

S P E E C H E S

EMERGING MARKETS PROGRAMME

**"Responding to the Challenges of the New Economy"
14 -19 October 2001, Conference Hall, Securities Commission**

SPECIAL ADDRESS

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Ladies and gentleman,

1. Good morning. First of all, I would like to thank the Securities Commission for inviting me to deliver this special address to such an important gathering of senior capital market regulators. Let me also take this opportunity to welcome all of you to Kuala Lumpur and to the Second Emerging Markets Programme organised by the Securities Industry Development Centre of the Securities Commission, Malaysia. I am very encouraged that in spite of concerns about the further uncertainties in the wake of the tragic incident on 11th September and the military action since 8 October, we have 26 foreign participants attending this second programme.
2. Ladies and gentlemen:

In recent months, prospects for a modest upturn in the global economy by the second half of 2002 have dimmed considerably. Indeed, world economic growth outlook has weakened further due to the expected delayed recovery of the United States in the aftermath of the terrorist attacks on New York and Washington.

In combination with slowing domestic demand growth in Europe; continued decline in information technology spending and deteriorating financing conditions in many emerging markets, prospects for most developing, emerging and transition economies will likely deteriorate significantly. In this region, Malaysia and other export-oriented economies have been affected to various extents by the downturn in IT spending by corporate America and Europe.
3. In this environment, policy makers everywhere face a particularly challenging task in trying to limit downside risks and implement policies to support activity and confidence.
4. With a roomful of captive audience comprising senior capital market regulators from 17 important emerging markets, I must seize this opportunity to share with you some of Malaysia's economic achievements and aspirations. First the macroeconomic indicators. While growth has slowed somewhat since the second quarter of this year, macroeconomic conditions remain fundamentally strong with a large current account surplus and low inflation at 1.6 per cent. We have experienced some resumption in FDI flows: external reserves has returned to a rising trend and external debt capped at below 50

percent of GNP. Looking ahead, we expect that the Malaysian economy will continue to be subject to the vagaries of the global business cycle. We are, after all, an open, trade-oriented economy and thus the slowdown in the external environment will no doubt impact the domestic economy. We will, however, continue to address all aspects of the changing environment in the upcoming budget which will be presented to the Parliament at the end of this week.

5. Ahead of the Budget, and taking into account the weakening global economy, the Government in September announced a stimulus package costing RM 4.3 billion aimed at generating economic activities with the greatest spin-off effects, which should translate into ensuring a fair and wide distribution of benefits to a large segment of the population. Some of this money will be spent on development projects in the rural and selected urban areas; training and re-training schemes; upgrading and maintenance of existing infrastructure and intensification of efforts to promote tourism.
6. Let me come now to the Malaysian capital market specifically. Despite the many constraints due to the Asian financial crisis, Malaysia's capital market remains one of the biggest and most developed in the region and among emerging markets globally. The KLSE has 807 listed companies with a total market capitalisation of RM411 billion or USD108 billion. We have also a market for high, growth companies - MESDAQ, which has currently 4 companies listed. We have a derivatives market, the Malaysian Derivatives Exchange or MDEX, which trades products like Crude Palm Oil (CPO) futures, interest rate futures, as well index futures and options. All these markets are supported by a regulatory and market infrastructure that is bench-marked against the best in the world, including a book-entry system and a T+3 settlement cycle. Additionally, like most other markets hit by the Asian crisis, we have learnt early about the need to develop a vibrant corporate bond market and took immediate efforts in this regard, and have achieved considerable progress. While the size of the corporate bond market remains small compared to the equity market, its growth over the recent years has been phenomenal.
7. At this juncture, let me to explain to you a unique feature of the Malaysian capital market, indeed the Malaysian financial market - this is a matter that is close to my heart, which I feel should be shared with all of you.
8. The unique feature of Malaysia's financial system that I wish to highlight to you is that our conventional banking, insurance and capital market system is strongly complemented by the Islamic banking, Takaful or Islamic insurance, as well as the Islamic capital market.
9. Our earlier achievements in the area of Islamic banking and Takaful are well documented. But given that you are all capital market regulators, let me outline to you our achievements in the area of Islamic capital market. The breadth of products is a clear testimony of the fact that our efforts in this area are showing results. For instance, 78 per cent of all listed securities on KLSE and MESDAQ are Syariah - compliant, which means that they have been approved by the Syariah Advisory Council of SC as being syariah compliant securities. These stocks form 63 per cent of the market capitalisation of the KLSE. In addition we have Syariah compliant or Islamic unit trust schemes - managed by professional portfolio managers in accordance with Syariah principles. There are currently 18 such unit trust funds with net asset value in excess of RM2 billion. This forms about 13 per cent of the 139 unit trust funds in the country.
10. The Islamic private debt securities or corporate bond papers have also developed in parallel with the equities market a significant. A significant 37 per cent of the total value of private debt securities issued in 2001 are structured as Islamic - this represent an amount of RM6.5 billion. The KLSE has also developed the Kuala Lumpur Svariah Index (KLSI) which is a board based price weighted average index

constructed from the list of Syariah compliant securities approved. Currently this index has 343 stocks.

