fiscal issues. Governments in other countries have started looking at innovative retirement income and care solutions entailing mechanisms like social risk pooling and long-term care insurance[7]. Attention is also drawn to the need to address private savings for the future. This entails enabling greater savings and investment risk-taking by the broader population. Millennials, with net worth of up to US$24 trillion globally[8], and the middle income or mass affluent segment, with net worth of up to US$140 trillion globally[9], have differing characteristics when it comes to savings and investment. Moving forward, these differences will fundamentally shape the growth of the asset management industry.

There have been initial developments around age technology (AgeTech) – digital technologies that improve the lives of the older population – for financial services. This is built around the needs and wants of senior investors, with digital-inclusive initiatives to bring senior investors along the digital financial services journey – all of which point to the start of markets' evolution to cater to longevity.

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7 *These countries are most ready to deal with ageing population*, World Economic Forum, February 2020.
8 *Responding to Megatrends*, Principles for Responsible Investments (PRI) and Willis Towers Watson, December 2017.
9 *Global Wealth Report 2019*, Credit Suisse, October 2019.

2.1.5 THE GREAT TECHNOLOGY AND DIGITAL ACCELERATION

Amid the disruptions caused by the pandemic, the world has seen greater innovation – such as those across retail services, healthcare, supply chains and capital markets – driven by significantly altered consumer behaviour as well as operational needs. In this new normal, businesses globally, including industry incumbents, have seen 'the great technology and digital acceleration', while technology platforms, in particular BigTechs, have increased in market dominance.

The advent of technologies like 5G, cloud computing, artificial intelligence (AI) and distributed ledger technology (DLT) could significantly reshape the future landscape of capital markets and their infrastructure – among others, transforming how issuers fundraise, redefining intermediation, shaping new investor behaviours as well as revamping clearing and settlement infrastructures. In addition, a new wave of entrepreneurship has emerged on the coattails of the new normal. The surge in creativity arises from the need to respond to new or emerging requirements that are currently not addressed by incumbent institutions. While these trends are expected to accelerate productivity gains, they will also alter the landscape for capital markets.

The rapid change in technology will give rise to data, AI, cloud and other technology-related risks, which requires regulators to rethink their approach to regulating the capital markets and enforcing investor protection. More recently in 2021, some countries have taken steps to protect digital users as well as better regulate digital services and markets by striving towards a level playing field for emerging innovative companies. This may mark the beginning of a new era of regulating technology and digital intermediaries.

To keep abreast with the industry, global regulators have started to adopt greater use of technology to improve oversight, surveillance and analytical capabilities as well as support forward-looking supervision and policymaking. Along with this, regulators have initiated collaborations with forward-looking regulatory technology (RegTech) to improve compliance outcomes, strengthen reporting and better manage key risks for greater overall efficiency.

2.2 OUTLOOK AND PRIORITIES FOR THE MALAYSIAN ECONOMY

Despite the setbacks from the COVID-19 pandemic, Malaysia is expected to continue exhibiting moderately strong growth potential over the medium term, supported by a diversified economy. With the global economy recovering post-pandemic, external demands and exports are also expected to rebound and contribute further to economic resilience. The ongoing pipeline of large-scale public transportation and digital infrastructure projects will also boost economic growth and attractiveness as a foreign direct investments (FDI) destination. Real GDP growth is projected to be between 4.5% and 5.5% p.a. during 2021 to 2023[10], with Malaysia forecasted to cross into the high-income country threshold as early as the middle of this decade[11].

For Malaysia to evolve with global megatrends, achieve its growth potential and transcend its status as a middle-income country, there are several priority areas that would require emphases – some of which have been exacerbated by the pandemic. Of these, there are two critical ones which the capital market can enable – the structural upgrade of the economy and the augmentation of the retirement savings landscape.

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[10] *Fiscal Outlook and Federal Government Revenue Estimates 2021*, Ministry of Finance Malaysia, November 2020.
[11] *Aiming High: Navigating the Next Stage of Malaysia's Development*, World Bank, March 2021.

