CHAPTER 5 THE EVALUATION OF FSMP AND CMP

5.1 INTRODUCTION

In order to meet the future intermediation needs, the Malaysian financial system should be strengthened and therefore the Financial Sector Master Plan (FSMP) and Capital Market Master Plan (CMP) were unveiled by BNM and SC respectively.

In this chapter, the FSMP and CMP will be broadly compared in terms of their vision and objectives, the institutions involved, phases of implementation, their recommendations and main focuses. Subsequently, the recommendations for both master plans will be evaluated with reference to the summary of future intermediation needs, and in terms of the regulatory framework, institutional and structural development, technological development, product innovation and human resources development.

5.2 FINANCIAL SECTOR MASTER PLAN (FSMP) VS CAPITAL MARKET MASTER PLAN (CMP)

5.2.1 What are They?

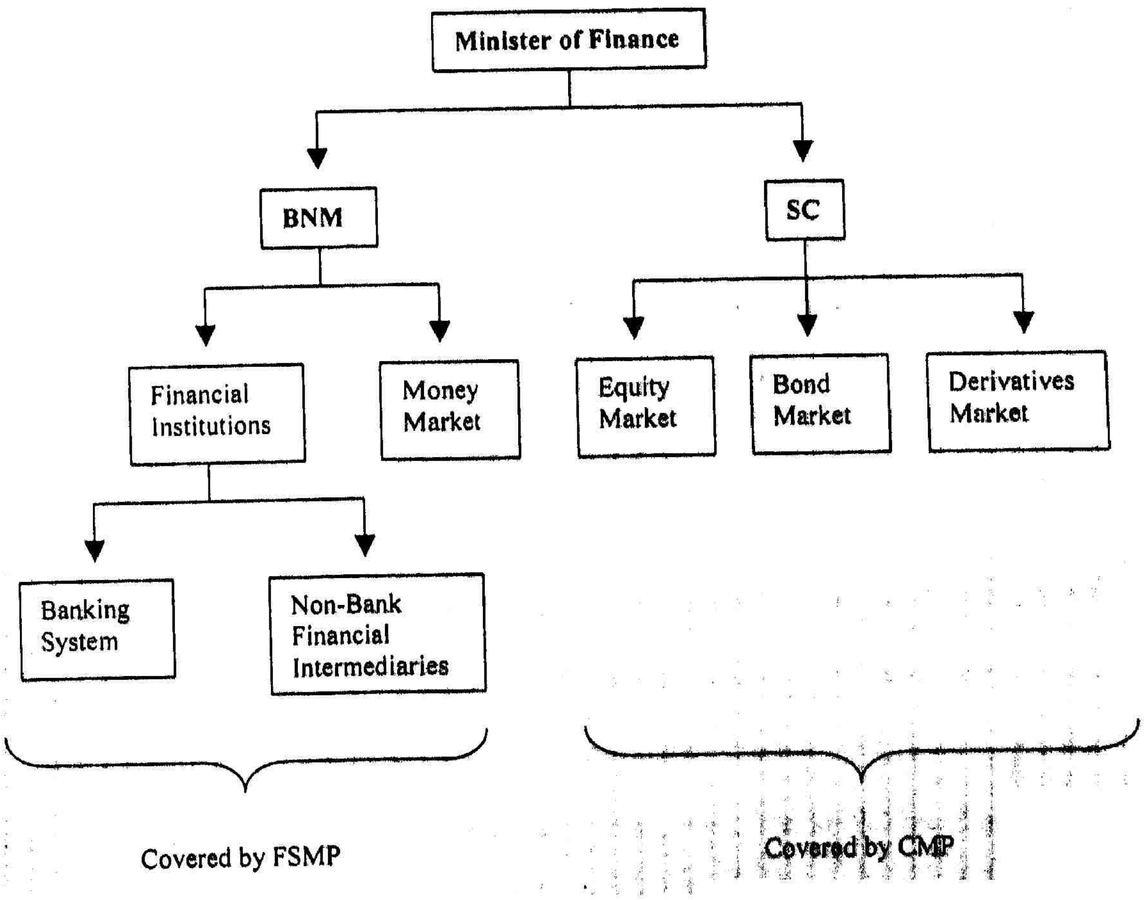
FSMP is a blueprint to chart the way forward for the country's banking, insurance and other financial sector players over the next ten years that will ensure its continued effectiveness, competitiveness and resilience. It was launched by BNM on 1st March 2001.

CMP, as another blueprint to complement FSMP, is a comprehensive plan charting the strategic positioning and future direction of the Malaysian Capital

Market for the 2001-2010 period. It is intended to ensure that the capital market is well positioned to play its role in supporting national growth needs, as well as in meeting the challenges of increasing globalisation. It was launched by SC on 22nd Feb. 2001.

As shown in Figure 5.1, basically FSMP covers the planning for banking system as well as non-bank financial intermediaries, which are under the purview of BNM. On the other hand, CMP covers the planning for equity market, bond market and derivatives market, which under the supervision of SC. However, both master plans are inter-connected. In particular, the implementation of the CMP will take cognisance of the FSMP to ensure hormonised and structured development of the Malaysian financial sector.

Figure 5.1 : The Coverage of FSMP and CMP



5.2.2 Vision and Objectives

In terms of the vision and objectives, in FSMP, the vision is defined based on five main characteristics, namely efficiency, effectiveness, stability, prudential regulations and infrastructure. In other words, with the guidance of this master plan, the financial intermediaries should strive for :

i. High productivity and returns on assets.

ii. Providing a broad range of products and services.

iii. A safe, sound and stable financial system.

iv. An effective prudential regulations and supervision.

v. Developing a strong infrastructure to ensure overall stability of the financial system.

As for CMP, this blueprint pays more concern to enhance the capacity and capability of capital market to support the basic capital and investment needs. It gives the broad direction for the market participants to strive for higher competitiveness in alignment with international standard, and increasing the efficiency conduit for the mobilisation and allocation of funds. In addition, SC will ensure that the capital market is supported by a strong and facilitative regulatory framework that enables it to perform its functions effectively and provides a high degree of confidence to its users.

In terms of objective, CMP looks more specific as compared with FSMP. As shown in Table 5.1, the first five objectives focus on each core areas of the capital market, comprising issuers, investors, market institutions, market intermediaries and the overall regulatory framework. The sixth objective focuses on establishing Malaysia as an international Islamic capital market centre in view of its comparative advantage in contrast with other countries.

