MALAYSIA

SECURITIES

SUMMARY

Prior to the regional financial crisis that began in July 1997, the Kuala Lumpur Stock Exchange (KLSE) had grown into one of the most vibrant and diverse Asian markets outside Japan. The spread of the crisis, and to a degree some poorly received policy responses to it, severely eroded investor confidence. By end of August 1998, the Kuala Lumpur Stock Exchange had lost approximately 73 percent of its capitalization and the ringgit 67 percent of its dollar value since the start of the crisis in early July 1997. Furthermore, GDP declined 4.8 percent for the first half of 1998 (year-on-year), loan growth slumped to just 7.5 percent (year-on-year), and consumption demand dropped precipitously.

On September 1, 1998, as part of a broader effort to reflate the economy, and stabilize its currency, the government of Malaysia took drastic action by fixing the exchange rate of the ringgit to the U.S. dollar at RM3.8/US$1 and instituting selective currency controls. Malaysia's principal objectives in instituting the controls are to eliminate offshore trading in the ringgit and insulate its domestic economy from external risks posed by short-term capital flows. Overseas trading of Malaysian securities has ceased and investors must now hold Malaysian securities, or the ringgit proceeds from their sale, for at least one year from September 1, 1998. The government has stressed that the measures maintain general convertibility of current account transactions, and do not impair repatriation of interest, profits and dividends and commissions on investments. Prior to the crisis, the government was progressively implementing institutional and regulatory reforms in an effort to attract further foreign capital and to create a regional financial center. Economic realities, however, have slowed implementation of some of these initiatives.

Foreign ownership in Malaysian stockbroking companies is limited to 49 percent of capital; only one securities firm holds a large minority stake in a Malaysian stockbroking firm. (The only firm granted 49 percent equity in a Malaysian securities firm to date is a U.S. firm.) Prior to institution of currency controls, U.S. firms interested in a Malaysia portfolio generally operated through subsidiaries in the regional hubs of Hong Kong and Singapore. Foreign firms are permitted to register in Malaysia as investment advisers and to conduct market research for overseas clients.

Although relatively small, Malaysia's market for private, fixed-income instruments had shown some signs of growth prior to the crisis, but it has since stagnated. The market for Malaysian Federal government securities, dominated by the Employees Provident Fund (the country's mandatory-contribution retirement system), had stagnated as recent years' redemptions have often exceeded issues – a situation which will change rapidly if, as expected, the government issues bonds to fund its planned US$14 billion in fiscal stimulus and bank recapitalization measures. Malaysia has a growing pool of pension funds and the government, up until September 1, had instituted a number

of measures to further develop the fund management industry, including allowance of 70 percent foreign ownership in local fund management companies working with both local institutional and unit trust funds.

DESCRIPTION OF THE MARKET

Regulatory Regime

On March 1, 1993, the Malaysian Securities Commission (SC) assumed regulatory responsibilities which had been distributed over a number of government bodies. In addition to the securities industry, the SC regulates property trust schemes, takeovers and mergers of companies, and unit trusts. The SC also has regulatory responsibility for two derivatives markets, the Malaysia Monetary Exchange (MME) and the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE).

In addition to the SC, three other agencies participate in the regulation of the securities industry. The KLSE is a self-regulatory, private sector organization. The Registrar of Companies (ROC), an arm of the Ministry of Domestic Trade and Consumer Affairs, administers the Companies Act of 1965. While the SC administers the Code for Takeovers and Mergers, the Foreign Investment Committee (FIC), chaired by the Director-General of the Economic Planning Unit of the Prime Minister's Department, approves applications under certain circumstances, such as exemptions on the basis of national policy.

The government has long envisioned Malaysia as a future regional financial center similar to Singapore. In working toward achieving this goal, the government has announced plans to introduce new derivatives instruments; develop secondary debt markets; provide more disclosure and transparency; institute punitive measures to deter insider trading; and develop the recently established the Malaysian Exchange of Securities Dealing and Automated Quotation (MESDAQ), which has yet to make its first offering, as a market where smaller high-tech enterprises can list with fewer requirements. Economic realities, however, have slowed implementation of a number of these initiatives.

