Suruhanjaya Sekuriti
Securities Commission

S P E E C H E S

Jakarta Stock Exchange Seminar "Government Policies on the Development of the Capital Market: The Primary Market."

I. Introduction

The Malaysian economy has undergone rapid structural change since Independence in 1957. It has transformed from one that is almost entirely dependent on tin and rubber into an industrialised economy with the manufacturing sector contributing about 27% of its GDP and 60% of Malaysia's total export. The Malaysian per capita income of approximately USD4,400 compares quite favourably with other newly emerging economies. Malaysia has consistently achieved growth rates in excess of 8% over the past decade with rates in 1994 and 1995 exceeding 9%.

This explosive growth in the Malaysian economy has, quite naturally, resulted in an equally unparalleled growth in the Malaysian capital market. Today, the KLSE is the largest bourse in Asean in terms of market capitalisation and is fifth largest in the Asia Pacific region after Tokyo, Osaka, Hong Kong and Australia. At the primary market level, the explosive growth in the Malaysian capital market is reflected by the fact that the number of IPOs and funds raised have surged from 4 and RM0.6 billion respectively in 1985 to 51 and 13.7 billion in 1995.

The Malaysian capital market has grown not merely as a by-product (albeit a significant one) of the nation's rapid economic growth; the capital market in itself is recognised as a sine qua non in achieving the various broad policy objectives of the government and the various regulatory authorities within the government. In my presentation I propose to take you through the various broad policy objectives that necessitate the development of the capital market, other global and domestic imperatives that further strengthen the need for a developed and mature capital market, the role of SC as facilitator of capital market development and finally you through some of the move recent measures that have been taken in the implementation of these objectives at the primary market level.

II. Policy objectives that mandate the development of the capital market

Let us look at the numerous broad policy objectives that mandate the development of the Malaysian capital market.

Vision 2020

In 1990, the Malaysian government set itself a target of achieving fully developed status within three decades, i.e. by the year 2020. Under this Vision the target per capita GNP by the year 2020 is USD32,000. To achieve this target, Malaysia must maintain an average growth rate of 7% p.a. Taking into account the country's massive infrastructure programme to ready the entire nation for the attainment of this Vision, it is estimated that the capital requirement during the period of the 7th Malaysian Plan (1996-2000) alone, is expected to be RM385 billion.

The attainment of Vision 2020 makes it imperative that domestic funds are efficiently mobilised and foreign funds attracted. Consistent with the process of disintermediation that is taking place in most financial markets, the nation's massive funding needs will clearly no longer be adequately met by the traditional banking sector alone. The capital market must play a privotal role in the mobilisation of both domestic and external funds in the attainment of Vision 2020.

Developing Kuala Lumpur as a regional capital market centre

Malaysia has an officially stated intention of making Kuala Lumpur a regional capital market centre. In the words of the Honourable Deputy Prime Minister and Minister of Finance in his speech to a gathering of fund managers on 22 June 1995:

"Malaysian economic development stand out when compared with that of other countries in the region. We have come to a stage where we can take a leading role and develop as a regional capital market centre"

While Malaysia can consider herself fortunate in that she has the fundamental requirement to achieve such an aspiration, viz. political and economic stability, no effort can be spared in developing the other necessary requirements for the attainment of this aspiration. This calls for well-planned and visionary efforts in deepening and broadening the capital market, strengthening every existing institution and intermediary as well as developing related activities such as the fund management industry, the strengthening of regulatory and market infrastructure as well as the introduction of new products or instruments to broaden and deepen the capital market.

The Privatisation Policy
The mid 80's was indeed a watershed both for the development of Malaysian economic policy as well as for the development of the Malaysian capital market.

The severe recession experienced by Malaysia in the early 80's made the government realise the need to downsize the public sector and public sector spending. Instead, the private sector was entrusted with greater responsibility in the nation's economic growth. During the period 1991-1995, 204 projects were privatised. In addition to the build-own-operate and build-own-transfer modes of privatisation, the government also hives off its assets to the private sector. Over the years, numerous huge government-owned enterprises such as Tenaga Nasional, Telekom and Malaysian Airline have been hived off in this manner.

The government's extremely successful privatisation policy completely changed the profile of the Malaysian capital market. There was an explosive growth in the equity market, a drastic reduction in the issue of government bonds as well as a steady, albeit slower, growth of the corporate bond market.

KLSE's objective of becoming a world class stock exchange
The Kuala Lumpur Stock Exchange (KLSE), has some two years ago, articulated its intent to create a world class exchange. While I am far from qualified to elaborate on this in the distinguished presence of one of the architects of that plan, KLSE's agenda has to be mentioned here as policy makers have hitherto been guided by KLSE's vision, in formulating policies pertaining to the capital market - be they in respect of the primary market or the secondary market. To name but a few, benchmarks of a world class stock exchange include liquidity, transparency, cost effectiveness and a sufficient array of instruments being traded.

