EUROPEAN COMMISSION
DIRECTORATE GENERAL XV
Internal Market and Financial Services
General matters and coordination
External dimension of the internal market and financial services

Brussels, 19 June 1995
Ref: PHP - jv\tcr\malaisie
XV.A.2

MALAYSIA

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Introduction

The GDP in Malaysia was MYR 166 bn (59.2 bn ECU[1]) in 1993 for a population of 18.9 mn this represented a per capita GDP of 8,776 MYR (ECU 3,132). In 1993, Malaysia's GDP grew for the sixth consecutive year by 8% or more. The same trend was expected for 1994. The development of the manufacturing sector (accounting for 40% of GDP) sustained by foreign investment has really been the engine of Malaysia's economic growth over the recent years. This process has undoubtedly helped to invigorate a domestic commercial banking sector that had suffered in the 1980s.

Malaysia shares to some extent the characteristics of a planned economy, in that sense that its development strategy from 1970 to 1990 was dominated by the need to achieve the targets set out in the National Economic Policy (NEP): eradication of poverty and redistribution of wealth through growth, emphasis in this respect was put on growth in the manufacturing sector. The New Development Policy (NDP) , encapsulated in the concept Vision 2020 and adopted in 1991 upholds the twin objectives of the NEP.

CREDIT INSTITUTIONS

In 1994, the Malaysian market counted 104 credit institutions (of which 7 discount houses, 8 national savings banks and 37 commercial banks). In spite of such an extensive banking presence, the market is highly concentrated. The five largest domestic banks hold 52% of total commercial bank assets.

In February 1991, Bank Negara, the central bank, freed the base lending rate (BLR) form its administrative control, introducing a market-oriented interest rate regime.

Commercial banks

Total assets of the commercial banking industry have kept expanding rapidly with an average increase of about 12.5% between 1990 and 1993. Total assets rose by MYR 17 bn or 7.6% to MYR 239.2 bn as at end-1994, compared with an increase of MYR 48.5 bn or 27.9% in the previous year.

Over the late 1980s, increased competition for funds in the banking sector had resulted in commercial banks accounting for a decreasing proportion of new deposits as funds are attracted to alternative financial institutions, particularly finance companies. However, that erosion recently slowed down. And the commercial banking market share of deposits has slipped only slightly from 68.2% of total deposits in the banking system in 1990 to 67% in 1993.

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1 Exchange rates :
At 1993 year end : 1 ECU = 2.802 MYR
Annual average : 1 ECU = 3.014 MYR

Finance companies

At the end of 1993, 40 finance companies (with 789 branches) were in 'operations compared to 45 in 1990. Four of them are 100 percent foreign-controlled and seven have some foreign equity participation. Focused on small loans, they are particularly dominant in the auto loan and home mortgage markets.

In 1994, total assets of the finance companies increased by MYR 10.2 bn or 16% to MYR 73.5 bn, compared with an increase of MYR 8.3 bn or 15.2% in 1993.

Between 1990 and 1993, deposits accrued at an average rate of about 13% representing RM 45.3 billlion in 1993 vis-à-vis 31.3 billion in 1990. In contrast, growth in deposits decelerated to 12% by the end of 1994, compared with 16.2% as at end-1993.

Merchant banks

There are 12 merchant banks in Malaysia, nine of which have some foreign equity participation. The activities of merchant banks have been widened in the early 1990s. Restrictions on deposit-taking have been relaxed, enabling the merchant banks to compete more effectively with the other banking institutions, though they may only accept term deposits from non-individuals, with specified minimum amounts. They may hold shares on their own account in companies listed on a Malaysian exchange, up to a limit of 10% of the paid-up capital of the company. However, acquisition of a commercial bank by a merchant bank is forbidden.

Total assets of Merchant Banks expanded by MYR 4.7 bn or 30.9% to reach MYR 20.1 bn at the end of 1994. During the same year, total deposits mobilised by the merchant banks increased by 7.8% or MYR 1.1 bn to MYR 14.6 bn.

National Savings banks

The National Savings Bank (NSB), the largest savings institution in Malaysia had a total of 478 branches at the end of 1994. The NSB maintained double-digit growth in 1994 in terms of increase in total resources by MYR 552 mn or 11.4%. The major source of growth emanated from deposits which rose by MYR 428 mn or 11% in 1994.

