**WORLD TRADE ORGANIZATION**

RESTRICTED

**TN/S/W/17**
**S/FIN/W/28**
30 July 2003

(03-4050)

**Council for Trade in Services**
**Special Session**
**Committee on Trade in Financial Services**

Original: English

**COMMUNICATION FROM MALAYSIA**

Challenges in the Financial Services Sector

The attached communication has been received from the delegation of Malaysia with the request that it be circulated to the Council for Trade in Services in Special Session and the Committee on Trade in Financial Services.

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## I. INTRODUCTION

1. Malaysia's financial system has evolved over several decades against the backdrop of rapid changes in the economy and the international financial environment. Policies have been modified according to changing circumstances, to focus on developing an efficient and sophisticated financial system that can meet the financing needs of the economy as well as support national policy objectives. In this context, while Malaysia recognises that the opening up of the domestic financial sector to foreign competition would contribute towards creating a more efficient, competitive and market-driven financial sector, thus enabling the sector to play a more efficient and effective role in the economy, such opening will have to be carried out in a careful and phased manner.

## II. FINANCIAL LIBERALIZATION - AN IMPORTANT OBJECTIVE FOR MALAYSIA

2. Malaysia remains committed to further liberalizing its financial services sector. Foreign participation has always been significant in the domestic financial sector. A careful study of Malaysia's commitments at the conclusion of the financial services negotiations in 1997 reflect the commitment of the Government to bind its existing liberal policies on foreign ownership. In the banking sector, the Government allowed the 13 foreign banks to maintain their 100 per cent equity ownership, but they were required to be locally incorporated. We had also bound foreign presence at an aggregate maximum of 30 per cent of the total equity of a domestic banking institution. In the insurance sector, existing foreign shareholders were allowed to increase ownership subject to a maximum 51 per cent of the equity of the insurance company. New entry of foreign insurance companies was also allowed through participation of up to 30 per cent of the total equity of a locally-incorporated insurance company.

3. The capital market has also progressively opened to global players, with gradual increases in foreign equity participation in stock broking, fund management and the entry of managers, specialists, experts and professionals. We have committed to 49 per cent foreign equity in stock broking companies. Under appropriate circumstances, Malaysia has allowed 100 per cent foreign ownership, such as in the fund management and investment advisory.

## III. CURRENT SITUATION

4. It must be pointed out, at the outset, that under the General Agreement on Trade in Services (GATS) of the World Trade Organisation (WTO) Malaysia has already made substantial commitments to progressively liberalise its financial system.

5. Malaysia's liberal policies in the financial services sector had resulted in significant presence of foreign services providers in the Malaysian financial sector. There are 13 fully foreign-owned banks, which maintained presence in Malaysia and, at the end of 2002, foreigners owned an average 23 per cent of the total equity in four domestically-owned banks. On an aggregate basis, foreigners accounted for about 33 per cent of total commercial bank assets. In the insurance sector, out of a total of 54 insurance companies, 23 companies were majority foreign-owned. The foreign market share in the insurance industry remained high and accounted for 77 per cent of life insurance premiums and 40 per cent of general insurance premiums.

6. In the capital market, 5 out of 79 licensed fund managers are majority or fully foreign-owned whilst in the investment advisory sector, close to half of the licensed advisers are majority or fully foreign-owned.

7. Besides equity participation, foreign participation has taken other forms, such as participation through strategic alliances with local entities. In the insurance sector, there are 10 bancassurance arrangements involving locally incorporated foreign-owned banks, of which nine were established with domestically-owned insurance companies.

## IV. CHALLENGES

8. In the aftermath of the economic and social turmoil created by the Asian financial crisis, Malaysia had found it necessary to vigorously pursue its long-term objective of building a resilient, competitive and dynamic financial sector, which would play a catalytic role in the transformation of the economy and serve as an engine of growth. To prepare the domestic institutions for liberalisation, a timeline of 10 years has been set aimed at building a core of strong and forward-looking domestic players. The timelines are encapsulated in the Financial Sector Masterplan, FSMP and the Capital Market Masterplan, or CMP. Both the FSMP and the CMP launched in 2002, provide a guide on Malaysia's approach towards financial liberalization and the strategies that would be adopted.

