CHAPTER 3

VISION AND STRATEGY

Vision and Strategy

The Malaysian capital market has witnessed significant change and development over the years. As much as this progress has helped in the nation's growth to date, however, it is clear that significant changes are now needed in order for the capital market to achieve greater efficiency and to meet the challenges of increasing global competition.

Capital markets today are evolving at an extraordinary pace, driven by the currents of technology and competition. Technological advancements translate into increasingly rapid information transmittal and the disintegration of traditional geographical and institutional barriers. Traditional channels of revenue cannot be taken for granted any longer by market participants. Increased competition among Malaysia and other financial centres means that the functions of the Malaysian capital market cannot be fully understood unless analysed in the international context.

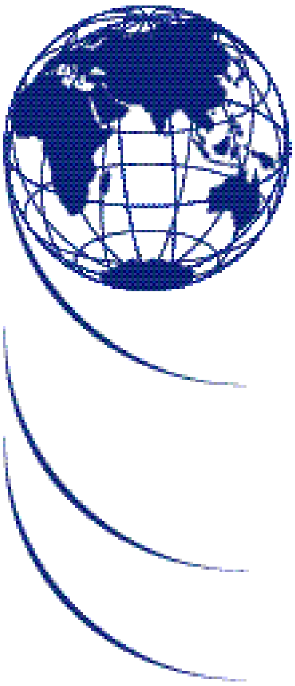
At the same time, the requirements for a developed national capital market, coupled with the need to enhance Malaysia's competitiveness as an investment destination, point to the need for a cogent and co-ordinated strategy to address existing weaknesses and lay the foundation for the capital market's effective future development.

Thus, a comprehensive framework is needed not only to ensure that the Malaysian capital market is characterised by the availability of internationally benchmarked services for all its participants, but also supports the overall diversification of the financial system. These measures will broaden the opportunities for capital formation and investment by participants in the capital market, and ensure that the capital market is well positioned within the changing global financial market environment.

VISION

It is envisaged that Malaysia will develop a capital market that is internationally competitive, bearing the hallmarks of high levels of efficiency, innovation and productivity. It must provide Malaysian investors and issuers with a wide range of products and services comparable with the leading financial centres in the world. At the same time, Malaysia must also continue to strongly develop the depth and breadth of all segments and services offered within the capital market, and develop the international positioning of select value-added areas of the capital market aligned with the country's comparative advantage.

Figure 16
Vision for the Malaysian capital market



The Capital Market *for* Malaysia should be:

- ***Internationally competitive*** in all core areas necessary to support Malaysia's basic capital and investment needs, as well as its longer-term economic objectives
- ***Highly efficient*** conduit for the mobilisation and allocation of funds
- ***Supported by a strong and facilitative regulatory framework*** that enables the capital market to perform its functions effectively and provides a high degree of confidence to its users

This vision reflects an overarching aspiration that is intended to drive the development and strategic positioning of the capital market, and lay a strong foundation for further growth thereafter.

The Malaysian capital market should be internationally competitive in all core areas necessary to support the country's basic capital and investment needs, as well as its longer-term economic objectives. It must also be a highly efficient conduit for the mobilisation and allocation of funds. Underpinning these characteristics should be a strong and facilitative regulatory framework that enables the capital market to perform its functions effectively, and that provides a high degree of confidence to its users.

A vibrant capital market will fuel growth in the economy by enhancing the role of the financial sector in financing economic activity, as well as through its direct contribution to national economic growth in terms of employment, investment and tax revenues. Given the information-intensive nature of capital markets and the demand for high skills levels within the industry, the continuous upgrading of skills and supplementary infrastructure in creating an internationally competitive capital market also contributes to the broader advancement of technology and knowledge capital within the domestic economy as a whole.

At the same time, ensuring that Malaysian issuers and investors have access to an internationally competitive capital market is all the more important in light of the increasing globalisation of financial sector services. However, it is recognised that the present and potential dynamics that influence the shape of financial markets do not realistically allow for exact forecasts of what the future financial market landscape will look like. Therefore, a pragmatic approach is taken whereby emphasis is placed on ensuring that the capital market itself has—and will continue to have—the capacity to meet the challenges arising from the changing financial market environment, in order to continue to serve its constituents' needs effectively.

This overall strategy is intended to represent and address both the current and longer-term needs of Malaysian companies, investors and intermediaries in the capital market. The objectives and strategic initiatives that will serve as the foundational basis of the Masterplan are described in the following section.

OBJECTIVES AND STRATEGIC INITIATIVES

The realisation of the vision necessitates a carefully planned approach that supports an orderly progression towards achieving the aspiration of an internationally competitive and highly efficient capital market for Malaysia, supported by a strong and facilitative regulatory framework. Such an approach should maintain the necessary balance between demands for expeditious yet sustainable development, to effectively meet the dual challenges of external competition and domestic consumer needs.

In order to achieve the vision, six key objectives have been identified that form the basis for the Masterplan's main strategic initiatives and specific recommendations. These objectives are:

- **To be the preferred fund-raising centre for Malaysian companies**
- **To promote an effective investment management industry and a more conducive environment for investors**
- **To enhance the competitive position and efficiency of market institutions**
- **To develop a strong and competitive environment for intermediation services**
- **To ensure a stronger and more facilitative regulatory regime**
- **To establish Malaysia as an international Islamic capital market centre**

The first five objectives focus on the respective core areas of the capital market: issuers, investors, market institutions, market intermediaries and the overall regulatory framework. The sixth objective focuses on an area of immediate comparative advantage that has been assessed to be an area where Malaysia bears substantial potential to occupy a leading international position. The following table outlines the strategic initiatives related to each objective.

1

To be the preferred fund-raising centre for Malaysian companies

1.1 Enhance the efficiency of the fund-raising process

1.2 Implement a comprehensive programme to develop the corporate bond market as a competitive source of financing

1.3 Facilitate the development of the venture capital industry to finance emerging high-growth companies

1.4 Foster a liquid and efficient market for the secondary trading of securities

2

To promote an effective investment management industry and a more conducive environment for investors

2.1 Develop a strong framework for corporate governance and shareholder value recognition

2.2 Heighten efforts to establish a vibrant and competitive investment management industry

2.3 Enhance the role of institutional investors in the provision and management of funds

2.4 Facilitate effective risk management by actively developing the derivatives industry

2.5 Facilitate the introduction of a broad range of capital market products catering to various risk-return profiles

3

To enhance the competitive position and efficiency of market institutions

3.1 Restructure Malaysian exchanges and clearing institutions to strengthen their efficiency and competitiveness

3.2 Ensure Malaysian exchanges are well positioned to respond to changing market dynamics through the adoption of flexible business structures and commercially-oriented strategies

3.3 Enhance the efficiency of the trading, clearing and settlement infrastructure

4

To develop a strong and competitive environment for intermediation services

4.1 Foster constructive competition through the deregulation of services, products and fixed fee structures

4.2 Develop strong full-service brokers to provide a competitive market for integrated financial services

4.3 Ensure Malaysian intermediation services are anchored on appropriate prudential standards, with high levels of business conduct and professional skills

4.4 Adopt a pragmatic programme for liberalisation, supported by appropriate safeguards

5

To ensure a stronger and more facilitative regulatory regime

5.1 Move towards a market-based system of regulation for capital market activities

5.2 Ensure regulatory parity and consistency between all institutions and participants conducting similar capital market activities

5.3 Ensure strong enforcement of the regulations governing the capital market

5.4 Enhance capacity for maintaining systemic and financial stability

6

To establish Malaysia as an international Islamic capital market centre

6.1 Facilitate the development of a wide range of competitive products and services related to the Islamic capital market

6.2 Create a viable market for the effective mobilisation of Islamic funds

6.3 Ensure that there is an appropriate and comprehensive accounting, tax and regulatory framework for the Islamic capital market

6.4 Enhance the value recognition of the Malaysian Islamic capital market internationally

1 To be the preferred fund-raising centre for Malaysian companies

Over the last decade, the Malaysian capital market has assumed a much greater significance in the nation's economic development, within its role as the meeting point for the seekers and providers of capital. The gradual liberalisation policies of the government, and initiatives to further develop a modern and efficient institutional infrastructure, have also stimulated the development of the capital market and the level of activity therein.

The capital market's role as a focal avenue for capital formation has been integral to the rapid expansion and development of the Malaysian corporate sector and its activities over the years. As the nation moves forward in the new millennium, fund-raising activity through the capital market—and the associated cost and efficiency of this process—is anticipated to become even more significant in financing Malaysia's economic growth and in diversifying the sources of funds within the financial system.

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In addition, the domestic capital market's position as the venue of choice for securities issuance by Malaysian companies will become increasingly challenged in the face of a progressively more globalised business environment and heightened international competition among capital-raising centres. High-quality companies—from start-ups to blue-chips—are already discovering and making use of opportunities to tap international capital raising centres to raise funds and list their securities. Issuers, and their investors will naturally choose to converge in markets that offer them the best value in terms of cost, liquidity, skilled professional services, and the diversity of fund-raising instruments.

It is clearly recognised that there are benefits to having the ability to raise external capital and maintaining a listed presence in an international market. However, it is essential that any Malaysian company's decision to seek a foreign listing should not be driven by a lack of value recognition for these companies on the Malaysian market, or a non-competitive domestic market for capital raising in general.

The Malaysian capital market must offer issuers the ability to raise funds through a variety of instruments commensurate with their maturities and risk profiles. Companies must be able to raise money efficiently through the equity market as well as the corporate bond market. Beyond providing a facilitative environment for continued domestic participation through ownership in domestic listed companies, there are also tangible direct and indirect benefits to be derived from having an active market that facilitates corporate and economic activity. This is particularly valid for risk capital funding in value-added sectors that are fundamental to Malaysia's progress towards a knowledge-based economy and developed nation status.

“The Malaysian capital market must offer issuers the ability to raise funds through a variety of instruments commensurate with their maturity and risk profiles”

Therefore, in order to ensure that the Malaysian capital market provides an effective avenue for capital raising, efforts will be made to address the shortcomings in the capital market's current capacity to meet local fund-raising needs, as well as to identify focused measures to ensure that the Malaysian capital market remains the preferred fund-raising centre for Malaysian companies in the future.

To achieve this objective, initiatives will be directed at ensuring that the overall process of raising funds is efficient and provides a competitive cost of raising funds for issuers. Measures will also be taken to promote sufficient breadth in the product markets and instruments to more effectively satisfy the maturity and risk profiles of issuers, particularly in the areas of the corporate bond market as well as financing through risk capital. Finally, there will be appropriate efforts directed at ensuring that there is sufficient depth in terms of liquidity and efficiency in the secondary market for issued securities.

STRATEGIC

1.1

INITIATIVE

Enhance the efficiency of the fund-raising process

Companies in Malaysia must be able to access the capital market on competitive terms compared with other sources of financing and markets. To ensure that the Malaysian capital market remains competitive—and consequently the market of choice for Malaysian issuers—it is necessary to address the issues of cost and efficiency in the fund-raising process.

Modern companies operate in an increasingly competitive and fast-paced environment, giving rise to the need for management to be able to respond quickly to developments that affect their businesses. The ability to access capital markets with maximum exposure yet minimum delay and cost is vital in ensuring that they are able to capitalise on business opportunities in a timely and cost-efficient manner.

To this end, therefore, there will be a continuous drive to further improve the efficiency of the regulatory processes intrinsic to the raising of funds within the capital market. This includes the identification of areas where multiple layers of regulatory approvals can be rationalised, and where innovative methods such as shelf-registration schemes can be introduced to expedite the issuance process for eligible companies.

The shift from merit-based regulation—which was inherited by the SC upon its establishment in 1993—to DBR is a key element of efforts to enhance the issuance process. Whereas the merit approach requires the offering of securities to be subject to regulatory review to determine the investment merits of such offerings, under the DBR approach, regulation focuses on the quality of disclosure by issuers while investors determine the investment merits of the offering based on the information disclosed. This reduces the costs of approval and will provide incremental efficiency gains as the market grows in depth and breadth. More broadly, this approach is pivotal to the effective progression towards a more sophisticated, innovative and commercially-driven financial system.

A more competitive market with respect to capital market advisory services will also help reduce the overall cost of raising capital. One direct implication of this will be to facilitate competition for underwriting, placement, advisory and other services related to securities issues. Efforts will be directed at identifying initiatives for the further deregulation and liberalisation, albeit gradually, of the market for corporate advisory services. The use of electronic media in the fund-raising process where applicable will be encouraged to take advantage of the greater reach, speed and efficiency that electronic platforms can offer.

“The ability to access capital markets with maximum exposure yet minimum delay and cost is vital in ensuring that companies are able to capitalise on business opportunities in a timely and cost-efficient manner”

In the medium to longer term, continuous reviews of the issuance process and related policies will be taken to ensure that they remain relevant to the broader objective of being the preferred funding base for Malaysian companies.

STRATEGIC
1.2
INITIATIVE

Implement a comprehensive programme to develop the corporate bond market as a competitive source of financing

A robust domestic corporate bond market is essential in order to provide a cost-efficient alternative method of financing the longer-term funding requirements of issuers, and to allow for the greater diversification of the sources of funds *vis-à-vis* the banking and equity sectors. It also provides an investment alternative for investors seeking long-term non-sovereign fixed income investments.

A well-developed domestic corporate bond market is vital for the efficient allocation of capital. In Malaysia, the banking sector has traditionally provided a significant proportion of debt funding to corporate borrowers, usually in the form of short-term debt, to fund the companies' long-term needs. This high degree of reliance on bank lending resulted in funding mismatches that, while manageable during the years of steady economic growth, were unfortunately aggravated during the crisis when many companies found themselves unable to service their debt, resulting in a significant strain on the banking sector.