Equity Market

The Kuala Lumpur Stock Exchange (KLSE) was founded in 1973 as a result of a bifurcation created between the Malaysian and Singapore stock markets. The KLSE's most rapid periods of development occurred after October 1989, when the Finance Minster prohibited firms incorporated in Malaysia from cross-listing on the Singapore exchange and in 1993 when Malaysia's weighting in emerging market index funds was separated from that of Singapore. KLSE development was driven by issuance of federal government securities in the 1980s, by privatization of parastatal enterprises in the late 1980s and early 1990s, and until most recently by corporate and large infrastructure listings.

At the end of 1997, first board companies numbered 444 and second board companies 264. A fully automated computerized order and execution system provides the KLSE with the capability to cope with high trading volumes that averaged roughly US$1 billion a day in the first half of 1997. The KLSE operates a call market system through SCORE (System on Computerized Order Routing and Execution). The Securities Clearing Automated Network Services Sdn Bhd (SCANS), a wholly-owned subsidiary of KLSE, provides clearing operations. In August 1997, the KLSE instituted the T+5 Rolling Settlement System, applicable to all instruments on the exchange, as an interim step towards T+3 in the future.

Foreign ownership in a Malaysian stockbroking company is limited to 49 percent of its paid-in capital, unless otherwise approved by the Ministry of Finance. Stockbroking companies are either private or public companies. As of March 1998, Malaysia had 62 stockbroking companies, 54 of which were public companies with both local and foreign corporate shareholders. In addition, the KLSE had 52 corporate and 53 individual members; of the corporate members, 11 were foreign owned.

After shrugging off the tequila effect of Mexico's 1994 financial crisis, strong macro economic performance, corporate and large infrastructure project listings, and regional market exuberance led the Kuala Lumpur Composite Index to (KLCI) 1,271 in late February 1997, just shy of its all time record of 1,314 in January 1994. The bottom began to drop out in July 1997 when Thailand's financial woes sparked investor caution in the region. Government measures to curb public spending and clamp down on reckless private sector lending appeared to help stem the tide. Other measures, however, raised concerns about liquidity, disclosure and transparency. Particularly troubling were the one-week designation of 100 KLCI stocks to inhibit short selling; limits on currency swap transactions; allowance of public companies to finance the purchase of their own stocks by third parties (since rescinded); prohibition of short selling and stock borrowing and lending arrangements; and the sidestepping of regulations in the purchase of ailing Renong Berhad by its healthier subsidiary. Hong Kong, South Korea and Indonesia provided further bad news late in 1997. At the end of 1997, KLSE market capitalization had diminished, from year-end 1996, by 53.4 percent to RM375.8 billion (US$94 billion). Through the first half of 1998, as the regional crisis took on a more global form; the KLSE continued to slump with the KLCI dipping to as low as 262.

Falling victim to the KLSE crash were several regulatory and institutional initiatives. In October 1997, in the midst of the crisis, the Malaysian Exchange of Securities Dealing and Automated Quotation (MESDAQ) was established as an alternate market with less restrictive listing requirements (in particular, no profit reporting requirements) where smaller high-tech enterprises could have easier access to equity capital. The MESDAQ is to operate in a full disclosure-based regulatory environment and will be self-regulated by market intermediaries with the SC providing oversight. Poor investor sentiment as well as the suspension of all stock borrowing and lending arrangements (in place since 1995 as a risk management and market-making tool) had slowed development of the MESDAQ, which, as of September 1998, has not begun operations.

Also on hold is implementation of the next phase towards a full-disclosure based regulatory system for the KLSE by the year 2001, as well as enhanced enforcement. Nevertheless, the passage of the Financial Reporting Act of 1997 established the Malaysian Accounting Standard Board and the Financial Reporting Foundation, putting in place an institutional financial reporting framework of international standard. Furthermore, Malaysia's insider trading laws were amended in April 1998 to broaden the definition of insider trading; increase the range of sanctions, including civil sanctions; require additional disclosure from directors and chief executive officers (CEOs); and increase the powers of the SC over directors and CEOs. The SC is also considering plans for risk-based capital adequacy requirements for stockbroking companies.

