7 VIBRANT FINANCIAL SERVICES

I. INTRODUCTION

7.01 Following soon after the Asian financial crisis, the Eighth Plan period recorded notable achievements in terms of restructuring and strengthening the domestic financial system. The consolidation of domestic banking institutions contributed to the development of strong domestic banking groups, providing a wider range of competitive, innovative and customised financial products and services. The phased implementation of the 10-year Financial Sector Master Plan (FSMP) and Capital Market Master Plan (CMP) strengthened the resilience and competitiveness of the banking system and the capital market.

7.02 During the Ninth Plan period, the financial services sector will continue to play an important role in driving the growth of the economy, both as a strategic sector as well as a mobiliser of funds for investment. While the FSMP and the CMP will provide the framework for the gradual liberalisation of the sector, efforts will focus on maintaining financial stability and enhancing the capability of financial institutions to meet increasing competition in a more globalised operating environment.

II. PROGRESS, 2001-2005

7.03 The financial services sector grew at an average rate of 8.1 per cent per annum with its share to gross domestic product (GDP) increasing from 12.7 per cent in 2000 to 15.1 per cent in 2005. Employment in the sector grew at an average rate of 7.9 per cent per annum, representing 6.8 per cent of total employment in 2005. A total of 232,100 jobs was created in the sector equivalent to 14.3 per cent of total net jobs created in the economy during the Plan period.

Financial System

7.04 Total funds available in the financial system, comprising both bank and non-bank institutions in 2005, amounted to RM1,908.5 billion with the major portion originating from the private sector, as shown in *Table 7-1.* In terms of its use, the largest component was loans and advances followed by the holdings of securities. During the Plan period, efforts were undertaken to develop a more diversified financial infrastructure and create new financial instruments that would meet the financing requirements of various businesses.

TABLE 7-1

SOURCES AND USES OF FUNDS OF THE FINANCIAL SYSTEM, 2000-2005

Item	*RM million*		*% of Total*		*Average Annual Growth Rate (%), 2001-2005*
	2000	*2005*	*2000*	*2005*	
Sources of Funds					
Capital, reserves and profit	120,990.7	176,332.3	*9.6*	*9.2*	*7.8*
Demand deposits	83,205.3	135,944.1	*6.6*	*7.1*	*10.3*
Other deposits of which:	503,079.1	786,255.2	*39.8*	*41.2*	*9.3*
Private sector	*339,770.3*	*508,958.5*	*26.9*	*26.7*	*8.4*
Insurance, provident and pension funds	236,640.1	374,114.0	*18.7*	*19.6*	*9.6*
Others [1]	319,271.1	435,843.2	*25.3*	*22.9*	*6.4*
Total	**1,263,186.3**	**1,908,488.8**	***100.0***	***100.0***	***8.6***
Uses of Funds					
Deposits with other financial institutions	183,470.2	255,983.0	*14.5*	*13.4*	*6.9*
Loans and advances	512,543.9	721,655.2	*40.6*	*37.8*	*7.1*
Securities	298,033.1	468,040.8	*23.6*	*24.5*	*9.4*
Others [2]	269,139.1	462,809.8	*21.3*	*24.3*	*11.5*
Total	**1,263,186.3**	**1,908,488.8**	***100.0***	***100.0***	***8.6***

Source: Bank Negara Malaysia

Notes: [1] Include currency, borrowings, funds from other domestic and foreign financial institutions, and other liabilities.

[2] Include currency, gold and forex reserves and other assets.

7.05 The FSMP and CMP were launched in 2001 to chart an orderly development of the financial sector and capital market, respectively, over a ten-year period to sustain the growth momentum and efficient financial intermediation to meet the needs of a rapidly growing economy. The first phase of the FSMP, 2001-2003, focused on measures to strengthen the capability and capacity of domestic financial institutions. The second phase, beginning 2004, emphasises the promotion of greater competition towards further enhancing the efficiency of the financial system.

7.06 *Enhancing Corporate Governance.* Initiatives were taken to further enhance corporate governance in the financial services sector. This included the revision and issuance of guidelines to prescribe broad principles, minimum standards and specific requirements for corporate governance, particularly with respect to improved financial disclosure, accounting standards and internal control, which also enabled benchmarking with international best practices. In addition, for the capital market, listing requirements were revamped, whistle blowing provisions were introduced and the range of sanctions for breach of requirements was expanded.

7.07 *Strengthening Regulatory Framework.* The regulatory and supervisory framework was strengthened to ensure continued stability. In the banking and insurance sectors, risk management practices were enhanced and prudential regulations were reviewed to ensure they remained effective while promoting competition and innovation. Supervisory activities were also strengthened with the introduction of the Informal Enforcement Actions Framework for banks, and as well as the issuance of new-risk based supervisory framework for Islamic banks. The enactment of the Anti-Money Laundering Act, 2001 provided a comprehensive framework for the prevention, detection and prosecution of money laundering. In the capital market, the conversion from merit-based to disclosure-based regulation coupled with the implementation of pre-emptive financial surveillance of public listed companies contributed to improvement in investor protection and efficiency in fund raising.

7.08 *Consumer Education and Protection.* During the Plan period, efforts to strengthen consumer protection included increased disclosure requirement by financial institutions on fees and charges, and changes in terms and conditions of financial products. In the banking sector, the Malaysia Deposit Insurance Corporation was established to provide explicit deposit protection to depositors. For the insurance industry, guidelines on provision of proper advice practices by insurance businesses were introduced.

