Suruhanjaya Sekuriti
Securities Commission

S P E E C H E S

Keynote Address
By YB Dato' Mustapa Mohamed
Second Finance Finance Minister
At the
1999 Securities Commission Annual Dialogue Dinner
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En. Abdul Kadir
Chairman, Securities Commission

Commission Members

Ladies and Gentlemen,

It is indeed a pleasure for me to be invited here this evening to share my thoughts on some of the present and future challenges facing the Malaysia capital market and the securities industry. I understand that the Securities Commission has had a series of discussions with you over the past three weeks on key issues facing the industry. The Government views these Dialogues with industry players very seriously as keeping the lines of communication open between the public and private sectors is the only way to ensure that we keep ahead of the competition in the global market.

The theme for this year's dialogue, "Moving Ahead Towards a Sustainable Future" is timely as the economic recovery is gaining momentum and a rebound is well on its way in the equity market. We have been through one of the most trying periods in economic history recently with the outbreak of the Asian financial crisis. The financial crisis has placed the financial system under considerable stress and revealed some of its shortcomings and weaknesses. While the immediate challenges thus far have been to minimise the adverse consequences of the financial crisis on the financial system so that it did not undermine the economy, we now face a new set of issues and challenges as we approach a new millenium in the aftermath of the crisis. Among the main challenges we face is that relating to the further development of the capital market to ensure it plays an effective role in supporting economic growth.

The Government, as you are aware, has undertaken a comprehensive set of measures to enhance the intermediary role of the capital market in financing economic activities in recent years. These measures, include, among others, the development of appropriate institutions, including the establishment of the Securities Commission, Cagamas, Monetary Exchange of Malaysia, Mesdaq, two rating agencies, the enhancement of the regulatory and prudential framework of the market and the introduction of a wider range of financial products to facilitate capital market development. While the capital market has developed significantly in terms of market size, a wider range of instruments and products and a higher level of market efficiency, much more remains, which can be done. To my mind, the single largest challenge facing us is further strengthening, broadening and deepening the Malaysian capital market to complement the role of the banks as traditional lenders, thereby reducing the excessive reliance currently placed on the banking system. Despite having a well-developed equity market, the banking system still accounted for most of the new financing in the 1995-97 period prior to the crisis. Bank lending constituted 58% of net funds raised, the equity market 15%, domestic debt market 11% with external debt contributing the remainder. The economy's over dependence on the banking sector for financing large-scale projects exposed the economy to systemic risks. Moreover, as long-term financing requirements of the corporate sector were met by short-term borrowings, corporates were exposed to large funding mismatches. These circumstances led a large number of corporate borrowers to face problems in the crisis due primarily to their funding structure and not their financial viability. Excessive reliance on the banking sector and absence of well-balanced risks in the financial sector is obviously a key issue we need to tackle in addressing the challenges ahead.

A key area in developing the capital market that the Government is presently paying much attention to is facilitating the development of private debt securities. The private debt securities market has the potential of meeting the financing requirements of infrastructure projects and allowing funding to be undertaken on a fixed rate basis. This enables corporations to undertake long-term investments with certainty in their planning as well as to avoid being caught with servicing problems when interest rates rise sharply as a result of external developments. Recognising the importance of a developed domestic bond market, efforts are presently being stepped up to deepen and broaden this market. Among others, these efforts will focus on introducing a shelf registration scheme for private debt securities, deepening the repo market and broadening the investor base. The further development of the domestic debt market will also allow the corporate sector to avail themselves to a variety of debt instruments to enhance the management of their liabilities. In the same vein, we are also studying the securitization of debt other than mortgage loans, to assist the banking system to manage their assets and liabilities and capital requirements.

Efforts to deepen and broaden the capital market and improve its efficiency is also part of an overall effort to realise the full potential of the services sector as an engine of growth for the economy. We have been relying heavily on the manufacturing sector in the past 10 - 15 years to generate the value added need to sustain growth in real GDP while the services sector, including financial services, has already emerged as the most dynamic sector in other economies in the world over the same period, or even earlier. Yet another challenge in developing the capital market is ensuring that the financial services sector grows in consonance with, even take the lead and be a catalyst in generating new growth for the economy whilst servicing the needs of a rapidly expanding economy.

Recognising the critical role of the capital market in driving the growth of the real economy and expanding the economy's productive capacity, the Government has approved the Securities Commission's initiative to develop a Capital Market Masterplan. The Masterplan, which I believe was announced today by the Securities Commission Chairman, seeks to prioritise immediate needs and chart the direction and long-term growth of our capital market in efforts to position Malaysia to not only face, but challenge the competition in years ahead. Given the strategic road map for the industry, you will be able to decide for yourselves, how best to tackle the challenges and exploit the opportunities coming your way in the future.

While the developments in the capital market pose serious challenges for industry players, regulators of the industry will similarly have to continually enhance their knowledge and skills to keep pace. Recent developments indicate that the increased complexity and breadth of activities and the pace of innovation taking place have important implications for the overall regulatory and supervisory framework. In the face of increasing sources of risk, not only industry players but regulators need to continually update their skills to keep up with the market and detect risks arising from new developments in the industry. In the recent crisis, the Government has undertaken several far-reaching measures to strengthen the regulatory regime and consolidate the industry.

