

Fourth Round Table on Capital Market Reform in Asia

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Country Note: Malaysia

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In the immediate aftermath of the 1997-98 financial crisis, efforts to strengthen the Malaysian capital market were mainly focused on regaining investor confidence, facilitating the raising of funds, supporting debt and corporate restructuring, and rehabilitating the securities industry.

As recovery mounted, work increasingly focused on positioning the Malaysian capital market to more effectively meet the future needs of the Malaysian economy. With this in mind, the Securities Commission (SC), in close consultation with the industry and government, formulated the Capital Market Masterplan to provide strategic clarity for this positioning and a framework for the future direction of capital market development. One important aim of the Masterplan, which was released in February 2001, is to provide capital market stakeholders with a clear point of reference, especially in relation to many on-going areas of work.

In relation to market and regulatory structures, corporate governance, and issuers, the Masterplan advocates, among other things, a reduction in trading costs, deregulation of market intermediation services, exchange consolidation and demutualisation, as well as measures to ensure a stronger and more facilitative regulatory regime. The Masterplan also recommends the continuation and extension of work on enhancing standards of corporate governance and supporting corporate sector restructuring.

1 Market Structures

With regard to market structures, key imperatives articulated by the Masterplan are towards exchange consolidation and demutualisation of the single exchange, consolidation of market intermediation services, and reduction of trading costs.

The consolidation of all existing exchanges in Malaysia was identified to reap economies of scale and to expand market reach. Demutualisation and self-listing of the consolidated exchange would follow, in order to enhance its capacity to deal with challenges on the basis of commercially-oriented strategies and practices.

Substantial progress has already been seen in the consolidation of local market institutions. On 11 June 2001, the two existing derivatives exchanges, the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE) and the Commodities and Monetary Exchange (COMMEX), were merged into a single Malaysia Derivatives Exchange Berhad (MDEX) under the Kuala Lumpur Stock Exchange (KLSE) group. On 18 March 2002, the country's two securities exchanges, the technology-oriented Malaysian Exchange of Securities Dealing and Quotation (MESDAQ) and the KLSE, were merged into a single securities exchange.¹

¹ The MESDAQ-KLSE merger has resulted in increased trading activity in MESDAQ counters. On the first trading day of the consolidated securities exchange, trading volumes for MESDAQ shares jumped ten-fold to 862,810 from 84,800 on the previous trading day. The prospect of increased liquidity for MESDAQ counters has also prompted companies to speed up plans for listing.

Work on the demutualisation of the consolidated securities exchange is also progressing, with a view towards enabling the listing of the demutualised exchange by 2003.

Another key priority at present is to develop a stronger and more competitive environment for intermediation services. A key aspect of this strategy is the promotion of industry consolidation to produce a core group of full-service domestic intermediaries known as Universal Brokers (UBs) which are able to maintain strong market positions.² As at end-2001, 5 stockbroking companies had been granted Universal Broker status, while the total number of stockbroking companies had been reduced from 63 to 48.

Measures have also been taken to progressively deregulate the fixed fee structures that have controlled the pricing variability of intermediation services. For example, in the derivatives industry, transaction rates were made fully negotiable in December 2001.³ While the liberalisation of brokerage commission rates for retail share trades had to be deferred due to difficult economic conditions prevailing in 2001, other costs of trading were reduced as planned. These include reductions of the exchange's SCORE (System on Computerised Order Routing and Execution) and clearing fees, as well as the SC levy, in July 2001.⁴

² To encourage the consolidation and rationalisation of the stockbroking industry, all stockbroking companies wishing to become UBs are required to merge with another three stockbroking companies. Stockbroking companies that do not aspire to become UBs are required to merge with at least one other stockbroking company. As a further incentive towards consolidation, UBs are allowed to give discounts for certain trades executed through electronic access facilities.

³ Includes futures broking commission rates, futures clearing and exchange trading fees, the commission sharing structure between futures brokers and their representatives, and shared commission rates between trading members and institutions.

