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S P E E C H E S

Regaining Investor Confidence in Malaysia
Recent Capital Market Efforts

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Introduction

Ladies and Gentlemen,

I am honoured to have been given the opportunity to address you this evening.

The tide appears to be finally turning for Malaysia. After being vilified for the past 18 to 24 months, I am sure that all of you will be more than aware of the recent changes in the stance of the many international investment research houses. They are now increasingly bullish on Malaysia and on the various investment opportunities that are currently available in Malaysia. I will not therefore repeat what many are now saying about Malaysia from an investment standpoint. Rather, as the regulator of the Malaysian capital market, I would rather focus your attention on the measures that we have undertaken, in response to the financial crisis that have afflicted the region and the rationale for these steps. In this way, I hope to clarify any uncertainties that you may have with respect to the appropriateness of and rationale for these measures in this crisis.

The Changing Global Consensus on the Asian Crisis

Asia and indeed the world have undergone a trying time in the past 20 months. We have seen the dynamic economies of Asia plunged into their deepest post-war recessions within a short period of time. Millions of workers have been displaced and standards of living that have taken years to elevate have been halved, if not more, in a manner of months.

Malaysia too has not been spared by the financial firestorm that has razed the region. The real economy, which had been expanding by an average of +8.8% over the last decade or so, contracted by -6.7% in 1998. The labour market which had been at practically full employment in the months prior to the crisis have seen the unemployment rate almost double to 4% of the labour force. The ringgit plummeted to levels that were previously unheard of, reaching a low of RM4.89 to one US dollar at one stage. These developments had a **significant impact on Malaysia's securities markets, in particular the stockmarket.** The market fell very sharply from its peak of about 1,200 to about 800 and bottomed out at levels of 250 in the second half of 1998. The size of the Malaysian stockmarket shrank dramatically as did share trading activity, although it is interesting to note that the market in Composite index futures expanded as the index's daily volatility grew beyond historical norms.

Restoring Order amidst Chaos

It is against such a backdrop that the crisis in Malaysia has been managed. To be sure there were indeed many vices in the practices of the days prior to the crisis. However, little is made of the virtues and the strides of progress that were achieved in the few years since investing in emerging markets became the vogue on Wall Street. In addition, significant and serious efforts were already underway to address the vices. If anything, the crisis sharpened the focus and intensified the efforts of the government in addressing the weak-points in the Malaysian economy and the shortcomings in the Malaysian financial market.

In the midst of the financial panic that had overwhelmed the region, there is no doubt that, with hindsight, not all the initial policy measures a'la IMF prescriptions were appropriate and that some mistakes were made. For instance, the curb on credit growth when liquidity was in fact needed, the increase in interest rates which further exarcebated the credit crunch, tightening of prudential requirements [NPLs from six- to three-months] when financial institutions were already finding it difficult to meet existing requirements, a cut in government expenditure when aggregate demand was already falling. These well-intentioned measures proved to be wrong principally because they were badly timed.

Indeed, the combined effects of these measures resulted in a rapidly decelerating economy and a crippling credit crunch which threatened to plunge the economy into a liquidity trap not too different from that which is currently being experienced by yourselves here in Japan. Consequently, measures which were anticipated to have a calming and restorative effect instead yielded opposite results. Similarly, the rapid downgrading of Malaysia's sovereign credit rating by international rating agencies to just above 'junk bond' status in the last quarter of 1998 and a marked rise in sell recommendations by international market analysts further exacerbated the situation.

However, the Malaysian government recognised these mistakes and quickly rectified them. The Malaysian government recognised that the key to restoring order amidst this disorder was to put a halt to the crippling capital flight and to fast track concurrently the implementation of measures to demonstrate convincingly that we are serious about restoring order and confidence in the Malaysian economy and capital market. The government was therefore forced to take some extraordinary to manage extraordinary circumstances.

Thinking the Unthinkable

As thinking men and women, one must pause at this juncture and ponder the alternatives available to a government authorised to rule with a democratic mandate. Political stability can only prevail in the midst of economic stability. The former, coupled with prudent management, can then in turn usher in economic prosperity. It is perhaps no coincidence that countries which have undergone massive and sudden economic contraction have historically experienced subsequent and oftentimes violent political upheaval.

We in Malaysia believe that this is an unacceptable consequence and have decided to challenge conventional economic wisdom by thinking the unthinkable. Selective exchange controls were introduced to prevent further speculation of the ringgit and to halt the capital flight as monetary policy was loosened to accommodate the rapidly decelerating economy. Fiscal policy was similarly reversed from an overly restrictive stance to take up the slack in domestic demand arising from the weak consumer sentiment. In the government's view, the key objective of this policy reversal was to mitigate the contractionary impact of the crisis and the misguided policies fashioned along the lines of the IMF programs within the region.