Table 5.1 : A Comparison Between FSMP and CMP

	FSMP	CMP
Launching Date	1st March 2001	22nd Feb 2001
Regulator	BNM	SC
Period	2001 - 2010	2001 – 2010
Vision	For the development of a well-diversified financial sector that is defined based on five main characteristics : 1. Efficiency 2. Effectiveness 3. Stability 4. Prudential regulations 5. Infrastructure	The capital market for Malaysia should be : • Internationally competitive • Highly efficient • Supported by a strong and facilitative regulatory framework.
Objectives	• To develop a more resilient, competitive and dynamic financial system with best practices, that supports and contributes positively to the growth of the economy throughout the economic cycle, and • Develop a core of strong and forward looking domestic financial institutions that are more technology driven and ready to face the challenges of liberalisation and globalisation.	1. To be the preferred fund-raising centre for Malaysian companies. 2. To promote an effective investment management industry and a more conducive environment for investors. 3. To enhance the competitive position and efficiency of market institutions. 4. To develop a strong and competitive environment for intermediation services. 5. To ensure a stronger and more facilitative regulatory regime. 6. To establish Malaysia as an international Islamic capital market centre.
Institutions / Markets Involved	1. Banking Institutions 2. Insurance Companies 3. Islamic banking and takaful institutions 4. Development financial Institutions 5. Labuan IOFC	1. Market institutions consist of KLSE, MESDAQ, KLOFFE, COMMEX, SCANS, MCD & MDCH. 2. Market intermediaries such as stockbroking companies and investment management companies. 3. Equity market 4. Bond market 5. Derivatives market

5.2.3 Institutions/ Market involved

As overall, the financial intermediaries that are involved in the implementation of FSMP consist of banking institutions, insurance companies, Islamic banking and takaful institutions, development financial institutions (DFI) and Labuan IOFC.

The institutions or markets involved in the implementation of CMP include the market institutions, market intermediaries, and the capital markets such as equity market, bond market and derivatives market. The market institutions consist of the individual exchanges, i.e. KLSE, MESDAQ, KLOFFE and COMMEX, the clearinghouses such as SCANS and MDCH, and the central depository, i.e. MCD. The market intermediaries comprise the stockbroking companies and investment management companies. The bond market consists of the public debt securities market and the private debt securities (PDS) market, where as the derivatives industry consists of the exchange-traded derivatives and OTC derivatives.

5.2.4 Phases of Implementation

As shown in Table 5.2, both master plans are implemented in a three-tier phase, over the 2001-2010 period. As overall, phase one focus on measures to increase domestic capacity and competitiveness. Phase two further strengthen the domestic financial system and at the same time intensify the market competition by gradually liberalise the market access. In phase three, greater liberalization emerges by introducing new foreign competition.

In terms of the timeframe, the sequencing for the implementation of recommendations is not set out clearly in FSMP. From a broad description in this document, phase one take about three years, i.e. from 2001 to 2003. Subsequently there will be a checkpoint to ensure that the financial institutions are ready for further competition before moving to the second phase. Hence, phase two is estimated to be three to four years, depending on the ability of domestic institutions to compete under a more liberalised environment. The third phase cover the remaining years up to 2010.

Table 5.2 : Phases of Implementation

	FSMP	CMP
Phase 1	Year 2001 – 2003 Focused on building the domestic capacity.	Year 2001 – 2003 Strengthen domestic capacity, and develop strategic and nascent sectors.
Phase 2	Year 2004 – 2007 Intensify competitive pressure in the domestic financial sector.	Year 2004 –2005 Further strengthen key sectors and gradually liberalise market access.
Phase 3	Year 2008 – 2010 Assimilate into global arena and introduce new foreign competition.	Year 2006 – 2010 Further expansion and strengthening of market processes and infrastructure towards becoming a fully developed capital market, and enhancing international positioning in areas of comparative and competitive advantage.

Source : BNM, SC.

In CMP, the timeframe of each phase of implementation is clearly stated under a specific section, i.e. Implementation Plan. Furthermore, the phasing for the implementation of recommendations is also listed down systematically according to different market segments. The timeframe for phase one of CMP is up to the end of 2003, followed by phase two for a two-year period. Phase three cover the longest period as compared to the previous phases, reflecting the effort to achieve the aim in the third phase take longer time.

5.2.5 Recommendations of FSMP and CMP

There are a total of 115 recommendations embedded in FSMP. The banking sector and insurance sector earned greater attention from the regulators as these two sectors have already taken the share of about 61% out of the total recommendations. The other recommendations deal with the Islamic banking and takaful, DFI, alternative modes of financing and Labuan IOFC.

As a whole, the recommendations are only presented briefly in FSMP, lacking in details on strategies to achieve the long-terms objectives of the plan. Without a clear description, the recommendations would just provide a broad direction to the regulators as well as the financial institutions. It is expected that BNM will come out with some more documents or announcements in the near future to fill the gaps in this blueprint.

Pertaining to the recommendations of CMP, there are all together 152 recommendations. The recommendations are directed to various areas, as listed in Table 5.3, with the number of recommendations for each one.

As overall, the recommendations are equally divided to every listed area. However, there are over 70% of the recommendations to be implemented and completed by the end of 2003. From this figure, about 20 recommendations have been implemented or announced by SC before the launching of CMP, including the liberalisation of fees, institutional settlement and delivery procedures. This reflects that CMP put more emphasis on the short term planning. Even though the total recommendations of CMP are more than that of FSMP, they look more specific and achievable. Furthermore, the purpose of those recommendations and the implementation timeframe are clearly defined in CMP. This will facilitate the process of implementation.

Table 5.3 : Recommendations of FSMP and CMP

FSMP		CMP	
Banking sector	39	Market institutions	16
Insurance sector	31	Equity market	16
Islamic banking and takaful	11	Bond market	17
Development financial institutions	8	Derivatives market	15
Alternative modes of financing	17	Islamic capital market	13
Labuan IOFC	9	Stockbroking industry	12
		Investment management companies	18
		Corporate Governance	10
		Regulatory Framework	16
		Technology and E-commerce	10
		Training and education	9
Total :	**115**	**Total :**	**152**

5.2.6 The Focuses of FSMP and CMP

With regard to the focuses, there are some similarities in FSMP and CMP, as reflected in their recommendations. Both master plans recommend the financial system to move towards a more consolidated structure by enhancing its capacity and expanding the potential financial businesses such as Islamic Banking, Islamic Capital Market and VC industry. Besides that, in order to support the more complex financial activities and the dynamic business environment, the rules and regulations for both financial institutions and capital market will be strengthened. In addition, consumer and investor protection receives great concern in both master plans, reflecting the efforts of regulators to increase consumer confidence on financial products and services.