⁴ The SCORE fee was reduced in two stages to 0.005% and 0.0025% with effect from 1 September 2000 and 1 July 2001 respectively. The SCANS (Securities Clearing Automated Network Services) clearing fee was reduced from 0.05% to 0.04% with effect from 1 July 2001, subject to a maximum of RM200 per contract. The SC levy was reduced from 0.02% to 0.015% with effect from 1 July 2001.

2 Regulatory Structures

The SC has strived to achieve strong and effective regulation of the capital market while facilitating greater competition and innovation. The regulatory approach in Malaysia is becoming more market-based, characterised by enhanced supervision, more effective enforcement and the use of appropriate incentives to promote a high level of regulatory compliance. At the same time, the SC is aware of the need to provide certainty and appropriate incentives for market development.

Towards this, the Masterplan recommends regulation by function (“functional regulation”) instead of by institution, as well as measures to improve regulatory transparency and accountability.

The move towards functional regulation has been adopted to address the growing complexity of financial markets leading to the blurring of lines between traditional asset classes and financial services. This is to ensure regulatory parity and consistency of treatment between all institutions and participants offering similar capital market services and products.

There has been some streamlining and rationalisation of regulatory functions in recent years, with the SC since 1 July 2000 becoming the sole approving and registering authority for prospectuses in respect of all securities other than securities issued by unlisted recreational clubs. Regulation of the issuance of private debt securities (PDS) and related hybrid securities has also been centralised with the SC.

The importance of regulatory transparency and accountability to the public are also recognised. The SC aims to promote greater transparency in its activities. At the same time, the SC continues to make full use of regular and wide-ranging dialogue and consultation with market participants, to identify and address issues of common concern.

As the principal market regulator, the SC is accountable to the Minister of Finance, and is required to present its annual accounts to Parliament. Decisions of the SC are also subject to judicial review. These arrangements provide mechanisms for public accountability by the SC.

There have also been moves in the area of international cooperation and coordination in improving cross-border surveillance, monitoring and enforcement capabilities, to complement the enforcement actions available domestically. Towards this, attention is paid to enhance linkages with foreign regulatory counterparts via Memorandums of Understanding (MOUs), as well as via international affiliations.

3 Corporate governance

Efforts to enhance standards of corporate governance in Malaysia have been ongoing even prior to the regional financial crisis of 1997-98. However, the crisis accelerated the impetus for more comprehensive and coordinated reforms in this area.

In March 1999, the Finance Committee released its *Report on Corporate Governance*, which set out over 70 recommendations for improving corporate governance under three specific areas: reforms of laws, regulations and rules; the Malaysian Code on Corporate Governance; and training and education.

Among the work completed since then have been amendments to the securities laws and the Companies Act 1965 requiring auditors to report suspected breaches of securities laws, the codification of key duties of directors, and the introduction of provisions to curb a controlling shareholder's right to vote in related-party transactions.

The Malaysian Code on Corporate Governance sets out international standards of best practices. While the adoption of these standards is voluntary, amendments to the KLSE's Listing Requirements announced in January 2001 brought the Code into effect by requiring companies to report in their annual reports the extent to which they have complied with the principles and best practices set out in the Code. A requirement has also been put in place for directors of public listed companies to be accredited with Research Institute of Investment Analysts Malaysian (RIIAM) under its Mandatory Accreditation Programme.

The Masterplan further builds upon the foundation laid by the Finance Committee's *Report on Corporate Governance*. Additional measures recommended by the Masterplan include efforts to enhance the enforcement of minority shareholders' rights, to improve continuous disclosure by listed companies, and to enhance auditors' responsibilities. The formation of the Minority Shareholder Watchdog Group (MSWG), which appointed its first Chief Executive Officer in July 2001, was also an important step in promoting greater shareholder activism.⁵ At the same time, the SC has continued to encourage greater awareness among investors as to their rights and responsibilities.

