

Building_{the}
Foundations
in CMP1

CHAPTER 1

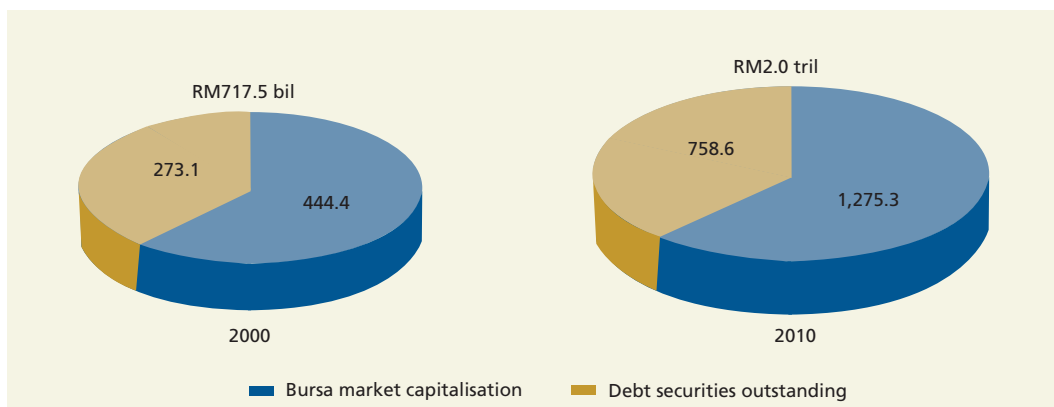
BUILDING THE FOUNDATIONS IN CMP1

Launched ten years ago, the first Capital Market Masterplan (CMP1) guided the development of the Malaysian capital market for the period of 2001 to 2010. CMP1 aimed to build a capital market that would be competitive in meeting the country's capital and investment needs and support long-term nation-building efforts.

Since 2000, the growth of the Malaysian capital market had outpaced the economy, with the size of the capital market expanding from RM718 billion to RM2 trillion or at an annual compounded growth rate of 11%. This strong growth was achieved through rapid industry expansion and strong regulatory oversight that underpinned investor confidence in the capital market.

Chart 1

Malaysia's capital market grew 11% pa during CMP1



Source: Securities Commission Malaysia, Bursa Malaysia

From a capital market comprising mainly equities and government debt securities in 2000, significant market segments were successfully nurtured for private debt securities and investment management, coupled with the development of a comprehensive and innovative Islamic capital market (ICM).

Today, these market segments rank among the leading centres in the region, broadening the Malaysian capital market landscape and complementing a well-established stockmarket which provides equity financing to almost one thousand PLCs and which has functioned as a growth platform for many small and mid-cap companies.

Table 1
Malaysia's stockmarket ranks highly for access to financing

Attributes	Ranking
Financing through local equity market	8
Number of listed companies per 10,000 people	11
Stockmarket capitalisation to GDP	5
Stockmarket turnover ratio	24

Note: Survey based on 57 countries

Source: Financial Development Report 2010, World Economic Forum

CMP1 provided a comprehensive roadmap for the orderly growth and diversification of Malaysia's capital market. The plan identified a total of 152 recommendations with strategic initiatives to strengthen fund-raising, promote the growth of the investment management industry, enhance market and intermediation competitiveness, provide a strong and facilitative regulatory regime and establish Malaysia as an international Islamic capital market centre.

By the end of 2010, 95% of the recommendations in CMP1 had been completed, with the establishment of a facilitative regime that promoted rapid industry growth and the building of a regulatory and institutional framework that provided investor protection at levels comparable with international jurisdictions. Malaysia's regulatory framework ranks highly for investor protection, corporate governance, anti-money laundering and enforcement. Malaysia is also viewed as providing the most consistent and comprehensive regulatory framework for Shariah compliance.

1.1 From a narrow to a broad capital market

In the mid-1990s, Malaysia's capital market was relatively narrow and infrastructure projects were largely funded by the banking system. The maturity mismatch was identified as a major source of systemic risk during the 1997–1998 Asian crisis.

