Malaysia

WT/TPR/S/31, 3 November 1997

122. Government procurement preferences accorded to Malaysian firms constitute government assistance to these firms. Selected state-owned enterprises are required by public procurement regulations to follow similar practices. These preferences not only restrict competition among suppliers, thereby impairing economic efficiency, but also raise the cost to the Government and state-owned enterprises of procuring goods and services. The competitiveness of state-owned enterprises is, in turn, hampered insofar as they are forced by preferential procurement regulations to purchase their inputs from relatively high-cost local suppliers. On the other hand, the Malaysian authorities take the view that government procurement plays a vital role in national development and that since state-owned companies contribute substantially towards Malaysia's development, these companies need to be regulated in terms of procurement procedures. In this context they consider any incidental increase in costs as unavoidable. However, the Ministry of Finance will regularly review these procurement regulations to enable the procuring enterprises to improve their competitiveness.

123. In order to foster economic efficiency, however, some state-owned firms are allowed greater autonomy, including freedom from public procurement regulations, while others have been privatized. Privatization has made a significant contribution to economic growth and government revenue. Efficiency gains resulting from privatization of certain enterprises are indicative of the efficiency losses associated with previous government control over them.[1] Foreign investors are allowed to participate in the privatization exercise in the form of equity financing and provision of management expertise. As a matter of policy, foreign investors are allowed to participate up to a maximum of 25 per cent of the share capital of a privatized entity. In addition, they can also participate in privatized companies listed on the Kuala Lumpur Stock Exchange. This is to enable foreign companies with the necessary expertise and capital to provide the required input for projects involving new technology not available in Malaysia. Foreign participation is also encouraged in order to raise foreign capital required for large projects and to provide access to foreign markets and global linkages.

(a) Government procurement

124. The impact of government procurement regulations goes well beyond current government purchases of goods and services and public investment, as federal operating and development (investment) expenditure, which currently amounts to RM 58.2 billion, is well over 20 per cent of GDP.[2] Federal procurement regulations also apply to procurement by the 58 Statutory Bodies of the Federal Government and the three largest Non-Financial Public Enterprises, NFPEs, (Petronas, Tenaga Nasional and Telekom Malaysia Berhad).[3]

---

[1] In the case of Telekom Malaysia, for example, the return on assets and output per employee more than doubled following privatization (Chapter IV(4)(iii).

[2] Ministry of Finance (1996).

[3] Items procured by Petronas, Tenaga Nasional and Telekom with a value of RM 15 million or more must be referred to the Ministry of Finance.

125. Among the objectives of federal procurement policies are to encourage use of local materials and components, reduce dependence on imports and diminish the balance-of-payments deficit. The scale of government expenditure suggests that procurement preferences may have a substantial short-term impact on the balance of payments. Such a policy would, however, attract resources from other more efficient uses, thus undermining the competitiveness of Malaysian firms in the long term. In practice, the Malaysian authorities allocate a substantial share of government procurement contracts to foreign suppliers (Table III.18). This policy contributes to the impressive performance of Malaysia's economy.

Table III.18
Overview of government procurement, 1991-97

	1991	1992	1993	1994	1995	1996	1997[a]
Federal government operating expenditure (RM billion)	28.3	32.1	32.2	25.1	36.6	41.8	41.4
Federal government development expenditure (RM billion)	9.6	9.7	10.1	11.3	14.1	14.9	16.8
Total Government contracts[b]	...	...	...	...	13.2	36.6	...
Government contracts awarded to foreign companies[b] (RM billion)	...	...	...	...	5.2	29.2	...

... Not available.

a Budget allocation.
b Including contracts for Statutory Authorities Petronas, Tenaga Nasional and Telekom.

Source: Data provided by the authorities and Ministry of Finance (1995 and 1996), Economic Report 1995/96 and 1996/97, Kuala Lumpur.