It should also be noted that these unconventional measures were followed by a rapid succession of recovery measures that sought to improve the effectiveness of monetary policy, provide the economy with a significant amount of fiscal and monetary stimulus and to stabilise and rehabilitate the financial system, including the securities markets.

Admittedly, the imposition of these measures did have a major impact on the market and on investor sentiment. Nevertheless, the measures allowed the authorities to regain some control over the economy and financial system, and provided the much needed "breathing space" to resuscitate the economy.

It is also important to realise that the government adopted a pro-active approach to the implementation of the controls. For example, in view of increasing concerns raised by foreign investors over the 12-month holding period requirement as well as to facilitate portfolio investment from abroad, the government revised the exchange controls earlier this year by replacing that particular rule with a graduated levy on the repatriation of portfolio capital.

Measures On the Capital Market Front

The capital market measures that were introduced focused on the following objectives:

- Maintain systemic stability
- Strengthen market intermediaries
- Rehabilitate the securities industry
- Improve market transparency and corporate governance

Preserving Systemic Stability

In order to address the concerns that the severe market movements would compromise systemic stability, the Securities Commission initiated or oversaw the implementation of various measures to strengthen the Malaysian capital market's resilience to systemic instability.

For example, the Securities Commission, in consultation with derivatives market institutions, devised an early warning system which enables the derivatives exchanges and clearing house to monitor the capital and liquidity positions of the futures brokers and facilitates pre-emptive action.

In order to assuage fears by investors that they were inadequately protected and hence minimise systemic risks arising from a potential "run" on a stockbroking company, the RM14 million compensation fund was expanded by the SC and KLSE on April 30th 1998 to over RM300 million.

To prevent failed trades, a standby facility of half a billion Ringgit for the stock exchange clearing system was established.

Further efforts are currently underway to further reduce settlement risk by implementing a delivery versus payment (DVP) system including the examination of the viability of having the existing clearing house for share trading as the central guarantor to all trades. This would mean that, counterparty risk for participants could now be against the clearing house rather than a stockbroker.

Strengthening Intermediaries

At **the intermediary level,** various efforts have also been implemented to guarantee that all investors domestic and foreign are assured of a level of integrity that is in line with best practices in global markets. In order to raise prudential standards in the Malaysian stockbroking industry, the SC approved a new risk-based system of capital adequacy requirements which will replace the current system of minimum liquid fund requirements and will bring rules on prudential requirements more closely in line with current international standards. The SC is also directing the introduction of a new framework for client asset protection framework with the KLSE which will enhance investor protection and increase confidence in the industry when the rules are introduced.

As for brokerages in distress, the Securities Commission has initiated a scheme which aims not only to resolve the problems faced by the stockbroking industry but also to address simultaneously the banking sector's exposure to these brokerages. A special task force comprising the SC, KLSE and Danaharta, the national asset management company, will implement the scheme. The scheme is also expected to facilitate the recapitalisation and consolidation within the stockbroking industry.

Increasing Transparency

Another area of weakness highlighted by the crisis was the need to **increase the level of transparency** in the Malaysian capital market.

In this regard, the SC directed the KLSE to incorporate several changes into its Listing Requirements which included inter alia a widening in the scope of rules, disclosure enhancements, improved voting rights, the appointment of corporate advisors and greater directors' responsibilities. In tandem with this, 1 January 1999 heralded the introduction of the new Malaysian Code on Take-Overs and Mergers which addresses previous deficiencies, enhances transparency and better protects the interests of minority shareholders. The new Code seeks to ensure that minority shareholders are given a fair opportunity to consider the merits and demerits of an offer and to enable them to make an informed decision. These changes and the new code coupled with tighter regulation would prevent a repetition of the Renong debacle, which stemmed from a loophole in then existing regulations.

In response to previous episodes where related-party and interested-party transactions were undertaken without due regard for the interests of minority shareholders, the SC also reviewed rules on related-party and interested-party transactions. Changes were made to the KLSE listing rules which related to a widening in the scope of rules, enhancing disclosure, voting rights, the appointment of corporate advisors and directors' responsibilities.

In addition KLSE has been asked to make revisions to its Listing Rules to stop possible abuses by large/controlling shareholders in connection with related party transactions. Among other things, the rule now requires a company to appoint an independent corporate adviser to advise minority shareholders of the company, and prevents directors, substantial shareholders or interested parties from voting on the transaction.