In this regard, I would like to commend the Securities Commission and the KLSE on the proactive stance they have adopted since the onset of the crisis in addressing the shortcomings of the market. A disclosure based regulatory framework has been introduced to promote higher standards of disclosure and due diligence by corporates and their advisors. Rules on related party and interested party transactions have been strengthened, regulation on takeovers and mergers improved and regulations on insider trading strictly enforced to ensure a well regulated market. In addition, efforts to strengthen market institutions by redefining their roles and responsibilities through a front-line regulation programme have been initiated. The Government has also introduced various prudential measures aimed at strengthening financial intermediaries in the industry. More importantly, where breaches have occurred, the Government has shown its commitment to ensuring compliance with Malaysian securities laws by market participants.

Much has been done to raise the standards of the industry and much more can and still needs to be done if we are to move ahead. While the Government remains fully committed to the measures in place to strengthen the industry, my personal fear is that lessons that we have learnt from the crisis may soon diminish and we become complacent and laid back once again with the economy regaining its momentum. Let me remind you that stalling reform efforts and losing sight of harsh lessons learnt will be to our detriment as we live in an increasingly competitive and interconnected world. Established trends in global markets indicate clearly that to survive, and survive well, we need to ensure best practices in the market or else lose credibility. The performance of markets are directly related to best practices, we are constantly reminded. While the Government undertakes to ensure that the level of regulation does not border on over regulation but remains sufficiently adequate to ensure best practices and a fair and orderly market, participants in the securities industry must in turn accept the responsibility to put their house in order. Market participants must accept the challenge of employing higher standards of risk management and best practices which will be to their benefit in the long run. In addition, market institutions must play their role as effective front-line regulators. And it must not be forgotten that good governance, disclosure and transparency also apply to market institutions and market intermediaries. Best practices can be legislated but not good behaviour as regulators can, at best, undertake to ensure compliance. However, so much more can be achieved by you, if you set your mind to the benefits that we can together derive from moving the industry forward. In this regard, I strongly urge industry participants to be committed to the successful implementation of a disclosure based regime in the year 2001 as it will be indicative of the progress, sophistication and maturity achieved by our market and that we have arrived.

In facing the challenges of an era of globalisation, the Government has been calling for further consolidation among market intermediaries in order that economies of scale and scope can be effectively realised and enjoyed. Consolidation has become the norm in the industry worldwide, both in terms of participants and markets, given the need to offer products at lower costs in order to attract investors into their markets. We see some consolidation on the part of markets in Malaysia with the merger of the Kuala Lumpur Commodity Exchange (KLCE) and Malaysian Monetary Exchange of Malaysia (MME) into the Monetary Exchange of Malaysia (COMMEX) and the KLSE acquisition of the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE). However, this trend is not discernible yet in the local securities industry. Strengthening the financial viability and capabilities of the local securities industry is imperative to the continued survival and growth of the industry given the current pace of developments in the region. We cannot afford to be laggards in the race for business with regional competitors if we do not want to see ourselves lose out to the competition. As an industry you must accept the challenge to brace yourself to meet the growing demands of an increasingly competitive business in the future.

In concluding, I would like to say a few words to update you on developments in the economy. We are very encouraged by trends in the key indicators on the economy in recent months. We are gaining ground on a number of fronts and the turnaround in economic activities has been further strengthened with the return of both consumer and investor confidence to the market. Stability and confidence which returned to the financial market with the introduction of exchange controls in September has been translated into visible signs of recovery in the real economy. Just to mention a few, manufacturing output which turned from negative in January (-15.3%) to positive in February (4.9%) has since gained momentum to register growth of 8.5% in May. In consonance with the improvement in manufacturing output, real GDP growth which recorded a negative growth of 1.3% as compared to 7.5% contraction in 1998 is expected to register stronger growth by the third and fourth quarters of this year.

Exports have of course performed exceptionally well, increasing by an average 10.0% in US dollar terms in the first six months resulting in twenty consecutive months of impressive trade surpluses. Meanwhile, external reserves increased from USD20.2 billion (3.8 months) at end August last year to USD31.6 billion, sufficient to finance 7 months of retained imports at 15 July 1999. At the same time, Malaysia's short-term external debt has declined steadily from USD11.1 billion at end 1997 to about USD7 billion recently. As such, Malaysia's external reserves is 4.4 times the short-term external debt. Meanwhile, our external debt-service ratio of about 5% remains well below the international average of 20%.

In the financial markets, market capitalisation in the KLSE has improved an impressive 157% from RM181.5 billion on 1 September 1998 to RM467 billion as at 5 August 1999. Unlike other regional bourses where the sharp gains in share values have been largely due to inflows of foreign funds, the net inflow of foreign funds to Malaysia since 15 February 1999 to 21 July 1999 represented but 2.3% of the RM202 billion increase in market capitalisation in the same period. I am confident that long-term and serious investors will return to our local bourse with the significant progress we have made in strengthening both the banking and corporate sectors coupled with the gains we have made in key macroeconomic fundamentals. Confidence in Malaysia's recovery is becoming increasingly evident as economic forecasts and credit ratings are being revised upwards while risk premiums are coming down.

I hope my remarks and thoughts about the developments affecting the capital market in general and the securities industry in particular have been useful in conveying to you some of the challenges we face as the economy moves ahead. Our success in meeting some of these challenges will certainly improve the prospects for a resumption of economic growth to higher but sustainable levels of the past and assist us in achieving our objective of developing an efficient and progressive capital market. Let us, therefore, collectively capitalise on the momentum of recovery we have achieved thus far to strengthen the foundations we have in place, to face the challenges associated with the pressures of globalisation in the next millenium. Thank you.

Bahagian Ekonomi dan Antarabangsa
Perbendaharaan Malaysia.

August 5, 1999.