Moreover, both master plans reflect that the regulators encourage all financial products and services providers to intensify the use of technology to improve their operation and payment system. In addition, both master plans emphasize on the continuous efforts in product innovation so as to widen the range of financial products and services. Due to greater needs for skilled manpower, both FSMP and CMP also aim to strengthen the education and training programs.

In spite of these similarities, FSMP and CMP also have differences in terms of focuses. For instance, BNM will aim to meet its socioeconomic objectives via numerous recommendations in FSMP, such as providing financial support to the priority sectors. However, such concern is not appeared in CMP. Besides that, FSMP also focus on strengthening the supervisory framework, whereas in CMP, the emphasis is given to market-based regulation as certain supervisory responsibilities are delegated to market institutions and the related parties.

In terms of product innovation, BNM aims to intensify the R & D efforts. Though, the concern is not mentioned in CMP. Nevertheless, CMP focus on enhancing the efficiency of trading system as well as clearance and settlement process via a new concept, i.e. end-to-end straight-through processing (STP).

This may assume a useful reference for BNM to further improve the processing of financial transactions and the payment system for financial institutions.

5.3. MEETING FUTURE INTERMEDIATION NEEDS

As mentioned in Chapter Four, there are several future intermediation needs that should be taken consideration by the regulators. As shown in Table 5.4, most of the needs are addressed in FSMP and CMP. Via the recommendations embedded in both master plans, BNM and SC aim to increase capacity and competitiveness of the existing financial intermediaries. This will fulfill the needs for financial resource mobilization and the challenges of market globalization.

In terms of the regulatory and supervisory framework, there are quite a number of recommendations aimed at enhancing the consumer and investor protection as well as further deregulation. However, the FSMP lack of details with regard to the overlapping of regulations among different regulatory authorities.

Pertaining to structural and institutional change, both master plans would be leading the financial intermediaries towards a more consolidated financial system. Besides that, the rationalization exercises for branches among domestic financial institutions would be promoted, as embedded in FSMP, so as to ensure that the branch network is sufficient to support the increasing needs of fund mobilization. In addition, both master plans contain recommendations to develop a more diversified financial system in order to meet different intermediation needs and investment needs.

Table 5. 4 : Meeting Future Intermediation Needs

Key Areas	Future Intermediation Needs	FSMP	CMP
Financial Resource Mobilization	• Increase capacity of financial intermediaries.	√	√
Globalization	• Increase competitiveness to meet complex intermediation needs and fund-raising needs.	√	√
Regulatory and Supervisory Framework	• Ensure that there is no gap or overlapping of regulations among different regulatory authorities.	X	√
	• Further deregulation to allow greater competition among domestic financial institutions and foreign players.	√	√
	• Enhance consumer and investor protection with more prudential regulations.	√	√
Structural and Institutional Development	• Further consolidation of domestic institutions.	√	√
	• Ensure that the branch network of financial intermediaries is sufficient to support the increasing needs of fund mobilization.	√	N/A
	• Promote the development of a more diversified financial system.	√	N/A
Human Resources Development	• Ensure that the human resources available in the financial sector are sufficient.	√	√
	• Training programs to enhance the productivity of labor force.	√	√
	• Skilled manpower is highly needed.	√	√
	• The benchmarking program on best practices and the co-operation with related international organizations.	√	√
	• Intensify the punishment of unethical business practices and enforce an organization's ethics control system.	X	X
	• Increase academic qualification of labor force.	√	√
Technological Advancement	• Further broadening of computerization and modernization in banking operation.	√	N/A
	• Increase allocation of IT fund.	N/A	N/A
	• Promote greater customer involvement in financial services.	√	√
	• Improve data security.	X	√
Product Innovation	• Provide wider range of products and services.	√	√
	• Promote electronic-banking and electronic trading system.	√	√
	• Enhance product facilities and communication infrastructure.	X	X
	• Intensify R & D efforts in product design.	√	X

With regard to human resource development, both master plans are quite well in addressing future needs except the issue of intensifying the punishment of unethical business practices and enforcing an organization's ethics control system. Regarding IT development, the issue of data security is only addressed in the CMP but not in FSMP. Besides that, there is no statistical data in both master plans to show the increase in allocation of IT fund. However, from the broad direction that reflected in these master plans, the regulators actually promote the use of technology among financial intermediaries.

With regard to product innovation, both FSMP and CMP reflect that more concerns are put on broadening the range of financial products and services. There are only a few recommendations mentioned on improving the delivery channel in both master plans and none of communication infrastructure. In addition, the CMP lack of details regarding the R & D efforts in product design, whereas it is well addressed in FSMP.

5.4. EVALUATION OF THE RECOMMENDATIONS IN FSMP

The evaluation of the recommendations will be discussed according to the main areas such as the regulatory and supervisory framework, institutional and structural development, technological development, human resources development, and product innovation. In view of the significance of consumer protection and education in FSMP, it will be discussed separately from the regulatory framework. The recommendations will be evaluated with reference to the list of recommendations of FSMP, which is attached with this report as Appendix A.

.4.1. The Regulatory & Supervisory Framework

Via FSMP, BNM will strive for a supervised market approach by which the focus will be on greater supervision of market integrity with minimal regulation imposed on business decisions. This approach is appropriate for the Plan period in view of the increasingly dynamic environment. It is expected that the revised regulatory and supervisory framework will provide an environment, which is conducive to the development of an efficient and innovative financial system.

As a strategy to strengthen the supervisory framework, BNM will implement a transparent and clearly structured early warning system, which means the specific early warning indicators such as risk-weighted capital ratio (RWCR) will be used to monitor the operation of banking institutions, as planned in Recommendation 3.24. This recommendation is appropriate, as it will assist the regulators to discover potential impediments at its early stage and thus implement the prompt corrective measures to resolve the problems. However, the lacking in professional skills will become the main challenge for this recommendation.

Besides that, in order to promote Islamic banking and takaful, the Islamic Banking Act (1983) and the Takaful Act (1984) will be strengthened. Furthermore, the BAFIA will be amended to facilitate the Islamic banking operations of IBS banks. These recommendations are unveiled at the right time as it reflects the effort of BNM to develop a more diversified financial system.

However, as reflected in Recommendation 3.9, 3.10 and 3.18, the border of products and services that provided by financial institutions are getting blurred. Therefore, it is necessary for the regulators to study the possibility of consolidating certain regulations and laws in order to further enhance the regulatory consistency for the supervision of the financial activities. For example, BNM should also study the possibility of consolidating the Islamic Banking Act and Takaful Act over the long term period while the two Acts are revised in accordance with the FSMP.