As important as laying the legal framework and in encouraging greater disclosure, there have been committed efforts to ensure that enforcement actions have also developed in line with the objective of promoting good corporate governance. Some enforcement actions taken in relation to this in recent years include the successful prosecution of the first insider trading case in the country, and the imposition by the Court of substantial fines on directors of several public listed companies for the submission of false or misleading information.

4 Issuers

In view of the difficulties experienced by the corporate sector following the regional financial crisis in mid-1997, the authorities have been actively involved in facilitating and, where possible, expediting corporate workouts and debt recovery.

⁵ The MSWG was founded by several major Malaysian institutional investors: the Employees Provident Fund, Lembaga Tabung Angkatan Tentera, Lembaga Tabung Haji, and the Social Security Organisation.

As an important part of these efforts, the Corporate Debt Restructuring Committee (CDRC) was established in August 1998 to facilitate debtor-creditor negotiation in debt settlement. Since its inception until end-2001, 42 cases with debts amounting to RM35.4 billion have already been resolved. As at that date, 21 cases with debts amounting to RM21.4 billion have remained outstanding.

The SC has also been actively involved in facilitating debt restructuring and corporate workouts where viable and necessary, including facilitating capital raising in order to assist in the revitalisation of economic activity. Efforts have been made, for example, to ease the burden of financial obligations faced by local firms and market participants without compromising investor protection or market integrity.⁶ Apart from this, new guidelines announced on 3 September 2001 include a reduction in the post-restructuring net-tangible-asset position requirement for distressed listed companies, thus allowing a wider pool of viable assets to be injected into distressed companies as part of their restructuring schemes.

The development of the market for risk capital—encompassing informal investment by business angels, venture capital and stock markets specialising in SMEs and high-growth companies—has also been an important facet of the country's overall thrust towards becoming a knowledge economy and the creation of a more value-added production base. The Masterplan has identified a range of measures to promote the development of high growth and technology companies in Malaysia, particularly in relation to enhancing MESDAQ's role as an effective exit mechanism for venture capitalists.

A number of these measures have been implemented, including allowing the listing of technology incubators on MESDAQ, and giving tax incentives for investments in venture companies.⁷

Additionally, the formation of a central co-ordinating agency for venture capital development under the Ministry of Finance—as announced in the Federal Budget 2001—is an important step towards spearheading the development of the industry.

5 Moving forward

Emphasis will continue to be on the areas mentioned above, as well as on efforts to further strengthen the capital market to better face challenges. A key priority in moving forward is the timely and effective implementation of the Masterplan's recommendations, while taking account of the readiness of market participants to respond to changes, as well as prevailing market conditions and the stage of market development.

In tandem with this, the regulatory authorities remain closely involved in discussions with market participants and their international counterparts to facilitate consistency with the appropriate international standards and close monitoring of international developments.

⁶ The SC had earlier allowed greater variations of profit guarantee agreements, subject to strict investor protection conditions, in cases where the guarantors could demonstrate that they did not have the financial capability to fulfil the profit guarantee obligation, effective 30 September 1999.

⁷ Companies that invest in venture companies are given full income tax exemption for 10 years, provided that 70% of the funds invested in venture companies are at start-up, seed capital and early stage financing.

APPENDIX 1: MACROECONOMIC DATA

| Table 1: Economic growth indicators | | | | |
|--|-------------|-------------|-------------|-------------------------|
| % growth | 1998 | 1999 | 2000 | 2001⁸ |
| Real GDP | -7.4 | 6.1 | 8.3 | 0.4 |
| Manufacturing sector | -13.4 | 13.5 | 21.0 | -5.1 |
| Public expenditure | -7.6 | 17.1 | 11.4 | 13.9 |
| Broad Money (M3) | 2.7 | 8.3 | 5.0 | 2.8 |
| Inflation rate | 5.3 | 2.8 | 1.6 | 1.3 |

Source: Bank Negara Malaysia

| Table 2: External balance | | | | |
|-------------------------------------|-------------|-------------|-------------|-------------------------|
| | 1998 | 1999 | 2000 | 2001⁸ |
| Current account balance (RM bn) | 37.4 | 47.9 | 32.0 | 27.4 |
| Current account balance as % of GNP | 13.9 | 17.1 | 10.2 | 8.9 |
| Import cover (months) | 5.7 | 5.9 | 4.5 | 5.1 |
| Reserves/short-term debt (times) | 3.1 | 5.1 | 6.5 | 6.0 |

Source: Bank Negara Malaysia

⁸ Preliminary data.