To add further market depth, guidelines were announced in September 1997 to allow for public-listed companies to buy back their own shares on the KLSE. Also, in April 1997, the SC released guidelines for the listing of foreign-based companies on the KLSE. At this stage only foreign-based companies with substantial Malaysian interests will be allowed to have primary listings in Ringgit. The SC, however, intends to widen in phases the scope of companies which are allowed to list. The SC did not receive any applications for foreign listings during 1997, which can be attributed to the downturn in market conditions as well as a freeze on submissions for new listings, rights issues and corporate listings imposed in December 1997.

Dramatic measures were adopted on September 1, 1998, when Malaysia imposed currency exchange controls and fixed the value of the ringgit to the U.S. dollar at RM3.8/US$1. Details of these controls are still being clarified. However, one objective achieved has been the elimination of overseas trading of Malaysian securities, which were primarily conducted in Singapore. In addition, foreign investors must now hold Malaysian securities, or the Ringgit proceeds from their sale, for at least one year, or until September 1, 1999, if assets were purchased prior to September 1, 1998.

Bond Market

There are no restrictions on the types of instruments that may be offered in Malaysia's bond market. In terms of tradable bonds on the secondary market, government issues, known as Malaysian Government Securities (MGSs), dominate. The first zero coupon Khazanah bonds were issued in 1997 in an effort to provide benchmarks for the growing Islamic and other bond markets. Other tradable bonds are fixed interest corporate issues listed on the Kuala Lumpur Stock Exchange (KLSE) including fixed-rate straight bonds, convertible redeemable bonds, convertible irredeemable bonds, and Cagamas bonds. To reduce the cost of raising debt, Malaysian banks in the past have provided guarantees to improve companies' bond ratings. The Scripless Securities Trading System (SSTS), introduced in 1990, conducts trades.

The domestic bond market in Malaysia was given a boost in 1986 when Bank Negara Malaysia (the central bank) established Cagamas Berhad, a government corporation that issues mortgage-backed securities (Cagamas bonds). Strong economic growth between 1987 and 1989 enabled the government to reduce external borrowings by prepaying some foreign loans with domestic financing, thereby improving the liquidity of MGSs. Privatization and tax revenue growth after 1989 has steadily reduced the need for domestic government borrowing and consequently the secondary market for public debt has become sluggish.

The government of Malaysia recognizes the importance of revitalizing the secondary markets for public debt to provide pricing benchmarks for further capital market development. Consequently, two new issues of MG were floated in 1997, a RM1 billion (US$250 million) 10-year issue in October and a RM2 billion (US$500 million) 5-year issue in November. Secondary markets, in spite of these efforts, remained sluggish as redemptions exceeded issues by RM1.4 billion (US$450 million) in 1997 and banking institutions preferred to hold on to existing or newly issued securities to meet statutory liquidity requirements. This may change, however, if, as expected, the government issues bonds to fund significant portions of approximately US$14 billion in planned fiscal stimulus and bank recapitalization measures and taps local sources to fund the recently established Asset Management Corporation, known as Danaharta which is designed to purchase banking system non-performing loans.

The market in government debt is dominated by the Employee Provident Fund (EPF), Malaysia's mandatory-contribution retirement system, which is required statutorily to hold a large portion of its assets in MGSs. At the end of 1997, the EPF held 56 percent of the stock of outstanding government securities, the banking sector held 20 percent and insurance companies held 8 percent.

Private debt securities have gained significant momentum in recent years as more Malaysian corporations ventured to raise funds locally. In 1997, outstanding private debt securities rose to RM47.5 billion (US$11.9 billion), still just 25 percent of total outstanding bonds. Most of the RM15.5 billion (US$3.9 billion) raised in 1997 was by unlisted corporations, and largely to fund major infrastructure projects which now may have to be delayed due to the financial crisis.

Designated principal dealers underwrite government primary issues (MGSs, Khazanah bonds, T-bills, Cagamas bonds, and Negara bills) and provide two-way quotations for the secondary market. Principals or approved dealers consist of commercial banks, merchant banks and discount houses. Financial institutions are designated as principal dealers based on their individual volumes of bond activities. Branches of foreign commercial banks are included among principal dealers.