The Securities Industry Act 1983 was amended this year to resolve weaknesses in insider trading rules in Malaysia. Steps have also been taken to achieve transparency of ownership. Amendments to the Securities Industry (Central Depositories) Act 1991 in October 1998 now prohibit persons from hiding behind their nominees by requiring securities accounts to be opened in the name of beneficial owners or authorised nominees.

Improving Governance by Regulators, Intermediaries and Corporates

Perhaps the most topical of all our initiatives at this juncture is our efforts at enhancing the standards of corporate governance. In recognition of the impact of good corporate governance can have in boosting investor confidence, several measures have been taken to raise standards of corporate governance in Malaysia. Chief among these was the establishment of a high level Finance Committee that reviewed the framework for corporate governance in Malaysia and recently released its report and recommendations to the public. The recommendations essentially seek to strengthen the statutory and regulatory framework for corporate governance; and to enhance the self regulatory mechanisms that promote good governance. The report also recommended the need for training and education programmes to ensure that the proposed framework will be supported by the necessary human and institutional capital and that the philosophy and culture of good corporate governance will be inculcated into all market participants including Malaysian boards and corporate participants.

Indications of success

At this juncture, I should perhaps draw to a close. I have outlined in general the philosophy underlying Malaysia's response to the Asian financial crisis. In particular I have highlighted specific measures which we have actually implemented to restore confidence in our capital market by ensuring that our markets are safe, transparent, fair and well-regulated.

Ladies and Gentlemen:

You have to be the judge of whether Malaysia is a good investment opportunity. Your country has been in recession for the past two years and have been subjected to considerable international pressure to pursue some prescribed course of action or the other but ultimately, you judge the success of any policy measure by its results not by whether it fits into a particular school of thought.

There is some cause to believe that the measures I have just outlined, as well as other measures taken by the government and through other agencies, appear to be having a positive effect, even at this stage of their implementation.

In terms of the broader economy, growth prospects for Malaysia appear to have improved. Consensus estimates put real GDP growth at around 1-2% in 1999 and 2.7% in 2000, while private consumption is expected to rise by around 2% in 1999-2000. Car sales, for example, have seen substantial growth in recent months. The outlook for inflation remains subdued and an average forecast suggests annual growth in consumer prices of no more than 4.3% over the next two years. The current account balance should register a surplus and recent estimates suggest a US$10.9b surplus by end-1999 declining to around US$9.7b at the end of the millennium. Foreign reserves have increased to their highest level since 1993 and currently stand at over US$26b. An important development is that domestic confidence in economic prospects appears to have stabilised.

Domestic confidence has been reflected in the performance of the stockmarket, which has shown marked improvement since September 1998 compared to the previous five quarters on active retail and institutional participation. Stock prices on the KLSE stabilised from the sharp declines registered since the onset of the financial crisis and the Composite index has gained over 100% since September 1st, currently trading at around the 550 level.

Importantly, there are also signs that foreign investor sentiment has improved. A string of positive recommendations have emerged over the last quarter. Many have noted and strongly approved of Malaysia's corporate restructuring efforts and point to the relative undervaluation of the equity market. There is finally grudging approval that Malaysia's current economic policy mix for encouraging demand expansion is a step in the right direction.

Policy and economic developments have also spurred a review of Malaysia's credit standing. Markets have begun pricing the country's sovereign risk more favourably. The benchmark yield spread of Malaysian international debt continues to decline substantially, from 547 basis points over US 30-year treasuries at end 1998 to just under 280 basis points currently. Recently, Standard & Poor's upgraded Malaysia's credit rating outlook to positive, citing.

- The government's pro-active policy response in a difficult domestic and external environment
- The halt in capital flight following the government's introduction of capital controls
- Successful and appropriate economic policies
- The government's recapitalisation and asset management efforts.

Indications are that other rating agencies will follow suit. Finally, there are strong indications that Malaysian equity will soon be reinstated into certain major global and regional benchmark stockmarket indices. The International Finance Corporation announced recently that it will reinstate Malaysia in the calculation of its key indices later this year and market expectations suggest that Malaysian equity will return to other benchmark indices in the near future.

On top of all this, we have not only talked about but have also taken solid action to ensure that our capital market infrastructure is on solid ground.

Is Malaysia a good bet? Don't listen to all the hype around, look at the numbers, look at our unwavering commitment, look at our determination to right our wrongs. You are thinking people, you be the judge.

Thank you once again for having given me this opportunity to speak at this forum.