"A robust domestic corporate bond market is essential in order to provide a cost-efficient alternative method of financing the longer-term funding requirements of issuers, and to allow for the greater diversification of the sources of funds vis-à-vis the banking and equity sectors"

Without a deep and resilient domestic corporate bond market, these funding mismatches will continue to make the corporate and banking sectors vulnerable to future financial shocks. In the longer term, Malaysian companies seeking to issue debt will also increasingly look towards more liquid and facilitative foreign markets with a ready market in debt securities.

Furthermore, the relatively underdeveloped securitisation market also meant that illiquid assets were typically "locked-up" in the books of their holders, instead of being repackaged and channelled to the financial markets in the form of tradable securities. While efforts have been made to develop this important segment of the market, particularly with the establishment of the national mortgage company, Cagamas, in 1986, further enhancements to the regulatory and tax frameworks for asset securitisation can be made to facilitate the issuance of asset-backed securities.

In moving forward to meet the demands of Malaysian companies in the years ahead, the corporate bond market must be further developed as a competitive source of financing that is able to effectively cater to the debt funding needs of issuers. Immediate priorities are the streamlining of the bond issuance process and the lowering of associated costs. This includes allowing greater flexibility for issuers through expediting and shortening the issuance process and moving to a more market-based issuance process

In order to encourage greater liquidity in the secondary bond market, the trading infrastructure and access to the market will be enhanced to allow a wider and larger representation of participants in the domestic bond market. On a broader scale, a co-ordinated approach by all relevant regulatory agencies is needed to ensure the effective development of the bond market. Although the SC has been designated as the single regulatory authority for the corporate bond market, there are several critical areas that require concerted action by the relevant authorities. These include the development of a benchmark yield curve and the asset-backed securities market.

"Immediate priorities are the streamlining of the bond issuance process and the lowering of associated costs"

It should also be noted that successful corporate bond markets tend to be associated with an environment in which the process of credit allocation is primarily market-determined, and interest rate levels are free to respond to market forces. To ensure the effective functioning of the Malaysian bond market, the cultivation of such an environment should also be undertaken concurrently.

Given the importance of further developing the bond market in order to establish a more balanced and comprehensive capital market, it is imperative that these areas are expediently addressed in order to ensure that the relevant prerequisites for a vibrant and efficient corporate bond market are fully in place. These efforts represent a collaborative commitment to ensuring the development of a liquid and wider-maturity corporate bond market, with a large number of participants, that constitute a competitive means of financing.

STRATEGIC

1.3

INITIATIVE

Facilitate the development of the venture capital industry to finance emerging high-growth companies

The development of the venture capital industry is an important component of the country's overall thrust towards becoming a knowledge-based economy, and in the creation of a more value-added production base. This is due to the important role it plays in meeting the financing needs of emerging high-growth companies—typically considered high-risk by nature of their lack of track records and relatively few tangible assets—in value-added industries.This enhances the competitiveness of Malaysian businesses through the development of intellectual and technological capital as the knowledge-based and high-technology sectors, in particular, are envisaged to be key areas where the Malaysian economy can derive its competitive edge entering into the new millennium.

Importantly, some key aspects of keeping these companies within Malaysia—such as job creation and the promotion of entrepreneurship within the country—will also support the country's continued progress towards developed nation status. As such, it is vital that focused efforts be directed towards developing avenues for capital formation for high-growth, value-added sectors that will support national long-term development.

To ensure that the Malaysian capital market remains the preferred fund-raising centre for Malaysian high-growth companies, there is a need to ensure that the capital market provides the appropriate breadth in terms of initial funding and other pre-IPO financing mechanisms. Therefore, efforts to promote the development of this segment of risk capital within the Malaysian capital market must be further enhanced.

The SC's efforts in this regard will be directed at ensuring that there is a conducive environment for the development of the private venture capital industry, to provide an attractive and competitive environment for emerging companies seeking funding. This includes ensuring that there are facilitative conditions for venture capitalists wishing to exit from their investments, which will be effected through the enhancement of existing markets and mechanisms that allow for the appropriate pricing, cost-efficient listing and value recognition for the issuers and the venture capitalists that invest in them.

“ ... it is vital that focused efforts be directed towards developing avenues for capital formation for high-growth, value-added sectors that will support national long-term development ”

While the government has already allocated substantial resources towards the development of critical mass in the venture capital industry, the role of the private sector needs to be enhanced in order to ensure the effectiveness of the industry's role is sustained over the longer term. Funding through bank borrowings, while a common means of financing for small businesses in the past, may not be appropriate for many New Economy and innovation-based businesses that do not have assets that can be easily quantified and which, despite their growth potential, are generally considered high-risk investments. For these reasons, Malaysia also requires venture capital investors and investment managers who possess the requisite expertise in valuing new technology, intellectual property, understanding new business models and risks in new high-growth industries and providing managerial guidance to investee companies.

As such, measures will be taken to facilitate the creation of a deeper pool of venture capital funds and related expertise that allow the effective matching of the risk appetites of private equity investors with the risk profiles of newly-emerging businesses. This will also allow for greater diversification of the sources of funds available, and widen the scope for such companies to choose between viable and cost-effective alternative capital structures best suited to their individual needs. At the same time, measures will be taken to facilitate a broader range of instruments available to investors for participating in venture capital financing, such as allowing the establishment of professionally-managed venture capital trusts.

Given the present nascent nature of the domestic venture capital industry, greater co-ordination between the relevant authorities and industry participants is also needed with a view to facilitating future developmental efforts. Moving forward, a centralised approach to the development of the venture capital industry will allow for the more effective implementation of such efforts.

STRATEGIC

1.4

INITIATIVE

Foster a liquid and efficient market for the secondary trading of securities

An active and efficient secondary market for securities allows Malaysian companies to be able to raise capital at competitive prices and reasonable cost through established market channels. It enhances the value recognition for these issuers because of the presence of established pools of liquidity within the market itself, consequently also increasing the attractiveness of investing in the Malaysian capital market. In addition, a vibrant secondary market in niche value-added sectors and their related support industries will also promote the country's profile as a strategic hub for these industries and their convergence point of choice.

These benefits are not unique to Malaysia and have been identified by many international markets as key to their long-term development. A common focus of attention has been the aggressive efforts by an increasing number of other markets to project themselves as leading trading centres within their own regions and market niches. A timely response is needed to ensure that Malaysia does not fall behind in this respect and lose its attractiveness as a trading base for not just Malaysian companies, but for high-quality and high-growth companies in general. In doing so, however, the experience of other jurisdictions also underscores the need for a judicious approach to enhancing liquidity whereby market integrity is not compromised at any time and investors are kept fully aware of the quality of listings they invest in.

As the largest and oldest exchange in the country, the KLSE has tended to attract the bulk of Malaysian listings—and hence trading activity—by virtue of its existing critical mass, reputational reach and familiarity to local market participants. Therefore, there will be continued efforts to ensure that the exchange's trading processes and market microstructure remain highly efficient and facilitate high levels of liquidity. However, liquidity in MESDAQ has been markedly less prominent, even after taking into account its more recent inception. Given this, the expedited yet orderly development of MESDAQ as a viable exit mechanism for venture capitalists and a fund-raising base for high-growth companies—which normally lack the profit records necessary for KLSE Main and Second Board listings—is needed. In addition, trading activity in the corporate bond market will be enhanced by widening access to the market and broadening the sources of intermediation services for this segment of the capital market.

The role of technology in facilitating greater liquidity has already been recognised very early on and addressed to some extent. In moving forward, there will be efforts to ensure the continued regulatory facilitation of broader and more efficient means of market access, and the use of electronic media in the dissemination and distribution of products and services.

Therefore, the merits of greater access to enhance the levels of market activity are recognised. In line with this, a programme for the selective liberalisation of access to the trading of equities, bonds and related risk management instruments will be undertaken to help build and sustain the liquidity necessary for a vibrant, efficient and growing market.

2 To promote an effective investment management industry and a more conducive environment for investors

Investors represent the lifeblood of the capital market. At the most fundamental level, the efficient mobilisation of domestic savings requires a capital market that can effectively accommodate the investment and risk management activities of a broad spectrum of users with heterogeneous investment needs and demands. For Malaysia, increasing individual wealth in line with economic growth, combined with growing financial literacy and investor sophistication, mean that the domestic capital market must have the continuous capacity to meet the changing needs and demands of investors.

To achieve this objective, the investing community must have strong confidence in the quality of the companies they invest in. This entails explicit recognition that growth is only one component of investment quality; the quality of and mechanisms for corporate governance within the local private sector are also vital for the maintenance and enhancement of investor confidence. Good corporate performance must be accompanied by high standards of business conduct, and therefore this link must be recognised in any strategy for the promotion of a more conducive environment for investors.

In this regard, good corporate governance has always been, and remains, an important priority for the SC. An important thrust of efforts in this area will be the further enhancement of corporate accountability—including accountability with regard to the efficiency with which companies manage their capital—and the promotion of good investor relations and enhanced communication channels between companies and their shareholders.

“... a strong culture of shareholder activism is necessary to complement regulatory efforts to enhance the enforcement of minority shareholders’ rights and to provide the appropriate incentives for companies to exercise greater regard for maximising shareholder value”

Moving forward, the continued promotion of high standards of financial reporting and the availability of timely and accurate disclosure are also crucial. To make investment decisions, investors need to have access to adequate and timely corporate information, and have confidence in the integrity of the companies and markets they invest in. Shareholders must be fully able to assess whether the companies they invest in are using their assets efficiently, and in their best interests. Importantly, a strong culture of shareholder activism is necessary to complement regulatory efforts to enhance the enforcement of minority shareholders’ rights and to provide the appropriate incentives for companies to exercise greater regard for maximising shareholder value.

At the same time, the investment management industry must be able to meet consumer demands for greater efficiency, diversity and cost-effectiveness in the management of their funds. This emphasis on enhancing the depth and breadth of the investment management industry will become more and more important as the investing populace grows and matures. Growing awareness of personal financial planning, rising income levels, and the need to moderate reliance on centralised public management of private retirement funds as the economy matures, are all combining to make individuals' financial decisions more important to their future well-being.

"This requires the effective management of investors' funds, including the building up of a competitive investment management industry that can service the diverse investment preferences of investors in the Malaysian capital market. Strengthening the domestic investment management industry is therefore a central element of any strategy to mobilise domestic savings more effectively"

The productive investment opportunities available to investors in Malaysia must, therefore, be adequate to meet these needs, both now and in the future, across the spectrum of investors' risk-return profiles. This requires the effective management of investors' funds, including the building up of a competitive investment management industry that can service the diverse investment preferences of investors in the Malaysian capital market. Strengthening the domestic investment management industry is therefore a central element of any strategy to mobilise domestic savings more effectively.

The enhanced involvement of institutional investors, in general, is also envisaged in the overall objective of promoting an effective investment management industry, given the important role they play in supplying and managing large amounts of capital. If these institutions and their clients or contributors are to attain efficient returns on their portfolios, there must be consistent and continuous upgrading of the efficiency with which their funds are invested and managed. Where necessary, undue restrictions on the scope of their activities need to be assessed and addressed accordingly, if the costs to their overall efficiency are greater than the benefits attained by such requirements.

In promoting a more conducive environment for investors, there is also a need to widen the range of investment opportunities available in the domestic capital market. There must be an accessible and sufficiently wide variety of financial instruments and services that allow investors to direct their funds into the most profitable investments available for their desired level of risk. The availability of liquid financial instruments that facilitate the hedging of investment exposures will also allow the risks inherent in financial market transactions to be appropriately priced and distributed more widely throughout the market. This will in turn allow for more active risk management among local investors and increase the scope for greater diversification and competition within the investment management industry.

STRATEGIC

2.1

INITIATIVE

Develop a strong framework for corporate governance and shareholder value recognition

The Malaysian capital market must have a transparent, accountable and performance-oriented corporate sector that presents efficient and value-focused investment opportunities for investors. There must be a recognition of the responsibilities of market participants themselves: on the part of stakeholders, to exercise their rights to good corporate governance; and on the part of management and directors, to maximise shareholder value.

"There must be a recognition of the responsibilities of market participants themselves: on the part of stakeholders, to exercise their rights to good corporate governance; and on the part of management and directors, to maximise shareholder value"

Proper market discipline is vital for ensuring that the Malaysian capital market is represented by good corporate citizens. In markets with a strong culture of shareholder activism, investors typically ensure that companies clearly link the objectives of their key processes to long-term value. In Malaysia, the demands for accountability must be more prevalent in order to facilitate a shift away from the present bias towards short-term trading to longer-term investment. Without sufficient shareholder pressure on local companies to focus on wealth-enhancing activities and to reward their efforts towards value creation for shareholders, Malaysian companies will gradually become less economically attractive long-term investments.

In a post-crisis environment, in particular, there is a need to focus efforts on developing a capital market that is grounded on a deep-seated awareness of the need for a transparent, accountable and performance-oriented corporate sector. Increasing emphasis by global companies on shareholder value maximisation means that competition for capital will become increasingly focused on the priority placed by company management on the welfare of their shareholders. Domestic companies that do not focus on maximising shareholder value will not be able to compete with other more efficient and value-oriented companies.

