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CAPITAL MARKET MASTERPLAN - A BRIEF OUTLINE

**Address by
Mr Ranjit Ajit Singh
Director, Securities Commission**

**at the
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1. First of all, I would like to thank the organisers of this Investors Conference for inviting the Securities Commission to deliver this address on the Capital Market Masterplan which, as many of you are all probably aware, was launched recently.
2. Less than three weeks have elapsed since then, but we have been nevertheless pleasantly surprised to see the extent of attention and publicity that the Masterplan has garnered from both the media local and foreign, industry participants as well as the general public over this brief period. We have also over the last few days hosted the Asia-Pacific Regional Committee meeting of the International Organisation of Securities Commissions (IOSCO) which the SC chairs and were very pleased to note that the broad thrusts of our strategies and recommendations were well endorsed by our fellow regulators. The task ahead of course is in the implementation for which of course the undoubtedly the emphasis will be placed.
3. Most of you may already know, by now, of course, the major thrusts of the Masterplan, particularly those in relation to the investment management industry. Let me say at the outset that SC views this industry as integral to the future development of the overall Malaysian capital market. This is because of the significant potential it holds and its importance to the financial future of Malaysian savers, and the more efficient deployment of funds within the economy as a whole.
4. In this context, I would also like to briefly explain the background in which the relevant recommendations were formulated and the main drivers for change that have been considered in formulating the Masterplan's strategy for enhancing the role of the investment management industry.

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Overview of the Capital Market Masterplan

5. Allow me to first outline to you the Masterplan's broad vision and objectives for the Malaysian capital market. In essence the focus of the Masterplan is to implement a set of key strategies and initiatives that will foster the development of a capital market that is internationally competitive, bearing the hallmarks of high levels of efficiency, innovation and productivity. To put it succinctly, it is envisaged that the capital market for Malaysia will be:
 - Internationally competitive in all core areas necessary to support the country's basic capital and investment needs, as well as its longer-term economic objectives
 - A highly efficient conduit for the mobilisation and allocation of funds to their most productive economic uses; and
 - Supported by a strong and facilitative regulatory framework that enables the capital market to perform its functions effectively and provides a high degree of confidence to its users
6. We are also particularly aware of the need to ensure that the Malaysian capital market remains internationally competitive in light of the increasing globalisation of financial sector services and the constantly evolving market environment. Therefore, instead of specifying a framework for any one particular capital market model, emphasis is placed on ensuring that the capital market itself has-and will continue to have-the capacity to meet the challenges arising from the constantly evolving and changing market environment. This will also lay the necessary groundwork for allowing the market itself to continue to serve its constituents' needs more effectively going forward.
7. To achieve this vision, the Masterplan is premised upon six key objectives that relate to all the key segments of the capital market. For one, we are committed to ensuring that the Malaysian capital market remains by choice the preferred fund-raising centre for Malaysian issuers. As we progress further into the future, fund raising activity through the capital market is anticipated to become even more significant than ever before in financing Malaysia's economic growth and in diversifying the sources of funds within the financial system. It is our estimation that, even under conservative assumptions, the Malaysian capital market would have to facilitate the raising of over RM500 billion worth of funds over the next 10 years to support the nation's growth aspirations. This is over two-and-a-half times more than that raised over the last 10 years. The role of capital market intermediaries such as yourselves therefore will be crucial, which leads me to the second objective.
8. The second objective relates to an area that I will speak in further detail in a moment; that is, the promotion of an effective investment management industry and a more conducive environment for investors.

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9. The third objective is to enhance the competitive position and efficiency of our exchanges and clearing houses. As most of you will already know, the strategy towards achieving this includes, among other things, significant recommendations that relate to the establishment of a single Malaysian exchange through the consolidation of all existing exchanges and the consequent demutualisation and listing of this proposed single market institution.
10. A fourth objective is to develop a strong and competitive environment for intermediation services. This has been a particularly challenging issue as it has meant a fair degree of industry consolidation and rationalisation to prepare for future liberalisation which is in tandem with necessary efforts to ensure that intermediaries services remain competitive and investors' interests are not compromised, such as in areas of commission pricing and enhanced access to integrated services. We are confident that these will prove fruitful in the medium- to longer-term, and provide a strong basis for the more effective development of the intermediation services industry.
11. The fifth objective frames the SC's commitment towards ensuring a stronger and more facilitative regulatory approach. Some key aspects of this commitment are reflected in the recommendations to move towards a more market-based approach to regulation in all major areas of the capital market, and in the promotion of competitive neutrality through the adoption of full functional regulation of all similar activities and products in the capital market.
12. Last but not least, the sixth objective focuses on an area of immediate comparative advantage that has been assessed to be an area where Malaysia bears substantial potential to occupy a leading international position. The promotion of Malaysia as an international Islamic capital market centre will also significantly enhance the profile of Malaysia globally and among investors seeking Syariah-consistent investments, and add further depth and breadth to the overall Malaysian capital market.
13. To achieve these objectives, 24 strategic initiatives have been mapped out, which are subsequently translated into 152 detailed recommendations in eleven key areas of the market

A Capital Market for Investors

14. Ladies and gentlemen,

Having presented to you the basic framework of the Masterplan, please allow me to now touch on some of the main issues that have underpinned our development strategy as far as the investors' side is concerned.