Fund Management

Up until very recently, fund management in Malaysia had generated a fair amount of foreign interest in light of the country's growing pool of pension funds. Investable funds of Malaysia's provident and pension funds grew by 13.7 percent in 1997 to RM143.8 billion (US$37.0 billion), the bulk of which are under the domain of the EPF. The government began taking steps in 1995 to further develop the country's fund management industry by providing tax incentives for local fund managers, allowing EPF accountholders to transfer up to 20 percent of their retirement accounts in excess of RM 50,000 (US$10,250) to unit trust funds and external fund managers, and allowing joint venture foreign fund management companies to manage domestic institutional and unit trust funds.

Local fund management companies in which foreign equity is less than 50 percent are unrestricted in the types and amounts of local funds they can raise. There are eight licensed local joint venture fund management companies. A joint venture with a U.S. firm surrendered its license in 1998. Foreign Fund Management Companies (FFMCs) consisting of joint ventures with at least 30 percent local equity can manage local institutional funds, but not local unit trust funds, provided the FFMC sources at least US$100 million in funds from outside Malaysia and at least RM10 million (US$2.5 million) within Malaysia. In December 1996, the SC said it would allow the first 10 joint venture FFMCs to apply to manage local unit trust funds. Only two joint venture FFMC applications to manage local unit trusts have been approved by the SC. Fully foreign-owned FFMCs in Malaysia are allowed only to manage global or regional funds on behalf of clients outside Malaysia. At the end of 1997, joint venture FFMCs numbered four and fully foreign-owned FFMCs also numbered four.

Derivatives

The economic crisis has highlighted the need for the government to further develop derivative instruments to enable investors in Malaysian assets to manage currency and other market risks. The Kuala Lumpur Options and Financial Futures Exchange (KLOFFE), established in 1995, offered only one product in 1997, Kuala Lumpur Stock Exchange Composite Index futures (FKLI), comprising 100 composite stocks. Total volume on the KLOFFE in 1997 rose by 395 percent to a record 382,974 FKLI contracts, reflecting increased hedging activities in response to uncertainties in the currency markets. As part of future development, KLOFFE plans to launch equity index options and individual equity options.

The Malaysia Monetary Exchange (MME), established in 1996, offers three-month KLIBOR futures contracts. Trading volume was moderate in 1997 with total turnover increasing to 76,382. The MME plans to introduce currency futures and options in 1998. Activity on the Kuala Lumpur Commodities Exchange (KLCE) is confined mostly to trading of crude palm oil futures.

Capital Controls

On September 1, 1998, the government of Malaysia took what it described as "drastic measures" by imposing capital controls and fixing the value of the ringgit at RM3.8/US$1. The government stated that the objectives of the controls were to eliminate manipulation of ringgit exchange rates, stabilize short-term capital flows, and to protect Malaysia from the contagion effects of external developments. The government has stressed that the measures maintain general convertibility of current account transactions, and do not impair repatriation of interest, profits and dividends and commissions on investments. The government has stated that the controls are temporary measures which will be retracted once the international financial infrastructure addresses destabilizing capital flows which the government blames in large part for recent economic difficulties.

U.S. PRESENCE IN THE MARKET

Merrill Lynch's joint venture with Smith Zain Securities, a member of the KLSE, is the only foreign joint venture stockbroking firm licensed in Malaysia with U.S. participation. Merrill Lynch's 49 percent ownership in Zain represents the largest percentage of foreign ownership in a Malaysian stockbroking joint venture; most other joint ventures top out at 30 percent.

Of Malaysia's 62 KLSE member stockbroking companies, 10 firms have significant foreign ownership interest. Aside from Merrill Lynch, no other U.S. securities firm has applied to operate in Malaysia either as a branch, or as a joint venture with a Malaysian stockbroking firm. Malaysia has 21 representative offices of foreign investment advisors, none of which are American, and 79 country and investment funds. Merrill Lynch is also the only U.S. investor which currently holds shares in a company which is a member of the KLSE, although several are reportedly exploring the possibility of minority participation. Joint venture Foreign Fund Management companies number 4 and fully foreign-owned FFMCs also numbered four. Only one joint venture FFMC application to manage local unit trusts has been approved by the SC. Only one U.S. company holds a stake in a local fund management company.

