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"The Changing Landscape of the Malaysian Capital Market - Meeting Challenges in the New Millennium"

at

MACPA Evening Talk to Members

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Firstly, my thanks to MACPA for kindly inviting me to talk to all of you on this interesting topic, which is indeed very timely given that the New Millennium is around the corner!

Secondly, I am grateful for the opportunity to meet with some old and familiar friends again, after leaving the Presidency and the Committee at the end of June.

THE CHANGING LANDSCAPE

1.0 Some of the factors that I consider will affect the financial landscape include the following:

- Technology and e-commerce
- Global and regional competition
- Disintermediation
- Liberalisation
- Changing demographic profile
- Institutionalisation of investors.

I will discuss each of these factors in turn.

2.0 I believe that domestic institutions will change the manner in which they conduct business in response to **technology advancements and product innovation.**

2.1 Firstly, technology will make it easier and cheaper for investors to trade in securities. For example, internet trading facilities allow investors to have greater, easier and cheaper access to markets including foreign markets. Securities firms will thus see the necessity to diversify its activities in view of technological advancements that will challenge the necessity for pure broking services, as well as economic demands for the lowering of their commissions. Already we see banks with links to securities firms venturing into e-commerce type of activities providing greater convenience to the investor. We will therefore see a diminishing role for the pure broking firms.

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- 2.2 In addition, the nature of exchanges will also change with the advent of technology. Exchanges will see a change in the nature of its role and services that it provides. Technology will enable over-the-counter markets to become increasingly organised, and more able to reduce the deficiencies previously associated with these markets. Price will become more transparent, information will be disseminated faster, execution and payment services will also be quicker, cheaper and more accessible, and possibly structures can be put in place to minimise credit risk. As such, exchanges will need to move quickly to differentiate themselves in terms of the functions they perform.
- 2.3 The combination of technology and financial engineering will make it easier for foreign institutions to challenge our domestic institutions. With derivatives, for example, it has become easier to replicate home grown products providing investors the same economic effects.
- 3.0 All these challenges will come, not just from within Malaysia, but from **global and regional competition**.
- 3.1 An example of global and regional competition from foreign markets has already been evidenced in 1998, when we saw Singapore threatening to introduce a Malaysian stock index futures that would affect the liquidity of our domestic exchanges. These are very real threats, to which our exchanges will need to respond and very quickly.
- 3.2 Then there are the bigger and more sophisticated international financial services providers who have been in this field for considerably longer than our domestic financial service providers. These provide a myriad of services that ours currently do not, in part because of size, regulations, experience and expertise.
- 4.0 In this connection, it can also be expected that there will be **increased disintermediation** in the financial sector. This is particularly with the regulatory and governmental support for the development of the bond market. Increased disintermediation will mean less reliance on the banking sector and equity market for long term funding needs.
- 4.1 The disintermediation process, whereby those in need of capital by-pass balance-sheet institutions (banks) in favour of direct fund raising via the capital markets, has already resulted in the diversification of banks in other financial services. Although bank intermediation can be expected to continue to play a role in the financial services sector, the shift towards direct financing is already evidenced by the growth of the capital market, and the shift by banking industry to fee and fund-based activities. Banks can be expected to continue to find ways to make inroads into the capital markets sector.

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- 4.2 While traditional service providers (banks) currently still dominate their particular fields, such as the provision of corporate finance services, stockbroking-related holding companies have, by forming subsidiaries or otherwise, also entered into other activities. Clearly there will be increased competition in relation to services and products in the capital markets.
- 5.0 Already the effects of measures to **liberalise** the activities that service providers may undertake can be seen.
- 5.1 The policies of the regulatory authorities have generally been to encourage the industries to open up and become more competitive and promote increased efficiency, through e-commerce and otherwise. Under current regulations, stockbrokers can underwrite and place issues of securities, manage investments (through subsidiaries), establish closed-ended funds, provide specialised broking services, such as clearing services and investment research, establish futures subsidiaries, trade other financial products (including Islamic capital-market instruments), offer margin financing, provide custodial and nominal services, and offer investment research. Stockbroking groups are therefore attempting to diversify into other areas such as corporate finance, though these are still fairly limited. However, in view of the fact that several capital market activities are now open to stockbrokers, the diminishing role of pure brokers as well as competition from banks, brokers can be expected to expand its services and compete or just disappear. But we need to see the stockbroking companies being well capitalised, well managed and efficient before we can allow them to venture into these areas.
- 5.2 We have already seen that with the emergence of capital markets for intermediating risks, there are, and there will continue to be, changes in the activities and risk profiles of financial institutions.
- 6.0 It is expected that all these changes will additionally be fueled by a **changing demographic profile**.
- 6.1 People are living longer, the number of pensioners are growing. As such pensioners will demand for their quality of life to be maintained. We can therefore expect that there will be a large demand for pension and other funds. With the development of the fund management industry as well as investor education, we can expect more savvy and more demanding investors, that will want more diversified and more sophisticated products. They will demand that exchanges have higher standards, they will want cheaper access to markets, etc. The challenge will be, to a large extent, in keeping investors in the Malaysian market.