APPENDIX 2: CAPITAL MARKET DEVELOPMENTS

| Table 3: Secondary equity market indicators | | | | |
|--|-------------|-------------|-------------|-------------|
| | 1998 | 1999 | 2000 | 2001 |
| Kuala Lumpur Stock Exchange Composite index (KLCI) at year-end | 586.13 | 812.33 | 679.64 | 696.09 |
| Kuala Lumpur Stock Exchange (KLSE) Market Capitalisation (RM bn) at year-end | 374.52 | 552.69 | 444.35 | 464.99 |
| Average daily trading volume (million) | 237.13 | 343.46 | 279.84 | 203.91 |
| Annual average monthly turnover velocity ratio ⁹ (%) | 29.8 | 34.3 | 39.9 | 18.7 |

Source: Bloomberg, KLSE, FIBV

| Table 4: Funds raised in the capital market | | | | |
|---|-------------|-------------|-------------|-------------|
| | 1998 | 1999 | 2000 | 2001 |
| Total value of equity raised (RM million) | 1,788 | 6,083 | 5,926 | 4,417 |
| New listings (number of companies) | 28 | 21 | 38 | 20 |
| New issues of debt securities raised by the private sector (RM million) | 14,152 | 26,558 | 31,097 | 37,026 |

Source: KLSE, Bank Negara Malaysia

⁹ The turnover velocity is the ratio between the turnover of domestic shares and their market capitalisation. The value is annualised by multiplying the monthly moving average by 12, according to the following formula:
$$\frac{\text{Monthly Domestic Share Turnover} * 12}{\text{Month-end Domestic Market Capitalisation}}$$

Equity Distribution by Value, as of June 2001¹⁰

| Table 5: Equity holdings by nationality (% of total) | |
|---|------|
| Bumiputera | 35.7 |
| Non-bumiputera | 48.4 |
| Foreigners | 15.9 |

Source: KLSE

| Table 6: Equity holdings by investor type (% of total) | |
|---|------|
| Individual | 20.3 |
| Institution | 37.7 |
| Nominee | 41.1 |
| Others | 0.9 |

Source: KLSE

| Table 7: Equity holdings by portfolio size (% of total) | |
|--|------|
| Less than 1,000 | 0.1 |
| 1,000 – 10,000 | 10.8 |
| 10,001 – 100,000 | 10.5 |
| 100,001 and above | 73.6 |

Source: KLSE

¹⁰ Government agencies such as Khazanah Holdings, Minister of Finance Incorp, Bank Negara Malaysia, Employees Provident Fund Board and Kumpulan Wang Amanah Pencen are classified as Non-Bumiputera.

Major Products traded in the Capital Market:

Equities:

- Share capital: Ordinary shares, Preference shares
- Fixed-income securities: Debenture stocks, Loan stocks
- Others: Warrants, Property trusts, Closed-end funds

Derivatives:

- Crude palm oil (CPO) Futures
- Kuala Lumpur Stock Exchange Composite index (KLCI) Futures
- Kuala Lumpur Stock Exchange Composite index (KLCI) Options
- Three-month Kuala Lumpur Interbank Offered Rate (KLIBOR) interest rate Futures
- Five-year Malaysian Government Securities (MGS) Futures

Corporate Bonds:

- Long-term private bonds: redeemable, non-conventional secured and unsecured
- Short-term bonds – Revolving Underwriting Facility (RUF), Note Issuance Facility (NIF)
- Islamic Debt Securities