Banking System

7.09 The institutional arrangements that were put in place in 1998 to resolve emerging vulnerabilities in the banking sector during the Asian financial crisis have been effective in preserving stability in the banking system. The key institutions, namely, *Pengurusan Danaharta Nasional Berhad* (*Danaharta*), *Danamodal Nasional Berhad* (*Danamodal*) and the Corporate Debt Restructuring

Committee (CDRC) essentially achieved their objectives, placing the banking sector on a stronger footing. During the Eighth Plan, the banking system remained resilient, recording improvement in asset quality and sustaining high capitalisation. Following consolidation and rationalisation, the number of domestic banking institutions decreased from 54 to 10 banking groups. The completion of the consolidation exercise enabled domestic banking groups to refocus on further improving productivity and competitiveness as well as benefit from economies of scale.

7.10 *Assets and Liabilities.* Total assets of the banking system expanded at an average annual rate of 7.8 per cent to RM959.4 billion as at end of 2005, as shown in *Table 7-2.* Loans and advances rose at an average annual rate of 7.1 per cent. In terms of liabilities, deposits grew 8.1 per cent per annum, with businesses and corporations accounting for the bulk of new deposits. The net non-performing loans (NPLs) ratio, based on the 6-month and 3-month classifications, improved from 6.5 per cent and 9.9 per cent at the end of 2000 to 4.6 per cent and 5.8 per cent at the end of 2005, respectively. The risk-weighted capital ratio (RWCR) also increased from 12.5 per cent to 13.1 per cent during the same period.

7.11 *Bank Lending.* The banking system continued to be the main provider of funds for the economy. Lending activities were strong, covering a broad range of economic sectors and customer segments. As at end of 2005, 26.7 per cent of total lending was for the purchase of residential property and 6.6 per cent for consumption credit. Lending to business expanded moderately as large corporations sourced financing from the bond market. The small and medium enterprises (SMEs) benefited from the change in lending strategies with outstanding loans to SMEs expanding at an average annual rate of 6.4 per cent between 2001 and 2005, accounting for 42.6 per cent of loans to businesses. Lending to SMEs was diversified with almost two-thirds being channeled to the distributive trade, manufacturing and construction sectors.

7.12 *Enhancing Capability.* During the Plan period, various initiatives were undertaken to build the capacity and capability of domestic banking institutions. This included the industry-wide benchmarking exercise, enabling cross-selling of products and services as well as developing alternative delivery channels such as Internet banking. This was complemented by initiatives to promote efficiency, innovation and dynamism within the financial sector. In addition, the banking sector commenced preparations for the adoption of the New Basel Capital Accord (Basel II), which is targeted for implementation in 2008 for those adopting the Standardised Approach, and 2010 for those adopting the Internal Ratings Based (IRB) Approach.

TABLE 7-2

TOTAL ASSETS, DEPOSITS AND LOANS OF THE BANKING SYSTEM, 2000-2005

(RM million)

	Total Assets					*Total Deposits*					*Total Loans and Advances*[1]				
Institution	*2000*	*%*	*2005*	*%*	*Average Annual Growth Rate (%) 2001-2005*	*2000*	*%*	*2005*	*%*	*Average Annual Growth Rate (%) 2001-2005*	*2000*	*%*	*2005*	*%*	*Average Annual Growth Rate (%) 2001-2005*
Commercial Bank[2]	512,715	*77.8*	885,909	*92.3*	*11.6*	362,991	*77.1*	645,699	*93.1*	*12.2*	303,367	*76.5*	526,771	*94.4*	*11.7*
Finance Companies	109,410	*16.6*	26,879	*2.8*	*-24.5*	82,649	*17.6*	16,030	*2.3*	*-28.0*	75,950	*19.1*	22,547	*4.0*	*-21.6*
Merchant Banks	36,876	*5.6*	46,612	*4.9*	*4.8*	24,764	*5.3*	31,696	*4.6*	*5.1*	17,359	*4.4*	8,748	*1.6*	*-12.8*
Total	**659,001**	***100.0***	**959,400**	***100.0***	***7.8***	**470,404**	***100.0***	**693,425**	***100.0***	***8.1***	**396,676**	***100.0***	**558,066**	***100.0***	***7.1***

Source: Bank Negara Malaysia

Notes: [1] Include housing loans sold to Cagamas Berhad.

[2] Include Islamic banks.

Islamic Financial System

7.13 *Islamic Banking.* The Islamic banking industry grew at an average annual rate of 18.9 per cent in terms of its assets, as shown in *Table 7-3.* The total assets of the Islamic banking sector accounted for 11.3 per cent of total assets in the banking system as at end of 2005, compared with 6.9 per cent in 2000. Total deposits from Islamic banking institutions increased more than double during the same period accounting for 11.7 per cent of total banking sector deposits. In view of the rapid development and steady performance of the Islamic banking industry, the liberalisation of the Islamic banking sector was brought forward from 2007 to 2004 with the issuance of new Islamic bank licences to three leading foreign Islamic financial institutions. As at end of 2005, seven domestic banking groups were granted approval to establish an Islamic