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15. From a macroeconomic perspective, it is a commonly known fact that Malaysia possesses a high savings rate: in fact, one of the highest in the world. From 1990-99, our average savings rate stood at about 33% of GDP, which itself was on average higher than that of most developed countries such as the US, Canada, Germany and Japan and most of the emerging market countries.
16. The effective mobilisation of these savings is an important issue that warrants careful consideration for the future. To put this situation into perspective, let me just cite a few illustrative figures. It can be seen that the value of savings mobilised by banking institutions has grown more than five-fold over the 1990s. In 1999 alone, approximately RM560 billion was channelled into the banking sector in the form of deposits. In comparison, managed funds, including EPF, amounted to less than half that amount, despite the growing popularity and public awareness of managed funds in recent years. It can be seen that the role of such managed funds is notably less prominent in Malaysia than in economies such as the US and even Australia, where capital market intermediaries play a far greater role in savings mobilisation.
17. Over time, as the level of national economic activity grows, as income levels increase and as global markets become more and more competitive, the burden on the financial system in mobilising funds will be substantially greater than it has been during the course of Malaysia's industrialisation years. The foreseeable consequence of this will be an increasing shift from traditional balance-sheet intermediation-that is, from the banking sector-to the more market-oriented allocation of private funds through the financial markets. Increasingly-sophisticated investors will also search for more effective investment channels for their desired risk appetites.
18. Naturally, this calls for a close look at how the investment management industry can best offer added value to the investing public and the economy as a whole in view of such challenges. The SC, together with industry participants, has undertaken broad-ranging initiatives to further develop this industry over the years, and this has been reflected in the overall growth of the industry over the 1990s. However, to date, the market penetration of managed funds remains relatively small as a proportion of the overall " pie" of financial assets, which has grown more rapidly over the years. The net asset value (NAV) of unit trust funds, for example, has accounted for an average of only 8.8% of KLSE market capitalisation over the past five years. This ratio dropped sharply in 1999 to 7.78% but showed a respectable recovery to 9.74% in 2000. The latest figures for the unit trust industry shows that as of 31st January 2001, there were a total of 34 approved management companies, managing 128 approved funds with total NAV of RM46.09 billion, representing 9.68% of the total KLSE market capitalisation. However, there still remains a fair concentration even here with over close to 70% of this amount related to government-sponsored funds.

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19. Clearly, there is a need for a more diversified financial system for the Malaysian economy. Moreover, while the existing institutions within the financial system have been able to adequately finance the needs of the growing economy thus far, the experience of the recent crisis points to the real danger of over-burdening the banking system with the responsibility for supporting economic activity. A more diversified financial system will allow for the more effective spreading of the funding role across the financial sector and facilitate the better dispersion of risks across a larger range of market segments and participants.
20. To achieve this, a non-bank capital raising avenue that offers investors sufficient scale and liquidity, attractive valuations and a strong regulatory framework that supports such financing and investment activity will be required. The emphasis within the Masterplan is on the role of liquidity, because it is an issue of fundamental importance to investors and consequently a major catalyst for further development. The significance of liquidity in influencing the competitiveness of capital markets has been reflected in, among other things, the recent decisions of global index compilers to formally incorporate the free-float component as a standard investment factor.
21. Other than liquidity, the issues of information quality and corporate governance are also critical factors in influencing investors' investment decisions. Investors must have confidence in the quality of the companies they invest in. The quality of corporate disclosure and governance is therefore a fundamental issue that can play a pivotal role in attracting investors to the capital market-or, lacking thereof, driving them away.
22. The challenges of the increasingly competitive marketplace demand a more vigorous approach towards reinforcing the fundamental responsibilities of companies to their investors. This, therefore, is where a large part of the challenge lies for the institutional investors in the marketplace. Those charged with the professional management of private funds must bear the accompanying responsibility for the effective discharge of their oversight and governance roles over the companies they invest in.

Implications for the Investment Management Industry.