"Domestic companies that do not focus on maximising shareholder value will not be able to compete with other more efficient and value-oriented companies"

To ensure that the Malaysian capital market remains the investment centre of choice for investors seeking Malaysian exposure, enhanced corporate governance and proper shareholder value recognition are critical. This requires both a strong public policy framework as well as greater investor literacy.

Therefore, the SC will work actively with other relevant regulators and the industry to initiate further measures to improve the incentives and avenues for exercising good corporate governance. These measures include further enhancing the awareness of and accountability for the fiduciary duties and obligations of company directors, management and officers, and ensuring the availability of adequate mechanisms for investor recourse. In this respect, efforts to enhance the corporate governance framework will be expedited through the timely implementation of the recommendations that were previously made by the Finance Committee's *Report on Corporate Governance*.

"... the availability of timely, relevant and accurate information is crucial so that investors can adequately judge the merits of the investment choices they are presented with"

To support the longer-term development of the capital market, there is a need for regulatory investor protection mechanisms to be supported by increasing frontline responsibility by the market participants themselves—encompassing the investors, issuers, intermediaries, market institutions and relevant professional bodies—who are actually at the vanguard of market activity. Thus, as the disclosure and informed use of relevant corporate information grows, the onus of assessing the merit of any investment venture will increasingly revert to the investors themselves.

As such, the availability of timely, relevant and accurate information is crucial so that investors can adequately judge the merits of the investment choices they are presented with. Whilst significant efforts have been taken to enhance disclosure requirements over the last few years,[41] the sustained development of a favourable investing climate requires the continued benchmarking of disclosure standards in the Malaysian capital market against international best practices. Having achieved these standards, in conjunction with the continuous emphasis on good corporate conduct and accountability, Malaysian companies in general will clearly be better positioned to offer attractive long-term investment propositions to investors.

[41] It should be noted that disclosure requirements have been reinforced significantly over the years, such as the requirement for quarterly financial reporting by all listed companies as practised by some developed markets.

STRATEGIC
2.2
INITIATIVE

Heighten efforts to establish a vibrant and competitive investment management industry

The investment management industry represents a vital transmission mechanism between domestic excess funds and productive investments. Importantly, investment management products such as collective investment schemes are vehicles that help to diversify investors' risk. They allow investors exposure to a broad range of products but at typically lower cost given that the pooling of funds enables them to undertake investments in a more cost-effective manner, with investors then free to choose the schemes that best meet their individual risk-reward preferences.

Given a sufficiently competitive and diversified investment management industry, the experience in other jurisdictions has shown that professional asset management services and collective investment schemes are relatively widely understood and accepted investment options for investors in these markets. Investors who wish to participate in the capital market, but who lack sufficient resources or incentives to undertake the research and costs that accompany direct investments in the market, commonly leave their excess funds in less productive accounts unless they can more effectively delegate the management of their funds.

Further development of the domestic investment management industry is therefore a central element of any strategy to mobilise domestic savings more effectively. Promoting the professional management of collective funds will also encourage greater innovation and sophistication in the services and products offered to investors, which will allow Malaysians greater choices in terms of the avenues through which they can obtain the most productive returns for their desired levels of risk. In addition, an active investment management industry will enhance liquidity on the local capital market and provide more competitive channels for institutions holding excess funds to outsource the management of these funds.

"... an active investment management industry will enhance liquidity on the local capital market and provide more competitive channels for institutions holding excess funds to outsource the management of these funds"

To achieve this, however, efforts to enhance the efficiency with which the investment management industry as a whole currently functions must be heightened. Essentially, this will require the industry to be more competitive and vibrant, whereby current and potential customers are able to access a diverse range of products and services at reasonable cost.

A key implication of this is the need to increase the number of industry players with greater access to a larger pool of funds for management. This is necessary for reducing the current concentration of funds under management and creating the critical mass within the investment management industry needed to accelerate its further development. At present, the bulk of Malaysian households' funds is concentrated within the banking system and the EPF.[42] While centralised EPF management of retirement savings has served

[42] As at end-1999, the amount of funds under management stood at approximately RM280 billion, the bulk of which was managed by the EPF, and which was substantially less than the amount channelled through the banking sector.

Malaysian workers well over the years, as the nation moves towards a developed economy, the need for more diversified and effective means by which to achieve better returns on these funds will grow in tandem with contributors' growing income and investment needs. However, in the absence of a competitive market for investment management, such avenues will be more difficult to find.

This concentration points to the need for the further decentralisation and deregulation of the investment management industry to become more vibrant and competitive, and to provide a more diverse range of investment management options for consumers. As such, there will be focused efforts on the core areas of enhancing competition, building up critical mass and laying a strong foundation for the further development of the industry thereafter. This will be effected through the further deregulation of the investment management industry and promoting the outsourcing of the management of a portion of publicly-held funds to Malaysian-based investment managers.

In addition, the regulatory framework governing the industry must be sufficiently responsive to the need for changes to the investment scope and diversity of funds under private management. As such, the SC will continue to ensure that the regulatory framework is facilitative of ongoing development, including allowing for greater flexibility in bringing new products to the market, while continuing to ensure a high level of investor protection and overall market integrity.

Within this framework, decisions based on commercial considerations will not be unduly inhibited by regulation, and appropriate steps will be taken to widen the scope for greater competition within the industry, including through further deregulation to allow for greater portfolio diversification and specialisation. In addition, the licensing framework will be streamlined to allow for the convergence of related investment management operations and uniform regulatory treatment of companies offering similar investment management services and products. The development of a wider range of investment schemes and the private pensions industry will also be facilitated, to promote a greater diversity of investment products and management services catering to different risk profiles of contributors.

Reinforcing these efforts will be the cultivation of a large pool of highly skilled professionals to help foster greater innovation and build up critical mass within the industry. While this will be achieved to some degree by the enhancement of competition among investment intermediaries for investors' funds, efforts to enhance the skills base of the industry will remain a priority to ensure that investors have access to investment management services and advice that are of high quality. This will be undertaken in tandem with the selective deregulation and liberalisation of the industry to foster competition, and to add to the diversity and depth of participants.

It is also important to continue educating retail investors of the investment management opportunities available to them. Therefore, measures will be taken to facilitate the development of a domestic financial planning industry and to co-ordinate a greater quantity and frequency of promotional and educational programmes to increase awareness among investors of investment management products and services.

STRATEGIC

2.3

INITIATIVE

Enhance the role of institutional investors in the provision and management of funds

Institutional investors in this context include asset management companies, unit trust management companies, pension funds and state-controlled funds, insurance companies, and banks and securities houses that invest for their own accounts as well as on behalf of their customers.[43] As collectors of savings and private assets and suppliers of capital, they have an important impact on the functioning of the capital market through the role they play in supplying and managing large amounts of funds.

Because of their substantial market holdings, their investment actions are not insignificant in influencing the level and direction of market activity.[44] This influence is only expected to increase as the market evolves, as changing investor demands will conceivably lead to a greater proportion of excess funds being deployed in favour of more performance-oriented instruments such as managed investment schemes.

At the same time, as the market becomes larger and more complex, investors will need to have sufficiently detailed knowledge and capacity to manage their investment portfolios, particularly those that involve a variety of products and markets. Institutions are generally better placed to do this, by virtue of their natural access to larger pools of funds and resources than the average retail investor. This, in turn, is also expected to lead to the increased influence of institutions handling private funds—including unit trust management companies, fund management companies, pension and provident funds, and insurance companies—in line with broader economic growth and consequently larger pools of private wealth placed with these institutions.

"... institutional investors are important because of their capacity to more effectively discharge their governance responsibilities as the larger and more influential shareholders and scrutinisers of the companies they invest in"

It is therefore clear that the role of these institutions, as well as that of private companies investing proprietary funds, is highly important in the efficient allocation and provision of funds to companies raising funds in the capital market. The greater involvement of Malaysian institutional investors will also support the development of a more liquid market. Liquidity typically expands with the scale of trading, and the presence of large and active institutional investors within the capital market will foster a more conducive environment in which liquidity can flourish.

In addition, institutional investors are important because of their capacity to more effectively discharge their governance responsibilities as the larger and more influential shareholders and scrutinisers of the companies they invest in. As fiduciaries of their clients' interests, institutional investment companies wield significant power in influencing the governance of the companies they invest in, whether by means of direct voting involvement or through their investment decisions. Institutional investors can therefore play a significant role in ensuring that the firms they invest in place due priority on value

[43] In addition, private companies that invest surplus cash reserves in the capital market may be considered important institutional participants in their own right.

[44] As of end-1999, institutions held up to 40.8% of total equity on the KLSE although they constituted only 1.7% of the total number of investors. Of this amount, the majority of institutional equity ownership was held by Malaysian institutions.

creation. In this regard, the more informed, dynamic and pro-active participation of these institutional investors is needed, particularly to ensure their beneficiaries the best returns for their desired levels of risk.

As the active interest of institutional investors in the companies they invest in builds in a high degree of independent external influence over corporate activity—from both the financial and voting perspectives—more active domestic institutional investor participation will be strongly promoted in the Malaysian capital market.

An important thrust in this regard is through the deregulation of restrictions—save for the necessary prudential requirements—that are imposed on institutional investors, in order to facilitate more efficient investment decision-making. Regulatory facilitation will also be extended so that the legislative provisions governing government-linked institutions' investment mandates allow for their efficient and productive management and are facilitative of their contributors' needs.

In addition, to support the important role of institutional investors in the area of corporate governance, the SC will continue its efforts to promote a high degree of awareness among these institutional investors of their governance role and fiduciary duties with regard to the companies they invest in. Therefore, this emphasis will continue to be actively promoted through the training and continuous education of investment professionals and directors involved in the management of these institutional funds, as part of overall efforts towards enhancing the institutional component of the investing community.

STRATEGIC

2.4

INITIATIVE

Facilitate effective risk management by actively developing the derivatives industry

The development of the risk management industry must occur in tandem with that of the underlying capital market, if the aim is to have a sustainable and orderly development process. Without a liquid and comprehensive domestic market for derivative products, local investors and businesses will not be able to effectively hedge their investment and business exposures and may have to look to offshore markets for suitable alternatives. This would entail genuine economic costs not only in terms of the greater vulnerability of potentially unhedged exposures to adverse market movements, but also in terms of foregone business opportunities for local market operators and intermediaries.

The growth of the derivatives industry in Malaysia has not been significant in the 20 years since the introduction of CPO futures in 1980, despite efforts to actively develop the market. This has been attributed to the lack of an active risk management culture among domestic investors and businesses, as well as structural impediments restricting the ability of potential market participants to engage in derivatives transactions.

While the development of the former is necessarily an evolving process—aided in part by the lessons of the recent financial crisis and ongoing training and awareness programmes—there need to be concerted efforts to address the latter issue as well. With technological advances, the rise in inter-exchange trading linkages and the ease of contract replicability resulting in increasing global competition for business, the local derivatives industry will face even greater challenges in meeting investors' risk management needs on a continued basis in the future.

Given the relatively small scale nature of the local derivatives market at present, a comprehensive programme for development is necessary to expedite the attainment of critical mass. To this end, there should to be a judicious deregulation of structural restrictions where necessary to liberalise access to the market, such as the relaxation of existing limits on institutional investors from participating in derivatives, and the facilitation of cross-border partnerships with other market institutions where appropriate. At the same time, such measures will be supplemented by continued efforts to enhance investor awareness of the uses of derivatives.

The SC also aims to create a conducive trading environment for risk management products and support greater public access to these products, through actively facilitating greater product diversity, the deregulation of fixed derivatives brokerage commissions, and allowing the trading of approved international products to create a more competitive market. It should be noted, however, that none of these measures implies any concession of the standards of investor protection and prudence that need to be maintained for the orderly development of the capital market. Rather, they recognise and build on the integral role of a vibrant risk management industry in overall efforts towards the development of an internationally competitive capital market.

STRATEGIC

2.5

INITIATIVE

Facilitate the introduction of a broad range of capital market products catering to various risk-return profiles

To effectively provide domestic savers with viable opportunities to mobilise their savings in investments that best suit their individual risk-return profiles, it is necessary for the capital market to be able to allow them access to a wide range of products that meet these preferences. Empowering consumers with greater choices in the variety and quality of products available to them is an important part of the overall strategy to enhance competition and efficiency within the capital market.

“Empowering consumers with greater choices in the variety and quality of products available to them is an important part of the overall strategy to enhance competition and efficiency within the capital market”

In Malaysia, the development of the product base has not been systematic across all capital market segments. For example, while there has been some degree of innovation in equity fund-raising, the range of products introduced in the bond market and derivatives markets has not developed in tandem. Asset securitisation and repo activity, for example, have been slow to take off; and the range of exchange-traded derivative products has remained relatively small. In addition, there is also scope for substantial enhancement of the product base within the investment management industry. Also, while the fund-raising capacity of the capital market has grown tremendously over the years, the span of products over the entire risk-return spectrum needs to be widened further to accommodate the funding needs of companies with high-risk profiles but possessing potential for significant growth.

These differing rates of development are due partly to the prior fragmented structures of some of these markets, the adverse repercussions of the regional financial crisis, lack of experience in product origination and domestic investors’ general lack of familiarity with the new products. In some cases, the relative difficulty faced by investors in gaining access to these product markets has been a contributory factor towards their lacklustre growth.

“In moving forward, it will be necessary to look into areas not only where the domestic market can more effectively meet the basic investment needs of residents, but also where it can open up new investment opportunities that provide added value to consumers”

While efforts to address these issues have been and will continue to be expedited, this imbalance in the pace of product origination is also very much linked to the imbalance in the levels of competition and barriers to entry within the various segments of the capital market. For instance, the relatively high degree of homogeneity within the unit trust industry, given the concentration of investment in the local equity market, has been linked to the limited supply of other types of securities and existing limitations on foreign investment allocations.

