Suruhanjaya Sekuriti
Securities Commission

S P E E C H E S

EMERGING MARKETS PROGRAMME
"Responding to the challenges of the new economy"

Special Address
By
Encik Ali Abdul Kadir,
Chairman, Securities Commission

9 April 2001
Securities Commission

Ladies and gentlemen:

1. It is my great pleasure to welcome all of you this morning to the Emerging Market Programme organised by the Securities Industry Development Centre and the International Affairs Department of the Securities Commission. This five-day programme is intended to offer a unique opportunity for capital market regulators from emerging markets to exchange ideas and share expertise with each other. Most emerging markets are undergoing rapid growth and significant change, and are operating in a more dynamic and challenging environment. As market regulators, it is vital that we are sufficiently trained and exposed to the breadth of policy, legal and technical issues concerning capital markets.

2. The theme for this inaugural year's programme is " Responding to the Challenges of the New Economy" . What I propose to do for the next half an hour or so is to kick-off the programme with a few thoughts on what exactly these challenges entail in relation to the capital market environment, and what issues it raises for capital market regulators such as ourselves. I should like to add at this point that the challenges being referred to are by no means applicable only to emerging markets. Recent developments the world over-including the global performance of the technology-related stocks since March last year-suggest that these issues are relevant to both the more developed as well as emerging markets.

Ladies and Gentlemen:

3. Several major global trends have resulted in significant changes in the environment in which capital markets now operate. It is becoming more dynamic and competitive. The internationalisation of financial activity has witnessed rapid growth in cross-border investment activity, increased international fund-raising and more cross-border mergers and acquisitions.

4. These developments have been prompted to a large extent by financial market deregulation in capital markets worldwide. This includes the lowering of barriers to cross-border activity and the increasing integration of financial products and services. At the same time, rapid advances in information and communications technology have brought many changes to market structures and the way they operate. These are well-known facts to all of us.

5. As regulators we recognise that we need to understand what drives the different market participants in the new environment

- Investors 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

- Issuers 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. At the same time they are also looking for efficient capital-raising processes

- Market intermediaries are looking to widen their scope of business opportunities in response to the more competitive and changing environment They are increasingly taking 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

- 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 order-flows. 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. For instance, there are now many exchanges that are part of cross-border trading networks and alliances, in order to widen their market reach and enhance market access.

Ladies and gentlemen:

6. Globalisation, deregulation and the changing characteristics of market participants and activities have given rise to a number of issues. Let me first turn to those concerning the role and interaction of the financial system with the domestic economy.

7. A simple yet important lesson that can be drawn from events over the last ten years- including the Mexican peso crisis in the mid-1990s, and the East Asian, Russian and Brazilian crisis in the latter half of the decade-is that financial markets can and do affect real economic activity. Now this statement may appear self-evident to many of you here, but there is still unfortunately a tendency to view the financial sector as auxiliary to the real economy. Policies are often skewed towards emphasising " real" sectors such as export-based manufacturing, and there is typically relatively less emphasis on the concurrent development of the financial system.

8. However, the experience of many countries has taught us many important lessons. One lesson is that weak and underdeveloped financial systems have the potential to undo what were thought to be " optimal" real-sector policies. Hence, financial market turbulence, if prolonged, can and will lead to a significant disruption of real economic activity across all sectors of the economy.

9. The implication of this is that sustainable economic development requires a holistic approach that does not dichotomise the economy into the real and nominal sectors. Therefore, in addition to industrial policies which attempt to shift agrarian economies up the value-added chain, it is necessary to make a conscious attempt to formulate a concurrent financial system and institutional development agenda which would be consistent with the anticipated demands arising from an evolving economy. In other words, financial sector development cannot be left to last, or worse, as an afterthought.

10. Events of the last few years have also led the international financial community to reassess its views on private capital flows and international capital mobility. It is now clear that the economic benefits that these bring can carry significant economic costs if capital flows should suddenly be reversed. Whatever their cause, the reality is that sudden and large shifts in capital flows can and do have significant effects on emerging economies.

11. A key to tapping the very real benefits that can accrue from private capital flows is to have strong initial conditions within the economy. National financial systems with insufficient regulatory and supervisory capacity to handle a deregulated and liberalised financial environment, and which then attempt to integrate into the global financial system, are likely to be exposed to considerable risks.

12. Furthermore, financial systems must also be able to ensure proper intermediation and efficient allocation of private capital flows. This requires a more diversified financial system in which the bank sector as well as the capital market both display relative depth and breadth. The problems that arise when the banking system carries a disproportionate burden of financing activity are now well known. So too are the difficulties in absorbing the shock from capital-flow reversals due to the absence of a deep and liquid debt market.

Ladies and Gentlemen:

13. From issues regarding the financial system and its structure, let me now turn to issues concerning the regulatory framework. National financial systems are clearly more interdependent now, and global financial activity become increasingly complex and dynamic. As previously convenient distinctions between institutional arrangements and financial activities have become blurred, the scope and nature of financial activity has also developed well beyond that of traditional regulatory structures and jurisdictions.

14. As a result, regulators today are faced with a whole host of issues and challenges that were either not as apparent before or were non-existent. A major challenge will therefore be in finding a regulatory structure that is appropriate and flexible enough to meet the demands of this dynamic and rapidly evolving environment. Regulators will have to consider a wider and more complex set of factors than they do now-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 the potential for players who are concurrently active in several markets to exploit regulatory loop-holes relating to supervision and enforcement across different jurisdictions.