III. Other challenges faced by the Malaysian capital market

Apart from the broad policies, visions and aspirations mentioned above the Malaysian capital market like most other markets, face challenges both on the domestic as well as the international fronts. These global and domestic imperatives also necessitate the formulation of clear forward-looking policies with respect to the development of the capital market.

The Global Imperatives
The global imperatives mandate the recognition that issuers have a choice of citizenship when raising capital and that intermediaries and investors are

increasingly international in their profile. The increase in the level of cross-border financial activities must be given due recognition. Globalisation require market institutions, intermediaries and regulators to prepare themselves for increasing turbulence or volatility resulting from greater co-intergration between markets. Financial innovation and the impact of information and communication technology will continue to 'stress test', if not to demolish inward-looking regulatory policies. Strategies and policies that are insular and intended to isolate capital market activities within national borders will not work, as geography and space become increasingly irrelevant in the world of finance.

The domestic imperatives

Working in tandem with the global imperatives are the domestic imperatives. Apart from the government's successful privatisation policy that I have mentioned earlier, other domestic imperatives include the governments' healthy fiscal surpluses over the past few years. This has resulted in a significant decline in the issue of government bonds or Malaysian Government Securities (MGS) as it is more commonly known. This trend can be seen in the fact that while in the 5-year period between 1976-1980, out of a total of RM10.0 billion raised from the capital market, 94% was in the form of MGS while 6% was in the form of equities. Contrast this with the pattern in 1991-1994 where out of a total of RM46.6 billion raised, 54% was from equities, 30% from corporate bonds and 16% from MGS. In fact, in 1995 the amount of MGS papers issued dropped to a level which resulted in the net funds raised by the public sector from the capital market reflecting a deficit of RM38 million arising from the maturity of some of the existing paper. This trend clearly highlights the increasing importance of both the equities market and the corporate bond market in the Malaysian capital market.

The other equally important domestic imperative relates to the fact that a decade of strong economic growth has resulted in increasing investor affluence and higher domestic savings. Greater affluence makes domestic investors look for capital market instruments that cater to their different risk-reward profiles and a market with sufficient depth and breadth. The high rate of gross national savings (in 1995 it was 36% of GNP) has also resulted in the growth of domestic institutions with massive amount of funds. Of the statutory funds we have the Employees' Provident Funds whose assets now exceed RM100 billion. The unit trust industry has also benefited from the growth in voluntary savings - total assets within the industry is currently in excess of RM52 billion. This huge available pool of domestic funds must be efficiently mobilised, given the fact that despite the high savings ratio there continues to exist a fairly significant savings - investment gap.

Finally, the other significant domestic imperative is the growing number of small and medium scale industries (estimated to be in excess of 300,000) in the country. Given the government's efforts to encourage the growth of technology-driven companies, quite a few of these companies, whilst not having a track record in the conventional sense, have good growth potential and huge appetite for capital. Consistent with the government's efforts not merely to encourage the growth of small and medium-sized industries but also to promote technology-intensive or technology-driven companies, the avenues for them to raise capital must be increased.

IV. The role of the Securities Commission (SC) in facilitating the development of the Malaysian capital market

The governments' recognition of the need for a single regulatory body not merely to regulate but also to promote and propel the development of the Malaysian capital market prompted the mention of the need for the establishment of a Securities Commission in the 6th Malaysian Plan (1990-1995). The Securities Commission was established in March 1993 as a statutory body under the Securities Commission Act 1993. Right from the start it was clear that regulation and development of the capital market were the twin pillars upon which the SC was established.

The statutory functions of the SC as enshrined in section 15(1) of the Securities Commission Act include several that underpin the developmental role of the SC. These are :-

- to advise the Minister on all matters relating to securities and futures industries
- to consider and make recommendations for the reform of the law relating to securities and futures contracts
- to encourage and promote the development of securities and futures markets in Malaysia including research and training thereto.

Given the numerous statutory mandates for it to develop the capital market, the SC right from its inception, established a Research and Development Division, which is dedicated to facilitating the development of the capital market on various fronts - product development, education and training, law reform, accounting standards and economic research.

Since its establishment the SC has made various policy proposals for the development of both the primary and the secondary market. Each of these policy proposals are in various stages of development. Consistent with the focus of this morning's discussion, let me elaborate on the major policies that have been proposed, adopted or implemented since the establishment of the Securities Commission with respect to the primary market. I will categorise these efforts to develop the primary market into 4 categories, viz.:

- Strengthening the regulatory framework
- Broadening and deepening the market
- Enhancing market infrastructure and investor protection
- Developing the corporate bond market

Let me elaborate on each of these categories.