TABLE 7-3

PERFORMANCE OF ISLAMIC BANKING SYSTEM, 2000-2005

Indicator	*RM million*		*Average Annual Growth Rate (%), 2001-2005*
	2000	*2005*	
Assets			
Islamic Banks	14,029	43,433	*25.4*
Commercial Banks	20,094	59,698	*24.3*
Finance Companies	7,150	1,254	*-29.4*
Merchant Banks	1,507	1,466	*-0.6*
Discount Houses	4,288	5,973	*6.9*
Total	**47,068**	**111,824**	***18.9***
Deposits			
Islamic Banks	11,304	35,625	*25.8*
Commercial Banks	16,091	42,775	*21.6*
Finance Companies	5,393	684	*-33.8*
Merchant Banks	867	797	*-1.7*
Discount Houses	2,268	3,993	*12.0*
Total	**35,923**	**83,874**	***18.5***
Financing			
Islamic Banks	6,426	20,627	*26.3*
Commercial Banks	8,606	45,398	*39.5*
Finance Companies	5,090	1,071	*-26.8*
Merchant Banks	769	268	*-19.0*
Total	**20,891**	**67,364**	***26.4***

Source: Bank Negara Malaysia

subsidiary under their commercial banking arm. The number of full fledged Islamic banks increased from two in 2000 to six in 2005. Following the consolidation of the banking system, the number of conventional banking institutions participating in the Islamic Banking Scheme (IBS) was reduced correspondingly. The number of finance companies participating in the IBS was reduced from 14 in 2000 to one as at the end of 2005. During the same period, IBS merchant banks refocused their business operations to fee-based activities from financing portfolios, which no longer required them to maintain dedicated Islamic banking.

7.14 *Takaful.* Total assets of the *takaful* fund expanded by an average annual rate of 25.0 per cent between 2001 and 2005. Islamic private debt securities, investment accounts and the Islamic money market accounted for majority of the *takaful* fund assets. Market share of the *takaful* industry in terms of assets rose from 3.7 per cent at the end of 2000 to 6.7 per cent at the end of 2005. Total combined net contribution income grew at an average annual rate of 20.6 per cent during the same period, increasing its market share to 6.2 per cent from 2.5 per cent in 2000. To improve the financial resilience and enhance the underwriting capacity of *takaful* operators, a higher minimum paid-up capital requirement of RM100 million was imposed on *takaful* operators with effect from end of December 2004.

Development Financial Institutions

7.15 The development financial institutions (DFIs) continued to provide financing to identified strategic activities including agriculture, infrastructure development and export-oriented and high-technology industries as well as to SMEs and for the development of Bumiputera entrepreneurs. Financing provided by the DFIs increased from RM22.0 billion at the end of 2000 to RM47.5 billion in 2005. Measures were announced in 2005 to restructure DFIs towards greater focus in financing SMEs, strategic industries and Malaysian companies going overseas. Towards this end, the SME Bank was established, focused on providing financial facilities as well as advisory services to SMEs, towards enhancing their competitiveness in domestic and international markets. *Bank Pembangunan Malaysia Berhad,* in turn would focus on financing capital intensive and high-technology industries, maritime and infrastructure. In addition, the Export-Import Bank of Malaysia Berhad and the Malaysia Export Credit Insurance Berhad were merged.

Insurance Industry

7.16 The insurance industry sustained its growth momentum during the Plan period. Total premium income increased at a rate of 11.1 per cent per annum between 2001 and 2005 to reach RM23.6 billion, mainly due to strong demand for investment-linked and endowment insurance products and the successful penetration by domestic insurers of bancassurance as an alternative distribution channel. Total assets of the insurance industry grew at an average annual rate of 13.8 per cent over the same period to RM96.7 billion. The allocation of insurance fund assets to corporate and debt securities increased from 41.2 per cent to 49.9 per cent between 2001 and 2005, thereby promoting a more diversified institutional investor base for the capital market. The financial position of insurers strengthened following the increase in minimum statutory capital requirement in 2001 from RM50 million to RM100 million. The higher capital requirement also spurred the consolidation of the insurance industry, which saw the completion of a total of 16 mergers, involving 29 insurers.

Capital Market

7.17 The CMP, launched in February 2001, envisaged the establishment of an internationally competitive capital market providing an efficient conduit for the mobilisation and allocation of funds, supported by a facilitative and strong regulatory framework. During the Plan period, implementation of the CMP was aimed at strengthening domestic capacity, developing strategic and nascent sectors of the capital market as well as promoting gradual liberalisation. By the end of 2005, 65 per cent of the recommendations was implemented. A market friendly regulatory framework combined with strong market infrastructure catalysed the rapid growth of the Ringgit denominated bond market. This in turn, contributed towards a more resilient financial system by addressing the pre-crisis overreliance on the banking system as a mobiliser of funds.

7.18 *Fund Raising Activity.* Between 2001 and 2005, funds raised by the capital market amounted to RM416.1 billion, an increase of 89.0 per cent compared with the period 1996-2000. As at end of 2005, the bond market accounted for 90.0 per cent of total funds raised, facilitated by initiatives to enhance issuance efficiency and product innovation. The first exchange-traded fund, ASEAN Bond Fund Index was listed on *Bursa Malaysia* in July 2005.

7.19 *Enhancing Efficiency of Market Institutions.* To enhance the strategic positioning of the capital market as well as increase liquidity, and widen access to investments and products through a single market place, the Kuala Lumpur Options and Financial Futures Exchange Berhad (KLOFFE) and the Commodity and Monetary Exchange of Malaysia (COMMEX) were merged in June 2001. This was followed by the merger of the Malaysian Exchange of Securities Dealing and Automated Quotation Berhad (MESDAQ) with the Kuala Lumpur Stock Exchange (KLSE) in March 2002. In addition, *Bursa Malaysia* formerly known as KLSE was demutualised in 2004 and subsequently listed in March 2005. In conjunction with this, the Capital Market Development Fund was established to promote growth and innovation in the capital market.