Since the implementation of CMP1, there have been structural changes in the channels of savings mobilisation and intermediation in Malaysia to address funding vulnerabilities. The sources of financing have been broadly diversified in tandem with the expansion of the Malaysian capital market. This has reduced concentration and maturity mismatch risks as well as provided greater avenues for the financing of large-scale projects. The diversification of financing sources through broadening the capital market provided a prudent balance between debt and equity assets and strengthened the resilience of the national financial system.

“The sources of financing have been broadly diversified in tandem with the expansion of the Malaysian capital market.”

The rapid growth in capital market assets over the last decade reflected the rising sophistication in financial intermediation. Deregulation and liberalisation lowered friction costs, increased economies of scale, reduced time-to-market and expanded distribution channels. The increased efficiencies and competitiveness provided the basis for rapid growth of the Malaysian capital market.

Table 2
Strong growth across market segments

Market segments	2000 (RM bil)	2010 (RM bil)	CAGR %
Stockmarket capitalisation	444.4	1,275.3	11.1
Debt securities outstanding	273.1	758.6	10.8
Derivatives (notional value traded)	84.0	512.1	19.8
Investment management (assets under management)	55.2	377.4	21.2
Islamic capital market	293.7	1,050.1	13.6

Source: Securities Commission Malaysia, Bursa Malaysia

During the past 10 years, stockmarket capitalisation grew by 11% annually to triple in size from RM444.4 billion in 2000 to RM1.3 trillion in 2010. The exchange landscape was transformed with the consolidation of exchanges and clearing houses. This was followed by the demutualisation and listing of the exchange. Transaction costs were substantially reduced while market infrastructure was upgraded with new trading platforms and a shortening in the settlement cycle to T+3 in line with international benchmarks. The consolidation of stockbrokers also increased the soundness of capital market intermediaries and strengthened competitiveness; with some stockbroking firms evolving into investment banks.

Malaysia's bond market grew annually by 10.8% with outstanding debt securities tripling from RM273.1 billion in 2000 to RM758.6 billion in 2010. During this period, Malaysia emerged as a leading regional bond market with an average issue size of RM670 million and an average weighted tenure of 16 years during 2000–2010.

The development of a vibrant bond market was supported by a facilitative regulatory framework that streamlined the issuance process with the

introduction of disclosure-based guidelines for private debt securities, asset-backed securities, structured products and Islamic securities. The enhancements to the rating process, improved price transparency and a conducive tax environment attracted a wide range of issuers including multilateral development banks, foreign multinational corporations, foreign governments and agencies.

The derivatives market, anchored by its strength as the global price discovery centre for crude palm oil (CPO), saw the notional value of derivatives traded annually grow by 19.8% from RM84.0 billion in 2000 to RM512.1 billion in 2010. Bursa Derivatives has positioned itself for rapid growth through a strategic partnership with the CME Group Inc. (CME Group), the world's largest derivatives exchange, and migrating to CME's Globex trading platform in 2010.

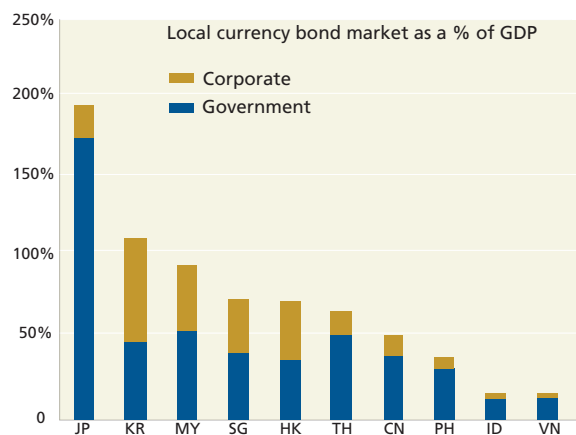
“The investment management industry witnessed high double-digit growth over the past 10 years.”

The investment management industry witnessed high double-digit growth over the past 10 years. Assets under management (AUM) grew by 21.2% annually from RM55.2 billion in 2000 to RM377.4 billion in 2010. The rapid growth was largely driven by the unit trust industry where net asset value (NAV) grew by 18.0% annually from RM43.3 billion in 2000 to RM226.8 billion in 2010.

The penetration rate of the unit trust industry (measured by unit trust NAV over stockmarket capitalisation) rose from 10.0% in 2000 to 17.8% in 2010.