Another good point of the FSMP is the BNM's effort to improve risk management in the financial sector. As shown in Table 5.5, the recommendations are considered sufficient to improve the risk management in banking system over the next ten years. Nevertheless, the degree of the improvement will still depend on the circumstances during the Plan period. For example, it is not an easy task to hire enough talents with related skills within such short period, hence the implementation of benchmarking of best practice and training for senior management will be more appropriate and achievable during this period.

Table 5.5 : Some Recommendations on Risk Management

Recommendation	Description
3.1	Benchmarking of best practice on risk management.
3.3	Seminar and training to senior management.
3.4	Hiring talents with risk management skills.
3.6	Set up board committees – Risk Management Committee.
3.17	Mandate all banking institutions to be rated.
4.23	Establishing prudential risk management standards.

5.4.2. Institutional and structural development

As reflected in the FSMP, BNM will enforce the consolidation process in financial sector for the 2001-2010 period. In order to accelerate the development of local insurance companies, BNM will increase progressively the statutory minimum paid-up capital of direct insurers. It is noted that the implementation of increasing the minimum paid-up capital will result in adding burden especially to the small insurers[24]. Nevertheless, this step is necessary if the domestic institutions wish to enhance their competitiveness in the more globalized economy. Therefore, the recommendation is appropriate as long as the consolidation exercise would not destabilise the financial system and the process of fund mobilization. ?

Besides that, merchant banks are encouraged to merge with discount houses or stockbroking companies of the same group to create full-fledged investment banks. This is in fact an appropriate action to improve the capability of merchant banks. However, as the activities of investment banks require the supervision from both BNM and SC, it is essential to have an appropriate supervisory mechanism in order to minimize the regulatory gap. This concern has been conveyed via FSMP but there is no specific step presented to strengthen the supervision.

Another aim of FSMP is to promote a more diversified financial system. There are a total of 12 recommendations set for promoting the venture capital

[24] In November, 2000, the insurers were required to raise the minimum paid-up capital from RM50 million to RM100 million by June 30, 2001. According to the 1999 Insurance Annual Report, 38 of the 51 insurers have a paid-up capital of less than RM100 million. Source : Investors Digest, March 2001, p 12.

(VC) industry, reflecting its significance in the future economic development. Currently, many of the traditional Venture Capital Companies (VCCs) in Malaysia are banks based, which are very conservative in their investment strategies, and are still wary of the dotcom companies.[25] In this particular, the recommendations should also include the provision of professional guidance in many areas to the borrowers such as dotcom companies, and encourage the willingness of VCCs to take more risks in financing the New Economy companies.

As for the financial infrastructure development, it is expected that the number of Islamic banks and takaful operators will be increased over the medium term, as stated by Recommendation 5.5 & 5.6 in FSMP. As at end-2000, there were only two Islamic banks and takaful companies. In order to promote their significance in the financial sector and facilitate the mobilisation of Islamic funds, the recommendation to establish more Islamic banks and takaful companies is indeed a wise action.

As the financial institutions move towards convergence or financial conglomerates, the border of supervisory framework of the associations of banks, merchant banks and finance companies will become blurred. Hence, it is necessary to develop a single association in order to play larger role in dealing with the issues relating to the financial institutions. Therefore, it would be appropriate to merge these three associations into a single association, and

25 Source : Malaysian Business March 1, 2001, p 8.

develop a comprehensive framework for consolidated supervision of financial conglomerates, as what found in Recommendation 3.20 and 3.26 respectively.

Besides that, FSMP includes recommendation to allow banking institutions to rationalise their branch network. This recommendation is feasible at this time, especially after the rapid consolidation exercise of banking institutions. As indicated in Recommendation 3.33, the rationalisation of branches by banking institutions will solve the problem of uneven distribution of branches in urban areas and rural areas. In addition, it will also help in increasing efficiency in fund mobilization process and achieving cost savings.

5.4.3. Technological Development

Through the FSMP, banking institutions are encouraged to improve their electronic communication networks and Internet banking or trading system, as reflected in Recommendation 3.14 and 3.30. This action is viewed feasible at this time, as it will promote greater competition among the financial players. However, it is yet to see some specific measures to enhance the network security. Without a clear guideline on Internet banking or trading system, some financial institutions may behave conservative in their way to improve the system.

FSMP is also aimed at improving the efficiency and competition in the payment system of banking institutions, via Recommendation 3.27. There are some specific steps embedded in the Plan in order to enhance the regulatory framework pertaining to this, which include policies on the conventional payment mechanisms, minimum standards to address consumer related issues and security standards for service providers. However, there is no measure to support the implementation of Multipurpose Card[26], as BNM planned to develop via its Payment System Master Plan. In such environment, the effectiveness of the implementation such as Payment Multipurpose Card (PMPC)[27] would be questioned.

5.4.4 Product Innovation

BNM intended to promote product innovation in banking sector by adopting 'What is not prohibited is allowed' regulatory philosophy, as reflected in Recommendation 3.15.1 and 3.15.2. Pertaining to this, banking institutions are required to increase product transparency and improve consumer education. The working of product notification process is not well described in FSMP, but it is expected that the notification process would be sufficient to ensure that regulators are aware of market development on new products. The recommendations should be achievable in the sense that the implementation will not involve any major change in the banking operation. However, a clear guideline on product transparency as well as the requirement of resolution for consumer complaints should be formulated so as to provide more certainty to banking institutions.

Besides that, FSMP is also aimed at intensifying R & D efforts, particularly for banking institutions, Islamic banking and takaful, and DFIs, as

[26] Multipurpose card is a smart card with integrated multiple government and financial applications on a single platform. It consists of three types of card structures, i.e. Government Multipurpose Card (GMPC), Payment Multipurpose Card (PMPC) and MEPS Cash.

reflected in Recommendation 3.15.1, 5.7 and 6.2. As for Islamic banking, these initiatives will be undertaken independently by the IBIs as well as on a collective basis via the industry-owned research and training institute. However, the FSMP is poor in delivering the requirements, for instance, to what extend should the R & D activities to be taken by individual IBIs in order to avoid duplicated work for both IBIs and the industry-owned research and training institute.

As for agriculture sector, FSMP suggested an establishment of a one-stop agriculture research and development centre as well as a comprehensive and integrated information database. The idea of a one-stop R & D centre is excellence, as it will facilitate the product innovation and at the same time it will enhance the knowledge and skills of bankers and insurers regarding the key information on the agriculture sector.