2.2.1 STRUCTURAL UPGRADE OF THE ECONOMY: THE NEED FOR PRODUCTIVITY-DRIVEN GROWTH

Since the early 2000s, the share of Malaysia's manufacturing sector, in particular the high-tech manufacturing sector, had been gradually declining as a percentage of GDP. However, this trend of deindustrialisation was not accompanied by a shift towards high value-added services, such as information technology and robotics. Instead, there was growth in the share of traditional services sectors such as wholesale and retail as well as food and beverages.

In addition, the past two decades also witnessed the continuous decline in labour productivity growth rates and increasing low-skilled foreign labour dependence within the existing economic sectors. As such, the Government has recognised the urgent need for a structural upgrade of the economy to deliver high value-added growth for the nation. In this regard, the next phase of Malaysia's economic transformation would be focusing on strong and meaningful shifts within the economy to be more productive and technology-driven. As the pandemic recedes in the future, this structural change will be critical to support Malaysia's longer-term economic growth and the livelihood of all Malaysians.

Today, Malaysia's dominant economic contributors are largely domestic-centric, resulting in its growth potential being constrained by its comparatively small market. To transform and grow, it is essential for the economy to cultivate and build internationally competitive, home-grown enterprises which are strongly embedded within global value chains, aided by high value-added technological developments to drive structural transformation.

This would require more effective resource allocation towards the internationalisation, digitisation and technological upgrading of Malaysian firms, especially unlisted MTCs. Today, the core intermediation of the savings-investment channel, dominated primarily by the banking system and government-linked investment companies (GLICs), has not been able to serve these segments of companies meaningfully. The conventional equity and bond markets mainly cater to listed companies, which contribute to only an estimated 15% of GDP[12], resulting in a shortage of access to capital within the wider economy. To cater to the broader needs of enterprises in the economy, including MTCs and MSMEs, Malaysia would require a more inclusive capital market – one that provides a more comprehensive financing ecosystem across the spectrum of funding needs. To that end, the SC could strengthen the scale and maturity of the alternative markets ecosystem to cater for higher-risk capital and to see greater deployment of patient capital through market-based financing for national development.

2.2.2 FAST AGEING NATION: THE NEED TO AUGMENT THE EXISTING RETIREMENT SAVINGS LANDSCAPE

By 2030, Malaysia is expected to become an ageing society, with people aged 60 and above making up 15% of the total population[13]. Structurally, this poses a challenge for the Malaysian retirement savings landscape. Currently, about 40% of the Malaysian population is estimated to be uncovered by any form of social protection, and many under the formal retirement system are expected to face insufficient funds for retirement. The future of work, brought forth by the pandemic, could also see significant growth in self-employment and gig economy workers – adding to the coverage challenges of the retirement savings system. In addition, the pandemic has also negatively impacted domestic household income, whereby a

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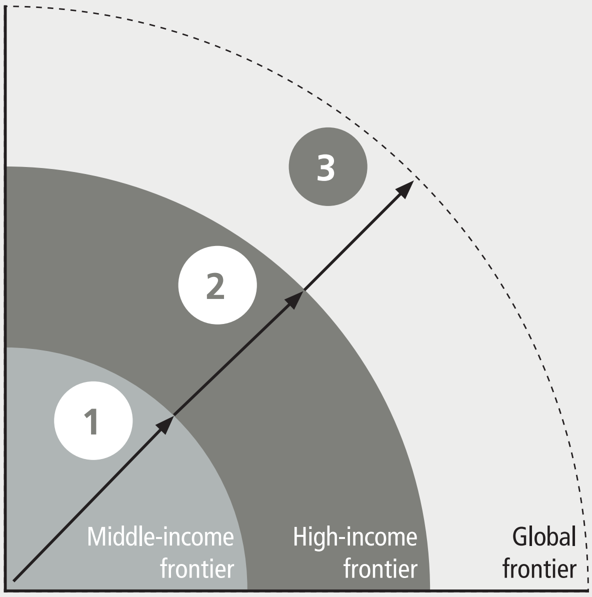
[12] Internal analysis, SC, 2019.
[13] DOSM, 2020.