11. Therefore, the Malaysian capital market, indeed our entire financial system, offers investment opportunities not merely for conventional fund managers but also for those looking for investment which are in accordance with the principle of the Syariah. Supported by the necessary infrastructure, such as Islamic stockbroking companies, Islamic banking facilities and Islamic insurance, an investor can choose to invest in a holistic Islamic manner in Malaysia

12. Ladies and gentlemen:

Let me now turn to what I believe to be the important role of capital market regulators in ensuring the efficiency, stability and integrity of markets. We are all involved in the regulation of products or function or institutions or a combination of all three. Whatever the approach to regulation, our underlying objective must be the avoidance of systemic risks and to maintain high standards of investor protection and market integrity.

13. I would also offer the view that the regulatory response to any set of circumstances, whether they be crises or market developments of a more positive kind, cannot be viewed in isolation. They have to be viewed against each country's socioeconomic and political backdrop. What might be an acceptable way of operating in one country may not be in another. For instance, the degree of intervention that is seen as necessary and acceptable in one place may be considered overbearing and anticompetitive in another. The balance between caveat emptor and investor protection may swing across a wide-range of possible approaches, depending on the domestic circumstances that the Government seeks to address. Of course, most Governments today recognise that their policies and objectives will be best served by having recognised standards of supervision that produce efficient and orderly markets, minimum barriers to the flow of capital and investment, protection for those who are encouraged to invest in the markets, and mechanisms for dealing with those who abuse them.

14. I understand that this five-day programme is intended to provide an opportunity for capital market regulators from emerging markets to exchange ideas and information, share experience and expertise with each other on approaches to survive the new economy. Some of these could be improving the performance of market, by, among others, promulgating global standards of reporting and disclosure, creating, refining and enforcing a legal structure that allow for well-designed contracts and formulating laws to protect minority shareholders against fraud. Your success as regulators has real world consequences, as indeed will be your lack of success. Indeed, ordinary people will be harmed if we fail in our role as regulators.

15. Ladies and Gentlemen:

In recent years, emerging markets have experienced significant changes in their domestic financial systems, either as a result of political and economic developments or in response to a more dynamic and challenging external environment. As regulators, it is vital that we are sufficiently trained and exposed to the breadth of policy, legal and technical issues concerning the development and regulation of capital markets.

16. As we all know very well, the internationalisation of financial activity has meant ever rapid growth in cross-border investment activity, increased international fund-raising and more cross border mergers and acquisitions. These developments have been prompted by deregulation of financial market worldwide. including barriers to cross-border activity being lowered as well as increasing integration of

financial products and services. Furthermore, rapid advances in information and communications technology are changing market structures and the way they operate.

17. In my view, it behoves all regulators to understand what drives the different market participants in the new economy. Let me try and address this aspect briefly.

- First, the investors who want to have the ability to take on exposure across a wide variety of investment opportunities and this carries a large premium. They prefer to invest in markets where liquidity is high and transaction costs are low. They want to see greater recognition of their rights and interests, and wish to have confidence and certainty in the environment in which they invest
- Next, the issuers who want low costs of raising capital and a breadth of financing options. They want appropriate value recognition of their securities within a vibrant and liquid market. They also place a premium on efficient capital-raising processes
- Third, we have the market intermediaries who are looking to widen their scope of business opportunities. They increasingly take advantage of technology and innovation to stay ahead of the competition, and to provide value-added services and products to their customers. And like issuers and investors, they are also seeking vibrant markets that generate revenue.
- And finally, the exchanges and clearing institutions are likewise taking active steps to offer all their stakeholders greater value. Being a national market clearly no longer guarantees an implicit franchise over listings and orderflows. There is now aggressive competition for a share of global investment activity. Hence, many have responded by restructuring, forming strategic alliances and becoming more commercially focused.

18. Ladies and gentlemen:

Let me now turn to issues concerning the role and interaction of the financial system with the domestic economy in the wake of globalisation, deregulation and the changing characteristics of market participants and activities and why regulators need to take cognisance of these in designing policies and regulatory frameworks.