Human Resources Development

Human resource development receives high concern in FSMP. As mentioned in Recommendation 3.4, the restrictions on salaries and staff mobility in banking industry will be removed. In addition, the employment of expatriates is also encouraged, as presented in Recommendation 3.5, 4.6 and 5.3. The impact from these actions would be greater competition among the financial institutions in attracting and retaining best talents. As overall, this recommendation should be viewed as healthy approach to reward the skilled

[27] PMPC is a financial card that will be developed by MEPS and it consists of credit, debit, e-money and ATM applications.

manpower and encourage the financial institutions to improve their staff development program.

There are various form of training programs planned in FSMP in order to improve the productivity of employees in financial sector. As overall, the recommendations, such as 4.20 and 5.2, would be feasible to enhance the skills and knowledge of employees. Though, there is a little comment on the plan in relation to establishing an industry-owned institution on Islamic banking and finance, as stated in Recommendation 5.2. The institution is dedicated to train and supply a sufficient pool of Islamic bankers and takaful operators as required by the industry. The recommendation sounds not realistic, as it requires not little amount of financial and human resources allocation to establish a training institution. After all, it will be used just for the Islamic banking and finance only.

The benchmarking approach of best practices, which will be implemented in most of the sectors, is indeed a good recommendation to drive performance improvement. As indicated in Recommendation 3.1, 3.2, 5.1, 6.3 and 8.4, the benchmarking program provides a powerful tool for greater strategic focusing and for guiding domestic financial institutions to measure their own performance against the industry-wide best practices.

5.4.6 Consumer Protection and Education

As overall, FSMP aims to develop an active consumerism. As mentioned in Recommendation 3.35, BNM require banks to have full disclosure for retail financial products. Besides that, via Recommendation 3.34, BNM and banking institutions will undertake a structured consumer education program to educate consumers on retail products and services. These recommendations are set at the right time because the increased price and product transparency would result in greater competition among financial players, and hence, promote product innovation. On the other hand, the increased consumer awareness of different products would allow consumers to make informed decision and reduce their risks involved.

In addition, Banking Mediation Bureau (BMB) is expected to play greater role to include the power on handling all consumer complaints and educating banking consumers of their rights and means of channeling their complaints as well as available courses of actions, as stated in Recommendation 3.36 & 3.37. Although this action will increase the consumer protection, it will also impose higher burden to BMB for its extended duties. As it is easier to increase funding than to train a pool of skilled personnel for handling the consumer complaints and education, these recommendations are only feasible to be implemented in the medium term or longer.

Besides that, deposit insurance fund will be placed under FSMP to reduce the financial burden of Government and to offset the moral hazard created by blanket guarantee or insurance scheme. One interesting part of this recommendation is that the contribution into this fund would be risk-adjusted, which means those depository institutions with higher risk would have to contribute more to the fund. This recommendation is excellence in the sense that it would create an incentive for prudent management.

As for insurance sector, the regulations will be streamlined to require the insurers to render best advice on financial products to meet the needs of client, and prohibit insurer from engaging in any unfair trade practices, as reflected in Recommendation 4.26 & 4.27. These recommendations are feasible as they would give pressure to insurers to improve their quality of services and to ensure fair competition and market conduct.

5.5 EVALUATION OF THE RECOMMENDATIONS IN CMP

The discussion in this section will be in the similar manner as the evaluation of the recommendations of FSMP. The list of the recommendations is attached with this report as Appendix B.

5.5.1 Regulatory Framework

Over the master plan period, SC will gradually implement market-based regulation across all segments of the capital market. Among those, the introduction of Disclosure-based regulation (DBR), Front-line regulators (FLRs) and Self-regulatory organisations (SRO) programme receive main concerns from the regulator.

DBR regulatory regime was in fact implemented since 1996, reflecting a shift in the SC's regulatory philosophy from the existing merit-based regulation towards a disclosure-based regulatory framework. Under the new environment, investors are expected to take greater responsibility for their investment decisions by determining the merits of their own investments. As overall, this recommendation is feasible as it will enhance the market transparency and hence improve the investor protection.

However, in order for DBR to achieve its fullest potential under the third phase of implementation, there are some pre-requisites that would become critical challenges to the regulators. With regard to this, the KLSE Executive Chairman, Dato' Mohd Azlan Hashim has pointed out four essential prerequisites for the successful implementation of the DBR, i.e. :

* Improving standards of disclosure
* Enhancing practice of corporate governance
* Fostering understanding by participants
* Generate greater awareness by participants[28]

Hence, SC should conduct periodical review to ensure that the prerequisites have been achieved or implementing appropriate actions to enhance the market readiness.

Besides that, as another way to move towards market-based regulation, the SC planned to delegate some of its responsibilities to market institutions and industry associations through the introduction of FLRs[29] and SRO[30] programme. (See Recommendation 120 & 121) These recommendations would be able to

ource : http://www.klse.com.my
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[28] Source : http://www.klse.com.my
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[30] As SROs, industry associations will be able to regulate certain operational processes, and could be considered for undertaking the licensing functions over time, which currently under the authority of SC.

increase flexibility into the regulatory framework and reduce the burden of SC. However, the supervision over FLRs and SROs might be a hard task to SC as well. In addition, the effectiveness of the recommendations will depend on the ability of FLRs and SROs to formulate the regulations and the consistency of the regulations between SC and these two parties, which would be a big challenge to the regulators.

In order to achieve regulatory parity, SC will apply functional regulation[31] to ensure that regulatory obligations of all capital market participants are commensurate with their respective functional role and risks, as mentioned in Recommendation 122. This reflects a good preparation to support the growth in cross-market and cross-border activity, especially in the face of the blurring of traditional borders between market players. However, this approach may involve higher cost and reduce the effectiveness of supervision as compared to institutional form of regulation. Furthermore, it is not easy to ensure the consistency in applying regulatory obligations for all participants in the capital market that having similar functional roles, particularly within such short period, i.e. 2001 – 2003, unless it is supported by enough skilled manpower.

In order to address the problems raised from the overlapping of the functions of different authorities, the SC will take initiative to further rationalise the involvement of multiple approving authorities in the fund-raising process. In addition, the SC will also study the possibility of consolidating the various securities and futures laws. This step is appropriate at this time to improve the

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[31] The regulation principally based on function of institutions and intermediaries, and not by types of institutions.

regulatory consistency in the treatment of capital market participants and activities.