V. **Strengthening the regulatory framework**
The shift from merit review to disclosure-based regulation

The shift from merit towards disclosure-based regulation is perhaps the single most important policy that the government has adopted towards strengthening the regulatory framework of the primary market.

Prior to amendments which were introduced in 1995 to the Securities Commission Act, Malaysian law enshrined the merit-review approach to securities regulation with some elements of disclosure being embodied, particularly in the prospectus provisions of the Companies Act 1965.

Hence until a year ago, in the regulation of the primary market, the law mandates the regulatory authority to look at the merits of each capital issue proposal and to make judgements on, inter alia, the viability of the company and its suitability for listing where applicable.

The need for a shift to a disclosure-based regulation was deemed urgent and inevitable given not only the geometric growth in the number of proposals for capital raising; it was also clearly anathema to the government's stated intention of developing Kuala Lumpur as a regional capital market centre. This is because merit review not merely affects the efficiency of capital raising activities in the primary market, it also stifles Malaysia's competitiveness as a capital market centre and imposes unreasonable and onerous responsibilities on the regulator.

Amendments were therefore introduced to the Securities Commission Act in 1995 which removed the statutory requirement for the SC to look at the viability of a company in giving its approval for the issue of securities. New provisions were also introduced which put the promoters, directors, advisers and experts acting on behalf of a company seeking SC's approval, under a statutory obligation to disclose all material information. A new provision with stiff criminal penalties relating to the giving of false or misleading statements, has also been incorporated. To complement this heavy responsibility, a due diligence defence has also been introduced.

Consistent with the statutory changes mentioned above, changes have also been introduced to the SC's Guidelines for the New Issue of Securities. A Code of Due Diligence has been prepared by the SC with input from industry practitioners. The format of prospectuses is also currently under review.

VI. Broadening and deepening the capital market

Listing of Infrastructure Companies

In its efforts to better facilitate the raising of capital via the stock market, the government has also taken measures to increase the types of companies that can seek a listing on the KLSE and to consider other avenues for capital raising by companies that do not qualify for listing on the KLSE. Initial efforts in this direction was indeed taken by the government and the KLSE long before the establishment of the SC, i.e. the creation of the Second Board in 1989 with the stated objective of providing smaller companies with an avenue to raise capital through a listing on the KLSE. The success of the Second Board of the KLSE is well-known to all.

Another significant decision in this respect was made by the government when it was announced that companies with major infrastructure projects which have long gestation periods can apply for listing on the KLSE. To implement the government's decision, the SC released the Guidelines for the Public Offering of Securities of Infrastructure Project Companies (IPC Guidelines) in September 1995. The release of the Guidelines is consonant with the government's strategy of shifting the burden of bearing infrastructure expenditure to the private sector and in the process, encourage better risk sharing, accountability, monitoring and management of infrastructure projects. Briefly, the IPC Guidelines allows the public offering of the securities a public company having an investment in an infrastructure project provided certain conditions are fulfilled. These conditions include the following

- that it contributes to the overall economic growth of Malaysia or is in accordance with national economic objective and policies;
- it has a remaining concession or licence from a government or state agency of not less that 18 years, and
- the project cost is not less than RM500 billion and it is able to generate a suitable rate of return to its investors.

Since the release of the Guidelines, two such companies have received approval an independent power produce and a highway construction company and a few others are awaiting approval.

Listing of Foreign Companies

The other policy decision that has more recently been taken by the government with respect to expanding capital raising opportunities on the KLSE is the listing of foreign companies. It is the view of the government that in an environment of rapidly increasing cross-border securities trading and of stock markets extending their operation beyond national boundaries, it is only natural for KLSE to offer its services to companies with assets outside Malaysia. Based on the policy decision of the government, the first phase of the implementation of this policy will be to allow foreign companies with substantial foreign assets or operations but owned and/or controlled by Malaysians, to be listed as foreign companies on the Main Board of the KLSE. This must be a primary listing or the listing of companies that though listed elsewhere, intend to shift their primary listing to the KLSE. Detailed guidelines for the implementation of this policy is currently being worked out by the SC, the KLSE and Bank Negara Malaysia. Subsequently, in line with the gradual liberalisation of the market, the scope of foreign companies allowed for listing may be widened beyond those allowed under the first phase.

Establishment of an Over-The-Counter (OTC) market for high growth companies

The Minister of Finance in his 1997 Budget Speech, has announced that an over-the-counter (OTC) equities market for shares of high-technology companies will be introduced to deepen and broaden the Malaysian capital market. This is yet another effort to boost the Malaysian capital market and to extend the capital raising facilities within the capital market, to smaller, high growth, technology-driven companies. It will also provide new investment opportunities for investors and new areas of business for market intermediaries.