In moving forward, it will be necessary to look into areas not only where the domestic market can more effectively meet the basic investment needs of residents, but also where it can open up new investment opportunities that provide added value to consumers. As a corollary, this points to the need to assess the implications of existing limitations on the ability of resident investors to access investment products both locally and internationally.

More specifically, the introduction of measures to facilitate this will include allowing for greater flexibility in the types of securities that collective investment schemes can invest in, progressively liberalising private investor access to alternative investment vehicles and streamlining the process for the introduction of new capital market products. To support wider investor access to the capital market, the establishment of a proper regulatory framework for the provision of products and services in electronic form—including online stock trading, electronic-based investment advice, financial portals and Internet information sites—will also be introduced.

3 To enhance the competitive position and efficiency of market institutions

The triune realities of globalisation, innovation and technology are not merely rapidly altering the characteristics and configuration of capital markets, they have also brought about changes to the role, influence and profile of market institutions. Against this background, exchanges and clearing houses worldwide are rethinking their operational structures and policies in order to improve their services, reinforce their competitive position and optimise their performance.

A major challenge facing market institutions in Malaysia is that of remaining internationally competitive within a more aggressive and dynamic business environment. Many market operators internationally are already rapidly pursuing the course of greater integration, both through enhancing linkages between their trading, clearing and settlement systems, as well as through combining stock and derivative product lines under a single organisation. In addition, exchanges around the world have been progressively moving towards the adoption of more efficient, integrated electronic trading platforms in order to accommodate larger trading volumes and further expand their market reach.

" ... exchanges and clearing houses worldwide are rethinking their operational structures and policies in order to improve their services, reinforce their competitive position and optimise their performance"

These trends constitute significant challenges for traditional market institutions in terms of their continued effective functioning within their respective economies. Market institutions run the possibility of being marginalised by global—and, in some cases, local—market participants if they do not respond quickly enough to both external competitive pressures as well as the changing needs and demands of their existing constituents.

Therefore, the ability of Malaysian market institutions to carve out and consolidate a position for themselves in the international marketplace will depend greatly on their ability to adapt promptly and appropriately to changes within the global environment. They must ensure that their business models and the organisational structures within which they operate are fully aligned with the evolving global financial landscape. At the most fundamental level, they must present investors with a liquid, efficient, secure and transparent trading environment on competitive terms.

In addition, they must offer competitive costs of listing and raising funds, as well as sufficient international visibility, so that issuers are able to obtain appropriate value recognition of their securities. In short, market institutions must strengthen, and where necessary redefine, their value proposition in light of the changing circumstances in which they are operating. This will require enhancing their collective efficiency through appropriate operational and organisational restructuring to tap economies of scale and scope, and positioning themselves to respond to a competitive and dynamic business environment through the adoption of facilitative business structures and marketing strategies. It will also involve strengthening the integrity of the market by ensuring high standards of corporate disclosure and market surveillance, and ensuring the efficiency of the trading, clearing and settlement infrastructure.

"A major challenge facing market institutions in Malaysia is that of remaining internationally competitive within a more aggressive and dynamic business environment"

While many of the wider-reaching enhancements to market processes will take time, more specific measures can be implemented relatively quickly with the main focus on laying the proper foundation for the further advancement of these institutions in the medium to longer term. These measures, undertaken together, will go a long way towards ensuring that the quality of listings within the Malaysian capital market remains high and that it remains the preferred listing and trading centre of Malaysian issuers and investors.

STRATEGIC

3.1

INITIATIVE

Restructure Malaysian exchanges and clearing institutions to strengthen their efficiency and competitiveness

International market institutions today are operating in a highly competitive and dynamic environment. Issuance and investment activity are increasingly being directed to exchanges that are able to accommodate their constituents' various needs, not only in terms of liquidity, product reach and diversity, but also in terms of speed, cost and efficiency. As a result, market institutions worldwide are facing greater global competition for their national franchises over order-flow and securities listing.

Given the prevailing diversity of international markets offering opportunities for issuers and investors alike to raise funds and invest in, there is increasing pressure on market institutions to manage their operations in a manner that achieves greater efficiencies of scale and scope. Clearly, the more fragmented market institutions are, the greater the potential for remaining small and lacking in liquidity. The need for strong market institutions to ably compete in the global marketplace calls for a certain amount of financial strength and operational capacity in order to maximise resources and tap new markets.

> *"Issuance and investment activity are increasingly being directed to exchanges that are able to accommodate their constituents' various needs, not only in terms of liquidity, product reach and diversity, but also in terms of speed, cost and efficiency"*

In view of these challenges, virtually every major capital market is looking closely at the issues of consolidation and upgrading competitive capacity. Some, such as Singapore and Hong Kong, have merged their stock, futures and clearing operations under single corporate structures. Others have used horizontal integration to expand their market breadth, such as the Chicago Board Options Exchange's 1997 acquisition of the New York Stock Exchange's (NYSE) options business, and Nasdaq's merger with the American Stock Exchange (AMEX) in 1998 to broaden its product base and capitalise on the latter's business in exchange-traded funds. Talks are also currently underway in Europe to achieve greater regional cohesiveness through pan-European groupings.[45] In most cases, these efforts at consolidation and integration are not purely supplementary measures aimed at extending a market's international presence, but seen as essential to the institution's basic strategy of remaining relevant to the home economy.

Malaysia itself has seen some restructuring of local market institutions with the aims of improving efficiency, depth and breadth over the last few years.[46] Further consolidation of the existing stock and derivatives exchanges and clearing houses within a single entity would allow for greater economies of scale in terms of the more efficient management of resources, including moving towards a shared market infrastructure and the integration of common operational functions across the merged institutions. Other advantages would also arise through greater capacity for introducing new products and services under an

[45] Despite difficulties encountered in bilateral or multilateral negotiations among some countries, the launch of Euronext (from the mergers of Paris Bourse, Amsterdam Exchanges and Brussels Exchanges) in September 2000 already marks an initial step towards this direction.

[46] MDCH merged with the Malaysian Futures Clearing Corporation in 1997, followed by the KLSE's acquisition of the holding company of KLOFFE, in 1998 in order to enhance efficiency and facilitate greater co-operation between the two exchanges. With similar aims in respect of efficiency, the MME merged with the KLCE later the same year, forming COMMEX, which officially

integrated environment, and the use of these institutions' combined financial strength to meet external competition. This is particularly relevant in mitigating the fragmentation of liquidity in market segments that do not presently have sufficient depth to support separate exchanges.

Most importantly, such consolidation would enable the merged institution to quickly achieve critical mass in all segments currently served by the various exchanges and clearing houses, thus strengthening their collective competitive positions through a single consolidated entity. A consolidated institution will be able to capitalise on unified commercial goals to position itself internationally as a single national exchange and the primary gateway to Malaysian listed securities and derivatives. Market intermediaries will also benefit, as it is envisaged that qualified members will eventually be able to participate across different product markets, while investors should be able to access these markets at greater convenience and lower cost. The establishment of a common clearing house would also offer substantial synergistic benefits, in terms of facilitating better risk management as well as reduced costs of compliance for market intermediaries.

> *"The need for strong market institutions to ably compete in the global marketplace calls for a certain amount of financial strength and operational capacity in order to maximise resources and tap new markets"*

These measures are necessary if local market institutions are to become internationally competitive service providers and readily meet the challenges of globalisation, as well as provide an efficient and liquid market for the listing, trading, clearing and settlement of securities in Malaysia. By pursuing this course of reform, the integrated market operator will be better positioned to take advantage of new business opportunities and operational efficiencies critical to its survival in an increasingly demanding domestic and global environment.

STRATEGIC **3.2** INITIATIVE

Ensure Malaysian exchanges are well positioned to respond to changing market dynamics through the adoption of flexible business structures and commercially-oriented strategies

As both internal as well as external markets evolve, domestic market institutions will need to adjust to new competition and developments in order to remain responsive to the needs of their customers. The environment within which Malaysian exchanges will need to compete in the future is likely to be very different from the one in which it previously and currently operates. The ability to adopt and pursue commercially-oriented strategies effectively and in a timely manner will be crucial. This has been increasingly recognised in other jurisdictions all around the world, resulting in a discernible acceleration in efforts towards shifting the orientation of market institutions towards more customer-focused, market-driven systems of ownership and governance.

Consequently, there has been increasing attention being paid to the issues of exchange demutualisation in order to enhance internal capacity and efficiency, and the formation of cross-border alliances and trading linkages to capitalise on multiple customer networks.

Among the more practical reasons for the demutualisation of many exchanges has been the fact that the mutual structure generally limits an exchange's ability to mobilise capital, which, among other things, could be used to upgrade their systems and attract high-calibre personnel. In the longer term, this restricts their ability to effectively undertake wider-reaching development schemes. The possible conflict between the interests of the members with those of the investors, issuers and other market participants is also recognised as a potentially significant competitive handicap. The multiple roles of exchanges as membership associations, service providers, regulators and semi-public organisations also have to be continually considered to ensure that all decisions under an exchange's purview—such as the development of products and investment in trading infrastructure—are consistent with these obligations.

"The ability to adopt and pursue commercially-oriented strategies effectively and in a timely manner will be crucial. This has been increasingly recognised in other jurisdictions ... resulting in a discernible acceleration in efforts towards shifting the orientation of market institutions towards more customer-focused, market-driven systems of ownership and governance"

To address these issues, most major international markets have looked or are looking to shift from traditional mutual-owned exchanges towards demutualised, commercially-oriented business structures.[47] Some of these exchanges have gone a step further by publicly listing their shares on their own exchanges to raise additional capital and allow the broadening of their shareholding spread to better reflect the interests of all market constituents.[48]

[47] Several exchanges that have already demutualised include those in London, Stockholm, Amsterdam, Australia, Hong Kong, Toronto and Singapore.

[48] An additional feature of having a publicly listed exchange also lies in the higher transparency and disclosure required of listed exchanges compared with unlisted ones.

The experiences of the jurisdictions cited above have been customarily positive, with the demutualisation strategy being seen as particularly critical to achieving strategic clarity. Clear profit and developmental objectives were credited with facilitating faster decision-making, while the independent structure accommodated greater objectivity and customer-focus on the part of the board of directors and senior management.

The similar challenges that Malaysian market institutions will face mean that they will have to look very closely at the development of their business focus over the years to come, and chart their strategies accordingly. In moving ahead, they must look closely towards ensuring that their business structures and management are readily responsive to competition and innovation, with clearly defined strategies to remain in the mainstream of global liquidity and to further enhance listing and trading activity.

"... domestic market institutions must be vigilant for opportunities beyond their geographic boundaries, in order to further enhance their appeal among their users"

Furthermore, as larger players continue to emerge, traditional exchanges will face increased competition on the basis of cost, reach and innovation.[49] Given their primary objective to serve Malaysian market participants, domestic market institutions must be vigilant for opportunities beyond their geographic boundaries, in order to further enhance their appeal among their users. In this regard, the establishment of foreign alliances, such as trading linkages within global multi-exchange networks, should be considered where synergies can be achieved and international positioning enhanced.

As such, it is recommended that the proposed consolidated Malaysian market institution be demutualised and operate as a for-profit entity, in order to ensure that its governance structure is more customer driven—particularly by investors and issuers—and market-oriented. The eventual listing of the demutualised institution, subject to appropriate shareholding limits, will facilitate the broader representation of its constituents' interests in its management and decision-making, and provide it with a strong financial base from which it can further tap new markets.

[49] The global ambitions of some larger exchanges have already been seen taking shape rapidly. Nasdaq, for one, has already clearly defined its vision of building "a worldwide market of markets built on a worldwide network of networks".

STRATEGIC

3.3

INITIATIVE

Enhance the efficiency of the trading, clearing and settlement infrastructure

An efficient trading, clearing and settlement infrastructure helps make more instruments accessible to larger pools of liquidity at minimum associated cost. It also gives investors and intermediaries the opportunity to participate in markets at lower costs, at the same time giving the operators of trading platforms greater opportunity to increase volumes, and to achieve economies of scale.

While Malaysian market institutions are already ahead of many major regional exchanges with regard to the efficiency of their transaction systems and processes, there is still scope for further efficiency gains. For instance, one of the immediate implications from the creation of a consolidated exchange is the immediate capacity for integrating the current separate front-end trading systems for the equity and derivatives markets. Maintaining the separate trading platforms and applications currently adopted by the different exchanges will, over the longer term, not only add to the exchange's operating costs but also to the costs of intermediaries operating in both the securities and derivatives markets. Therefore, one clear area for immediate action is the initiation of measures to establish a common trading platform across all exchange-traded products.

> *"While Malaysian market institutions are already ahead of many major regional exchanges with regard to the efficiency of their transaction systems and processes, there is still scope for further efficiency gains"*

There are also potentially considerable benefits to be derived from an integration of the derivatives and equity clearing systems. However, the practical issues in achieving a union between these systems—which operate based on different risk management frameworks—require substantial study and deliberation. A first step towards this integration should begin with the consolidation of the two clearing houses into a single institution in order to facilitate the development of a unified system in the future. Furthermore, the prospect of common clearing members mean that a unified clearing system will also generate cost savings and operational efficiencies, and facilitate the netting of the obligations, collateral and risk of clearing participants.

The integration of the money settlement system, operated by the central bank, with the clearance and settlement system of the exchange-traded market also offers several major benefits. An integrated system would help to reduce settlement risk by introducing finality and certainty to payments.