7.20 *Enhancing Stock Market Liquidity and Efficiency.* The Government implemented several initiatives to enhance liquidity in the stock market. In 2003, board lots were reduced to 100 shares and free float was increased by reducing moratoriums on promoter's shareholdings. The Government also unveiled a 10-year transformation programme for government-linked companies (GLCs) in 2005 to make them attractive to investors while Budget 2006 introduced a facilitative tax and regulatory regime to promote mergers and acquisitions.

7.21 *Building Competitive Intermediaries.* Following consolidation, the number of locally-owned stockbroking companies (SBCs) was reduced from 60 to 32 at the end of 2005. Six SBCs emerged as Universal Brokers. Progressive deregulation was also undertaken, allowing for the setting up of branches and expansion in the scope of activities. A framework was also introduced to facilitate the creation of investment banks. In addition, five global stockbrokers established operations in Malaysia.

7.22 *Islamic Capital Market.* Malaysia's Islamic capital market continued to register strong growth. As at October 2005, a total of 857 or 85 per cent of total listings on *Bursa Malaysia* were *Syariah*-approved counters. The Securities Commission (SC) released the Guidelines on the Offering of Islamic Securities and extended its *Syariah* compliance review process to pre-initial public offering (IPO) securities. To enhance the international profile of Malaysia's Islamic capital market, the Government launched the world's first sovereign Islamic bond in June 2002.

7.23 *Venture Capital.* The venture capital industry continued to grow at a steady rate of 10.6 per cent per annum with the number of funds and investee companies increasing from 31 and 159 in 2000 to 48 and 380 in 2005, respectively. The largest source of venture capital funds was the Government followed by private corporations. The major portion of investments was in information and communications technology (ICT) followed by manufacturing and biotechnology.

7.24 *Investment Management Industry.* The unit trust industry grew at a rapid pace with the number of funds launched rising from 127 in 2000 to 340 with a net asset value of RM98.5 billion as at end of 2005. During the same period, the number of *Syariah*-based funds increased from 17 to 83 with the net asset value increasing five-fold to RM8.5 billion. The first *Syariah* index fund was introduced in January 2002. The Real Estate Investment Trusts (REITs) funds were launched in 2004. Exchange-traded funds and open-ended investment funds were introduced in June 2005.

7.25 *Provident and Pension Funds.* The role of the provident and pension funds (PPFs) in mobilising long-term savings became increasingly significant. Total assets of PPFs expanded by 34.3 per cent to RM291.3 billion in 2004. Employees Provident Fund (EPF) accounted for 82.5 per cent of total PPFs assets. The asset allocation of PPFs was increasingly diversified to tap growing opportunities in the capital market with the share of investments in private debt securities and loans at 13.6 per cent and 16.3 per cent, respectively.

7.26 *Derivatives Market.* The derivatives market provided more hedging instruments to meet the growing needs of investors to manage and diversify financial risks. In tandem with the rapid development of the domestic bond market, the 3-year, 5-year and 10-year Malaysian Government Securities (MGS) Futures Contracts were introduced in 2002 and 2003. The Palm Oil Kernel Futures (FPKO) Contract was launched in 2004. Equity ownership of futures broking firms was liberalised while futures brokers and futures fund managers were allowed to invest in a wider range of futures contracts in overseas markets.

Labuan International Offshore Financial Centre

7.27 Increased efforts were undertaken to promote Labuan as an International Offshore Financial Centre (IOFC). During the Plan period, 2,431 new offshore companies were established in Labuan, bringing the total to 5,152 since Labuan was launched as an IOFC in October 1990. The offshore companies incorporated in Labuan, originated from 93 countries of which 53 per cent were from the Association of South-East Asian Nations (ASEAN) and the Pacific region, 16 per cent from the Far East, 15 per cent from the Americas, 14 per cent from Europe and 2 per cent from the Middle East. Islamic banking and finance continued to be developed as a strategic niche market segment for Labuan. At the end of 2005, there were six Islamic banks, including two foreign Islamic banks established on the island. With regard to the Islamic capital market, six Islamic instruments were listed on the Labuan International Financial Exchange (LFX) with a market capitalisation of US$2.1 billion. In the area of *takaful*, Labuan offered general and family *takaful*, *re-takaful, takaful* management and underwriting services.

Co-operatives

7.28 More than 60 per cent of the co-operatives focused on providing consumer credit with the balance for small loans to activities in transportation, construction and housing. The size, membership and assets of co-operatives are, as shown in *Table 7-4.* The National Co-operative Policy (NCP), 2002-2010, was launched in 2002 to provide for the orderly re-development of co-operatives. The Malaysia Co-operative Commission (MCC) was approved to replace the present Department of Co-operatives Development of Malaysia to effectively regulate and supervise the co-operative sector and to realise its full potential.

TABLE 7-4

PERFORMANCE OF CO-OPERATIVES[1], 2000-2005

Indicator	*2000*	*2005*	*Average Annual Growth Rate (%), 2001-2005*
No. of Co-operatives	4,154	4,771	*2.8*
Membership (million)	4.5	5.5	*4.1*
Amount of Shares (RM billion)	4.2	6.3	*8.3*
Total Assets (RM billion)	15.8	26.2	*10.6*

Source: Department of Co-operatives Development

Note: [1] Co-operatives registered with the Department of Co-operatives Development.

