# KEYNOTE ADDRESS ON "THE DEVELOPMENT OF THE MALAYSIAN CAPITAL MARKET" BY Y BHG DATO' AINUM MOHD SAAID DEPUTY CHIEF EXECUTIVE, SECURITIES COMMISSION IN CONJUNCTION WITH MINGGU PELABURAN PERMODALAN NASIONAL BERHAD 10 JUNE 1999, PWTC, KUALA LUMPUR

Distinguished Guests, Ladies and Gentlemen, thank you for inviting me to speak to all of you today.

It wasn't so long ago that the government announced its intentions to develop Kuala Lumpur as a regional fund management centre. Since those heady days when other aspiring financial centres looked at our efforts with increasing concern and alarm, our capital market has been subjected to the greatest pressures as a result of the crisis. Only now, some eighteen months after the onset of the financial turmoil, is the country able to begin to refocus its attention on the way forward. Up to now, all of us have devoted much of our resources towards the successful management of the crisis.

I was invited to say a few words about the development of the Malaysian capital markets. Given the diversity of issues this topic entails and particularly in the context of my audience today, I would like to address this topic by focusing on the fund management industry and the critical role it plays in the development of our capital markets. Let me assure you that the SC, even through the recent trying times, has been and always will be committed to the development of the Malaysian fund management industry. In fact, during the financial crisis, the SC was continuously looking at ways of liberalising and developing the fund management industry further. The fruits of these efforts, we hope, will be realised by the industry as a whole in the near future.

So why are we at the SC putting so much emphasis on the development of the fund management industry? Well, a strong and vibrant fund management industry is a fundamental element to the blueprint of a well-developed capital market. Yes, it will provide for a deep and liquid capital market but I believe more importantly, it will impart greater institutionalisation and professionalism to the market. Furthermore I would also argue that a more developed fund management industry will ensure a more efficient mobilisation of domestic savings to fund corporate growth and fuel economic expansion.

## Where do we stand now?

Although most industries experienced severe contractions during the 18 months of the crisis, the fund management industry especially in relation to collective investment schemes have continued to grow, albeit at a slower pace. Let me share some statistics with you to put our focus in perspective. The number of approved unit trust funds has increased from 79 in April 1997 to 98 as at 31 March 1999, with total net asset value of the funds growing from 7.5 per cent of market capitalisation to 9.2 per cent as at March 1999. 9.2 per cent of the market capitalisation is still small by international standards and shows the potential for growth in this industry. I must further qualify that the size and success of institutions such as PNB and other government-sponsored funds camouflage this figure. Within the composition of figures I have just mentioned, there are 70 approved private schemes with a NAV of only RM6.27 billion, or 1.97 per cent of the market capitalisation. We are, therefore, still a long way off when compared with the mutual fund industry in the United States where mutual fund assets have already overtaken the amount of deposit at commercial banks. The Investment Company Institute [1] reported that the combined assets of the mutual funds in the US as in March 1999 stood at USD5.768 trillion and have more than 73 million individual investors.

So why although there is growth in the industry are we such a long way from more developed markets? Investors argue that one of the reasons that they have only shown a limited interest in collective investment schemes is because there is not enough diversity in the products offered to them by Malaysian fund managers. This is illustrated by the fact that of the 70 approved private schemes, only five are bond funds whilst the rest have portfolios that are significantly invested in stocks quoted on the KLSE.

Therefore the investing public question the advantage of paying someone a commission for investments they can make directly. Although in principle, there is an argument that retail investors are not in a knowledgeable position, due to lack of information and technical skills, to invest directly in the KLSE, that such investments offer the public a well-diversified portfolio and that collective investment schemes are for the long term and not speculative, in reality these reasons may not be enough of an argument to entice investors.

Fund managers should therefore provide investors with the opportunity to invest in products that are more sophisticated which retail investors might not be able to participate in due to constrains in financial resources and research. These, amongst others, should include futures contracts, bonds and global funds:

- Futures Contracts

  The investment in futures contract will provide a sophisticated investment product to retail investors, and at the same time fund managers should use futures contracts as hedging instruments against underlying risks so that they are better able to manage their assets.

- Bond Funds

  Investments in Bond Funds, in principle, should provide the long-term low risk investor with a steady flow of income. The SC is aware that there are certain impediments to the development on the Ringgit bond market, including the prolonged and multi-layered approval process of the primary market, as well as the inefficiency and illiquid secondary markets. Be assured that the SC is presently looking into measures to overcome this. Hopefully, in the not too distant future, bonds will become a viable investment alternative.

- Global Funds

  Of Global Funds: this category of funds is the cornerstone of vibrant fund management centres in places like Singapore and Hong Kong. Managers there have realised that with such a limited scope of investments within their own capital market, new investments in foreign jurisdictions must be sought. The availability of such funds can attract foreign investment managers with the consequential transfer of knowledge to the domestic industry. The acquisition of global investment skills will only enhance the capability of the local industry. Furthermore, Malaysian fund managers who invest in approved overseas markets stand to benefit from diversifying their portfolios into other markets and more importantly being able to provide investors with an opportunity to invest in markets that they are not proficient with or physically able to invest in.

  The SC as you are aware released guidelines formally removing restrictions for the establishing of "global funds" in May 1997. However, the advent of the economic crisis had required at that time a careful reassessment of implementation in light of financial outflows from our capital markets.