The investor protection is also one of the main focuses in the regulatory framework. In this concern, an investor compensation programme is recommended in CMP, which contains two possible methods, i.e. the compensation schemes and professional indemnity insurance. As a whole, it is inevitable that there will be moral hazard risks and financial cost involved in this programme, though, its welfare gain will offset the costs involved by increasing investors' confidence and ensuring compensation against firm failure. Therefore, the recommendation should receive good response from both the investors and the investment management companies.

5.5.2 Institutional and Structural Development

The Malaysian capital market is facing a critical challenge to remain internationally competitive in a more globalised economic environment. In view of that, the efficiency and capacity of market institutions and market intermediaries should be enhanced through operational and organisational restructuring. In CMP, the first nine recommendations are planned to facilitate the consolidation of market institutions and Recommendation 78, 79 and 80 explore the concern of SC to encourage the consolidation exercise in stockbroking industry.

As shown in Table 5.6, all Malaysian exchanges will be merged to form a single Malaysian Exchange. However, consolidating the exchanges not only involves the merging of exchange's name and organization, but also involves their operational structures and trading systems. (See Table 5.7)

Table 5.6 : Some Recommendations for Market Institutions

Phase	Recommendation	Recommendation No.
1	• Establish a single Malaysian exchange. • Establish a single clearance and settlement institution for all exchange-traded products. • Demutualisation of the Malaysian Exchange.	1, 2 8 3
2	• Create a common trading platform across all exchange-traded products. • Create an integrated clearance and settlement system for all exchange-traded products.	6 7
1-3	• The Malaysian exchange should pursue appropriate strategic alliances internationally.	5

Table 5.7 : Summary of Key Characteristics of Malaysian Exchanges and Clearing Houses

Exchanges	KLSE	MESDAQ	KLOFFE	COMMEX
Products	Equities, warrants, bonds and loan stocks	Equities: High-growth and technology companies	KLCI futures	Crude Palm Oil (CPO) futures 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) futures
Date established	1973	Approved on 6 Oct. 1997 Commenced trading on 30 Apr. 1999	Commenced trading 15 Dec. 1995	KLCE and MME merged on 7 Dec. 1998 to form COMMEX
Trading System	System of Computerised Order Routing and Execution (SCORE)	MESDAQ Order Routing and Execution (MORE!)	KLOFFE Automated Trading System (KATS)	Floor open outcry trading
Clearing House	SCANS		MDCH	
Central depository	MCD		N/A	
Number of members companies as at end-Sept. 2000	62	16	25	22

Source : Securities Commission

Consolidating the different trading systems is not a simple task. At present, KLSE is still in the process of consolidating the different trading systems of the exchanges under its control, such as KLOFFE[32]. Hence, merging with MESDAQ will be another burden for KLSE. However, in order to strengthen the capital market, it seems that these steps are inevitable. In view of that, the timeframe of implementation and the ability of working groups would be the two critical considerations of these recommendations.

Besides that, due to there are substantial practical differences in SCANS's and MDCH's operation, it is hard to determine to what extend the implementation of the merging of clearance and settlement system will be achieved. For instance, as reflected in Recommendation 7, the financial settlement in SCANS is done on a 'net basis', whereas MDCH operates the settlement process through the calculation and imposition of margin requirements. Hence, the aim to complete the integrated clearance and settlement system by 2005 will be a bit idealistic, as the Malaysian capital market is also facing the shortage of skilled manpower with such expertise.

Pertaining to the demutualisation process, when the unified exchange lists on the stock exchange, it will be owned by stockholders and not its members any more. As a result, commercial decisions will be made by all stakeholders instead of its members only, hence, move the exchange towards more customer-driven and market-orientated. Since SC also plans to establish the market institutions as full front-line regulators, it raises a concern that whether the market institutions can still maintain their regulatory role and at the same time provide investors with a fair and efficient market. In other countries, for

Source : Investors Digest, March 2001, p 7.

example, Australia has now seen the need to establish a separate body to audits and validate the exchange's supervisory activities, and the London Stock Exchange has given over all their regulatory functions to the British equivalent of Malaysia's SC after the demutualisation process.[33] Therefore, in this concern, SC should further study and communicate with the international agencies to find out an appropriate approach for the Malaysian capital market.

As reflected in CMP, the efforts to promote the consolidation of the stockbroking industry will be pursued. In order to encourage the merging process. SC introduces a new category of full-service intermediaries, i.e. Universal Brokers (UB). The UBs will be able to undertake the full range of capital market services, and they are allowed to open new branches so as to broaden their market reach. However, to qualify as UBs, stockbroking companies will also be required to effect consolidation with at least three other stockbroking companies.

These recommendations imply a prudent market incentive for stockbroking companies to find merging partners and thus strengthen their capital base towards further liberalisation of foreign ownership limits. In addition, permitting to open new branches will allow investors, particularly in areas that currently not served by any stockbroking company, to have better reach to capital market products. However, UBs tend to choose areas with high potential to open their new branch, and not what SC wishes them to do, this has resulted in higher competition in some strategic areas that would threaten other

[33] Source : Investors Digest, March 2001, p 8.

existing stockbroking companies.[34] Therefore, SC should review this recommendation in order to have further control over the application of opening new branches and continue promoting the establishment of new branches in those areas that are really lacking in these services.

.5.3 Technology and E-Commerce

In CMP, most of the recommendations in relation to technology are interconnected. Among those, the main action that SC will implement under Phase 3 of CMP is the end-to-end straight-through processing (STP). STP is recommended to reduce processing inefficiencies and minimise the associated risks, and thus, lowering overall transaction costs, as mentioned in Recommendation 137. However, it is not easy to implement this recommendation in view of there are numerous challenges from different areas and involved different parties, as shown in Table 5.8. These challenges would be the preconditions for the establishment of STP. Table 5.9 summarizes the challenges according to their areas in number, and the recommendations of CMP that addressing the impediments.

In view of the urgency of the preparation, most of the recommendations, which were planned to overcome the challenges, will be implemented under the first phase, reflecting that the master plan provides some lead time for the implementation of STP. However, the plan would also impose pressure to market institutions and market participants, which may adversely affect the performance of those parties. Therefore, while supervising the development of

[34] Source : Nanyang Press, 12 Dec 2001.

all these actions, the regulators should not only concern about the accomplishment of those plans but also ensure the accuracy and effectiveness of the consolidated system and the standardised back-office system to avoid any destabilising consequences to the overall capital market.