15. Regulators will also have to consider the fact that that the sources of systemic risk can no longer be neatly packaged. Thus, while the financial system can theoretically be dichotomised into the banking system and the capital market system, reality affords no such convenience to financial regulators. The implication is that at both the domestic and international level, banking, securities and possibly even insurance regulators will have to co-ordinate their activities and co-operate on joint surveillance of the entire financial system in order to successfully contain any threats to systemic stability.

16. In the case of 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 of the capital market while facilitating greater competition and innovation.

17. Therefore, as outlined in the Capital Market Masterplan, which was released on February 22nd this year, and which you will be hearing more about later today, the Commission will be enacting a gradual shift in its regulatory approach by adopting a market-based system of regulation for all capital market activities. What this means is that we will be gradually moving towards the greater use of market disciplines and processes to achieve regulatory objectives.

18. Generally speaking, our long-term goal is to have no more regulation than necessary to achieve the public policy objectives of consumer protection, and financial soundness and integrity. Practically speaking, this will mean, among other things:

- gradually shifting away from merit-based approval processes to disclosure-based regulation across all fund-raising activities in the capital market-a process we have already started to implement in varying degrees in relation to equity and bond issuance

- adopting enhanced risk-based supervision and the use of appropriate incentives to promote a high level of regulatory compliance

- developing improved mechanisms for self-regulation and front-line regulation by industry participants and exchanges, so that those who are actually at the front-line of market activity will have a greater role to play in promoting regulatory compliance among their peers and constituents

19. To make sure there is a level playing field for all participants in the capital market, we will also be pursuing full functional regulation of the capital market. We believe that this will help ensure a more " seamless" regulatory framework and will reduce the scope for regulatory arbitrage. The regulatory framework will also be strengthened through enhanced enforcement and supervision capacity, as well as the formulation of a framework for maintaining overall systemic and financial stability in the capital market.

20. 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. We hope to facilitate these as best we can, 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. The Securities Commission of Malaysia is committed to the promotion of high standards of training and education among regulators and through this programme seeks to share its resources, facilities and experiences towards that aim. I wish you a fruitful week ahead.

Thank you for your kind attention.

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Background Information on Emerging Markets Programme

The Emerging Markets Programme (SIDC-EMP) organised by the Securities Industry Development Centre (SIDC) and the International Affairs Department of the Securities Commission (SC) is a five-day programme offering a unique opportunity for regulators of emerging economies to share ideas, information and experiences on significant capital market development and regulation issues.

In its inaugural year, the theme for the SIDC-EMP is " Responding to the Challenges of the New Economy" . Premised on this theme, the programme will examine the role of emerging markets regulators in addressing issues arising against a backdrop of rapidly changing global demands and challenges.

Thirty-one individuals of senior to middle management level with experience in capital market policy work will be participating in the programme this year. These participants represent 19 countries including India, Nigeria, Philippines, Tanzania, Turkey, Lithuania, Oman, Indonesia, China, Bahrain, Uganda, Taiwan ROC, Thailand, Sri Lanka, Egypt, Nepal, Mauritius, Brunei and Malaysia.

The Malaysian Capital Masterplan has stated that the SC will develop SIDC as the regional capital market training centre. The SIDC-EMP is one step in the implementation of this objective.

The SIDC-EMP has been divided into five main parts to address different core areas, as follows:

- Global integration of financial markets - challenges to regulators of emerging markets;
- Architecture of capital markets - the need for a strong regulatory framework and effective enforcement which will ensure market confidence and investor protection;
- Changing paradigms in supervision & enforcement in securities regulation;
- Training and education - the other role of regulators, frontline regulators and market participants; and
- Fostering greater international cooperation between regulators.

Participants will also have the opportunity to visit the frontline regulators and market institutions, namely the Kuala Lumpur Stock Exchange (KLSE), Malaysian Central Depository (MCD), Securities Clearing Automated Network Services (SCANS), Kuala Lumpur Options and

Futures Exchange (KLOFFE), Commodity and Monetary Exchange of Malaysia (COMMEX) and Malaysian Exchange of Securities Dealing & Automated Quotation (MESDAQ).

Speakers at the programme comprise distinguished industry representatives as well as key figures in economic policy-making:

Dr. K. Govindan, Deputy Secretary, National Economic Action Council (NEAC), Prime Minister's Department;

Mark Dickens, Executive Director, Securities & Futures Commission, Hong Kong;

Khairil Anuar Abdullah, Chairman, Malaysian Exchange of Securities Dealing and Automated Quotation Bhd (MESDAQ);

Dato' Dr. Munir Abdul Majid, Director, Telekom Malaysia Berhad;

Datuk Abdul Azim bin Mohd Zabidi, President, Federation of Malaysian Unit Trust Managers (FMUTM);

Datuk Mohaiyani Shamsuddin, Chairperson, Association of Stockbroking Companies Malaysia;

Associate Professor Merouane Lakehal-Ayat, Fulbright Fellow, University Utara Malaysia;

Alwin Kwan, Interim President, Malaysian Futures Brokers Association; and

Tunku Afwida Tunku Abdul Malek, Vice Chairman, Malaysian Association of Asset Managers.

Members of the SC's senior management team will also be amongst the presenters and facilitators.

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