Among publicly owned sources of housing finance, it is worth mentioning the innovative role played by National Mortgage (Cagamas Berhad). The governement's aim in setting up Cagamas was to promote an active secondary mortgage market and to securitise the commercial banking system's long-term assets, thereby releasing these funds for new loan availability. National Mortgage buys housing loans and refinances them through bond issues.

Discount houses

Several reforms governing the operations of discount houses were introduced in October 1991 as part of the central bank's policy to transform discount houses into fully-fledged securities houses. Discount houses are permitted to invest, trade, underwrite and manage issues of private debt securities approved by trhe central bank. Discount houses could also apply to Bank Negara to undertake fund management operations. The interbank lending limit on discount houses was lifted to allow them to compete equally with other institutions. A new niche was created for them in the market for non-interbank repos with maturities of less than one month. Only the principal dealers (a total of 23 institutions including all seven discount houses) can participate in the market.

Total deposits mobilised by the discount houses continued to increase by MYR 2.3 bn or 35% in 1994.

Table 1 - Banking sector indicators - Year 1994

	Number	Assets (bn MYR)	Deposits (bn MYR)
Domestic institutions			
. Commercial Banks	23	239.2	123.8
. Finance Companies	40	73.5	57.3
. Merchant Banks	12	20.1	14.6
. Discount Houses	7	n.a.	8.9
. National Savings Banks	8	n.a.	4.3
Foreign institutions (in 1992)	16	69.1	26.5
. Non-EU foreign banks	12	48.6	19.9
. EU foreign banks	4	20.5	6.6

Source : Bank Negara Annual Report

The Labuan International Offshore Financial Center

The Labuan IOFC is a scheme promoted by Bank Negara, as a contribution both to the development of the island of Labuan situated off the coast of Sabah and the role of Malaysia as a regional financial center.

Since its creation in October 1990, the Ministry of Finance has granted 31 bank licenses and awarded three offshore insurance licenses. In addition, 11 trust companies have been approved to operate in Labuan.

The IOFC.is characterized by low taxes, zero or marginal exchange control requirements, a high level of secrecy of the identity of borrowers and lenders, and few regulations and restrictions on the flow of funds.

Presence and market share of EC financial institutions:

Foreign presence is very important in certain segments of the market. In the commercial banking business, there are 16 foreign banks (with 146 branches) out of a total of 37 banks; foreign banks accounted at the end of June 1993 for 24.7% of total assets. Two foreign banks were bought out and have become local banks. Then among the 14 foreign banks, the 4 EC owned or controlled banks held 10.7% of total bank assets.

As at the end of June 1993, there were, in the financial offshore zone of Labuan, four wholly-owned foreign banks engaged in foreign currency transactions with residents and non-residents.

MARKET ACCESS PROBLEMS FACED BY EC CREDIT INSTITUTIONS

Under existing policy, since the mid-1970s, no new bank licences (including those for merchant banks and finance companies) have been issued to foreign and domestic companies outside the Labuan IOFC. The Malaysian Government believes that the banking needs of the country are already adequately served.

Foreign owned banks' shareholdings in an existing domestic bank are limited. If the foreign bank is licensed under the Banking and Financial Institutions Act 1989, it is prohibited from holding shares in another licensed bank. However, a commercial bank may acquire a merchant bank. Aggregate foreign ownership of a commercial bank or a merchant bank is limited to 30 percent and an approval, based on an economic needs test criteria, is already required for 5% or more foreign shareholding.

Under the Banking and Financial Institutions Act 1989, only public companies (ie companies incorporated in Malaysia under the Companies Act, 1965) that hold a valid banking licence may conduct banking business in Malaysia. As a result, all foreign bank branches have had to locally incorporate themselves as public companies by October 1st 1994 (unless specifically exempted by the Ministry of Finance). Foreign banks have been allowed to keep a 100% shareholding in the newly incorporated banks.

Additional branches, whether of foreign or domestic banks, are not permitted unless approval has been granted by the Central Bank. No approval for additional branches has been given to foreign owned banks in the last 20 years. Banks that have a majority local shareholder are however allowed to open new branches. While the number of foreign branches remained fixed at 146 (74 of which belong to EC owned or controlled institutions), the number of domestic branches rose from 765 to 1018 in less than five years.