Table 5.8 : Issues facing implementation of STP in Malaysia

Area	Parties	Challenges
1	Investors and brokers	Implementation of online broking.
2	Brokers	IT systems of intermediaries are not sufficiently developed to enable STP within their organisations, particularly, for the back office systems.
3	KLSE and brokers	Order routing from the investor to the exchanges requires manual intervention by brokers.
4	KLSE, MESDAQ, KLOFFE and COMMEX[a]	KLSE, MESDAQ and KLOFFE operate on separate electronic trading platforms. They have different outlays, protocols, interfaces and front-end systems. Foreign orders for instruments listed on domestic exchanges need to be routed through domestic intermediaries.
5	SCANS and MDCH	There are separate clearing systems for the equities and derivatives markets.
6	MCD	Absence of a global depository account requires investors to maintain separate accounts with each broker.
7	Banks	Establishing more direct linkages between the capital market clearing and settlement systems, and corresponding payment system to facilitate online transmission of money settlement via electronic links to banking institutions and other payment sources.

Sources : Securities Commission; Arthur Andersen.
Note : a) COMMEX continues to support an open outcry system, although trade information is electronically disseminated and transmitted to relevant institutions.

Table 5.9 : The Recommendations that Addressing Challenges for the Implementation of STP.

Area	Recommendation No.	Implemented under Phase
1	86	One
2	87	One
3	35	One and two
4	1	One
5	7,8	One & two
6	11	One
7	9,137,138	Three

With regard to have more direct linkages between the capital market clearing and settlement systems and corresponding payment system, the co-operation from other regulator such as BNM is needed. The concern has been addressed in CMP via Recommendation 9 and 138, however, there is no specific recommendation raised in FSMP. Hence, it is expected that SC will take initiative to communicate with related parties including BNM to develop possible approaches so as to facilitate online transmission of money settlement via electronic links to banking institutions and other payment sources.

Besides that, the surveillance and enforcement capabilities of online capital market activities will also be enhanced, as reflected in Recommendation 141. The regulations in regard to this will be amended to facilitate the effective surveillance. As the activities will be conducted via Internet, it is expected that this recommendation will also need closer relationship and co-operation between SC and other international bodies. It also indicates that the Malaysian capital market may obtain certain benefits from the enhanced relationship such as information sharing of regulatory experience and possibly the transfer of technology from other developed countries.

The issues in relation to network security are also addressed in CMP, via Recommendation 143. The market institutions and market participants are required to ensure that their systems and infrastructures are secure and reliable. This recommendation is appropriate as a sound security policy is really needed at this point of time to increase investors' confidence on trading via online system. In addition, it will help in reducing the fraudulent activities and investment risk, and thus facilitating the development of online capital market activities. However, the challenge that SC would have to face is to study and understand the different systems of all market intermediaries in order to ensure the compliance of security and privacy requirements.

.4. Product Innovation

In order to increase the competitiveness of the Malaysian capital market, SC aims to widen the breadth and depth of market products through a number of its recommendations in CMP, as listed in Table 5.10.

Table 5.10 : Some Recommendations in Relation to Product Innovation

Area	Recommendation	No.	Phase
Equity Market	• The introduction of Exchange Traded Funds will be allowed. • The establishment of VC trusts that can invest up to 100% in unquoted companies will be allowed.	23 28	1 1
Bond Market	• A phased programme to encourage international financial institutions and multinational corporations to issue ringgit bonds should be considered.	45	2 & 3
Derivatives Market	• Derivative funds will be allowed to be established and offered to investors in 2001. • KLOFFE and COMMEX should actively pursue the introduction of more derivative products. • The process for the introduction of new domestic exchange-traded derivative products will be streamlined.	51 53 54	1 1-3 1
Islamic Capital Market	• Efforts to introduce more competitive and innovative Islamic financial products and services will be actively pursued. • Efforts to introduce and promote a wider range of Islamic collective investment schemes will be facilitated.	65 66	1-3 1-3
Stockbroking Industry	• The scope of capital market services that may be offered by stockbroking companies will be widened. • Stockbroking companies and their representatives will be allowed to offer a range of services under a single license.	81 82	1 & 2 1
Investment Management Industry	• The development of the financial planning industry will be facilitated. • The further development of the trust/custodial services industry will be promoted.	106 107	1 1

Those recommendations reflect that in the near future, domestic investors would be explored with greater choices, either locally or internationally, in the variety and quality of financial products available to mobilise their savings in investments.

Besides that, the liberalisation steps and further use of technology, as recommended in CMP, will have a significant implication on the traditional role of remisier. They can no longer retain their role just as middlemen between investors and the marketplace, but also provide a wider range of value-added services such as financial services. In fact, these value-added services are essential to retail investors especially in the face of more variety of market products and services.

In Islamic capital market, it is expected that there will be numerous types of new Islamic products and services to be developed in the near future with the unveiling of CMP. It is noted that the products are structured not only to satisfy the Syariah but also to be consistent with the commercial and legal systems of the country. In view of the lacking in skilled professionals in this area, the process of product innovation based on various Islamic concepts is projected to take some years. Nevertheless, the approach of identifying existing conventional capital market instruments that are acceptable to Islam should be applied in the first stage of implementation.

With regard to Syariah matters, SC proposed to combine the two separate Syariah Advisory Councils (SACs) that advising the SC and BNM respectively into one. This recommendation is considered appropriate as it will bring benefits not merely the better co-ordination of Syariah rulings and ensuring consistency of decisions, but also a saving of resources and convergence of best talents.

Besides that, the introduction of Exchange Traded Funds[35] (ETF) indicates that the SC also put efforts to expand the range of investment options available to investors. As compared to mutual fund, ETF typically charges lower management fees and it combines the flexibility of owning stocks with the diversification provided by index funds. Similar to the closed-end funds, ETF will also allow investors to participate in the capital market through professional fund managers. In view of the good response of ETF in other countries such as Canada, Europe and US, this recommendation is worth to be implemented at this time, subject to the readiness of investment management companies and the adjustment of regulatory framework to support it.

As overall, most of the recommendations pertaining to product innovation will be implemented and completed in the first phase of CMP, it reflected that the ability and capacity of both market institutions and market intermediaries should be enhanced in a very quick manner in order to be in line with the development of the Malaysian capital market. This is indeed a great pressure to the related parties, particularly during the present economic downturn. With regard to this, a feasible review on the recommendations and closed communication with the market participants are needed to ensure the

[35] ETF is an open-ended fund that trades in the same manner as individual stocks listed on an exchange. The trading value of the ETF is based on the NAV of the underlying securities in the index, with investors able to buy and sell ETF units in real time prices which fluctuate throughout the day to track the underlying index. Source : SC (2001), p 139.

effectiveness of the recommendations and to avoid any adverse effect that might be resulted from the uncertainty and inappropriate timeframe.