No U.S. firms are designated as principal dealers in the government bond market; U.S. banks are approved dealers, however. U.S. firms may participate in underwriting on a cross-border basis only if the underwriting is not denominated in Malaysian Ringgit.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

Foreign ownership of a KLSE member firm is restricted to a maximum 49 percent share if a positive contribution to the local stockbroking industry can be demonstrated. New licenses for joint venture securities firms providing broking and underwriting services are subject to an economic needs test. At this juncture, no new brokerage license approvals are anticipated as the government is encouraging industry consolidation. Branching is generally not permitted; however, the Securities Commission allowed 24 percent foreign-owned Hwang-DBS Securities' to assume failed Omega Securities obligations in return for a branch.

Foreign fund management companies (FFMCs) can have up to 70 percent foreign shareholding, provided they have locally sourced funds of at least RM10 million (US$2.5 million) and outside sources of US$100 million. Generally, local funds must be sourced from institutional funds and collective investment schemes other than unit trusts. However, a limit of ten FFMCs with 70 percent foreign shareholding can seek approval from the Securities Commission to manage funds of local unit trusts.

While there are no restrictions on foreign firms trading in the corporate debt market, foreign purchases of government debt are limited to Negara bills, T-bills, and MGSs.

Although there are generally transparent rules governing Malaysian financial and capital markets, the financial authorities maintain substantial discretionary authority when approval is required for certain transactions. Foreign financial institutions are treated no differently from domestic financial institutions vis-à-vis opportunities to comment on, and be notified of, regulatory changes.

Generally speaking, current levels of openness to foreign participation in Malaysia's securities markets are fully bound in Malaysia's GATS schedule of commitments. Malaysia already permits up to 49 percent foreign equity ownership in local stockbroking firms even though this commitment will not take effect under its GATS obligations until July 1, 2000. The government has shown flexibility, on a case by case basis, with regard to its bound limits on expatriate workers.

Funds Raised in the Capital Market
(Ringgit millions)

Sector	1993	1994	1995	1996	1997p
By Public Sector					
Government Securities					
Malaysian Government Securities (MGS)	1,600.0	2,229.1	2,000.0	6,000.0	3,000.0
MGS Advanced Subscriptions		270.9			
Khazanah Bonds (KB)					794.4
Government Invest Issues (GII)	1,200.0	3,000.0	750.0		
Malaysian Savings Bonds (MSB)	948.0				
New Issues of Government Securities	3,748.0	5,500.0	2,750.0	6,000.0	3,794.4
Less: Redemptions					
MGS	2,224.5	3,549.0	2,250.0	3,809.0	3,648.0
KB	0.0	0.0	0.0	0.0	0.0
GII	200.0	200.0	500.0	900.0	1,400.0
MSB	93.0	69.8	37.8	34.0	154.8
Less: Government Holdings	50.0	(97.0)	(2.6)	(74.1)	(1.2)
Net Funds Raised by Public Sector	1,180.5	1,778.2	(35.2)	1,331.1	(1,407.2)
By Private Sector					
Shares					
Ordinary Shares[1]					
Initial Public Offers	912.7	2,972.9	4,175.0	4,099.2	4,755.7
Rights Issues	1,176.9	3,436.7	5,240.2	5,268.5	8,524.9
Private Placement	658.8	798.9	1,146.9	4,554.4	3,125.3
Special Issues	684.2	1,249.4	875.5	2,002.3	1,818.8
Preference Shares					
New Issues of Shares	3,432.6	8,457.9	11,437.6	15,924.4	18,224.7
Debt Securities[2]					
Straight Bonds	2,109.8	1,021.7	3,929.9	2,675.4	3,832.0
Bonds with Warrants	1,089.6	2,861.4	3,607.7	5,563.7	3,300.3
Convertible Bonds	164.6	1,323.1	863.1	1,784.1	1,994.9
Islamic Bonds		300.0	800.0	2,350.0	5,249.7
Cagamas Bonds	1,650.0	4,760.0	3,022.0	4,665.0	5,169.0
New Issues of Debt Securities	5,014.0	10,266.1	12,222.7	17,038.2	19,545.8