126. The Government Procurement Management Division (previously known as the Contract and Supply Management Division) of the Ministry of Finance is the central federal procurement agency. On an annual basis, this agency manages procurement amounting to RM 5.3 billion. In 1994, government procurement regulations were revised as part of a regular review, leading to the replacement of 151 Treasury Circular Letters by 34 new Treasury Circular Letters.[4] Contracts are divided into three categories, supplies, services and works. Each Ministry has its own procurement unit, but supplies and services contracts with a value above RM 7 million and works contracts with a value above RM 50 million are referred to the Ministry of Finance.

127. For supplies contracts, Malaysian Bumiputra companies receive a margin of preference of 2.5 to 10 per cent over a reference price. The margin of preference is inversely proportional to a value of not more than RM 15 million. Malaysian Bumiputra manufacturing companies also enjoy preferential treatment of 3 to 10 per cent, with the margin of preference being inversely related to the contract value up to RM 100 million. All supplies contracts with a value between RM 10,000 and RM 100,000, and works contracts up to RM 100,000 are reserved for Bumiputra suppliers. As a matter of planning for procurement of works contracts, at least 30 per cent of the annual value of works contracts is set aside for Bumiputra contractors. Contracts above these limits are open to competitive bidding. Competitive tenders not exceeding RM 10 million are open to 100 per cent Malaysian-owned companies. Tenders with a value ranging from RM 10 million to RM 25 million are open to locally incorporated joint ventures listed on the Kuala Lumpur Stock Exchange (KLSE) with foreign equity of less than 30 per cent. Tenders exceeding RM 25 million are extended to joint-venture companies listed on the KLSE with foreign equity up to 40 per cent. For the delivery of imported goods, five local multi-model transportation companies are requested to give a quotation for the delivery of imported goods, and

[4]The Financial Procedure Act 1957, as amended in 1972, authorizes the Minister of Finance to manage, supervise, control and direct all federal financial matters.

agencies are required to select the company which tenders the best offer. Countertrade requirements are waived for international tenders.[5] Foreign export- or mixed-credit offers are considered in tender evaluations on the basis of value for money.

128. Open tenders are used to ensure openness, fairness and transparency. All tenders are to be announced in local daily newspapers unless a written exemption has been obtained earlier from the Ministry of Finance. Restricted tenders are used sparingly when the number of suppliers are limited. Direct negotiations are considerd if there is only one supplier. All restricted tenders and directly negotiated contracts must be considered and approved by the Ministry of Finance.

129. Treasury Circular Letter 15/1981, relating to State-level procurement, was repealed on 13 April 1995. Federal Tender Boards in States headed by State Development Officers have the authority to approve works contracts up to RM 5 million only. They are not empowered to decide on supplies contracts of any value or works contracts where decisions are non-unanimous. The authority for state government procurement matters rests with the 'state financial authority' who decides on procurement through procurement boards, and acts in accordance with the directions given to him by the Chief Minister of the State. Decisions made in the States are also to be in accordance with the federal rules and regulations pertaining to procurement.

130. In addition to the these policies, there are also various informal policies to promote local content. On a case-by-case basis, the Government encourages NFPEs and private companies to make use of local components when undertaking their projects. The Government has announced that every international tender document must now ensure the active involvement of local companies, and the areas in which the local companies can be actively involved should be identified. An added measure is that civil engineering works must be awarded to local companies. All civil engineering works are to be procured locally. However, according to the authorities, the policy is not enforced strictly. Where local expertise is not available, procurement is still open to others. The state-owned oil company, Petronas, for example, requires contractors to procure inputs locally, but this policy appears to be subject to an unspecified preferential margin, and is only applied when local suppliers are able to provide the same quality as foreign suppliers.

131. Public tenders may be contested to the procuring authority if there is a suspicion that specifications for a particular tender are tailored to an individual brand or product; according to the authorities, such practices are strictly prohibited. Challenges have to be filed within 21 days of the tender advertisement, and if sustained lead to cancellation of the tender. So far two objections have been formally received and remedial action has been taken upon investigation.