> *"The development of linkages between exchanges, clearing houses and the national payment system will pave the way for the eventual attainment of end-to-end straight-through processing ..."*

The development of these linkages between exchanges, clearing houses and the national payment system will pave the way for the eventual attainment of end-to-end straight-through processing (STP), which involves electronically capturing and processing financial transactions right from the point of initiation to final settlement and confirmation. This will substantially reduce processing inefficiencies and minimise processing risks, thus lowering the overall costs of trading, clearing and settlement in the capital market.

Given that technology is a pervasive element in the transaction process, a framework for the application of e-commerce in the capital market will also assist in clarifying the regulatory treatment of such issues. This framework will seek to facilitate the use of advanced technological solutions within the capital market in a manner that improves efficiency, through the provision of legal certainty and clear policy guidelines for such applications.

In addition, the continued benchmarking of trading, clearing and settlement standards and processes against international best practices will remain a key priority, particularly where there is a need to further enhance the market infrastructure and regulatory framework in connection with the implementation of these standards.

4 To develop a strong and competitive environment for intermediation services

Malaysian capital market intermediaries must be able to offer internationally competitive services to their customers. To do this, however, they need to be able to respond effectively to the impact of changing consumer demands, technological developments and the increasing integration of financial services on the competitiveness of the services they render.

The international financial intermediation landscape has seen many fundamental changes in recent years. Around the world—as well as in Malaysia to some extent—traditional core financial intermediation activities such as banking, investment management, insurance, broking, investment banking and advisory services are quickly becoming less independently distinct and more diverse, complex and integrated. Increasingly, successful financial institutions are becoming actively involved in more than one of these core activities and those that are not, tend to be niche players offering specialised or discount services. These changes have been driven, to a large extent, by the need to either grow larger or differentiate one's operations in order to remain competitive in the increasingly integrated marketplace.

"Around the world—as well as in Malaysia to some extent—traditional core financial intermediation activities such as banking, investment management, insurance, broking, investment banking and advisory services are quickly becoming less independently distinct and more diverse, complex and integrated"

It is expected that the level of competition among market intermediaries will rise even further with greater usage of technology in the capital market. Online broking, for example, has revolutionised the face of intermediation in many jurisdictions, allowing end-users faster, cheaper and more direct access to the market. Although total disintermediation is not yet a reality, market intermediaries that have not responded to changing consumer demands, evolving competition from non-traditional sources and opportunities for developing their range of services and product offerings will not be able to create strong and defensible positions for themselves in the marketplace of the future.

Capital market intermediation services in Malaysia, while having experienced substantial growth over the last decade, have now reached a stage where further competition is needed in order to allow the industry to more effectively service their clientele. Barriers to entry and protected revenue structures that have fostered the development of domestic market intermediaries thus far are beginning to have an inhibiting effect on the impetus for further services differentiation and value addition for consumers through greater innovation and more cost-effective structures.

In view of this, there needs to be the facilitation of greater competition among local capital market intermediaries through the progressive deregulation and liberalisation of this industry. Domestic deregulation will entail, among other things, allowing a more comprehensive range of services and products that may be offered by intermediaries and developing full-service domestic brokers to provide a competitive market for integrated financial services. Measures will also be taken to progressively deregulate the fixed fee structures that have hitherto controlled the pricing variability of the services offered by these institutions. In this manner, there are greater economic incentives to improve the overall variety and quality of services provided by capital market intermediaries. On a broader level, a pragmatic programme for the liberalisation of the intermediation services industry will ensure that users of the Malaysian capital market are able to access internationally competitive services at reasonable cost, albeit subject to the appropriate safeguards.

"Capital market intermediation services in Malaysia, while having experienced substantial growth over the last decade, have now reached a stage where further competition is needed in order to allow the industry to more effectively service their clientele"

To strengthen the domestic broking industry ahead of inevitable further external liberalisation, however, efforts to develop strong full-service brokers will be expedited. Encouraging the creation of one-stop capital market intermediaries also promotes a substantially more competitive market for integrated financial services in Malaysia, to the consumers' benefit. At the same time, the prudential standards, levels of business conduct and quality of professional skills within the intermediation industry remain important priorities in order for Malaysian intermediaries to remain resilient and competitive within the dynamic market environment.

STRATEGIC

4.1

INITIATIVE

Foster constructive competition through the deregulation of services, products and fixed fee structures

To effectively respond to global trends and competitive challenges, intermediaries in the Malaysian capital market must be able to offer a wide range of products and services at competitive prices. By offering superior value for their customers, Malaysian market intermediaries can better attract liquidity and play a key contributory role in market development.

However, the principle of constructive competition means that the gains from greater competition will be weighed against the potential corresponding ramifications of pro-competition policies on these businesses, their stakeholders and the future landscape of the capital market. In view of these considerations, deregulation must be managed in a manner such that there are no greater economic adjustment costs than necessary in the attempt to build up efficiency and diversity in the market with minimum delay.

Nevertheless, it is clearly recognised that a more competitive environment for the product and service offerings of local capital market intermediaries is crucial to the immediate and longer-term ability of the Malaysian capital market to fulfil its function effectively. In addition, the need for widening domestic intermediaries' scope of business is all the more critical as the emergence of increasingly powerful global players and technological inroads are redefining the competitive landscape in which Malaysian intermediaries operate.

Therefore, existing structures that are incompatible with the successful adaptation to the evolving local and global market environment will need to be reviewed. These include the review of existing limitations on the range of services and products that these intermediaries have hitherto been able to participate in, and the liberalisation of investment restrictions in specific areas of the market to allow local intermediaries to offer international products.

"... a more competitive environment for the product and service offerings of local capital market intermediaries is crucial to the immediate and longer-term ability of the Malaysian capital market to fulfil its function effectively"

These measures are expected to not only generate greater innovation and efficiency within the capital market, but also provide an avenue for expansion of business activity and diversification of revenue for these institutions. In the longer run, it is envisaged that the widening of allowable activities will equip them with the flexibility to innovate and differentiate themselves to better face the challenges of increased competition.

Heightened competition is also likely to drive the continued rationalisation of the cost of intermediation services. In such an environment, implicit revenue guarantees through fixed fee structures such as fixed brokerage commission rates need to be reviewed in order to allow for earnings streams that are more reflective of the scope, quality or efficiency of services rendered. The liberalisation of broking rates is an archetypal step that is taken as capital markets expand and mature. At present, 13 of the 15 largest stock markets (by market capitalisation) in the world have adopted a system of freely negotiable brokerage commission rates.[50] Most major international derivatives exchanges have also adopted freely negotiable commissions.[51]

> *"The liberalisation of broking rates is an archetypal step that is taken as capital markets expand and mature"*

As brokerage commission rates in Malaysia are relatively high compared to the rest of the region, the move towards market-driven pricing of intermediaries' services is timely. Capital market participants in Malaysia should be able to obtain services of international standards at reasonable cost. Negotiable brokerage rates allow firms offering value-added services the flexibility to price their services differently from those that do not offer such services, and ensure that the quality of services rendered is commensurate with the fees received. In this manner, there are greater financial incentives to the intermediaries to improve the overall variety and quality of services they provide. In addition, the liberalisation of commission rates is expected to facilitate the growth of online broking, which should broaden public access to the Malaysian capital market.

[50] These include the US, UK, Japan, France, Germany, Canada, Italy, the Netherlands, Switzerland, Spain, Australia, Sweden and Finland.

[51] These include derivatives exchanges in the US, UK, France, Australia, Singapore and Korea.

STRATEGIC **4.2** INITIATIVE

Develop strong full-service brokers to provide a competitive market for integrated financial services

The increasing prominence of multinational integrated financial institutions in the global marketplace is redefining the competitive landscape for intermediation services. Such institutions are able to offer a wide array of products and services across multiple markets, thus allowing greater convenience and accessibility for clientele doing business with them. In addition, specialised players offering services such as research or low-cost order routing and matching are competing with the traditional brokers who offer bundled services.

This growing convergence is also occurring, to some extent, within the Malaysian financial services market as well. Merchant banks, for example, engage in a wide range of capital market services covering areas such as underwriting, mergers and acquisitions, corporate restructuring and capital raising. At the same time, many insurance companies offer to the public investment-linked products, while some commercial banks act as distribution-networks for various unit trust and stockbroking companies with whom they have established business linkages.

“The experience of other markets suggests that it is generally the participants that are well-capitalised, diversified, operationally efficient and well-managed, and sometimes with strategic alliances with reputable foreign partners, which can forge a strong market presence in a dynamic and maturing market”

Currently, however, intermediation services in the Malaysian capital market are still relatively segmented whereby intermediaries require separate licences to engage in the various capital market activities. Branching restrictions have controlled the establishment of new stockbroking institutions according to their geographical location: a policy that has been highly successful in ensuring greater access to stockbroking services by residents in all Malaysian states. However, technological advancements and increasing competition in the market for integrated financial services since then have provided consumers with the connectivity and market familiarity necessary to participate in multiple markets from different locations, thus largely reducing the future role of multiple licences and restrictive branching policies.

The size and scope of market intermediaries’ activities also become more important as the capital market develops and expands. The experience of other markets suggests that it is generally the participants that are well-capitalised, diversified, operationally efficient and well-managed, and sometimes with strategic alliances with reputable foreign partners, which can forge a strong market presence in a dynamic and maturing market.

These factors speak directly to the benefits of consolidating the domestic stockbroking industry into a fewer number of larger players. Consolidation among these institutions would strengthen the industry as a whole and facilitate the formation of a core group of well-capitalised full-service domestic stockbroking companies that can provide more efficient and cost-effective intermediation for investors. These companies would be expected to be robust enough to withstand the pressures from risks inherent in the stockbroking business, and their ability to expand their revenue base beyond their traditional pure agency business will also be enhanced. In addition, these consolidated entities would be better placed to withstand the competitive pressures that are likely to be faced by the industry as the capital market is gradually deregulated and liberalised.

Over the last few years, the government and the SC have emphasised the need for industry consolidation, but progress on this front had been far less than desired. To expedite this process, therefore, measures will be taken to lay the groundwork for the formation of a strong core of domestic intermediaries through the introduction of the Universal Broker (UB) framework.

"... these consolidated entities would be better placed to withstand the competitive pressures that are likely to be faced by the industry as the capital market is gradually deregulated and liberalised"

Under this framework, the consolidation exercise will be allowed to proceed according to market-driven processes—subject to the appropriate safeguards and regular assessments on progress—with no regulatory directives on the identification of merger partners or company valuations. In addition, specific incentives for industry consolidation will be awarded to merged institutions that meet the criteria for UBs. These include the deregulation of the scope of activities in which these full-service brokers may participate, with corresponding re-regulation to streamline the licensing framework and reform the branching policy, in order to accommodate the development of an even playing field for integrated financial services.

It is expected that these flexibilities will support the expansion of the capacity of these core institutions, facilitate greater innovation and flexibility in the types of services and products they may offer, and allow them to apply their brand strength across a wide range of activities. They are also essential to ensuring that capital market intermediaries are free to deliver their full potential in preparation for further liberalisation and competition.

STRATEGIC

4.3

INITIATIVE

Ensure Malaysian intermediation services are anchored on appropriate prudential standards, with high levels of business conduct and professional skills

Malaysian market intermediaries must consistently remain strongly capitalised and prudently managed, not only to withstand the vagaries of volatile markets and changing competitive dynamics, but also to effectively position themselves for future growth and compete for greater market share.

The experience of the financial crisis of 1997–98 highlighted weaknesses in many broking companies and the consequent importance of having strong market intermediaries operating on high standards of business conduct and prudential safeguards. Over this period, these broking companies had been found to possess inadequate internal controls, and faced difficulties in complying with their prudential obligations.

In view of these weaknesses, concerted measures have been taken over the past few years to improve market integrity through the introduction of enhanced prudential standards, such as internationally-benchmarked risk-based capital adequacy requirements and an early warning system for the advance detection of problems relating to derivatives brokers.

In moving ahead, there will continue to be efforts directed at ensuring that market intermediaries are fundamentally prepared to meet the challenges of the changing market landscape and make the effective transition from their current operating environment to a more liberalised one. In this respect, the quality and integrity of the prudential standards and business conduct practised by these institutions will be closely monitored, with appropriate market and regulatory incentives to ensure high levels of compliance. In addition, where necessary, appropriate enhancements will be made to the prudential rules and standards to reflect the risks prevalent within a deregulated, more competitive and integrated environment within which these intermediaries will operate, whilst ensuring that no undue regulatory burden is imposed.

The successful development of the securities market is also very much dependent on the breadth and depth of the human resources available within the intermediation industry. These skills range from advisory services and research, sales, dealing, risk management, backroom operations, to legal, technical and accounting support. A continued commitment to training and upgrading the skills of local professionals will help local participants enhance their skills, resources and understanding so that they can compete effectively in an increasingly integrated marketplace.

Key areas of human capital development will also be identified for co-ordinated efforts between the SC, the relevant industry bodies and academia to work on training initiatives and continuing professional education in these areas. Where there are major skills gaps, there will be co-ordinated measures to facilitate the greater involvement of qualified foreign professionals who will add value to the Malaysian capital market intermediation industry and provide for effective skills transfer. This is particularly important for market segments that are still in their infancy and which need a certain degree of accelerated professional development.

STRATEGIC

4.4

INITIATIVE

Adopt a pragmatic programme for liberalisation, supported by appropriate safeguards

The issue of liberalisation is an important one for developing nations, given the difficulties of achieving sustainable long-term growth and development without tapping global resources, particularly with regard to skills, technology and financial capital. However, the possible adverse effects of liberalisation—particularly liberalisation strategies that are not cohesively managed—must be given due consideration.

