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S P E E C H E S

Keynote Address
by
Dato' Dr Mohd Munir Abdul Majid
Chairman, Securities Commission, Malaysia
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First of all, let me thank the FIBV for giving me this opportunity to make this keynote address at your 1998 Annual Meeting. Let me also congratulate the KLSE on its successful hosting of this conference at this very significant time for economies, financial markets and regulation. As a Malaysian I would particularly like to welcome our foreign guests, with the hope that they will get a real feel of our recently much maligned country. You will find that we are not red-eyed ogres, breathing fire, deaf to reason and with a closed mind. You will find that we do cherish ethical behaviour from a deep and profound perspective.

The subject matter of ethics in financial markets is most apposite at this time in the history of the international financial system and of markets, as we approach the next millennium. Indeed, to my knowledge, the subject has not been taken on by any international organisation of note, less still by one as avowedly market-oriented as the FIBV. The membership, and in particular your Secretary-General, are therefore to be congratulated for bringing it to the fore. My hope is that there will be progress from a shift in the intellectual ground to the reassessment of the ethical bases of and in financial markets, leading to the establishment of better standards and systems. For a whole generation, the growth and growth of financial markets has been breath-taking. There has been no respite. The process often called globalisation has indeed taken grip, driven relentlessly by powerful progress in technology. Perhaps in no other field is the process so total and all-encompassing, with global trading around the clock, with movement of huge flows of capital in many directions with compelling consequences, with convergence of regulatory standards, market practices and microstructures which has spawned a dominant style and language which project a commonality, if not of norms of behaviour, at least of purpose.

If you were to ask a market professional, be he in New York or in Mumbai, what is the role of financial markets, it is likely that he would dwell on the various market-introverted functions that financial markets perform, founded essentially on the role of financial markets to obtain and process information - not just information about a company's expected future profits (which is what stock prices, under ideal conditions, are supposed to reflect) but all information relevant for the transfer of capital from savers to borrowers. While you could hardly quarrel with the reply, it certainly would be woefully intellectually inadequate for not also emphasising the wider social functions of financial markets. What has been happening is that an appreciation of these latter functions has been left behind in the sweep of financial market expansion, innovation and sophistication where we are progressively getting to know more and more about less and less, where we have become distanced from and mostly forget the basics of the purpose and norms of financial markets as a social organisation. We have come to the stage where the tail is wagging the dog. We must reassess the situation.

From the social perspective, only the instruments of globalisation have been applied with full force in financial markets, without the intellectual grasp of or care for their real global implications. While it may be argued that this may be too much to expect of mere barrow-boys, albeit highly paid ones at that, surely they should then not be let loose before international public policy has properly addressed a system to promote and protect the global social good. The world is crying out loud for a system that will realise that social good, rather than one that exposes it to forces of globalisation unleashed which are agnostic to social order and objectives.

It may be argued that financial markets embody the capitalist creed in its perfect form, and that they must be unbridled and unfettered because of the social good that they bring through the imposition of market discipline. Even if, for a moment, you were to accept this argument, the empirical record cannot sustain the point about bringing social good. From the experience of financial market turmoil in East Asia over the last 16 months, what have been left in the wake of this so-called market discipline are destroyed economies, destroyed industries, destroyed jobs and markets causing hardship and dislocation, bringing instability and political problems - all of which would cause a contraction in demand and confidence which would come back to haunt those all-powerful financial markets themselves, with jobs also being lost at the points of origin of these forces of market discipline. Has any social good been achieved?

But the argument about the good that market forces bring, assuming a rationality and allocative ability which belie gross imperfections and misallocations, is not correct to begin with. We have become rather overawed by financial markets - not without reason, just look at their size and sophistication. But let's not confuse form and substance. Rather like the late Arthur Ashe once said of the then young and brash John McEnroe, the market can be immature beyond its years. Look at the reality as expressed by a foreign-exchange trader - and this was quoted in the Wall Street Journal way back in 1988 - on the non-fundamentals, "perception-based" trading phenomenon:

"Ninety percent of what we do is based on perception. It doesn't matter if that perception is right or wrong or real. It only matters that other people in the market believe it. This business turns on decisions made in seconds. If you wait a minute to reflect on things, you 're lost."