Besides that, there is no recommendation set in CMP to intensify the R & D efforts that are very much needed at this time to promote product innovation in the capital market, such as an establishment of R & D unit or institute. In view of the similarity of the financial products and services that provided by the financial institutions and the capital market, the SC should further co-operate with BNM in conducting R & D activities such as sharing the people and facilities of the existing R & D institutes in financial sector.

5.5.5. Training and Education

As reflected in Recommendation 144 and 146, there will be different types of training programme scheduled for market professionals as well as FLRs and SROs. Moreover, the SC also introduced a mandatory Continuing Professional Education (CPE) programme for all licensed representatives, with its primary objective to maintain and enhance technical knowledge and professional expertise of licensed representatives. It is expected that those people involved in the capital market activities can no longer escape themselves from attending certain mandatory courses and always updating themselves with the latest market information. This is indeed a good step to foster the development of specialised skills and knowledge to support the future needs of capital market, albeit it will also impose higher pressure to those participants.

In terms of education, SIDC will be playing an increasingly role to promote study and research in the area of capital markets and in charge of investor education. As mentioned in Recommendation 147, the regulator will co-operate with the universities to offer different level of courses, such as certificate or diploma programmes and undergraduates' programmes. This effort is expected to increase the availability of skilled graduates for the capital market. In fact, the existing work force in capital market should also be encouraged to take certain external courses offered by those participating universities, as this will not only reduce the burden of SIDC as a training centre, but also increase the number of people who benefit under those courses.

It is no doubt that Internet would assume an important tool to widen the accessibility of training and education programmes to the public. The use of Internet will enable the up-to-date market information being conveyed at the right time to the related persons. According to Recommendation 149, SIDC will work towards conducting examinations online, which are considered as more efficient and cost-effective method. However, the effectiveness of such examinations would be questioned, as it may not be able to prevent plagiarism.

Besides that, investor protection and education will be further promoted through awareness programmes, as written in Recommendation 151. The emphasis will be on promoting fundamental capital market literacy, such as on the structure and systems of the capital market, the different types of financial products and services available and their corresponding risks and benefits. It is viewed as a comprehensive plan and adequate to enhance investor protection, especially more emphasis will be taken to promote awareness in smaller towns and rural areas. In order to achieve its highest potential, the SC should use various languages such as Malay, English, Chinese and Tamil for the printed materials distributed during the implementation of this recommendation.

5.6. CONCLUSION

In brief, both master plans are launched at the appropriate time to further strengthen the Malaysian financial system during the period of 2001-2010. From the above evaluation, it is clear that each of the master plans has its strength and weaknesses. Table 5.11 shows the summary of the main strength and weaknesses of FSMP and CMP.

As overall, there are several recommendations in FSMP that build its strength to meet the future intermediation needs. One of them is the focus on greater supervision with minimal regulation imposed on business decision, particularly the implementation of benchmarking approach of best practices. Besides that, the efforts to encourage the consolidation exercise in the financial sector are indeed needed to enhance the competitiveness of domestic financial institutions in the more globalized environment.

An expansion of certain potential businesses such as Islamic Banking, Islamic capital market and VC industry is also a wise action towards a more diversified financial system. In addition, the recommendations on improving the consumer protection are feasible and sufficient, such as the increasingly role of

BMB and the greater product transparency. Besides that, the FSMP also reflects the good efforts of BNM to intensify the R & D activities in the financial sector.

Table 5.11 : Summary of The Strength and Weaknesses of FSMP and CMP

Strength	
FSMP	**CMP**
♦ Greater supervision with minimal regulation imposed on business decision. ♦ Further consolidation of financial institutions. ♦ Promote Islamic Banking, Takaful and VC industry. ♦ Enhancing consumer protection. ♦ Intensifying R & D efforts in production innovation.	♦ The purpose of the recommendations and the implementation timeframe are clearly written in the plan. ♦ Shifting from merit-based regulation towards a disclosure-based regulatory framework. ♦ Rationalise the involvement of multiple approving authorities in the fund-raising process. ♦ Focus on investor protection. ♦ Efforts to improve human resources development and education.
Weaknesses	
FSMP	**CMP**
❖ Lacking in clear strategies to implement the recommendations. ❖ Lacking in details on the linkages between BNM and SC. ❖ Inadequate concern on enhancing data security. ❖ Inadequate concern on the issues of unethical business practices. ❖ Inadequate concern on the possibility of overlaps in rules implementation.	❖ Too tight timeframe for certain recommendations. ❖ Lacking in details on the linkages between BNM and SC. ❖ Inadequate concern on the issues of unethical business practices. ❖ Inadequate concern on the R & D efforts in product innovation.

As for CMP, purpose of the recommendations and the implementation timeframe as well as the sequencing of recommendations is clearly written in the blueprint. This will make the master plan easier to be understood and hence facilitate its implementation. Besides that, shifting from merit-based regulation towards a disclosure-based regulatory framework is indeed a good effort to encourage greater involvement of investor in fund-raising process, and subsequently enhance the investor protection.

In addition, the overlaps of rules implementation of multiple approving authorities are well addressed in CMP. The rationalization of the involvement of multiple approving authorities in the fund-raising process is a wise action to overcome the overlap problem. The recommendations such as awareness and education programme would be useful to promote investor protection. Furthermore, the attempt to improve the skill and knowledge of workforce in the capital market is great, especially with the help of Internet and the greater role of SIDC.

However, the recommendations are only presented briefly in FSMP, lacking in details on strategies to achieve the objectives of the master plan. In addition, the FSMP lack of recommendations on the issues of data security, the enforcement of ethical business practices, and the possibility of overlaps in rules implementation.

With regard to CMP, the timeframe for certain recommendations are relatively tight, such as the implementation of STP and its preconditions, and the merging of exchanges as well as the clearance and settlement system. The tight timeframe would impose pressure to market institutions and market participants, which may adversely affect the performance of those parties. Besides that, it is yet to see the efforts of SC to intensify the R & D efforts in relation to product innovation, such as an establishment of R & D unit or institute.

In view of the interconnection between the FSMP and CMP, it is crucial to mention the linkages between both BNM and SC in the master plans. Furthermore, the regulators should further co-operate in providing training programmes, developing an integrated payment system, and sharing resources in R & D activities. In addition, both BNM and SC should also study together the possibility of consolidating certain laws and regulations, and solving problems raised from the overlapping of the functions of different authorities.