III. PROSPECTS, 2006-2010

7.29 During the Ninth Plan period, the financial services sector is expected to grow at an average annual rate of 7.0 per cent per annum, with its share of GDP increasing to 15.8 per cent by 2010. Employment in the sector is expected to expand at an average rate of 2.5 per cent per annum. The FSMP and CMP will continue to provide the framework for the development of the financial services sector.

7.30 Efforts will also be taken to equip human resource in the sector with the necessary skills and expertise and promote a culture of continuous learning. Clear policy guidelines and practices will be introduced with respect to talent management to produce professional and well-trained employees. To meet the increased demand for expertise in Islamic finance globally, Malaysia will establish the International Centre for Education in Islamic Finance (INCEIF), which is designed to act as a professional certification body and a training institute for post-graduates. In meeting the demand for specialised expertise in the capital market, increased efforts will be focused on expanding the pool of talent, creating centres of intellectual excellence and accelerating capacity building. Particular attention will also be given to augmenting the supply of skilled Bumiputera participants in the capital market.

7.31 Initiatives to empower consumers through the provision of appropriate information will be further intensified so that consumers can take responsibility for their own financial decisions. Measures to promote greater consumer awareness and activism will be further enhanced through more targeted consumer education programmes and by strengthening the overall consumer protection infrastructure. In addition, the regulatory and supervisory framework will be further strengthened to provide better protection for consumers and enhance supervision and oversight.

For the *takaful* industry in particular, consumer protection will be strengthened by setting up a *takaful* guarantee scheme fund, which will serve as the final safety net in the event of failure of a *takaful* operator.

7.32 The overall thrust under the Ninth Plan will be to develop a more robust financial services sector to support socio-economic development and capitalise on new growth and wealth creating opportunities. The key strategies will be:

- *building an internationally competitive financial services sector, through progressive liberalisation;*
- *promoting competitive domestic financial institutions and nurturing their expansion into regional markets;*
- *improving the delivery system of the regulatory framework and enhancing enforcement;*
- *developing Malaysia as an international centre for Islamic banking and finance, as well as initiating niche capital market specialisations at regional and global levels;*
- *focusing DFIs towards development of competitive and globally oriented SMEs;*
- *promoting Labuan as a unique IOFC, especially for innovative Islamic financial products and services; and*
- *mobilising resources and improving the capability of co-operatives as an alternative source of financing.*

Banking System

7.33 The Ninth Plan coincides with the implementation of the second half of Phase II and Phase III of the FSMP. Phase III aims to bring about greater integration of domestic financial system with the global environment. The recommendations of the FSMP will be implemented in a systematic manner, driven by the need to remain practical and guided by the consultative process. Existing regulatory framework will be reviewed with the objective of achieving a balance between promoting innovation and market development, and safeguarding financial stability through prudential requirements. The regulatory burden will be reduced to achieve competitive equality within the financial sector. Gradual liberalisation measures, including the possibility of introducing new foreign competition, will be properly sequenced to ensure it brings maximum benefits while preserving overall financial stability.

7.34 *Improving Efficiency.* Domestic banking groups will be encouraged to provide complete and integrated financial solutions to their customers and achieve cost efficiency through group rationalisation. The emphasis will be on enhancing the role of financial holding company in pursuing group strategies that promote greater risk and income diversification, synergy creation and enhanced branding. The greater use of ICT will also be promoted to enhance risk management capabilities, to improve service delivery, and provide seamless and customised services. Competitive pressure will accelerate adoption of international best practices and standards towards strengthening the level of professionalism and encourage banking institutions to continually differentiate themselves through product and service offerings.

7.35 *Expanding to Regional Markets.* With significant opportunities emerging from regional integration and economic cooperation, financial institutions will be encouraged to increase effective presence in new and competitive regional markets to support intra-regional trade and investment whilst giving support to local entrepreneurs abroad. For this purpose, banking institutions will need to be prepared with the necessary resources and expertise to compete effectively.

7.36 *Improving Access to Financing for SMEs.* Banking institutions will continue to be one of the main providers of funds to SMEs with the Government complementing them in the form of special funds and financing packages. The Government schemes will include financing for micro enterprises and SMEs involved in agriculture and agro-based industries in the emerging growth areas of biotechnology and ICT. The newly established SME Bank will further enhance its role in mobilising and providing alternative sources of funding as well as facilitating access to related non-financial services. Among others, the SME Bank will guarantee loans granted to SMEs by other banking institutions as well as facilitate securitisation of SME loans, enabling them to also tap the capital market. To encourage greater participation of SMEs in export markets, new trade-financing arrangements covering pre-shipment and post-shipment financing will be introduced. Measures will also be taken to improve dissemination of information of various financing schemes as well as consultancy and advisory support services.

7.37 *Venture Capital Funds for Agriculture.* The two venture capital funds of RM150 million each for the agriculture sector, established by Bank Negara Malaysia (BNM) to support the Government's objective of realising the potential of the agriculture sector as a third engine of economic growth, will focus on creating and developing integrated agricultural businesses. The targeted areas for investments are integrated farming and fisheries as well as biotechnology-related ventures.