Diagram 1
HOW FINANCIAL DEVELOPMENT CONTRIBUTES TOWARDS ECONOMIC DEVELOPMENT



1. Development of the financial sector plays a foundational role in allocating resources for the broader economy
2. The financing available in an economy, whether coming from banks or the capital market, matters for growth past the middle-income frontier
3. Capital markets stimulate resource allocation towards activities that are driven by innovation and/or geared for export-orientation – activities that are riskier but entail higher rewards

Source: SC.

significant number of households have had to withdraw their retirement savings early to tide them through the economic crisis. If left unresolved, the growing gap between retirement savings and actual needs could lead to a drag on the economy in the coming decades, as the government is forced to step in to close the funding gap.

In addition, the Malaysian pension system, like most global pension systems, will see significant pressures to generate high returns from existing savings to meet future retirement needs. This is given the expectations of lower asset returns moving forward, evidenced by the decline of investment returns and discount rate assumptions by global pension schemes over the past decade[14]. The search for returns may drive retirement schemes towards investing in riskier alternative assets on behalf of their members or lead to members demanding to withdraw and invest their retirement savings in other instruments that offer better returns.

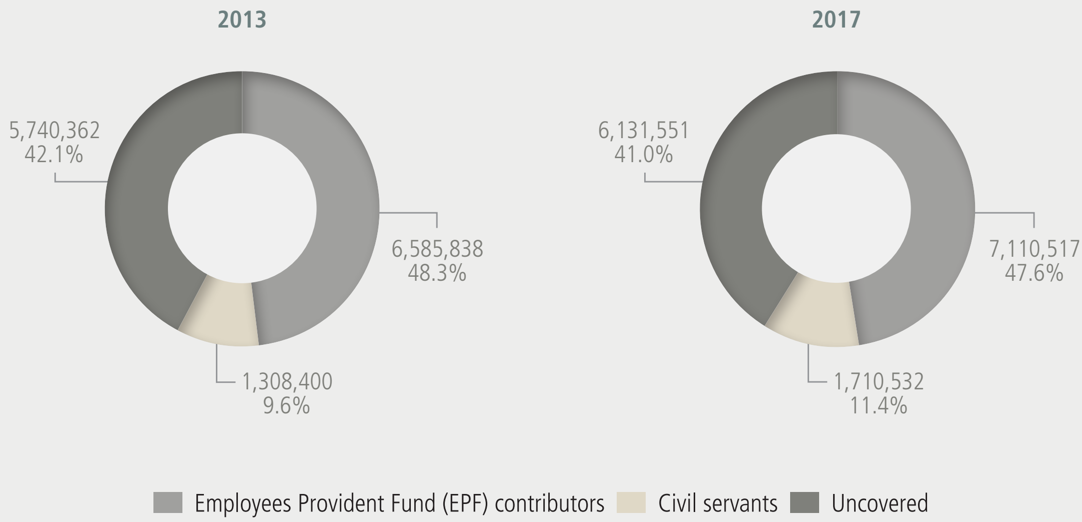
Moving forward, the current shortfall in retirement savings requires serious and urgent attention before it precipitates into a bigger problem in the future. At the same time, to encourage Malaysians to invest for their future to supplement their mandatory retirement savings, it is also imperative that the broader population of Malaysians are empowered to tap into alternative investment products according to their risk preferences. This will require a holistic approach to enhance investor literacy and awareness, investment access and options, investor confidence as well as investor protection in the capital market.

[14] *Investment Return Assumptions*, US National Association of State Retirement Administrators, July 2021; *Pension Accounting Trend*, PricewaterhouseCoopers UK, March 2021.