(b) Non-financial public enterprises and privatization

132. Investment by public agencies and NFPEs accounted for 17.7 per cent of GNP during 1991-95, down from 24.1 per cent during 1981-85, but slightly up from the 14.2 per cent during 1986-90. For the 1996-2000 period, an average of 11.5 per cent share in GNP is envisaged. From 1991 to 1995 out of a total public sector development (investment) expenditure of RM 142.8 billion, 27 per cent was made by the Federal Government, 9.7 per cent by State governments, 8.6 per cent by local and statutory authorities, and 54.7 per cent by NFPEs. While some of these investments earn a commercial rate of return, others are made on the basis of non-commercial criteria reflecting the Government's policy objectives formulated in its economic development plans (Annex II.1).[6] As a consequence of privatisation, the number of the main NFPEs declined from 42 in 1993 to 31 in 1996, although their revenue increased somewhat (Tables III.19 and AIII.14).[7]

---

[5]Since July 1992, countertrade has been taken into account in two cases, one with a Commonwealth of Independent States country and one with Italy, dealing with an aircraft contract.

[6]At the end of 1996 there were 528 government-controlled companies compared to 504 at the end of 1995. These companies were mainly engaged in providing services (157 companies), manufacturing (74 companies),

Table III.19
Financial position of NFPEs, 1991-96
(RM million)

	1991	1992	1993	1994	1995	1996
Revenue	41,032	42,540	43,679	43,323	46,615	50,101
Operating expenditure	27,835	28,999	30,036	28,520	30,251	33,990
Current surplus/deficit	13,197	13,541	13,643	14,803	16,364	16,111
Development expenditure	11,156	16,147	19,458	16,196	15,222	18,654
Overall balance	2,041	-2,606	-5,815	-1,393	1,142	-2,543
Sources of financing						
Domestic financing	-3,602	-295	-868	-6,875	-11,094	-5,585
External borrowing	1,561	2,901	6,682	8,268	9,952	8,128

Source: Data provided by the Malaysian authorities.

133. Privatization of firms producing goods and services may include the transfer of management responsibility, assets or the right to the use of assets and personnel involved. Privatization is seen as important because it can contribute to economic efficiency, promote economic growth, reduce the Government's administrative and financial burden, increase government revenue and facilitate Bumiputra participation; foreign participation in privatization is expected to assist in promoting global international exposure for Malaysian entities.

134. Malaysia's privatization policies were set out in the Privatization Master Plan (PMP) published in 1991. Together with the PMP, the Government introduced the Privatization Action Plan (PAP) which is a two-year rolling plan to assist the annual implementation of the programme. The PAP is reviewed annually with a view to identifying measures to expedite the implementation of the programme and to determine the entities to be privatized in the following two-year period. At the end of 1995, there were 12 different methods of privatization in use, including sale of equity, sale of assets, lease of assets, management contract, build-operate-transfer, build-operate-own, build-operate, build-transfer, land development, management buy-out, joint ventures and asset swap.[8] As a general rule, the authorities

(..continued)
investment holding (48 companies), plantations (30 companies), property development (37 companies), recreation and resorts (29 companies), transportation (29 companies), agriculture (17 companies), construction (17 companies), and other activities (58 companies). State-owned companies in manufacturing, investment holdings, finance, services and property development accounted for 83.8 per cent of investment by government-controlled companies Ostensibly 323 out of the 481 government-controlled companies that submitted financial information were profitable.

[7]Non-Financial Public Enterprises (NFPEs) are public sector agencies undertaking the sale of industrial and commercial goods and services. They include statutory bodies, government-owned or government-controlled companies and agencies owned by statutory bodies. Ownership and control refer to a government or public-sector agency controlling more than 50 per cent of total equity. The numbers in the text refer to the NFPEs with minimal annual sales of at least RM 50 million.