Islamic Financial System

7.38 The Islamic banking industry will continue to expand in parallel with conventional banking. By 2010, the Islamic banking industry is expected to constitute 20 per cent of the overall banking and insurance market. To elevate the domestic Islamic financial system and further integrate it with the international financial infrastructure, strategic initiatives will continue to be undertaken to strengthen Malaysia's position as a global Islamic financial hub. The move is expected to strengthen financial, trade and investment ties as well as linkages between Malaysia and other countries.

7.39 *Developing into a Global Islamic Financial Hub.* Capitalising on the strength and experience that Malaysia has garnered over the years, the hub will serve as a platform for origination, issuance and trading of Islamic capital market and treasury instruments, for fund and wealth management, offshore Islamic financial services market as well as *takaful* and *retakaful* business. This will be complemented by the formation of centres of excellence for education, training, consultancy and research in Islamic banking and finance. Malaysia will also have the presence of a strong and diversified range of Islamic financial institutions that are able to offer a comprehensive and broad array of Islamic financial products and services. Other initiatives will include nurturing Malaysian Islamic financial institutions to venture abroad, promoting a strong Malaysian brand globally, establishing an effective and efficient delivery system, fostering strategic alliances with other financial centres and establishing monetary policy conduct for the Islamic financial system. Concerted efforts will be directed at providing the requisite regulatory and prudential framework to facilitate the development of a sound and efficient Islamic financial system.

7.40 *Takaful.* The *takaful* industry will be developed to form an integral part of the financial system by 2010. During the Plan period, the main objective is to develop a number of strong and highly capitalised *takaful* operators offering a complete range of *takaful* products and services. Steps will be undertaken to enhance the ability of *takaful* players to capitalise on the unique features of takaful. This will include measures to ensure the availability of well-trained, high-caliber individuals and management teams with the required expertise, especially in terms of *Syariah* compliance and product development. Additional *takaful* licences will be granted to eligible parties to generate greater competition and further expand *takaful* businesses to enable the industry to achieve the target of 20 per cent market share of the total insurance industry.

7.41 Malaysian *takaful* operators will also be encouraged to increase their global presence either through equity participation or through management expertise with their foreign counterparts. With the formation of the Malaysian

Takaful Association, industry efforts towards enhancing market conduct and strengthening customer protection will be effectively and efficiently implemented. Alternative distribution channels such as *bancatakaful*, financial advisers and Internet will be further developed. Professionalism of the agency force will be enhanced to ensure better customer service.

7.42 In order to protect the interest and increase the confidence of the public in the *takaful* industry, the regulatory and supervisory initiatives will focus on strengthening its financial soundness and sustainability. Regulatory regimes on solvency and capital adequacy, which are the cornerstones of prudential supervision, will be improved upon. Future regulatory and supervisory efforts will also be directed at strengthening governance practices and cultivating greater risk management culture within the *takaful* industry. Enhancement to the legal framework, particularly those related to consumer protection will be undertaken. Realising the potential of *re-takaful* (Islamic re-insurance) to fulfil the needs of *takaful* operators, emphasis will be placed on measures to enhance the *re-takaful* industry. This will include strengthening the ASEAN *Re-takaful* International Ltd. (ARIL) to enhance its capacity and capability so as to position itself as an important *re-takaful* operator in the region.

Development Financial Institutions

7.43 DFIs will continue to complement banking institutions in providing financing, especially in priority and new growth areas. To ensure that DFIs are able to continuously perform their mandated functions in an effective and efficient manner, the restructuring and rationalisation of the four DFIs that was initiated during the Eighth Plan period will be followed through by increasing the capital base as well as upgrading management capabilities and corporate governance. DFIs are also expected to play a greater role in providing other non-financial services including serving as reference points and data centre for credit information and the development of a credit scoring system for targeted sectors. In addition, institutional arrangements of selected DFIs will be strengthened to enable them to provide sustainable micro financing schemes premised on international best practices.

Insurance Industry

7.44 Significant opportunities for growth in the insurance industry are expected to result primarily from changing demographics in terms of an expanding ageing population with increasing wealth levels and rising awareness of the need for, and benefits of, insurance. The industry will, therefore, need to position itself, both financially and in terms of its reputation to meet the increasing demand for insurance. Efforts will continue to be undertaken to enhance capacity building.

This will include monitoring and where appropriate, driving initiatives by the industry in the area of developing human resource capability to ensure that industry standards are continuously raised in tandem with the expectations of increasingly sophisticated consumers and financial markets. Greater focus will be given to strengthening the role of market discipline to foster an environment of improved customer service as well as high standards of integrity and professionalism. This will be achieved by increasing education and awareness among the consumers, promoting greater transparency in the conduct of insurance business and continuously raising the level of professionalism.

7.45 *Improving Risk Management.* Continued focus will be given to strengthening the financial risk management capabilities of insurers to support the implementation of a risk-based capital framework. This will be complemented by the on-going development of the capital market, which will expand investment avenues for insurers to improve their asset-liabilitiy management.

7.46 *Liberalisation.* Further deregulatory and liberalisation measures will be introduced. This will include greater flexibility accorded to foreign insurers to establish branch offices, the progressive deregulation of pricing for tariff-rated insurance products, greater investment management flexibility, and removal of limits on management expenses. It will also ensure continuing improvements in disclosure standards to promote greater market discipline in the more deregulated environment. Consistent with the deregulatory measures, the prudential framework will continue to be adjusted to establish principles of sound financial and business practices. In addition, to promote greater international integration, new licences will be issued and greater opportunities will be provided to internationally-reputed insurers to acquire equity interests in, or forge strategic alliances with domestic players, both in the direct insurance as well as re-insurance sectors.