Chart 11

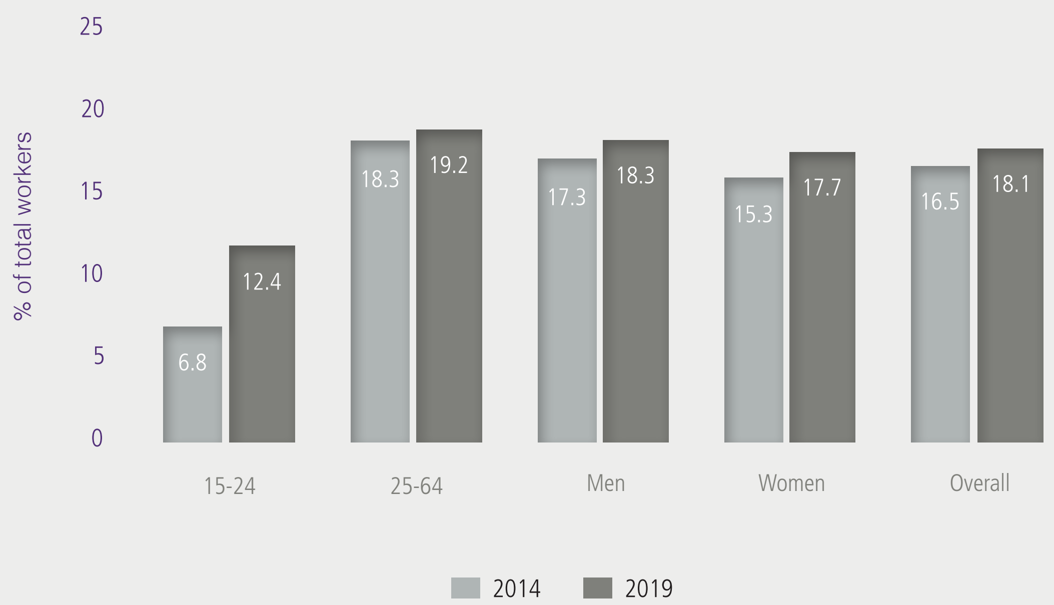
MALAYSIAN POPULATION WILL CONTINUE TO SEE CHALLENGES IN ADEQUACY OF RETIREMENT SAVINGS AS THE FUTURE OF WORK EVOLVES FURTHER

Share of 'uncovered labour force' in Malaysia, 2013 and 2017



Source: Expanding Old-Age Income Protection to Informal Workers, World Bank Group Global Knowledge and Research Hub in Malaysia, Based on DOSM, EPF and Public Service Department, Amanina Abdur Rahman, Mark Dorfman, Achim, Schmillen.

Share of own-account workers by age group and gender



Source: DOSM Labour Force Survey, DOSM, 2014, 2019.

2.3 THE FUTURE OF MALAYSIA'S CAPITAL MARKET

Over the next five years, the CMP3 aspires to see a capital market that grows in **relevance** with the upgrade of the Malaysian economy and its stakeholders. It will be more **efficient** in mobilising capital into productivity sectors of the economy, and will encourage greater **diversity** in the market – a multi-layered market, supported by a competitive and technology-enabled intermediation landscape, creating greater value for both investors and issuers.

Diagram 2
OVERVIEW OF THE CMP3

Desired outcomes for the capital market

Relevant	Efficient	Diversified
Grows in **relevance** with the upgrade of the economy and its stakeholders	**Efficient** in capital mobilisation, accompanied by evolved regulatory approach	**Diversified**, competitive and differentiated to create value for diverse participants

Development thrusts	Regulatory thrusts
Catalysing competitive growth	Embedding shared accountability
Empowering investors for a better future	Prioritising efficiency and outcomes
Shaping a stakeholder economy with SRI and ICM	Embracing the digital age

This would be underpinned by three key development thrusts, which aim to facilitate a capital market that:

- **Catalyses competitive growth** with greater fundraising efficiency for companies across their business lifecycle, enabled by competitive markets and intermediation.

- **Empowers investors for a better future** with accessible and quality investment advice and greater diversity for emerging needs through a digitally inclusive ecosystem.

- **Shapes a stakeholder economy** with effective capital mobilisation through SRI and ICM solutions to sustainable, responsible and stakeholder-oriented businesses.

In tandem, three key regulatory thrusts have been set out to enable a regulatory approach that:

- **Embeds shared accountability in the capital market** to promote responsible businesses, industry self-regulation and investor advocacy, underpinned by principles-based regulations.

- **Prioritises efficiency and outcomes** in protecting investor vulnerabilities, with a fit-for-purpose regulatory architecture as well as effective supervisory and enforcement approach.

- **Embraces the digital age** with the industry, as they navigate through RegTech and emerging technology risks, while enhancing the SC's digital capabilities.