19. Many countries that have, experienced financial crisis, and this includes the East Asian economies, Russia and Brazil, learnt too late that weak and underdeveloped financial systems can undo achievements in the real-sector. As devastatingly demonstrated in the closing years of the last century, prolonged financial market turbulence almost wiped out the hard-earned gains of the East Asian miracle economies.

20. Sustainable economic development therefore requires a holistic approach that does not divide the economy into the real and financial sectors. Hence, in addition to industrial policies which attempt to shift agrarian economies up the value-added chain, it is necessary to formulate policies that thoughtfully takes into account the intricate links that the financial system has to other parts of the economy and its institutions. In short, financial sector development cannot be treated in isolation.

21. Allow me to now discuss private capital flows, the essential ingredient for investment and growth. Events of the last few years have led the international community to review conventional thinking about the role of private capital flows and international capital mobility. In Malaysia, we welcome FDI as it brings with it not just capital, but also knowledge and market access. We encourage stable, productive flows, while discouraging rapid round-trips of short-term money. Of course we recognise that there are benefits from short-term flows. and as learnt from the 1998 crisis. having strong initial preconditions

meant that we were able to mitigate somewhat the country's exposure to the volatility of such flows.

22. In the aftermath of the 1998 financial crisis, we took steps to put in place the building blocks of a financial system that will ensure proper intermediation and efficient allocation of private capital flows. This requires a more diversified financial system in which the bank sector and capital market both have relative depth and breadth. The problems that can arise when the banking system carries a disproportionate burden of financing activity are now well documented. So, too, are the difficulties in absorbing the shock from capital-flow reversals due to the absence of a deep and liquid debt market.
23. Ladies and Gentlemen:
Let me now turn to issues concerning the regulatory framework of financial system and its structure. In most economies, national financial systems are getting more interdependent and global financial activity increasingly becoming complex and dynamic. Distinctions between institutional arrangements and financial activities have blurred in recent years and the scope and nature of financial activity has developed well beyond that of traditional regulatory structures and jurisdictions.
24. As a result, regulators today are faced with a whole host of issues and challenges that were either not apparent before or were non-existent. A major challenge before us is to find a regulatory structure that is appropriate and flexible to meet the demands of the new economy. Regulators have to consider a wider and more complex set of factors than before, including the assurance of effective supervisory standards, surveillance operations and regulatory co-operation across the entire scope of financial activity. For instance, regulators will have to consider how to effectively supervise players who are active in several markets and having the potential to exploit regulatory gaps across different jurisdictions.
25. Regulators will also have to consider the fact that that the sources of systemic risk no longer appears in neat parcels. The reality is the financial system cannot be divided into the banking system and the capital market system. Within the domestic economy, at the international level, the choice for banking, securities and even insurance regulators is to co-ordinate and cooperate especially with respect to surveillance of financial conglomerates and the entire financial system to ensure that threats to systemic stability are dealt with early and effectively.
26. In Malaysia we see the existence of a strong and facilitative regulatory regime as critical in supporting our aim of achieving a capital market that is internationally competitive and an efficient conduit for the mobilisation of capital. We realise that as the market changes, so too must our regulatory approach if we are to ensure continued effective regulation at the same time facilitating' greater competition and innovation.
27. Therefore, as outlined in the Capital Market Masterplan, which was launched by the Minister of Finance early this year, and which you will be hearing more about later today, the Government has endorsed the Commission's approach of a market-based system of regulation, to be adopted for all capital market activities. The Commission will be moving towards greater use of market disciplines and processes to achieve its regulatory objectives.
28. To make sure there is a level playing field for all, participants in the capital market. I believe the Commission is pursuing full functional regulation of the capital market, which will provide for a "seamless" regulatory framework, thereby reducing the scope for regulatory arbitrage. The regulatory framework will also be strengthened through enhanced enforcement and supervision capacity. including

through training.

29. There are undoubtedly many more issues in relation to the challenges of the new economy to consider, and you will no doubt be touching upon them in your discussions over the next few days. I am sure the programme is designed to facilitate these as best as possible, so that you will have ample opportunity to update yourselves on developments concerning the world's capital markets but also to raise and discuss issues concerning the situation in your own particular markets. In Malaysia we take a serious view of training and education and I am pleased that the Securities Commission of Malaysia is committed to the promotion of high standards of training and education among regulators. I am convinced that all of you will, through this programme, find effective ways to share resources, facilities and experiences with each other.

30. On that note I wish all of you a fruitful week ahead.