Chart 2

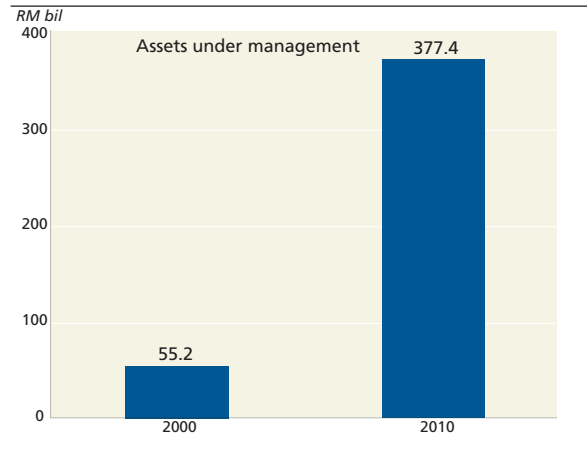
Malaysia is the 3rd largest local currency bond market in Asia



Source: Asia Bonds Online as at September 2010

The robust growth of the investment management industry was due to several factors, including regulatory enhancements that facilitated product expansion and increased investor safeguards, favourable demographics in the form of an expanding labour force and high domestic savings. Regulatory facilitation increased time-to-market efficiencies and promoted an expansion in the range of collective investment schemes such as real estate investment trusts (REITs), exchange-traded funds (ETFs), wholesale funds as well as the development of over-the-counter (OTC) and structured products. The liberalisation of restrictions on investing abroad facilitated the launch of international product offerings by domestic intermediaries. Distribution channels were also widened to encompass institutional agents, fund supermarkets and financial planners.

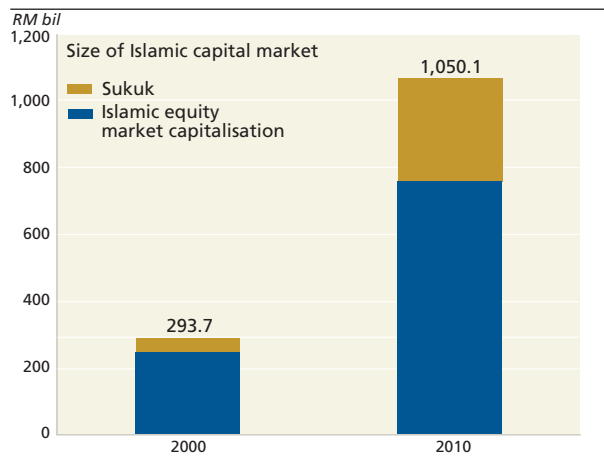
Chart 3

High-growth investment management industry

Source: Securities Commission Malaysia

Reflecting the strong underlying demand for Shariah-compliant assets, growth in ICM outpaced the conventional sector, expanding by 13.6% annually from RM293.7 billion in 2000 to slightly over RM1.0 trillion in 2010. As at the end of 2010, more than half of Malaysia's capital market assets were Shariah-compliant.

Chart 4

Malaysia's Islamic capital market tripled in size

Source: Securities Commission Malaysia

Over the past decade, Malaysia established itself as a major centre for the innovation and intermediation of Shariah-compliant products. Malaysia pioneered the launch of many ICM products and structures such as the exchangeable sukuk, sovereign sukuk and Islamic REITs, and maintains a significant presence in the global sukuk market and fund management industry.

Malaysia's ICM also benefited from a comprehensive regulatory framework for Shariah compliance and Shariah decisions, based on scholarly research, made by the Shariah Advisory Council. The Malaysian framework provided the advantages of clarity and consistency in investor protection on an extensive range of products such as sukuk, structured products, REITs and ETFs. Close collaboration between the Shariah Advisory Council, regulators, industry players and the exchange also facilitated the launch of Bursa Suq Al-Sila', a Shariah-compliant commodity trading platform.

Tax incentives were offered to attract greater international participation in origination, trading and fund management activities in Malaysia. This resulted in international sukuk issuances and listings and attracted international players to establish Islamic fund management operations as well as international Shariah advisers to offer their services in Malaysia. The success in growing international participation was spurred by the promotional efforts under the Malaysia International Islamic Financial Centre (MIFC) initiative; in which the SC has been active in efforts to strengthen international profiling of Malaysia's ICM.