Within the context of the Malaysian capital market intermediation industry, liberalisation is seen as an important factor in its further development, with eventual liberalisation inevitable if the aim of developing an internationally competitive capital market is to be achieved. However, there clearly needs to be a pragmatic approach to effectively address the challenge of deriving maximum value from globalisation while ensuring that the transition to a more liberalised market does not result in the marginalisation of domestic financial institutions and the destabilisation of the broader economy.

Consistent with the general national stance on deregulation and liberalisation as responses to globalisation, the emphasis is on both the need for continued commitment to the liberalisation of the capital market, but in tandem with careful consideration of the socio-economic aspects of globalisation. This means that the maintenance of equity, self-determination, responsibility and development must be key factors for consideration at each successive phase of deregulation and liberalisation, to ensure that the measures initiated cohere with the broader objectives of the nation.

"Within the context of the Malaysian capital market intermediation industry, liberalisation is seen as an important factor in its further development, with eventual liberalisation inevitable if the aim of developing an internationally competitive capital market is to be achieved"

Among Malaysian capital market institutions and intermediaries, prior attempts to introduce greater competition through liberalisation were delayed to some extent by the slow progress of domestic participants themselves in preparing for heightened competition. However, it is also recognised that as long as the status quo is observed, the incentives for the continual upgrading of services are reduced. Such continual upgrading is necessary if the Malaysian capital market is to provide efficient and competitive intermediation services to investors and issuers. This is particularly pertinent in view of the rapid steps taken by other countries in the region to loosen foreign ownership restrictions on their capital market intermediaries and accelerate the development of their financial markets in recent years.

In view of the urgency of these issues, a blueprint articulating the specific timeframes and parameters for deregulation and liberalisation for the Malaysian capital market is needed. As a precise prediction of the direction and performance of the financial system over the next ten years cannot be made, it is also necessary to lay the appropriate developmental framework so as to strengthen the market's resilience and capacity to meet the challenges of globalisation.

To approach these issues in a pragmatic manner, a domestic deregulation programme will be implemented immediately as the first step. This will allow domestic market participants time to prepare for eventual increased foreign competition. Efforts will also be made to encourage the formation of strategic partnerships between domestic market intermediaries with suitable leading foreign institutions, and to accelerate the facilitation of online capital market services.

"The schedule for liberalisation will be closely co-ordinated across all sectors in the capital market to ensure an orderly and harmonised transition"

These measures will enable local intermediaries to build up their respective market shares and presence during the deregulation phase, and allow—where relevant—for their resources to be reinforced by access to the resources and knowledge base of their strategic partners. This is also in line with broader efforts to facilitate greater global integration and cross-border partnerships that will strengthen the domestic market position of these partnered institutions and expand the international profile of the Malaysian capital market.

The schedule for liberalisation will be closely co-ordinated across all sectors in the capital market to ensure an orderly and harmonised transition. This approach takes into account the need for certain nascent sectors of the capital market to be liberalised earlier than others in order to accelerate the development of these sectors. In doing so, it is expected that some of the benefits of early liberalisation will also extend to the broader market without the overwhelming implications of unilaterally opening up the capital market. Such targeted sectors are those that are deemed critical to overall capital market growth, but are still at early stages of development and require significant input from external sources to accelerate progress. They include the Islamic capital market, investment and risk management industries, and the markets for venture capital and high-growth companies.

The co-ordination of the liberalisation strategy also takes into consideration the various forms of liberalisation that may be introduced, such as the employment of skilled foreign personnel, the freeing up of limits on foreign ownership of domestic institutions, and the physical establishment of foreign-controlled institutions' offices locally. Figure 17 illustrates the factors considered in evaluating the liberalisation approach for the capital market, as well as the parameters for the liberalisation strategy.

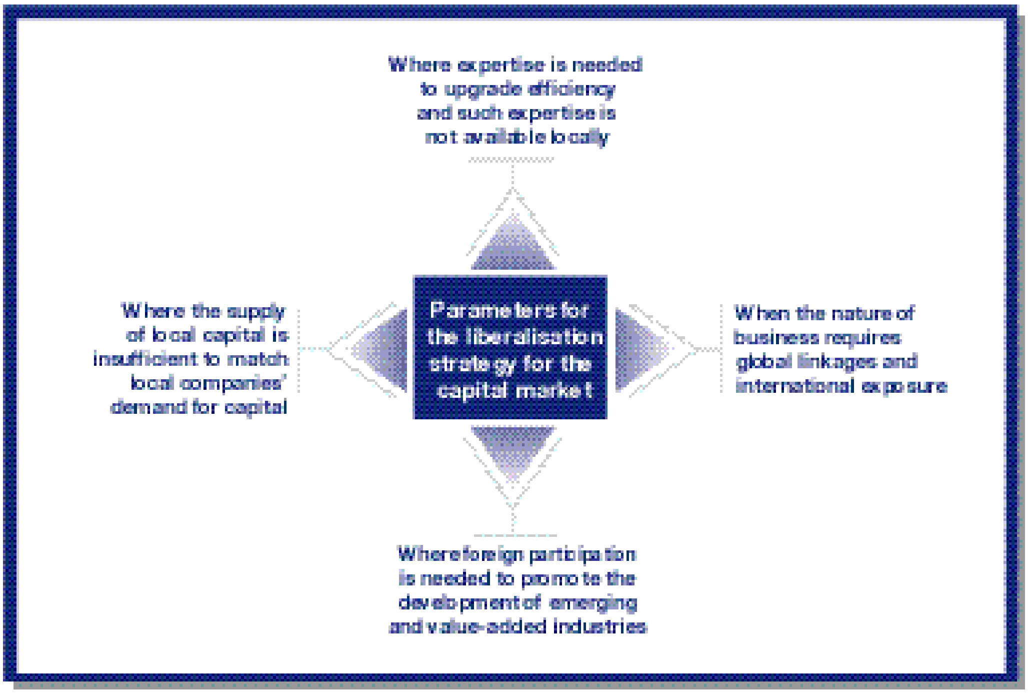
It is important that the sequencing of liberalisation measures is supported by the appropriate safeguards against potential economic dislocation. These safeguards will include ensuring adequate market capacity to deal with the fewer restrictions on market access, and a high degree of vigilance during the entry of institutions—whether foreign or domestic—into new market segments. Deregulation and liberalisation will be accompanied by the appropriate re-regulation to ensure that investor protection and market integrity are not compromised. These efforts, among others, will help strengthen the capacity of the local market to deal with the challenges of increasing integration with global markets.

Figure 17

Liberalisation strategy for the capital market

Factors considered in formulating the liberalisation strategy for the capital market

- Impact on domestic growth, competition and innovation
- Extent of foreign ownership and transferral of domestic wealth
- Readiness of domestic market players
- Impact on level of professional skills
- Capital flow implications
- Analysis of the implications of capital market developments in other jurisdictions



5 To ensure a stronger and more facilitative regulatory regime

The legal and regulatory framework governing the capital market is one of the foundations upon which the capital market operates and develops. Its profound influence on the structure and scale of economic activity is in itself an important driver of change in the manner in which the market functions, as well as its direction and composition.

Given the increasing pace and magnitude of the changes and developments that are occurring in the domestic and international financial markets, it is to be expected that the regulatory system governing the Malaysian capital market—as with many other markets—will face increasing challenges in many aspects. For instance, the growing complexity of financial markets leading to the blurring of lines between traditional asset classes and financial services, coupled with increasing capital mobility, present substantial implications for the appropriate regulatory treatment and approach needed within such an environment.

> *“... the regulatory regime must be able to adapt and respond to the realities and implications of the changing financial landscape in a timely and appropriate manner, in order to ensure that the capital market continues to operate fairly and efficiently and that its role in supporting the economic, financial and commercial interests of its constituents is further enhanced”*

One thing is clear, however: the regulatory regime must be able to adapt and respond to the realities and implications of the changing financial landscape in a timely and appropriate manner, in order to ensure that the capital market continues to operate fairly and efficiently and that its role in supporting the economic, financial and commercial interests of its constituents is further enhanced.

To facilitate the development of an efficient and internationally competitive Malaysian capital market that is able to effectively serve the needs of the Malaysian economy, it is imperative that the capital market is characterised by a strong and facilitative regulatory framework. Primarily, it should enable the capital market to perform its basic economic role—that is, the mobilisation and allocation of capital—in the most efficient manner, provide a high level of market confidence and protection to investors as well as encourage innovation, with minimum compliance and regulatory costs.

Whilst significant efforts have been made in improving the regulatory framework since the establishment of the SC in 1993, it is imperative for continuous efforts and appropriate initiatives to be directed towards strengthening and enhancing the regulatory framework in alignment with the capital market’s overall development. An ideal regulatory scheme requires a balance between preventing market failure and allowing financial markets to perform efficiently the functions for which they were designed. In addition, regulation must be consistently formulated and applied, with strong supervision and effective enforcement to ensure compliance.

Therefore, several key strategic initiatives have been identified to achieve this objective. For one, there will be a gradual implementation of market-based regulation across the capital market. At the same time, there will be efforts to ensure regulatory parity and consistency through the adoption of full functional regulation. Efforts will also be undertaken to strengthen enforcement activity and enhance systemic risk management within the capital market.

The move towards a market-based system of regulation represents a clear shift in regulatory philosophy on the SC's part towards the use of competitive market disciplines and processes rather than direct intervention—unless absolutely necessary—in regulating capital market activity and steering its development. As a broad-based strategic initiative, a long-term programme to implement a system of market-based regulation across the capital market will be implemented on an incremental basis. This will entail concerted efforts to further strengthen supervision and enforcement, and the greater use of incentive structures that promote a high level of compliance. At the same time, enhanced disclosure and transparency, as well as greater regulatory accountability and dialogue, will be emphasised in order to make certain the effectiveness of existing and future regulation. Such a framework will allow for more flexibility, innovation and competition where needed, while maintaining mechanisms for ensuring high standards of investor protection and market integrity.

“Underlying all these initiatives, investor protection remains a priority. Therefore, there will be measures to enhance investor empowerment through a strengthening of rules in relation to shareholder rights and making available alternative avenues for the redress of grievances”

In addition to and concomitant with the shift towards market-based regulation, there is a need to ensure regulatory parity and consistency of treatment between all institutions and participants offering similar capital market services and products. This means that all market participants should be subject to consistent regulatory obligations commensurate with their functional role and risks. This is particularly necessary in areas where some participants straddle more than one regulatory sphere, and where further refinement of the regulatory framework is needed to ensure that a level playing field exists for all participants, effective investor protection, and the prevention of regulatory arbitrage.

There is also a need to uphold strong and effective enforcement of the regulations governing the capital market. This is important for ensuring that public confidence in the integrity of the market is preserved at all times, and that systemic stability is not compromised. Stronger enforcement entails enforcement action that is timely and impartial, with sufficient deterrent penalties, and measures to ensure that there is sufficient regulatory capacity in this regard.

As the Malaysian market grows larger, more complex and dynamic, there will be a growing need to safeguard systemic stability within an increasingly deregulated, liberalised and integrated market environment. This calls for an explicit systemic risk management framework to ensure a co-ordinated and systematic approach to strengthening the market's capacity to withstand systemic disruption. Given the increase in external sources of risk in recent years, in particular, the enhanced surveillance of areas of risk concentration and trading activity in general will support the early detection of heightened market volatility and areas of potential systemic concern.

Underlying all these initiatives, investor protection remains a priority. Therefore, there will be measures to enhance investor empowerment through a strengthening of rules in relation to shareholder rights and making available alternative avenues for the redress of grievances. These efforts will be supported by continued efforts at promoting investor education to ensure investors are fully aware of their rights, the risks they face and available recourse in relation to their investment activities. In addition, further efforts will also be directed at further improving the standards of business conduct of market participants and regulated entities.

STRATEGIC

5.1

INITIATIVE

Move towards a market-based system of regulation for capital market activities

As capital markets become increasingly larger and more complex, it is imperative for market regulation to be flexible enough to facilitate innovation and growth, yet address investor protection and prudential concerns effectively. Markets will deliver economic efficiency where market-based decision-making is not unduly inhibited, competition is allowed to thrive and where participants have confidence in the integrity and safety of the financial system. In this vein, the regulatory framework should set out the appropriate balance between pursuing regulatory goals and allowing the private sector to take risks that will encourage innovation and competition—with the recognition that some risks will result in failures and losses, as consistent with a more market-driven environment. At the same time, a commitment to sound, transparent and facilitative policies is essential in safeguarding the Malaysian capital market's integrity and reputation for fair and transparent regulation.

"The adoption of a market-based approach to regulation over the period of the Masterplan represents a clear paradigm shift on the part of the SC towards the greater use of competitive market disciplines and processes, with minimum direct regulatory intervention, in the pursuit of its regulatory objectives"

These issues point to the need for a strong regulatory framework that allows market participants the flexibility to compete effectively within the parameters of broad functional regulatory goals that are fully reflective of the desired regulatory and industry outcomes, and which reinforce natural incentives for compliance.

The gradual adoption of a market-based approach to regulation over the period of the Masterplan represents a clear paradigm shift on the part of the SC towards the greater use of competitive market disciplines and processes, with minimum direct regulatory intervention, in the pursuit of its regulatory objectives. This approach will have a strong focus on the cost-effectiveness of regulation, in particular the appropriate mix of regulatory effectiveness and efficiency. The central features of this regime will be enhanced disclosure and accountability by regulated industry players, accompanied by greater regulatory transparency and substantive consultation with market participants. These are necessary characteristics for ensuring that the regulatory approach continues to be in close alignment with its constituents' changing needs as the overall capital market matures.