9. The focus of both master plans in phase 1 has been on building capacity. For this purpose, the emphasis is to enhance the effectiveness and competitiveness of domestic financial institutions and to establish an efficient consumer protection infrastructure. While progress has been on track, several developments in the past year had posed serious difficulties for the domestic institutions, and the authorities have had to review some aspects of the implementation, so that we are basically on track.

10. One of the greatest challenges faced by domestic institutions is their ability to compete effectively in a more liberalized environment due to skill gaps which are still lacking in critical areas, particularly in the area of credit and treasury risk management. In the banking sector, it was acknowledged by the Basel Committee on Banking Supervision on the New Capital Accord that the emerging economies in Asian do face difficulties in implementing the BASLE requirements due to the lack of skills.

11. In the next decade, the banking and broking sectors are expected to experience greater and more dramatic structural changes. Advanced communication technology is rapidly and irreversibly changing the way business is being conducted. The ability to tap information technology becomes

increasingly important to meet the more sophisticated demands. As such financial services entities will require large amounts of capital investments to remain competitive and be able to assume higher risks. To provide for stronger capitalization of the domestic institutions, the banking and broking institutions have embarked on a merger programme.

12. As at end December 2002, from 54 institutions, the domestic banking institutions have consolidated into 10 banking groups. In contrast there are 13 foreign owned commercial banks. In the broking sector, as at December 2002, the number of stock broking companies stood at 40, as compared to 66 when the consolidation programme commenced in 2000.

13. The merger process was a first for Malaysia in terms of the scale and complexity as it involved more than 50 banking institutions and 66 stock broking companies. It is not surprising therefore that the financial sector is still undergoing a process of restructuring and consolidation, particularly in the broking industry, where some players are still at work finding merger partners.

14. For those in the banking and broking industries that have completed their merger exercises, much still needs to be done to consolidate the corporate cultures of the merged institutions. There are also difficulties in merging databases and IT systems without disruption to operational efficiency. Other difficulties have also surfaced. In particular, human resource management and manpower deployment issues are still being addressed, primarily to ensure there will be minimal social disruption. In the light of the geo-political uncertainties developing in the region and nascent economic recovery, it is important to manage these developments carefully to ensure the stability of the financial system. There are concerns that there would be another round of mergers involving the domestic financial institutions and in the wake of such developments, a longer period of adjustment and consolidation may be necessary.

15. In the meantime, although the Malaysian financial services sector has long been acknowledged as well supervised and well regulated, our financial services regulators continue to work with domestic institutions to ensure ongoing compliance with applicable BASEL, IOSCO and IAIS standards and best governance practices.

16. Malaysia, as a Member of the WTO, is certainly committed to long-term gradual and progressive liberalization of the financial services sector. But at the same time, we must ensure that the implementation of liberalisation must be in the context of our own needs, and that is for the financial sector to assume the role of supporting the nation's economic development agenda.

## V. CONCLUSION

17. Malaysia's position is that for the benefits of liberalisation to be fully realized, the pace of liberalisation has to be in tandem with the capacity and ability of the system to absorb these changes without undermining financial stability. Liberalisation must be carried out at a pace that is consistent with the prevailing conditions, infrastructure and regulatory framework and the needs of the economy. It is also important that liberalisation does not marginalise the domestic financial institutions. An important lesson of the last financial crisis is that liberalisation strategies must go hand in hand with increased regulation, effective supervision and enhanced capacity building.

18. We have a responsibility to our people to ensure that wealth is distributed equitably. To achieve this, it is imperative that domestic institutions are given a fair chance to equip themselves to face global competition. This is why we have chosen to approach liberalisation in a sustainable and progressive manner. <u>It is a question of time, not intention</u>.

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