Capital Market

7.47 During the Plan period, the third phase of the CMP will be implemented. It will focus on enhancing international competitiveness and leveraging on the foundation built during the first and second phases. Initiatives will centre on further broadening and deepening the capital market, promoting the regional and international profile of the Malaysian capital market and identifying new growth opportunities. The broad strategic thrusts to achieve these objectives involve enhancing Malaysia’s position as a premier market, ensuring sufficient supply of financing to nurture new sources of growth, enhancing liquidity and transparency in the secondary bond market and positioning Malaysia as a global hub for Islamic capital market. At the same time, the focus will be on enhancing the role of the investment management industry in mobilising savings and accelerating the pace of development of the derivatives market as well as increasing the use of technology and connectivity across market segments, enhancing the delivery of regulatory services and developing human capital to build a world-class market.

7.48 *Positioning Malaysia as a Premier Capital Market.* To position Malaysia as a premier market, initiatives will be taken to improve its attractiveness as a destination for listing, a hub for intermediation and a host to high-quality and innovative companies that are committed to good governance. In this regard, measures will be introduced to enhance the quality of the market framework to ensure that Malaysia's capital market is attractive to issuers, intermediaries and investors. Efforts will be focused on building more high quality and competitive public listed Malaysian companies that will be able to attract an increasing share of domestic and global investors and capital. This will also be complemented by measures to transform listed GLCs towards a new level of performance and resilience.

7.49 *Financing New Sources of Growth.* Continuous efforts will be made to strengthen the role of the capital market in providing appropriate access to funding at reasonable costs including for SMEs. In this regard, the capital market will effectively complement traditional sources of funding for SMEs by facilitating the introduction of innovative financing instruments for knowledge-intensive as well as technology-intensive start-up enterprises with intangible collateral such as ideas, knowledge and expertise as their principal assets to source funds from the capital market.

7.50 *Enhancing Liquidity and Transparency in the Secondary Bond Market.* Initiatives will focus on further deepening and broadening the secondary bond market by expanding product range and structures, particularly with a view to lengthening tenures and broadening risk spectrums. In addition, initiatives will be undertaken to further improve secondary market liquidity by enhancing the trading infrastructure, broadening market access and expanding the number and representation of participants in the bond market. In tandem with this, the regulatory framework including the requirements for information disclosure will be reviewed. Efforts will also be geared towards further liberalisation of the existing regulatory framework to promote product innovation. In line with this, initiatives will be identified to make available a wider spectrum of asset classes and innovative instruments structured on *Syariah* as well as conventional principles. The Government will also promote the integration of Asian bond markets.

7.51 *Positioning Malaysia as a Global Hub for Islamic Capital Market Products and Services.* Efforts will be intensified to enhance Malaysia's position as a key provider of Islamic capital market products and services by strengthening the role of Islamic institutions in the domestic intermediation process, particularly in terms of mobilising savings and fostering an enabling environment for innovation. Increasing emphasis will be placed on enhancing the linkages between domestic institutions and other Islamic capital market centres towards building a global Islamic capital market network through sharing product knowledge, distribution channels and other resources. The promotion of greater cross border trade and investment linkages is also expected to contribute substantially to the expansion of Malaysia's Islamic capital market.

7.52 *Enhancing the Role of Investment Management Industry.* Further initiatives will be implemented to accelerate the growth and development of the investment management industry and expand the range of cost-effective products to enhance its role in mobilising savings and meeting the varied demands of savers. This will be complemented by initiatives to ensure comprehensive regulation for the maintenance of high professional standards as well as high levels of investor protection and corporate governance. Greater investor awareness and knowledge of financial planning, wealth management and available financial products will be created. Steps will also be taken to improve information disclosure and performance measurements to aid investor understanding of the risks and returns on their investments.

7.53 *Accelerating the Pace of Development of the Derivatives Market.* The derivatives market will continue to serve as an alternative avenue for investment as well as for cost-effective hedging and risk management facilities. In this regard, efforts will be geared towards product innovation to spur the growth of the derivatives market and increase the breath and depth of the capital market. Priority will be placed on building institutional capacity to undertake product innovation and the regulatory framework will be strengthened to support the development of innovative financial instruments. Guidelines will be provided to allow fund managers to use derivatives in portfolio management. The implementation of the new common trading platform for the derivatives markets will also facilitate the introduction of new products, trading algorithms and auction mechanisms. The new platform will offer enhancements in terms of its ability to integrate order execution between the various market segments on a single platform, which will increase trading velocity by encouraging greater participation by intermediaries and investors. This combined with increasing foreign participation in the Malaysian capital market will have a substantial impact on the liquidity and vibrancy of the derivatives market.

7.54 *Enhancing the Delivery of Regulatory Services.* The regulatory framework and processes will be streamlined through consolidation of licensing requirements while turn-around times for corporate and other approvals will be further shortened. Efforts will also focus on further streamlining regulation with the aim of encouraging business efficiency and cost-effectiveness while ensuring a strong framework for enforcement of good corporate governance. In this regard, regulators will seek to enhance their delivery of service to the public in a seamless and efficient manner and initiatives will be implemented to ensure more timely and effective enforcement. Efforts will be focused on ensuring efficient regulatory coverage and parity in addressing issues of investor protection and market integrity.