While the details of the establishment of this market is still currently being worked out, it is expected that this market will provide an avenue for high growth, technology-driven companies to raise equity financing and for their shares to be subsequently traded. The primary market structure for the OTC market will be designed to allow the raising of equity finance by small high growth companies, either to raise investment capital to start up, upgrade or expand their operation. As such it will have lower quantitative entry requirements than the existing requirements for the KLSE's Second Board.

VII. Enhancing Investor Protection

Publication of application forms for IPOs in national newspapers

Perhaps one of the most visible indicators of the success of the Newl Economic Policy in the redistribution of wealth is the extreme popularity of IPOs among members of the Malaysian public.

It is not uncommon to have IPOs being oversubscribed by more than 20 or even 50 times. Problems arose due to the shortage of application forms during 2 large IPOs namely HICOM and Petronas Dagangan in 1994. Given the limited supply and the excessive demand for IPOs, the SC in the interest of the public has to ensure that the process of the application for IPOs shares is efficient, fair and transparent. In this regard, SC in 1994, introduced a requirement that companies seeking a listing on the main board publish share application forms in local newspapers for IPOs, so that such forms are readily available to the public. This mode of distribution together with other existing modes (at the issuing houses, member companies and merchant banks), made share application forms readily available to members of the public throughout the country.

To ensure that applications made through forms published in newspapers are practical to use and are not subject to any bias during the balloting process the SC monitored the introduction of such forms and audited the balloting process for the first few IPOs using application forms from newspapers.

Electronic balloting and Electronic Share Application

As an extension to the initial effort mentioned above and as part of its longer term commitment to make the application for IPOs more convenient by reducing the time and cost involved in the process, the SC also undertook to facilitate the development of an integrated electronic system that addresses each process of share application, balloting and refund of monies. The SC is currently working together with other authorities and industry participants such as the KLSE, Bank Negara Malaysia, the Issuing Houses, the Registrar of Companies, the Association of Banks and the Association of Merchant Banks, in finalising the development of an electronic system for IPO share application, allocation and refund of monies to unsuccessful applicants. Computerised balloting can currently be done by one of the two issuing houses. This process replaces manual balloting by introducing a random number generator computer programme.

VIII. Developing the primary market for corporate bonds

The corporate debt market in Malaysia as with many other countries within the region, had a late start compared to the equities market - total outstanding debt in 1995 was in the region of 50% of GDP compared to KLSE's market capitalisation which was in the region of 280% of GDP. However, the government is fully conscious of the benefits which as an efficient and liquid debt market can confer on the capital market as a whole. It will, inter alia, lower the cost of borrowing and reduce reliance on offshore funding by local corporations, thus reducing the economy's vulnerability to global economic cycles. Towards this end, measures to develop the primary as well as secondary market for corporate bonds is a key agenda in the SC's Business Plan (1995-1997). Identified below are some of the measures that are intended to boost the primary market for corporate bonds.

Streamlining the issuance process

The process of issuing corporate bonds currently involves no less than that four agencies - the SC, the Central Bank and the Registrar of Companies, the rating agency and if the bond is to be listed, the KLSE. It has been observed that the entire approval process could take in excess of six months, during which time the issuer will be exposed to interest rate movement and the risk of the issue becoming less attractive to investors.

The SC together with other authorities mentioned is looking at various measures to streamline the regulatory framework for corporate bond approvals and to shorten the time taken for the primary issue. One area that is currently being actively studied is 'shelf registration' for bond issues.

Promoting the issue of benchmark securities

The supply-demand imbalance of Malaysian government securities has presented a liquid, default-risk free benchmark yield curve from developing in the Malaysian Ringgit bond market. Without such a benchmark the pricing of corporate bonds in both the primary and secondary market will be inefficient and difficult, this creating an environment which is not conducive to the growth of the local bond market. In fact, as result studies have shown that the more credit worthy Malaysian corporations find it cheaper to raise corporate debt overseas, a perverse development considering most of these companies do not need the foreign exchange exposure in their balance sheets. The Malaysian government has recently accepted the SC's proposal with respect to building a benchmark yield curve. The successful implementation of this proposal would, it is hoped, removes one of the more significant hurdles in developing both the primary and secondary market for corporate bond.

Conclusion

The government's vision for the development of Malaysian capital market which is not only for the fulfilment of domestic needs but also for the development of Kuala Lumpur as a regional capital market centre is well-known and well articulated. Efforts to facilitate the development of both the primary market and the secondary market have been and will continue to be initiated and facilitated by the authorities. At the end of the day however, the success of the Malaysian capital market, as is the success of any market, is a function of the interest and participation of the investors, issuers and intermediaries.