"The Malaysian framework provided the advantages of clarity and consistency in investor protection..."

1.2 Evolved into a well-regulated and resilient capital market

Throughout CMP1, the SC adopted a regulatory model premised on market-based regulation with strong oversight to provide a balance between facilitating intermediation activities and ensuring high levels of investor protection. The strengthening of the regulatory framework underpinned the healthy and sustained growth of the capital market over the decade.

As market participants and advisers enhanced their professional standards and capabilities, there was a progressive shift to a disclosure-based regime that reduced issuance costs and shortened time-to-market for equity and debt fund-raising activities and the launch of investment products.

At the same time, investor protection requirements were reinforced through higher standards for disclosure, due diligence and accountability. Intermediaries were subject to ethical codes of conduct, know-your-client (KYC) rules and were also required to upgrade internal controls on governance, compliance and safe-keeping of client assets.

The increasing convergence of financial activities prompted a pragmatic shift towards risk-based supervisory approaches from a prescriptive rule-based approach. Regulatory oversight was extended to credit rating agencies and bond trustees to ensure higher professional standards. Surveillance and supervisory coverage was also expanded to improve early detection of incidents of market abuse and misconduct as well as to enhance the effectiveness of regulatory actions.

The shift to market-based regulation was also assisted through the formal recognition of the Federation of Investment Managers Malaysia (FIMM) as a Self-Regulatory Organisation (SRO), responsible for registering and monitoring the conduct of unit trust agents.

Legislative changes were enacted to broaden the range of civil and administrative enforcement tools, including extending the SC's ability to pursue enforcement action beyond disclosure-related offences and providing the ability to disgorge profits as well as to seek restitution for investors.

Over the years, the SC used its civil and criminal prosecution powers to take action against directors and officers for falsifying financial accounts of listed entities and furnishing misleading statements, against individuals and hedge funds for market rigging and manipulation and successfully disgorged profits for insider trading. The SC cooperates with other international regulators in actions against internet scams and ponzi schemes and, in a major case, obtained restitution for 19,000 investors.

In addition to the existing compensation fund, the investor safety net was strengthened with the establishment of the Securities Industry Dispute Resolution Center (SIDREC) in 2010. SIDREC acts as an independent redress mechanism for the mediation and adjudication of small monetary claims filed by individual investors in their dealings in capital market products. The SC also launched a comprehensive investor education blueprint to promote financial literacy and widen investor knowledge with coverage of more than 40,000 individuals annually.

Malaysia was among the earliest in the region to implement corporate governance reforms. The *Malaysian Code of Corporate Governance* was issued in 2000 and incorporated into Bursa Malaysia's listing rules in 2001. Consequently, the roles and responsibilities of Boards and audit committees were strengthened while internal audit guidelines and whistle-blowing provisions were introduced. The Audit Oversight Board (AOB) was established in 2010 to enhance the quality of audits and raise professional standards. Malaysia has also committed to converge with the International Financial Reporting Standards (IFRS) in 2012.

“Malaysia was among the earliest in the region to implement corporate governance reforms.”

Prudential safeguards against systemic risks were also strengthened through the introduction of a risk-based capital adequacy framework and the ring-fencing of customer assets and capital to minimise potential areas of vulnerability to contagion risks. Market stability objectives were achieved through the introduction of circuit breakers, extensive market surveillance and a regulated framework for short-selling. Malaysia was relatively unaffected by the 2007-2008 global financial crisis due to regulatory requirements that ensured the financial soundness of its intermediaries.

Over the decade, there has been increasing international recognition of Malaysia's achievements in regulating its capital market. The SC became a signatory to the International Organization of Securities Commissions' (IOSCO) Multilateral Memorandum of Understanding (MMOU) for international cooperation on cross-border enforcement. In 2007, Malaysia was assessed as being highly compliant with the IOSCO *Objectives and Principles of Securities Regulation*.

Global recognition of Malaysia's regulatory framework and capabilities is already providing tangible benefits by supporting positive international assessments of the country, attracting portfolio investments and paving the way for Malaysian intermediaries to gain access to other markets via cross-border regulatory arrangements.

Through building a diversified market with strong intermediaries operating in a well-regulated environment, CMP1 provides a sound foundation from which to move forward with CMP2.