It is also a gross exaggeration and wanton misrepresentation to talk about market discipline in relation to the controversial hedge-funds, a lot of whose activities are to arbitrage between the smallest price differences between markets which by no stretch of the imagination can be said to be trading activities based on economic or company fundamentals. We have therefore to be careful not to be too carried away by the argument about rational market forces and market discipline bringing about a social good as this is not overwhelmingly borne out by what they actually achieve and what actually drives them.

To say this about financial markets does not mean that one does not believe in them; it is only to say that they are not working in the way it is often glibly assumed they are; by extension, it is a call for serious efforts to make them work the way they should.

The triumph of the free market and the collapse of communism in 1989, an epochal moment in the history of the world, should not result in the replacement of one theology by another. That triumph was based on a living democracy, which must be true of the international as much as of national systems. There must be debate about the workings of the free market, and adjustments made to curb excesses and to ensure ethical practices. After all, in the US, the Securities Act of 1933 and Securities Exchange Act of 1934 were introduced to curb and control unethical practices to give a foundation and protection in law for the free market system. They were responses to perceived market failure. There is a great need in the international financial system today for a similar ethical response. The perpetuation of an unworkable and unjust system would cause its breakdown, leading to economic and social disorder. Therefore, I would say, if we want to talk about ethics in financial markets today, we must start with the review and reform of the international financial and trading system which is unjust, does not function in the way it is purported to work and which is weighing down the whole world economy. Some might go so far as to say: "If Dante had seen the Treasury bond pit (representing the international financial system) at the Chicago Board of Trade, he would have added another circle to his vision of hell...", but suffice it to say, if I may reach out to Shakespeare's Hamlet, Something is rotten in the State of Denmark.

I am only too aware that financial markets are not bereft of regulations founded on law and practices involving both ethical and economic/financial market considerations. But somehow the whole is not the sum of the parts and, I must say as well, many of the parts do not measure up under close scrutiny, especially when setting principle against practice and when testing for consistency and congruity.

Let us come back to the purported essential role of financial markets to obtain and process information. Are financial markets able to fulfil this role ideally all the time? Information differs from conventional commodities in that it is fundamentally a public good - in other words, a good whose consumption can be neither rivalled nor excluded (So if I tell somebody something I know, I still know it; and their knowledge of it does not subtract from mine). As is well known, market economies provide an insufficient supply of public goods - including information. Among other things, acquiring information involves fixed costs, which means that markets that are information-intensive are likely to be not perfectly competitive, and hence not likely to be able to maximise social welfare. Therefore there are bound to be inefficiencies and assymmetries.

On the other side of it, whatever information there is, its delivery and reception cannot be in equal measure to all market participants. Leaving aside ability to digest and analyse which can never be the same, the more important considerations are accessibility and information reach. There are striking differences which make it imperative that disclosure-based regulation, a critical foundation of modern financial markets, continuously strives to address informational assymmetries in the interest of a just and fair market. If we add to this factor, the ability to act on information received and to move markets, the imbalance between the big and the small, the individual investor against institutional investors, relatively small countries and markets with limited resources versus powerful international investment institutions, the assymmetries and incongruities are palpable.

It is but a small step from such a condition to market manipulation, a situation that cannot be countenanced ethically and legally. While, as we must, we strive to ensure that such practices do not occur in our respective markets and that there is sufficient deterrence against their commitment, it is important from the international regulatory perspective that we recognise the forces we are pitted against, even as we painstakingly enforce within national jurisdictions, largely against domestic players, measures against manipulative and deceptive practices.