23. These issues are clearly recognised and reflected upon in the Masterplan, as is the investment management industry's vital role in promoting these key elements of the capital market. From the broadest perspective, the industry represents a vital transmission mechanism between domestic savings and productive investments. Importantly, it helps diversify individual investors' risks and facilitates their exposure to a broad range of products, but at typically lower cost given the economies of scale gained by the pooling of funds. An active investment management industry will enhance liquidity in the capital market and provide more competitive channels for institutions holding excess funds to outsource the management of these funds.

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24. To achieve this, however, concerted measures need to be taken to ensure that the investment management industry is more competitive and vibrant, whereby current and potential customers are able to access a diverse range of investment management products and services at reasonable cost. A key implication of this, as identified within the Masterplan, is the need to ensure that there is a significant number and diversity of industry participants with greater access to funds available for management. This includes promoting the wider outsourcing of institutional funds to investment managers based in Malaysia, to reduce the current concentration of funds under management and facilitate more diversified and effective means by which to achieve competitive returns on funds invested.
25. The further deregulation and decentralisation of managed funds will also provide the competitive impetus for the development of a more diverse range of investment management products for consumers. To further enhance efficiency and foster innovation, the Masterplan recommends, among other things, the adoption of a more market-based approach to regulation for the investment management industry, and the deregulation of specific investment restrictions placed on management institutions to allow for greater flexibility in their portfolio management operations. To facilitate the development of a wider range of collective investment schemes and their more efficient rollout, the SC plans to introduce measures to streamline the process for introducing new investment management products. In addition, the SC will work closely with the relevant authorities and industry participants to promote the development of the private pensions industry, including studying the necessary measures and policy alternatives available to effectively promote this sector.
26. At the same time, because of their larger market holdings compared to the average retail investor, investment management companies have the capacity to more effectively discharge their governance responsibilities as the larger and more influential shareholders and scrutinisers of the companies they invest in. The truth is, no regulatory body can marshal the kind of resources to oversee fully the management of every company. In many cases, this is not necessarily even the prerogative of the regulator, but rather the company's stakeholders. Therefore, as fiduciaries of their clients' interests, investment management companies can also play a significant role in ensuring that the firms they invest in place due priority on value creation. In recognition of this, the Masterplan seeks to promote an institutional investing community that is strongly committed to ensuring appropriate corporate accountability and performance orientation with regard to the companies they invest in. This includes specific recommendations aimed at promoting the governance role and fiduciary duties of institutional investors, including collaboration with specific representative associations of institutional investors to develop a set of principles, best practices and standards to encourage institutional investor activism in corporate governance and the promotion of shareholder value recognition.

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27. To reinforce these efforts, the Masterplan also aims to facilitate the cultivation of a large pool of highly skilled investment management professionals, that will allow investors ready access to investment management services and advice that are of high quality. As such, efforts to continuously enhance the skills base of the industry will remain a priority to ensure there is a sufficiently diversified and extensive pool of such professionals, which will in turn promote greater innovation and competition within the industry itself.
28. We also recognise that the education of both retail and institutional investors must necessarily be an ongoing-if not increasing-priority, if the investment management industry is to more effectively play its role in managing private financial assets within the economy. In view of this, the SC, through the Securities Industry Development Centre, will actively facilitate and co-ordinate a greater quantity and frequency of promotional and educational programmes-both independently as well as in partnership with the industry, including FMUTM-to increase awareness among investors of the investment products and services available to them.
29. Underlying all this, the regulatory framework governing the industry must also be responsive to the need for changes to the investment scope and diversity of funds under private management. As such, the SC will continue to ensure that the regulatory framework facilitates ongoing development, and the enhanced role of industry self-regulation to complement the SC's regulatory function. Within this framework, decisions based on commercial considerations will not be unduly inhibited by regulation, and steps will be further taken to widen the scope for competition by allowing for-and even encouraging-greater portfolio diversification and specialisation. It is hoped that the combination of constructive competition and market discipline will help build the investment management industry in Malaysia into a vibrant, self-reinforcing and highly productive segment of the market that, at the same time, boasts a high level of investor protection and overall efficiency.

Conclusion

30. In conclusion, I would like to note that today, we face new opportunities and new challenges that bring a greater relevance and urgency to the further development of the investment management industry. Yet the dynamic nature of today's capital markets creates issues that increasingly blur the line between traditional markets and approaches towards development. More and more often, we as regulators and you as industry participants have to grapple with questions for which there are no easy answers.

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31. It is in such an environment that a balance of pragmatism, good judgement and ambition are needed for effective development. The Masterplan seeks to achieve this for the investment management industry; not by presenting you with a automatic checklist of measures, but by laying out the strongest foundation possible for its effective long-term development in a transparent manner. In this respect, your feedback and support are integral to the realisation of the Masterplan's vision and objectives, and we hope that our joint efforts and commitment will see them through in the not-too-distant future.

Thank you.

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