7.55 With increasing sophistication of the Malaysian capital market, it will need to strengthen the mechanisms and capacity for self-discipline among listed companies, as well as increasingly rely on market regulation to enable greater precision, flexibility and timeliness in serving investors and public interest. For the purpose of self-discipline, self-regulatory organisations will be encouraged to monitor business conduct and ethical behaviour among market participants.

7.56 The SC will further enhance its role as a surveillance and enforcement agency. This includes strengthening its risk management capacity and capability, and further enhancing its pro-active and pre-emptive approach to surveillance and enforcement. It will continue to leverage on cooperation with other international capital market regulators, particularly in the identification and prosecution of cross border securities and corporate offences.

7.57 *Increasing the Use of ICT Across Market Segments.* As many aspects of capital market development will be continuously driven by advancement in information and technology platforms, technological initiatives taken by *Bursa Malaysia* to introduce integrated trading platforms as well as the clearing and the settlement systems will be continued. This will be complemented by establishing higher levels of straight-through-processing linking domestic and global payment systems. At the business level, deregulatory measures will be pursued to create a facilitative environment to leverage technology for trade execution, information and service delivery to customers.

Provident and Pension Funds

7.58 Taking into cognisance the social and demographic changes such as higher life expectancy, an ageing population and changing priorities, new strategies will be considered to provide adequate replacement income, ensure long-term sustainability of PPFs, maximise returns and expand coverage as well as safeguard the interests of contributors. Towards this end, a more holistic approach will be adopted to enhance the PPFs so as to assist retirees to ensure that they have sufficient financial assurance. The PPFs will also serve as a platform to mobilise domestic savings in a more effective manner to spur financial market development to support economic growth. In tandem with overall efforts to supplement the national pensions system and provide for greater competition and diversity in institutional management of private funds, steps will be taken to expedite the development of the private pensions industry.

Labuan International Offshore Financial Centre

7.59 To enhance the competitiveness of Labuan as an IOFC, increased promotional activities will be undertaken. In line with increasing global demand for financial services, emphasis will be directed at attracting investors and institutions from the Asia Pacific, Middle East as well as the European Union to set up base in Labuan. Improved incentives will be considered to encourage international institutions to issue financial papers, undertake listing and trade on the LFX.

7.60 The Government will also continue to identify various strategic initiatives to develop Labuan into a unique offshore financial centre. In this regard, the major areas of focus will include the further development of Islamic and conventional financial services related to the capital market, fund management, trade financing as well as *takaful*, *re-takaful* and cash *wakaf*. Increasing emphasis will be placed on strengthening the available legislation and guidelines, particularly related to Islamic financial services. To facilitate the further expansion of Labuan IOFC, the legal framework will be continuously improved to ensure it remains relevant, up to date with global requirements, and reinforces the supervisory powers of the Labuan Offshore Financial Service Authority (LOFSA) as well as maintains Labuan's reputation and competitiveness as an IOFC.

Co-operatives

7.61 In order to enhance access to financing through co-operatives, the industry will be strengthened with priority accorded to improvement in their financial capacity and operational capability. Towards this end, the newly formed MCC will play a significant role in spearheading the implementation of the NCP that focuses on a more holistic approach in the development of co-operatives. The focus will be on ensuring the stability and soundness of financial and management operations of co-operatives. Among others, this will include the mandatory registration, regulation and supervision of all co-operatives including those which were previously under the *Lembaga Pertubuhan Peladang* and *Lembaga Kemajuan Ikan Malaysia.*

IV. INSTITUTIONAL SUPPORT AND ALLOCATION

7.62 The Ministry of Finance, BNM and SC will continue to lead new developments in the financial services sector. The development expenditure and allocation to support the financial services sector for the Ninth Plan is, as shown in *Table 7-5.* The focus will be on providing adequate funding for the development of priority segments of the economy including SMEs and new growth areas such as ICT and biotechnology.

TABLE 7-5

DEVELOPMENT EXPENDITURE AND ALLOCATION FOR FINANCE, 2001-2010
(RM million)

Programme	*8MP Expenditure*	*9MP Allocation*
Venture Capital	690.0	1,600.0
Small and Medium Enterprises Development	1,412.2	1,100.0
Government Equity	4,520.2	1,200.0
Dana Hartanah	–	2,000.0
Others	468.0	480.0
Total	**7,090.4**	**6,380.0**

Source: Economic Planning Unit

V. CONCLUSION

7.63 The Eighth Plan period witnessed the consolidation and strengthening of the financial sector after the Asian financial crisis, following the initiatives undertaken by *Danaharta, Danamodal* and the CDRC. The banking system, following its rationalisation, refocused on further improving productivity and competitiveness benefiting from economies of scale. The capital market also underwent rapid development, increasing its prominence as an alternative source of financing. The thrusts under the Ninth Plan will be geared towards establishing an internationally competitive and efficient financial services sector alongside encouraging domestic financial institutions to expand abroad. Key initiatives will include improving access to financing for all sectors, especially SMEs, developing the necessary human capital, promoting greater innovation of financial products and services as well as providing a market-friendly regulatory framework with strong enforcement. The Islamic financial system will be further developed to tap its potential and serve as a new source of growth, leveraging on Malaysia's position as a modern and rapidly developing Islamic country. Progressive liberalisation will continue to be undertaken to bring maximum benefits to the sector and the economy while ensuring overall financial stability. The completion of the implementation of the FSMP and CMP by the end of the Ninth Plan period will place Malaysia as an emerging advanced financial market.