I am sure that if fund managers provide these alternatives to investors and are responsive to their needs, the Malaysian fund management industry will experience significant growth. My statement is supported by the fact that Malaysia has one of the highest gross national savings rate in the region and has therefore a large pool of funds to tap into. The most prominent of which is the EPF with assets in excess of RM120 billion. Not to mention the funds of other pension and benefit schemes like the Pilgrims Fund (LUTH), Social Security Organisation Fund (SOCSO), Armed Forces Fund (LTAT) etc. and, last but not least, the funds of insurance companies. The SC is looking into the possibility of redistributing some of these funds to help develop the industry. One obvious way is to allow the management of portions of these funds by the private sector. At this point, eligible EPF accountholders are allowed to transfer part of their funds in their account to "Approved fund manager institutions under the EPF members' investment scheme". I believe that further liberalisation of pension fund rules is needed to accelerate the growth of the fund management industry.

Ultimately as the fund management industry develops and the investing public shows greater interest in it, the institutionalisation of the KLSE and Malaysian exchanges will transpire. Institutional investors play a predominant role in developed markets accounting for up to 80 per cent of total participation on their respective exchanges. This will subsequently reduce shareholder passivity and augment fundamentally driven investment decisions.

### On New Products for Fund Managers

In the area of product development, the SC continues to strive for a balance between investor protection and facilitating product innovation. In this respect we had in fact amended the Futures Industry Act 1993 late last year to facilitate the licensing of those involved in the management of the futures fund industry. Managers of approved unit trust funds are now exempted from licensing requirements under the Futures Industry Act provided they invest only up to 10% of the net asset value of their funds for hedging purposes only.

The amendments have also allowed us to license other funds that wish to invest a larger proportion of their funds in futures contract. This allows fund managers to come up with more innovative investment products. These newer, more creative products must however be properly supervised to avoid undue risk to investors or to the financial system as a whole. In this regard the SC is pleased to announce that we are working closely with the industry in formulating a set of guidelines for the setting up and regulation of futures funds. We expect these guidelines to be released toward the end of the year.

### The role of the fund management industry in the development of the capital markets

Let me now briefly talk about a topic that I am sure is on the tips of most industry participants' mouths - "liberalisation and the opening up of the fund management industry". The decision by the Government to allow the entry of foreign fund management companies is a gradual step to open up the fund management industry. The liberalisation and de-regulation of the industry is intended to encourage and facilitate the cross-fertilisation of experience, expertise and professionalism within the fund management industry. With respect to foreign participation, local partners of joint ventures should insist that they be allowed to take an active role in the operations of the joint-venture, in particular the management of funds. Only then, can the real transfer of technology and expertise take place. This I believe is the way forward.

However it should be noted that as foreign fund management companies begin to play a more significant role in the growth of our capital market, global competition between international and domestic exchanges would become more evident. In this competitive environment, exchanges are continually forced to look for greater efficiencies. The most recent trend has been for international exchanges to form strategic alliances among each other.

Examples of strategic alliances include those between NASD (National Association of Securities Dealers) and the American and Philadelphia Exchanges, and among European futures exchanges[2] , such as MATIF (Marche a Terme International de France), DTB (Deutsche Terminbourse) and Soffex (of Switzerland). NASDAQ has also formed links with the SES (Stock Exchange of Singapore) and the SEHK (Securities Exchange of Hong Kong). These are but a few of the many examples.

Up to now I have talked about the major initiatives that the Commission has undertaken. I have also outlined the general strategies that the Commission intends to pursue from hereon. In both instances, I have shown that the Commission is committed to the development of the fund management industry. Allow me now also to turn the tables round.

In light of recent events, there is clearly a need to consider the role played by the fund management industry as the Malaysian capital market emerges from the crisis. I don't have to tell you that the Commission sees the fund management industry playing a significant role in the development of the capital market. A role that requires more activism than has previously been the case. Active shareholder management is a key pillar upon which the government's initiatives on corporate governance rest. To be sure, corporate Malaysia, the regulatory authorities and the investing public at large all have our respective roles to play. But fund managers can have a real and positive impact in the inculcation of corporate governance in Malaysia. Through each of your shareholdings, you can influence the behaviour of these companies. You can use your position to require these companies to adopt best corporate governance practices. I urge you to consider the idea of active shareholder management; not because it will help to protect minority investors (although it will certainly do that) but primarily because it makes good financial sense for you.

In the new paradigm that Asian companies are now operating in, there will be increased scrutiny of the quality of corporate governance practices among corporates. Those that practice sound corporate governance policies will attract greater demand from institutional investors than those that are seen to have weak governance. The reality now is that funds are increasingly asking questions on corporate governance: how safe are these companies, how transparent are they, are there really checks and balances? I therefore believe that it is in your interest and in the interest of your investors to ensure that each and every company which you have a stake in embrace and are seen to abide by the concept of corporate governance.

I hope that I have given you a sense of the commitment, past and present, within the Commission to the development of the capital market within the context of the fund management industry. Let me also reiterate our resolve to rebuild our capital market and to set it on stronger foundations over the next few years. And, perhaps, more importantly, I hope that I have communicated the importance of your role in our efforts.

Thank you once again for having given me this opportunity to speak to you on a subject that is important to all of us who have a stake in Malaysia's capital markets.

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