Activity

Recent introduction by Bank Negara of a two-tier banking system puts local establishments of foreign banks at a severe disadvantage compared to local banks, because of excessive prudential and capital requirements, in dealing on local foreign exchange markets. Since 1 December 1994, exporters are indeed allowed to retain a portion of their foreign currency proceeds, without converting them into ringgit, but these have to be deposited in foreign currency accounts maintained with designated banks in Malaysia. Only these designated banks, the "first tier" financial institutions, will be allowed access to new financial activities. Qualification for first tier is decided by Bank Negara based on CAMEL:

- Capital requirement of RM 500 million to be increased in the future to RM 1 billion. In this respect, only local capital counts. Parent guarantees or subordinated loans are not allowed for this purpose;
- Asset quality,
- Management efficiency,
- Earnings performance,
- Liquidity position.

The two-tier approach is defended by the Malaysian authorities as a way to facilitate the emergence of a core of strong domestic banks (because it would constitute a strong incentive for the second tier to restructure in order to move to the first category) and a means to ease controls by the central bank. However, the high capital requirement imposed by Bank Negara, further to the compulsory subsidiarisation of local branches of foreign banks, negatively impacts on the ability of foreign subsidiaries to develop into this new market. Moreover, it risks undermining their current position in local trade financing: not being allowed to provide as wide a range of services as designated banks, they may become less attractive for their current customers. Because of its very construction, the Camel system is directly detrimental to banks that favour a "niche" market approach (which will often be the case of foreign banks) over a global one.

In addition, this approach of segregating banks on their ability to meet very high capital requirements, independently of the size and underlying risk of their asset base, is foreign to internationally recognized supervision requirements.

Non-resident controlled companies (NRCCs), which includes those companies where the majority of paid up capital is owned or managed by foreigners or a branch of a company incorporated outside Malaysia, may only obtain up to 40% of loans from foreign bank branches operating in Malaysia. Under exchange control regulations (ECM 8), 60% of credit facilities obtained by NRCCs must be from finacial institutions which are incorporated in Malaysia and are controlled by Malaysians. Malaysian authorities have indicated that this regulation is aimed at preventing restrictive business practices and that NRCCs may exceed the 40% limit if they can prove that the terms offered by foreign banks are not worse than those offered by domestic banks.

Foreign banks had to maintain a risk-based capital adequacy ratio of 10%, as opposed to 8% for the domestic banks. Malaysian authorities indicated that the higher ratio imposed is due to a different calculation of the foreign banks' capital adequacy ratio, which is based on "net working funds", rather than on shareholders' funds as in the case of local banks.

However, since October 1994, the same capital adequacy ratio applies both to foreign and domestic banks, due to local incorporation of foreign bank branches.

The employment of foreign expatriates by financial institutions requires prior approval by the Bank Negara. Under existing policy foreign banks may employ one expatriate if the bank employs less than 500 workers and may employ one further expatriate for every additional 500 employed. Additional expatriates may be permitted if they are specialists required to carry out a technical task for a specific period.

Banks and finance companies (both foreign and domestic) are required to comply with lending guidelines that require that at least 20% of their loan portfolios must be allocated to priority sectors which comprise of loans to the Bumiputra community and the small-scale enterprises.

Foreign-owned banks are not allowed to participate in the ATM network, since ATMs are deemed to be branches, and the opening of new branches is at present not allowed. Similarly, they are not permitted to join ATM networks, since this would be treated as branch expansion ; however, domestic banks are not subject to this limitation.

INSURANCE

The Malaysian insurance industry is highly fragmented. The central bank, Bank Negara, that is in charge of insurance supervision, has been advocating small companies to merge with larger insurers, in an effort to sanitize the market. Indeed, between 1990 and 1992, the total number of insurance companies already fell from 58 to 50.

On the other hand, the Malaysian government implemented on 1 January 1994 a "Scheme for insurance of large and specialized risks", designed to build up an adequate domestic insurance capacity in these sectors.

Malaysia is currently re-examining the 1963 Insurance Act with a view to strenghtening its prudential provisions by imposing more stringent conditions on companies' financial returns, paid-up capital and solvency requirements.