Measures to enhance transparency on regulatory processes—with the exception of areas where secrecy and confidentiality requirements take precedence—will be supported by greater consultation with industry on the formulation of new policies, as well as on the general effectiveness of existent regulation. The SC will also implement appropriate mechanisms for rigorous and systematic assessments of the costs, benefits and effectiveness of regulatory programmes.

Taken collectively, these measures will ensure that the regulatory framework is fully reflective of the issues of concern to both regulators and industry participants, and will result in mutually accepted regulatory aspirations. Allowing for progressively greater leeway for market competition to flourish will also give market participants increasing scope to develop the most appropriate standards and procedures within their respective industries to effect compliance with these shared regulatory goals. This will provide a strong foundation for the private sector to play a much greater role in market and product development going forward, with reduced need for regulatory intervention to drive new developmental initiatives.

To some extent, elements of market-based regulation have been reflected in the gradual shift, which began in 1996, from the merit-review process for the public offering of securities to DBR, which relies on higher standards of disclosure and accountability by issuers, and due diligence on the part of investors. Moving forward, however, a more comprehensive programme will be formulated to gradually implement a system of market-based regulation across all segments of the capital market.

For the primary market, this will involve a move towards adopting a full DBR regime across the entire spectrum of fund-raising activities. A comparable approach will be adopted for the regulation of investment management and other relevant capital market services and products. In the secondary market, measures to be taken by the SC will include enhancing the supervisory process and adopting a more risk-focused approach, which will give emphasis to the assessment of the risk-management capacity of market intermediaries. This will be supported by the wider adoption of risk-based prudential requirements for market intermediaries, and incentive structures to ensure a high level of compliance.

Concomitant efforts will also be taken to ensure that the SC has the requisite regulatory powers and resources necessary to undertake a more challenging supervisory and enforcement role within the market-based environment. This will include greater self-regulation by the industry associations where appropriate, as well as front-line regulation by market institutions as a complement to SC's own regulatory functions. Education is another key area where the SC will continue to take the lead in ensuring that all participants in the capital market are fully aware of their respective rights and obligations within a less prescriptive and increasingly deregulated environment.

> *"... the ultimate aim of achieving market-based regulation will be to have no more regulation than necessary to achieve public policy objectives of safety and soundness, competition and the protection of consumer interests"*

In the longer-term, the ultimate aim of achieving market-based regulation will be to have no more regulation than necessary to achieve public policy objectives of safety and soundness, competition and the protection of consumer interests. Nevertheless, in working towards this aim, the need to ensure that there is also sufficient capacity and preparedness in the market is paramount. Implementation will therefore be appropriately managed, in close collaboration with the industry, and will take place in a pragmatic and sequential manner. The overall progress towards market-based regulation across the capital market will therefore be achieved gradually over time, depending on the level of industry readiness and feedback, and of regulatory capacity.

STRATEGIC

5.2

INITIATIVE

Ensure regulatory parity and consistency between all institutions and participants conducting similar capital market activities

It is important that as markets mature, the relevant authorities should continuously assess the efficacy of regulatory structures and systems. The regulatory framework governing Malaysia's own financial sector has evolved substantially over the years, from centralised regulation at the initial stages of development to the current structure of separate specialised regulators for the banking and insurance sectors and the capital market. This present system has largely been developed in incremental stages to allow for more focused and effective regulation and development of each of the various sectors of the financial market.

However, the rapid evolution of the international financial landscape, particularly in recent years, calls for a close assessment at this time of where the efficiency and efficacy of the present regulatory framework needs to be further improved upon. Financial institutions such as banks, insurance companies, investment houses, investment management companies and stockbroking companies have increasingly assumed overlapping functions and services over time. One outcome of this has been some ambiguity as to the precise regulatory treatment of certain cross-market and hybrid financial market activities that are not clearly defined under the existing regulations. This has also led, in some cases, to differential regulatory requirements for market participants carrying out similar activities, by virtue of these various participants falling under the purview of different regulatory agencies.

The fact that many capital market participants in Malaysia currently sit within different regulatory domains is growing increasingly important given the need to facilitate the greater convergence of financial services and products. The primary issue arising from this is therefore the need to ensure that all capital market participants are subject to consistent regulatory obligations commensurate with their functional role and risks undertaken. This is all the more urgent given the push towards the consolidation of players in the financial sector, the challenges of further liberalisation and the rapid increase in financial market integration.

The regulatory structure governing the capital market should ideally reinforce the strengths of the current system, as well as address existing gaps and overlaps in regulation. With this in mind, a number of other jurisdictions have already seen to the re-regulation of their respective financial services sectors to accommodate and adapt to the new environment in which they operate. In some cases, the optimal course of action has been a widespread overhaul of the regulatory framework; in others, reinforcing existing structures has been adjudged the best way forward.[52]

Many of the challenges and changes already seen in developed countries may be expected to eventually occur within the Malaysian financial services sector as well, if not already present in some form. In weighing the experiences of other jurisdictions and the practical considerations specific to the Malaysian environment, the SC will work over the course of the Masterplan towards ensuring that the regulation of the Malaysian capital market is "seamless" and based principally on function rather than institutional form. This means

[52] In the UK, there is now a single regulatory agency for the financial sector in the form of the Financial Services Authority (FSA), while issues relating to monetary policy are managed by the Bank of England. In Australia, there are three authorities overseeing the financial markets: one for prudential regulation of the financial sector, and another for ensuring market integrity and consumer protection, while the Reserve Bank of Australia oversees monetary policy. Singapore has a one-stop financial authority in the form of the Monetary Authority of Singapore (MAS), which conducts monetary policy, regulates the entire financial system and acts as the banker and financial agent of the

that, to the extent that institutions perform similar functions, they should be regulated based on similar regulatory objectives and degree of regulatory oversight.

The establishment of the SC in 1993 as the primary regulator overseeing capital market activity and subsequent rationalisation of capital market activities under the SC over the ensuing years has to some extent laid the foundation for functional regulation of the financial market. Nevertheless, there still exist gaps and overlaps in the regulatory process that do not allow for full functional regulation and regulatory parity in the capital market. It is recognised, for instance, that differential compliance obligations between licensed intermediaries and exempt participants under other regulatory jurisdictions give rise to uneven regulation of players engaging in identical or similar capital market activities. Issues such as these may affect fair and transparent competition, and investor protection, which would require that intermediaries performing comparable functions be regulated in a similar fashion.

"To cultivate an efficient and competitive environment for capital market services, there must be equal regulatory burden on all players offering similar services"

To cultivate an efficient and competitive environment for capital market services, there must be equal regulatory burden on all players offering similar services. The broad-based application of functional regulation will ensure competitive neutrality for all capital market participants, while at the same time minimising regulatory duplication and the scope for circumventing regulation. It will also reduce the costs of compliance for the supervised groups, allowing them to focus more on improving the efficiency of their services and overall business development.

The SC will work closely with the relevant authorities within the financial services sector to ensure that appropriate review and changes are made to resolve potential differences in regulatory treatments. This will be accompanied by efforts to ensure that appropriate mechanisms are also in place for greater co-operation and co-ordination between all relevant regulatory authorities.

To further enhance regulatory efficiency and consistency within the existing regulatory framework, the SC will also work towards the establishment of a single licensing regime as well as assess the viability of consolidating the various securities laws into an omnibus legislation. At the same time, measures will be taken to seek to eliminate market segmentation in respect of, among others, underwriting, corporate finance, asset management and brokerage services, to facilitate more active competition within these industries. Overall segmentation within the financial system should also be reviewed to promote greater competition.

On a broader level, the longer-term effectiveness and applicability of the overall regulatory structure and framework will be closely monitored over the course of future financial modernisation, with periodic reviews of the regulatory system in collaboration with relevant private sector experts.

STRATEGIC

5.3

INITIATIVE

Ensure strong enforcement of the regulations governing the capital market

Enforcement relates to the process of ensuring the application of the relevant rules and regulations governing the capital market, including correcting unethical and unfair market practices where they may be found. Effective enforcement of securities laws ensures that investor rights are protected, and that confidence in the integrity of the market is maintained at all times. It also strengthens the motivation for market participants to develop the self-discipline needed to comply with the laws and exercise best industry practices, thereby raising the quality of financial services in the country.

"... enforcement that is applied in a timely and consistent manner is required, to instil such assurance among market participants in the fairness, efficiency and integrity of the capital market"

Even as the Malaysian capital market grows larger and more complex, it is important that confidence in the integrity of the market is maintained at all times, and that overall systemic stability and investor protection are not compromised. As such, enforcement that is applied in a timely and consistent manner is required, to instil such assurance among market participants in the fairness, efficiency and integrity of the capital market. In this respect, it is recognised that the enforcement of regulation is as critical to an effective regulatory system as are the substantive rules themselves.

In view of this, the SC will take all necessary measures to ensure that there continues to be strong and effective enforcement of regulations in the capital market. Stronger enforcement includes enforcement action that is timely and impartial with sufficient deterrent penalties. The observance of due process and perception of fundamental fairness are necessary elements in this regard. Therefore, continuous efforts will be made to ensure that proscribed behaviour is clearly and unambiguously defined, and that rules are determined on a prospective basis and vigorously and fairly enforced.

While the SC has broad powers under various legislation to undertake investigation and enforcement activity, further enhancements to its regulatory capacity will be necessary for it to conduct these activities more efficiently and effectively. In addition, it is recognised that enforcement should also make use of remedies, where appropriate, that allow swifter and more immediate actions to effectively prevent further abuse or damage to the market and to investors. At the same time, mechanisms for dispute resolution will also be enhanced to allow for easier access for investors to seek redress in terms of cost and time.

"... the enforcement of regulation is as critical to an effective regulatory system as are the substantive rules themselves"

In addition, the SC will aim to provide further clarification on the application and parameters of securities laws, which would not only assist in improving market participants' understanding of the regulatory framework and reduce uncertainty, but also serve as a cautionary measure for encouraging market participants to adhere to high standards of business and market conduct. The SC will also strengthen mechanisms to increase information flows to and from investors, to ensure that investor protection is not compromised.

Given the resource-intensive nature of enforcement, measures will be taken to further reinforce the SC's enforcement capacity on a continuous basis, particularly in terms of ensuring that those who perform enforcement duties are continuously equipped with up-to-date knowledge and information on financial trangressions, which are becoming more complex in their execution. To complement their work, front-line regulators (FLRs) and self-regulatory organisations (SROs) will be expected to play an increasing role in policing their respective segments of the market. Increased surveillance and compliance responsibilities conducted by these parties at the vanguard of market activity will be facilitated by clear policy directions and mechanisms to enhance their ability to carry out these functions effectively. To complement the enforcement actions available domestically, the SC will also work towards further improving its cross-border surveillance, and enforcement capabilities through greater co-operative avenues with regulatory agencies in other jurisdictions.

STRATEGIC

5.4

INITIATIVE

Enhance capacity for maintaining systemic and financial stability

Systemic risk refers to the potential for "a disturbance which severely impairs the working of the system; and at the extreme causes a complete breakdown of it".[53] In the capital market, these risks arise mainly from the transmission of market shocks among market participants linked by the transaction process. As the Malaysian capital market expands and becomes increasingly complex, sophisticated and dynamic, it is important that confidence in the integrity of the market is maintained at all times, and that systemic stability is not compromised.

"As the Malaysian capital market expands and becomes increasingly complex, sophisticated and dynamic, it is important that confidence in the integrity of the market is maintained at all times, and that systemic stability is not compromised"

As the East Asian and other international financial crises have shown, sources of systemic risk can no longer be neatly distinguished and addressed. Disturbances across the broader financial system and the macroeconomy can adversely affect the smooth functioning of markets, which in turn increases systemic stress to the capital market. These disturbances may involve external shocks from other markets, high risk concentrations within specific sectors or individual players in the domestic market, and inadequate internal controls in financial intermediaries. These issues are significant because of their potential knock-on effects on other participants in the financial system, and their concomitant negative effect on market confidence that, in turn, further exacerbates these adverse conditions.

Although it is hoped that significant progress will be made, over time, on the successful detection and prevention of crises, it should be recognised that financial crises are unlikely to disappear as the market continues to evolve. As markets grow larger and more complex, the early detection of areas of systemic vulnerability grows more complicated as well.

Given that the concept and existence of risk is fundamental to the very existence of dynamic and efficient markets; systemic risk *per se* cannot be wholly eliminated without doing away with competitive financial markets altogether. What market regulators and participants can do, however, is to anticipate areas of potential vulnerability and address them in advance so as to prevent or mitigate the effects of adverse shocks to their financial systems, and to ensure their speedy and effective resolution.

In the light of these issues, the regulatory framework will be enhanced to promote market stability and resilience to systemic shocks, and manage the risks of systemic disruption. An explicit systemic risk management framework will be formulated for the capital market to ensure a co-ordinated and systematic approach to strengthening the market's capacity for maintaining systemic and financial stability. This framework will focus on, among other things, enhanced surveillance of market activity and processes, and the identification of areas of risk concentration and weaknesses in the market microstructure, with a view to reinforcing systemic stability within the capital market.

[53] As defined in *Systemic Risks in Securities Markets,*Organisation for Economic Co-operation and Development, Paris 1991.