Sector	1993	1994	1995	1996	1997p
Less: Redemptions					
Private Debt Securities[3]	474.2	383.5	1,249.1	1,765.0	1,358.0
Cagamas Bonds	900.0	850.0	2,635.0	750.0	1,640.0
Net Issue of Debt Securities	3,639.8	9,032.6	8,338.6	14,523.2	16,547.8
Net Funds Raised by Private Sector	7,072.4	17,490.5	19,776.2	30,447.6	34,772.5
Net Funds Raised from Capital Market	8,252.9	19,268.7	19,741.0	31,778.7	33,365.3
Short-Term Securities					
Commercial Paper	1,715.0	16,601.9	20,216.5	34,320.5	55,994.2
Cagamas Notes	2,685.0	2,490.0	3,395.0	5,790.0	13,890.0
New Issues of Short-Term Securities	4,400.0	19,091.9	23,611.5	40,110.5	69,884.2
Less: Redemptions					
Commercial Paper	100.0	14,228.2	18,842.7	31,009.2	53,238.0
Cagamas Notes	2,382.0	2,855.0	1,945.0	5,290.0	11,700.0
Net Issue of Short-Term Securities	1,981.0	2,008.7	2,832.8	3,811.3	4,946.2
TOTAL	10,170.9	21,277.4	22,564.8	35,590.0	38,311.5

[1] Excludes funds raised by the exercise of Employee Share Options Scheme, Transferable Subscription Rights Warrants, and Irredeemable Convertible Unsecured Loan Stocks.

[2] Excludes bonds issued by the banking institutions.

[3] Includes all straight bonds, bonds with warrants, convertible, and Islamic bonds.

p = Preliminary.

Average RM/US$ exchange rates are as follows: 1993, 2.57 RM/ US$; 1994, 2.62 RM/$; 1995, 2.50 RM/$; 1996, 2.51 RM/$; 1997, 2.81.

Source: Bank Negara 1997 Annual Report

Licensed Stockbrokers with Foreign Ownership Interests
(as of December 31, 1997)

KLSE Member Stockbroking Co.	Foreign Participation	Country	Percentage
Straits Securities Sdn Bhd	G.K. Goh Holdings Ltd.	Singapore	30
Seagroatt & Campbell Sdn Bhd	Caisse Nationale de Crédit Agricole	France	30
K & N Kenanga Bhd	Morgan Grenfell Asia Holdings Pte Ltd & Ors	Singapore	26
Smith Zain Securities Sdn Bhd	Merrill Lynch Investments PLC	USA	49
Ke Zan Securities Sdn Bhd	Kim Eng Holdings Ltd	Singapore	30
Mohaiyani Secutities Sdn Bhd	Asia Equity Holdings Ltd	Bermuda	30
OCBC Securities Sdn Bhd	OCBL Holdings Singapore Pte Ltd	Singapore	30
Thong KHJC Sdn Bhd	Kay Hian Holdings Ltd	Singapore	30
Apex Securities Sdn Bhd	Jarding Fleming Holdings Ltd	BVI, UK	30
Hwang-DBS Securities Sdn Bhd	DBS Securities Malaysia Pte Ltd	Singapore	24

Source: Malaysian Securities Commission

Capital Market Debt Instruments, Amount Outstanding[1]
(Ringgit millions)

Instrument	1993	1993	1995	1996	1997p
Malaysian Government Securities	66,018.1	64,969.1	64,719.1	66,910.1	66,261.7
Government Investment Issues	2,000.0	4,800.0	5,050.0	4,150.0	2,750.0
Malaysia Savings Bonds	1,273.0	1,177.3	1,130.6	1,092.0	918.4
Private Debt Securities[2]	10,081.0	15,131.2	22,700.9	33,517.0	46,543.4
Cagamas Bonds	5,015.0	8,925.0	9,312.0	13,227.0	16,756.0

[1] Refer to instruments with a maturity period of more than one year
[2] Exclude debt securities issued by the banking institutions. Private Debt Securities are assumed to be redeemed or converted at maturity
p = Preliminary

Average RM/US$ exchange rates are as follows: 1993, 2.57 RM/US$; 1994, 2.62 RM/US$; 1995, 2.50 RM/US$; 1996, 2.51 RM/US$; 1997, 2.81.

Source: Bank Negara 1997 Annual Report