The most effective way of ensuring that unacceptable regulatory double standards are not in fact practised, is by being insistently consistent on standards of disclosure and transparency of all market participants big and small, in and across all markets, from one asset class to another. The Byzantine secrecy that attends to the activities of some major institutions in some rather significant asset class markets which have stunning cross-markets implications, is a slap in the face of effective and meaningful international regulation of financial markets. I am sometimes driven to despair by the attitude of international regulatory organisations which choose to gloss over the big and dark issues of this nature by busying themselves with minutiae. I have no problem with minutiae for as long as the big and major issues are also taken on.It is morally indefensible to fiddle and prevaricate while whole economies and markets burn. It would also not serve the cause of international regulatory cooperation if a willingness to act is only occasioned when one's own market is affected after many months of so-called objective and professional arguments against any kind of regulatory action. While serious moral and ethical issues about the operation of financial markets have been thrown up by the current turmoil and crisis, international regulators expose themselves to the charge of moral cowardice, professional incompetence and double standards if they do not show courage and come out of the safe cloisters of pure technical discourse.

Of course, I perfectly understand that you would be concerned about what would be the meaning and result of the weight of new regulation. There can be legitimate concerns if regulation acts only as the oppressor of free markets and serves exclusively as the salvation of the consumer. You might feel, and not without basis, that there is a limit to what markets or law can do, in the face of determined unethical behaviour. You will be right to have those concerns, but let me allay your fears.

I would describe regulation as policy-making which requires the formulation of judgments involving both ethical and economic/financial market considerations. In other words, it must always seek to strike a balance between the free market and protection of the investor. I have tried to argue there is an urgent need to review and reform based on evident market failure, including the failure of effective regulation. I am not talking about new regulation per se but about making effective regulatory principles long on the table but left behind in their practical impact by the race of financial markets well ahead of regulation and regulators. I am talking about regulators having the courage to admit this and to take steps based on established regulatory principles to correct the balance in favour of the public good.

The existence and growth of financial markets is a public good. An important function of financial markets is the mobilisation of savings (and, by definition, allowing for future consumption). Banks and other financial institutions, for instance, aggregate the relatively small savings of large numbers of individuals and make these funds available for larger-scale enterprises. This is socially desirable because through so-called scale effects, individuals are thus able to benefit from returns that would otherwise have been not available were they limited to investments that only they themselves could finance. At the same time, financial markets offer reduced investment risk by allowing for diversification.

Moreover financial markets allow capital to agglomerate. Take the stockmarket for instance. Liquid stockmarkets provide a way for people to "cash in" their investments by selling their shares to others who may wish to put off their consumption for later. Consequently, firms are more efficient because their capital is maintained which, in turn, generates a virtuous side-effect of ensuring the accumulation of human capital. What this ultimately means is that growth in income per head can accelerate.

Financial markets also allocate the savings accumulated through them by collectively assessing which managers and which projects are most likely to yield the highest returns. And having allocated those funds, financial markets perform an important function in monitoring that they are used in the way promised by the borrower -- and that borrowers, in responding to new contingencies, take into account the interests of providers of capital. In this sense, financial markets are also involved in the enforcement of contracts, the choosing of managers and of projects, and in providing the right incentives.

There is no doubt about it that financial markets are absolutely necessary and desirable. Just as the world would be, literally, a poorer place without them, when not working well they can also impoverish the world. Therefore the ethical imperative of the moment is to review and reform the international financial system and markets, so that they can fulfil their promise. Insofar as regulators are concerned they should have the moral courage to admit it when regulation is not working and to set about making it work through international collaboration and cooperation. They should not try to duck the issue by saying that the big questions about some of the serious failures of financial markets are not their concern, that they are matters best left to policy-makers. Issues of regulatory consistency and application, of effective investor and market protection, must be their concern. International regulators must take up the major ethical challenge of financial markets in our age as we approach the new millennium.

I had said at the beginning that it was pleasing FIBV was discussing the subject of ethics in financial markets, even if it is somewhat ironic that the subject should be initiated by a private sector, non-governmental international organisation. I congratulate you and I hope you will take on the big ethical issues of the day, as I suggest you should, as well as the small not to be neglected ones. That you would discuss international and system-wide matters, as well as those relating to microstructures and specific conduct. I hope you will make something come out of it, resulting in a representation of issues and concerns that should be addressed. It would be sweet irony indeed if you are able to move discussion to meaningful action.