In addition, mechanisms will be established to facilitate the collation of the relevant information from domestic and external sources, and to enable the full and timely analysis of market and economic conditions. This will include appropriate procedures to ensure the prompt reporting of an increase in systemic risk, and to have at hand appropriate operational and policy responses in the event of crises. The implementation of cohesive crisis management procedures for co-ordinating responses to crisis situations, should they arise, will draw on the regulatory and communication tools available to the SC, as well as formal and informal arrangements between the SC, other relevant regulatory agencies and industry participants. In the event of nascent crises, such mechanisms will enable prompt and co-ordinated action to be taken more easily.

Improvements to the overall market microstructure and trading, clearing and settlement processes, which are typically some of the main channels for the transmissions of systemic risk, will also reinforce the resilience of existing linkages within the capital market. Therefore, the systemic integrity of the market infrastructure will be further strengthened, particularly through the progressive and consistent application of high standards of security and reliability in these processes.

It is also important to note that the capital market does not exist in isolation but is also vulnerable to pressures from external sources. The European Monetary System crisis of 1992, the Mexican peso crisis of 1994–95, and the contagion effects of the East Asian crisis in 1997–98 very clearly exemplify the seriousness of such risks. Therefore, there must be avenues for sufficient inter-jurisdictional communication and co-operation to facilitate the timely and effective exchange of relevant information and expedite the process of regulatory actions that require cross-jurisdictional co-ordination.

“An explicit systemic risk management framework will be formulated for the capital market to ensure a co-ordinated and systematic approach to strengthening the market’s capacity for maintaining systemic and financial stability”

In view of this, the SC will seek to strengthen these links through expanded bilateral ties with its counterparts in other jurisdictions, as well as through its active involvement in international forums such as IOSCO. At the same time, its participation in such forums will also facilitate Malaysia’s continued involvement in the formulation of international standards of practice with regard to securities markets, and their application in the Malaysian capital market in particular. This will ensure that the domestic capital market is continuously benchmarked against international standards in terms of its capacity to maintain systemic and financial stability.

6 To establish Malaysia as an international Islamic capital market centre

Niche markets where Malaysia has a comparative and competitive advantage represent potentially significant areas where the domestic market can effectively position itself at the regional or even global forefront, particularly where there is largely untapped potential for such development. Efforts must therefore be taken to improve on the segments of the Malaysian capital market that have hitherto not developed in tandem with other areas of the market, and where the country has the natural strengths and potential to become a leading player. This will enlarge the breadth of the overall capital market beyond the borders of basic conventional financial products, and the positive implications for broader capital market activity will also contribute to the overall growth of the financial services industry.

The Islamic capital market is one such niche area. Malaysia has seen significant development and expansion in the Islamic equity and bond markets over recent years, which has resulted in much innovation in Islamic project financing, and the growth in Syariah-approved investment products and related capital market services. Malaysia has also earned a reputation as one of the pioneers in Islamic capital market-related research and development, partly driven by the SC's continued efforts in promoting this field of study. The country's access to an increasingly affluent population with a high level of savings, coupled with the significant concentration of prospective consumers of Islamic financial products and services within Asia, provides a potentially significant market for Malaysian products and services which conform to Islamic religious principles.

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Given these inherent strengths, Malaysia's Islamic capital market—and indirectly, the overall capital market—would further benefit from a comprehensive strategic programme for enhancing its international competitive position. Taken in conjunction with the availability of an established market infrastructure and Islamic financial market within the country, coupled with the relatively nascent status of Islamic capital markets around the world compared to conventional markets, Malaysia is well positioned to be an international Islamic capital market centre. It is also well positioned to carve its position as one of the key players for providing Islamic capital market services and products.

From a broader perspective, the development of this niche market sector into a strong and viable component of the domestic financial services value chain will also provide an important starting point for the expansion of other key areas of comparative and competitive advantage in the capital market within the region or internationally.

In order to establish Malaysia as an international centre for Islamic capital market activities, initial efforts will focus on facilitating the development of a wide range of competitive products and services related to Islamic securities. To do this, a certain level of liquidity is needed to create a viable market for the effective mobilisation of Islamic funds. In addition, low levels of public awareness and the absence of clear precedents in the area of Islamic securities dealings mean that there must be comprehensive efforts to ensure that there is an appropriate and comprehensive accounting, tax and regulatory framework for the Islamic capital market. It is expected that these efforts, in conjunction with additional measures to promote the profile of the Malaysian Islamic capital market, will greatly assist in enhancing the value recognition of the Malaysian Islamic capital market internationally.

"This will enlarge the breadth of the overall capital market beyond the borders of basic conventional financial products, and the positive implications for broader capital market activity will also contribute to the overall growth of the financial services industry"

STRATEGIC

6.1

INITIATIVE

Facilitate the development of a wide range of competitive products and services related to the Islamic capital market

To build an Islamic capital market that is competitive and attractive to issuers and investors, there need to be co-ordinated efforts to develop a variety of Islamic securities instruments. The range of products available should be adequate to meet the investment, capital raising and risk management needs that form the basic structure of any segment of the capital market.

Although the domestic market for Islamic securities has grown steadily over the last few years, in particular, certain types of products are still currently unavailable or lacking in liquidity. Developing a wide range of competitive products and services entails developing the range and quality of local expertise in Islamic securities through comprehensive training and education efforts. In view of this, there needs to be measures to facilitate industry and academic efforts to develop appropriate Islamic securities products, to ensure that they are competitive compared with conventional products. Efforts in this respect will include measures to assist in the promotion of Islamic collective investment schemes among investors, especially to cater to the demands of investors who would prefer to invest in only Islamic investment products.

"... there need to be measures to facilitate industry and academic efforts to develop appropriate Islamic securities products, to ensure that they are competitive compared with conventional products"

The range and quality of local expertise in Islamic securities, training and education in this area also need to be enhanced in order to ensure the availability of a pool of skilled specialist practitioners in this niche market segment. To this end, there will be joint efforts by the SC, qualified private training providers and universities to promote the development of human capital in this area. In addition, the entry of suitable foreign financial institutions and professionals with expertise in Islamic financial advisory services and investment to provide advice and the transferral of knowledge to their Malaysian counterparts will be facilitated and encouraged, where such expertise is not available locally.

"With a strong supportive framework and pool of skilled resources, the domestic Islamic capital market can act as a gateway for foreign funds to access both local and foreign Islamic securities, thus generating additional value from the external use of its services"

With a strong supportive framework and pool of skilled resources, the domestic Islamic capital market can act as a gateway for foreign funds to access both local and foreign Islamic securities, thus generating additional value from the external use of its services. This will also facilitate the inflow of untapped external Islamic investment funds for the capital-raising needs of domestic corporations issuing Islamic securities.

STRATEGIC
6.2
INITIATIVE

Create a viable market for the effective mobilisation of Islamic funds

The Islamic capital market should be liquid and efficient enough to provide the domestic Islamic banking, investment management and Takaful industries with competitive investment avenues that facilitate the more efficient mobilisation of these funds. The effective mobilisation of Islamic funds requires those managing these funds to have the ability to distribute at least a portion of investible capital into the capital market, in order to attain sufficiently diversified portfolios and ensure the flexibility to obtain maximum risk-adjusted returns. However, the participation of institutions managing Islamic funds in the capital market has been limited, a fact that has been attributed to the combination of structural impediments and insufficient depth in certain areas of the Islamic capital market, among other things.

In view of this, strong measures are needed to facilitate the more effective participation of Islamic funds. This will necessarily entail selective liberalisation of the uses of these funds to allow greater risk diversification and to obtain competitive returns. Also, the identification and development of new avenues and instruments in which Islamic funds can be invested will need to be more actively pursued.

"... the identification and development of new avenues and instruments in which Islamic capital can be invested will need to be more actively pursued"

To develop avenues for the deployment of Islamic funds to generate more efficient returns within their prudential mandates, several areas for further action have been identified. For one, efforts to mobilise untapped Islamic assets through securitisation should be pursued. These include allowing the securitisation of Islamic assets and properties belonging to Islamic institutions such as the Wakaf Corporation and Baitul Mal, which in turn would also effectively increase the availability of viable Islamic investment products.

In addition, the liberalisation of specific investment restrictions on institutions specifically managing Islamic funds such as the Takaful industry will allow excess funds within these institutions to be invested in the Islamic capital market, subject to these institutions' and industries' own investment mandates and prudential requirements. The mobilisation of these funds can also lead to more pro-active and efficient management through the engagement of professional Islamic investment managers that, in turn, will promote the development of the Islamic investment management industry.

STRATEGIC

6.3

INITIATIVE

Ensure that there is an appropriate and comprehensive accounting, tax and regulatory framework for the Islamic capital market

As a "one-stop" international Islamic capital market for both global and domestic investors and issuers, the domestic regulatory and business climate should be characterised by a well-defined and widely accepted accounting, tax and regulatory framework for the Islamic capital market. Similar to conventional markets, a strong framework covering these fundamental areas is an essential requirement for a successful Islamic capital market. Such a framework should be benchmarked against international standards, and should effectively facilitate informed decision making by market participants, as well as foster market integrity through the timely disclosure of relevant and reliable information.

Thus, efforts will be made to establish a facilitative environment for encouraging innovation and efficiency in Islamic securities dealings, in compliance with strong Syariah principles. There is a clear need for the establishment of a single SAC, with sufficiently wide industry representation, to enhance the consistent application of Syariah rulings within the financial system and to advise on matters pertaining to capital market, banking and Takaful issues. The consolidated SAC should be in a position to establish standardised Syariah guidelines and decisions to guide the appropriate treatment of financial services and instruments in Malaysia's Islamic financial sector.

From the accounting perspective, a set of accounting guidelines for Islamic securities dealings is needed in order to ensure consistent reporting and user certainty. The MASB is currently reviewing the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) standards for adoption in Malaysia in order to enhance the quality of published accounting information relating to Islamic financial products and services. To ensure that the Malaysian Islamic accounting framework is consistent with international best practices, the SC will also collaborate with MASB to identify and address new accounting developments and needs for Islamic financial products and transactions.

It is also recognised that the current tax treatment of certain Islamic financial transactions is not congruent with that of comparable transactions in the conventional financial market, resulting in the former bearing an additional taxation burden. This creates a non-level playing field whereby such tax disparities will need to be addressed in order to allow consistent opportunities for development across both the Islamic and conventional capital markets. Therefore, to ensure neutrality in the current tax regime governing Islamic securities transactions, the SC will collaborate with the tax authorities to accelerate the process of addressing current tax provisions that may be potentially inhibiting the development of the Islamic capital market.

With regard to the legal framework, there is scope for further fine-tuning to cater to the needs of the Islamic capital market. To enhance the legal process for cases related to such transactions, Islamic financial transactions should be clearly distinguished from conventional financial transactions, with due consideration of the relevant Islamic concepts and contracts. This will provide a more appropriate approach towards cases relating to Islamic financial transactions.

STRATEGIC

6.4

INITIATIVE

Enhance the value recognition of the Malaysian Islamic capital market internationally

Despite the nascent nature of the Malaysian Islamic capital market, it is relatively well developed within the context of the present stage of the global Islamic financial market, in terms of the depth and breadth of Islamic investment opportunities and market expertise available. Compared with many other major Islamic countries such as Bahrain, Oman, Kuwait, Saudi Arabia, Pakistan and Egypt, the stock market in Malaysia generally has a larger number of listed companies, significantly higher market capitalisation and greater liquidity.

"... this calls for a bold approach towards raising the international profile and name recognition of the Malaysian Islamic capital market ..."

There is substantial scope for Malaysia to capitalise on its comparative advantage in serving Islamic clientele and businesses to establish itself as a major international and leading regional Islamic capital market. In doing so, this calls for a bold approach towards raising the international profile and name recognition of the Malaysian Islamic capital market, with the ultimate aim of enhancing the overall capital market's capacity to draw international funds into the domestic market for Islamic financial products.

A vital element of this approach is to galvanise local industry participants to develop and exploit opportunities arising from the specialised needs of a large global consumer base with relatively few major market providers. In view of this, in addition to its other developmental efforts in this area, the SC will work closely with the government and relevant industry participants to assess the viability of issuing Islamic securities in international financial markets. This will not only serve to enhance the profile of Malaysian Islamic paper within the global market, but the availability of these products will also enhance the competitiveness of Malaysia's Islamic capital market.

"A vital element ... is to galvanise local industry participants to develop and exploit opportunities arising from the specialised needs of a large global consumer base with relatively few major market providers"

Co-ordinated promotional efforts are also needed to achieve the kind of global recognition that is needed to attain this initiative. In line with its mandate to develop Malaysia's Islamic capital market, the SC will play an active role in efforts to enhance the awareness of the market at the domestic, regional and international levels. This will involve comprehensive educational and promotional programmes with industry participants aimed at enhancing general awareness among issuers and investors keen to participate in the Malaysian Islamic capital market. At the international level, particularly in key target markets, efforts will be undertaken to familiarise foreign intermediaries such as fund managers, investment bankers and the relevant financial service providers with the Malaysian Islamic capital market, its products and services.

With regard to the international agenda, it must be borne in mind that establishing Malaysia as a major Islamic capital market is intended to complement and not compete with other key global Islamic capital markets. As such, Malaysia will seek synergistic relationships with other key market jurisdictions, including establishing strategic alliances with other major Islamic capital markets to undertake co-operative endeavours to enlarge and strengthen their respective distribution channels. In the longer term, by being part of an established Islamic capital market network, it is expected that the international positioning of the overall Malaysian capital market—of which the Islamic capital market is a subset—will be enhanced as well.