[8]During the 1991-95 period, a total of 204 projects were privatized in all sectors of the economy, including infrastructure and government services. During this period 46 projects were privatized in the construction sector, of which 23 through sale of assets and 13 through build-operate-transfer modes. Overall, the sale of equity was the mode used in 94 (out of the total 204) projects, of which 27 were in the manufacturing sector, 13 in wholesale, retail trade and hotels and restaurants, and another 13 in finance, real estate and business services. However, privatization is an ongoing process with the number of privatized projects increasing from 25 in 1991, to 27 in 1992, to 40 in 1993, to 47 in 1994 and 65 in 1995. Approximately 55 were federal projects, the remaining were State projects. During this period the proceeds from sales of equity were RM 11.8 billion compared to revenue from sales of assets of RM 2.3 billion, and an additional capital expenditure of RM 51.6 billion was saved. A total of 43,000 public sector employees were transferred to the private sector. Selected data suggest that productivity improved significantly in the companies following their privatization

seek to use the method which results in a maximum degree of private-sector involvement and a reasonable return to the Government. The Government provides various forms of support, including soft loans, tax incentives and other concessions, to selected projects which have a high social component. The privatization process is managed by the EPU in the Prime Minister's Department through the National Privatization Committee (Table II.1). Foreign consultants may participate in studies and provide advice on privatization.

135. Foreign companies may take shares in privatized companies up to a limit of 25 per cent, under certain circumstances.[9] Of the 42 entities which were privatized during 1993 to 1997, foreign interests held shares in five of 15 major companies for which records were available. Only in the case of Malaysian Airlines did the foreign share exceed 10 per cent.[10] At the end of 1995, a total of 24 privatized companies were listed on the KLSE with a total market value of RM 124.7 billion (22 per cent of total market capitalization). These listings made a major contribution to the turnover on this stock exchange. Foreigner investors are allowed to invest in the listed companies up to the prescribed limits (Chapter IV(4)(ii)).

136. Privatized companies are, in selected cases, obliged to assume socio-economic obligations. Examples are vendor development, marketing arrangements, training, technology transfer and research and development (section (2)(iv)). In this context, seven of the largest privatized companies allocated RM 119 million to training programmes in 1995, up from RM 79 million in 1993 and RM 90 million in 1994.[11] Privatization is thus used as in instrument to facilitate the transfer and development of technological and entrepreneurial skills.

137. In the absence of a comprehensive competition policy, the authorities established 11 regulatory authorities to maintain standards and protect consumer interests in terms of pricing, availability and quality of service as well as to ensure the healthy development of the industry. Regulatory authorities were established to cover electricity and gas supply, ports, airports, highways, posts, telecommunications, railways and sewerage (section (vi) below). However, the "regulatory authorities were not able to function effectively particularly due to the difficulty in operating within a rapidly

(..continued)
(Government of Malaysia (1996a).

[9]Participation of foreign firms is permitted if their expertise is required and not locally available; foreign participation is required to promote exports; local capital is insufficient to absorb the share capital offered; and the nature of the business requires global linkages and international exposure. Foreign participation is not restricted to any particular sector, but is normally considered for projects involving advanced technology as well as projects requiring active research and development efforts.

[10]Of the 42 entities which were privatized during 1993 to 1996, records are available for the share of foreign equity in 15 major companies. The total sale value of these 15 companies was RM 8 billion. Non-Malaysian investors hold 24.09 per cent of the equity of Malaysian Airlines, privatized in 1994 at a total sale value of RM 3.1 billion by sale of equity; 0.49 per cent of Petronas Dagangan Sdn. Berhad privatized in 1994 through public listing at a value of RM 264.6 million; 6.29 per cent of Heavy Industries Corporation (HICOM), privatized in 1995 through a sale of equity of RM 1.7 billion; 1.8 per cent of Petronas Gas Berhad, privatized in 1995 at a public listing valued at RM 1.9 billion; 4.14 per cent of Perhak SEDC Subsidiaries, privatized in 1996 through sales of assets and sales of equity valued at RM 208 million.