Besides this "onshore" restructuring and strenghtening of locally incorporated insurance companies, the Malaysian government has amenaged the Labuan International Offshore Financial centre, by permitting offshore insurers licensed in Labuan to have management offices in Kuala Lumpur until the end of 1993. This deadline can be postponed on a case-by-case, upon recommendation of Bank Negara.

Table 2 - Indicators of Insurance Business - Year 1993

	Life	Non-life	Total
Total premiums (bn MYR)	2.9	3.1	6.0
. Premiums as % of GDP	1.7	1.9	3.6
. Premiums per capita (in MYR)	153.0	164.0	317.0
. Number of insurance companies	5	54*	59

Source : SIGMA

*) Include 13 composites insurance companies.

Foreign presence

In 1992, foreign-owned insurance companies accounted for nearly three-quarteers of the paid-up capital or net working funds of life insurance companies in Malaysia, one third in general insurance companies and nearly 70% in composite insurance companies.

In 1992, nine branches of foreign insurance companies operate in Malaysia. Their current status as of 1 January 1995 is not known, local incorporation of foreign branches being a requirement of the NDP plan.

Among 50 locally incorporated firms, one is 100% foreign-owned, while 19 have foreign equity ranging from 30%-86%. Foreign interests are spread among 10 countries. All EC insurance companies were locally incorporated with the European partner holding a minority share.

MARKET ACCESS PROBLEMS FACED BY EC INSURANCE COMPANIES

Establishment and acquisition

No new licenses are being granted in respect of life and general insurance ouside the Labuan IOFC. New granting is unlikely before the next decade, according to the trade and industry ministery. The current policy line is rather to improve the domestic industry's level of expertise and technical competence in both sectors. However, more flexibility is shown with regard to reinsurance activities. In 1993, 2 foreign companies, of which one EC owned, have been allowed to set up branches to conduct general reinsurance business to complement the capacity of Malaysian National Reinsurance, previously the only licensed reinsurer. The objective is to cut the outflow of premiums by reducing reinsurance abroad.

Foreign investors may acquire shares in existing insurance firms. But specific conditions apply to aggregate foreign shareholding: it is subject to a maximum ceiling of 30% and an approval, based on an economic needs test, is already required for 5% or more foreign shareholding. Branches of foreign companies are being required to locally incorporate and to reduce foreign share ownership in line with NDP (NEP). However, no fixed deadline for this conversion has been set and in individual cases foreign participation beyond 30% may be allowed. This is a general policy applying to all sectors of the economy, according to which the Government intends to keep a balance between the different races in the country ; thus, 30% of the shares in any company are reserved to native Malaysians, 40% to non-indigenous Malaysians, and up to 30 to foreigners.

A company is not allowed to acquire shares of another insurance company in the same insurance business.

The use of expatriate managers require the prior approval of the Bank Negara Malaysia which follows specific guidelines. These include the limitation that only one expatriate may be employed in foreign controlled insurance companies where there are less than 200 staff and one further expatriate is allowed for each additional 200 staff employed. Furthermore, for insurance companies with Malaysian equity of at least 51%, the Chief

Executive Officer must be Malaysian (unless it is judged that a suitable Malaysian candidate is not available). The Bank Negara indicates that these guidelines may be applied flexibly. The employment of an expatriate must also be approved by the Permanent Committee of Citizenship and the Immigration Department.

Activity

The activities of Lloyds Underwriters are limited to re-insurance business and surplus line direct business, the latter being subject to prior authorisation by the insurance authority. These measures aim at optimising retention capacity of the Malaysian insurance industry and at developing the expertise of the local workforce. Reinsurance abroad is permitted only where there is insufficient capacity or expertise in Malaysia.

Section 34A of the Insurance Act 1963 requires that all ships aircraft and property policies must be insured with insurers registered under the Act. This includes both domestic and foreign insurers who have registered.

The Malaysian Government gives certain fiscal incentives to promote the domestic insurance market, although these incentives are available to both domestic and foreign branches and foreign insurance firms operating in Malaysia.