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- 7.0 In this connection, I believe that over the millennium there might also be a change in the type of investors that will typify the investor within Malaysia. My question is, will **institutionalisation** minimise the direct participation by the retail investor?
- 7.1 My feeling is that there will be a mixture of both, the institutional investor and the retail investor. Originally the Malaysian market developed with a large retail base of investors. With the development of fund management and pension schemes, we will see a move may be seen towards institutionalisation, provided that our fund management industry markets their products and perform as they should.
- 7.2 However as the retail investor becomes more sophisticated, better educated and more able to assess risks for themselves, I believe that e-commerce will again affect the make-up of the investing community. E-commerce will provide real time information, ease of execution without intervention by brokers, cheaper modes of execution and more products combined with other financial services. So what do we have? An ability for investors to manage some of their funds at least, directly and cheaply. Thus, it is quite possible that investors are likely to put some of their funds in the hands of fund managers, and continue investing part of their portfolio directly using the opportunities that e-commerce will present.

THE EFFECTS OF THESE CHANGES

- 8.0 In sum, these are some of the changes I see as a result of the factors I have described so far. There will be:
- A different type of investor with greater demands for a variety of products and services and at greater efficiency, convenience and a lower cost
 - Greater competition for capital/products
 - Lower costs for investors, easier access to markets and companies and a diminished role of the pure broker
 - Lower costs of companies seeking to raise funds
 - Development of "financial supermarkets" to provide these products and services and to meet this competition
 - Development of the niche/boutique players to provide specialised services and products and to harness funds of particular types of investors
 - Increased activity in research and development
 - A different type of exchange perhaps with international links providing more facilities, services, products, credit and other enhancements.

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MEETING THE CHALLENGES

9.0 I agree that no one can predict the future with total certainty - too many factors are involved. The only things certain in life are death and taxes! However, this much I am certain of -- the next millennium will see many changes. And the nature and extent of the changes and our success in meeting these challenges will to a large extent depend on how we, the regulators and industry, manage these changes. Hard thought will need to be given to how we can meet these challenges.

10.0 Already financial institutions are being encouraged to merge into larger entities, and there are likely to be fewer regulatory barriers against these structures becoming larger. In addition, I think that the next millennium and challenges from foreign financial institutions will see the necessity for our domestic institutions to conceive of ways to diversify into more financial activities both for more synergies and "brand-name" advantages. This is particularly important keeping in mind that barriers to international competition can only be sustained for a limited period of time and in view of Malaysia's aim to become a global competitor.

11.0 For sure there will be market pressure for stockbroking companies to merge, to meet the challenges of liberalisation, globalisation, technology and e-commerce. The Government has offered incentives in its Year 2000 Budget, so the stockbrokers are being encouraged to merge -- the carrot and stick approach (the stick comes later).

12.0 The other manner in which I see that the capital markets sector can meet these challenges is to capitalise on its existing strengths. In terms of regulatory structures and framework, the Malaysian market in this region has a distinct advantage over many of our neighbours. The challenge is in ensuring that the regulatory framework is flexible and relevant while ensuring that investors and market integrity are protected and that systemic risks are addressed. Regulators have this in mind and we at the SC for one are constantly attempting to keep our laws up to date and in keeping up with international standards..

13.0 As for industry, I believe that it should also look at niche areas - such as the Islamic instruments for example - to see how these areas can be further developed

14.0 We will also need to increase the confidence and understanding of investors and the general public. When was the last time you saw the press, especially the foreign press, spending a lot of time on what is good about our market? To keep local investors in our market, and to attract international investors, the reputation of our issuers exchanges intermediaries and regulators must be unblemished. No one can guarantee high returns to the investors - that is the nature of risk taking. However,

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in matters such as market integrity, matters that are within our control, we should keep cause for complaint by the investors at a minimum.

15.0 We must take full advantage of the Government's initiatives to progress the e-commerce industry. We have already countless international and domestic examples of how technology changes the face of the financial services industry, if not obliterating inefficiencies and inefficient participants in the process. The SC is in the process of producing a "Draft Regulatory Framework for E-Commerce in the Capital Market" and we will give the draft a 3-month exposure and invite comments from industry groups before we finalise and issue it.

16.0 We will also need to accelerate the progress the fund management industry. I believe that the industry has an important role to play in providing investors with efficient and skilled management services, as well as to enhance liquidity in our markets, both in securities and the futures industry. With greater participation of institutions, will come more sophisticated players, more liquidity and greater attractiveness to the regional and international investors.

17.0 To relieve the pressure on the banking sector, a Ringgit Bond Market is being set up, and will be regulated by the SC. A National Bond Market Committee is already hard at work!!

18.0 Finally, regulatory authorities and industry alike should have clear objectives for our financial services industry and capital markets and stick to those objectives as far as possible.

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CONCLUSION

19.0 As you know, the SC has initiated the setting up of the Capital Market Strategic Committee that will undertake a study of the capital markets. I have already mentioned the need for there to be clear and achievable objectives for our capital markets. This is what the Committee is intended to carry out.

20.0 The Committee will undertake industry consultations, which we feel to be very important, since it is industry that should drive the developmental vehicle and help determine its fate. The Committee will then make recommendations for a Capital Markets Masterplan, with strategies and a comprehensive "road map", if you like, as part of a larger exercise for the financial services sector in Malaysia as a whole.

21.0 These are only some of my thoughts for the development of the capital markets in the next millennium. As for the rest, I believe that it is crucial for industry to understand the need to keep abreast of threats such as global and domestic competition, technology, disintermediation, and inasmuch as possible to work with the regulatory authorities in meeting the challenges posed by these threats.

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