All insurance companies operating in Malaysia are required to maintain at least 80% of their assets in Malaysia. In addition 25% of their total assets must be maintained in Government securities. Furthermore, the existence of the Government's compulsory employee's provident fund has partly hampered the development of pension-fund schemes offered by insurance companies, despite the fact that individuals are permitted to purchase additional policies.

SECURITIES

The privatization policy followed by the Malaysian government in the mid-80s through stock offerings of large public sector companies (national airline, telecommunication, electricity utility) fostered the development of the Kuala Lumpur Stock Exchange (KLSE). The Malaysian stock exchange was equally strenghtened by the separation of the KLSE and the Stock Exchange of Singapore. All Malaysian incorporated companies were removed from the SES, while Singapore based companies were removed from the KLSE on 1 January 1990.

In spite of an immediate fall in the KLSE market capitalisation after that de-listing operation, the general increase in the volume of transactions throughout that year led the Ministry of Finance to introduce capital adequacy rules. This has resulted in the restructuring of the sector, particularly by mergers or flotation on the KLSE. Guidelines introduced by the KLSE limit foreign brokers to a maximum 30% shareholding of stockbroking companies.

Several measures have been implemented in recent years to modernise and improve the efficiency of the capital markets. These include the establishment of a Securities Commission in 1993 which assumes regulatory responsibilities that were previously shared between five government bodies. New exchange indexes were launched in 1991 as additional tools to assist investors. The efficiency of the settlement and clearing system has been upgraded with the establishment of a scripless Central Depository System which allows the exchange to handle a higher trading volume. The introduction of new financial products is still being studied, and the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE) has not yet starting any trading activity.

At the end of 1993, 413 companies were listed on the KLSE. By the end of 1993, an exceptional year compared to the past 20 years, total capitalization had risen to RM 592 bn compared to RM 129 billion in 1990. In 1993, Malaysia was the largest stock market in Southeast Asia. Of the 59 member companies of the KLSE, 11 stockbroking companies have foreign partners.

Segragation of activities through the setting up of a separate subsidiary is required from securities companies or banks that want to manage funds (unit trusts, mutual funds, pension funds). Foreign ownership of such subsidiaries is limited to a 30% ceiling. Liberalization of local unit trust legislation allows unit trusts to invest in a broader range of stock.

On the same path, restrictions on pension funds' investment have been relaxed in June 1991: an amendment to the Employee Provident Fund (EPF) Act removed the requirement that the funds maintain a 70% weighting in government securities. The goal of this change was to encourage funds to invest in the private debt securities market. This 70% floor has been lowered to 50%. However, the bond market remains largely dominated by the issuing and trading of Malaysian Government Securities (MGS). Mid-1993, the outstanding stock of Malaysian Government Securities totalled RM 65.8 billion, whereas corporate debt amounted to RM 9 billion.

Table 3 - Securities Market Indicators - Kuala Lumpur Stock Exchange

	1992	1993
Turnover in equity shares (MYR bn)	50	377
Turnover as % of GDP	34	227
Capitalisation equity shares (MYR bn)	239	592
Number of listed companies	366	413

Source : FIBV

EC Market Access Problems Faced By EC Securities Companies

Establishment and acquisition

Under current Government policy, the granting of brokerage licences is conditioned by an economic needs. No new licences have been awarded for years. The Malaysian

Government argues that the securities market is currently adequately served by the existing number of securities firms. However, Deputy Prime Minister Anwar Ibrahim recently announced a possible opening in the near future.

Foreign interests may acquire existing firms or establish on a joint-venture basis, but foreign brokerage houses may hold a maximum of 30% equity share at the beginning of a joint venture agreement. If the participation of the foreign firm can be shown to have resulted in a contribution to the local stockbroking industry, for example, by bringing in foreign institutional investors or improving research techniques, this participation may be increased to a maximum 49% equity share. A foreign stockbroking company is permitted to hold shares in only one stockbroking company. At present there are 4 brokerage firms set up with foreign partners. The Malaysian authorities consider that it is necessary to limit foreign participation in the securities industry to maintain market stability and to promote the development of domestic securities firms.

Activity

Any purchase of 15% or more of the voting rights of a Malaysian corporation by a foreign investor requires a prior approval of the Foreign Investment Committee. The same mechanism applies to any purchase above RM 5 million by any investor.