[11]Other examples include the vendor programmes undertaken by privatized companies. For example, Perusahaan Otomobil Nasional Berhad agreed to a RM 569.1 million Component Scheme Promotion; Telekom Malaysia Berhad agreed to a RM 452.6 million Entrepreneurs Development Programme and a Credible Supplier Scheme; Tenaga Nasional Berhad agreed to a RM 337.2 million Entrepreneurs Development Programme, an Umbrella Scheme, a Credible Contractor Scheme and a Strategic Joint-venture; Indah Water Konsortium Sdn. Berhad agreed to a RM 6.3 million Construction of Treatment Plant and Pumping Station Sewerage System and Pumping Station Network. (Government of Malaysia (1996b), p. 211)

changing technological environment".[12] The authorities have ensured that all privatized roads and highways have alternative routes, thus providing some competition to the privatized entities.

[12]Government of Malaysia (1996b), p. 216.

Annex AII.1 Planning in the Executive Branch

Malaysia maintains both long-term development plans, setting broad objectives for the more distant future, and medium- and short-term plans that tend to be more specific in both objectives and policy instruments. The Malaysian authorities have indicated their long-term, 25-year, objectives in "Vision 2020". The Vision envisages Malaysia as a united, developed nation by the year 2020 with a competitive, dynamic, robust and resilient economy. At the same time, however, great emphasis is placed on sustainable development, and on the evolution of an economically just and equitable, democratic, liberal, caring, moral and ethical society.[13] To ensure Malaysia's future competitiveness in global markets, the Government seeks to encourage productivity improvement through a strategic shift to capital- and technology-intensive production processes; to reduce its role in the economy through the continuing privatization of publicly-owned companies and assets; and to maintain healthy fiscal and monetary management.

The Second Outline Perspective Plan (OPP2) (1991-2000), follows the first OPP (1971-1990) in which the New Economic Policy (NEP) was formulated. Under the NEP, various preferences were enacted to favour selected segments of society, particularly the indigenous Bumiputra population, with the view of reducing economic inequality among ethnic groups, thus promoting racial harmony. Such preferences were modified during the Second Outline Perspective Plan (OPP2) under the National Development Policy (NDP), moving towards more general economic and social objectives.[14] Under the NDP, preferences for indigenous Malaysians are targeted at "Bumiputra with potential, commitment and good track records" and "groups within the Bumiputra community who are new in business and do not have the necessary track record".[15] A range of tax and non-tax incentives is also provided to the business sector, irrespective of ethnicity; the expansion of public amenities and social services in rural and urban areas alike is available to all residents.

The Seventh Malaysia Plan (SMP) covers the centre period of the National Agricultural Policy[16] and the second half of the OPP2. The National Agricultural Policy stresses the role of market forces and research and development in the agricultural sector (Chapter IV(2)). The SMP stresses the acceleration of total factor productivity growth as a major policy objective (Chapter I(1)). Total factor productivity growth is to be fostered by large-scale production, labour-saving techniques including automation, enhancement of labour quality, efficient management and expansion of infrastructure; the development of high-value-added activities is encouraged including, in the farm sector, horticulture and aquaculture; integration with the global economy is to be promoted through trade and investment and greater backward and forward linkages of the external sector. Price stability and the current account deficit are identified as indicators of the resource constraint to the realization of these objectives. To alleviate the savings-investment gap and the balance-of-payments constraint, domestic savings are to be encouraged through the further development of a dynamic and innovative capital market (Chapter IV(5)(ii)).

[13] Government of Malaysia (1996c), The Way Forward - Vision 2020, Kuala Lumpur, posted on the Internet.

[14] "While the NDP maintains the basic strategies of the NEP, its new dimensions will be to: (a) shift the focus of the anti-poverty strategy towards eradication of hard-core poverty while at the same time reducing relative poverty; (b) focus on employment and the rapid development of an active Bumiputra Commercial and Industrial Community (BCIC) as a more effective strategy to increase the meaningful participation of Bumiputra in the modern sectors of the economy; (c) rely more on the private sector to be involved in the restructuring objective by creating greater opportunities for its growth; and (d) focus on human resource development as a fundamental requirement for achieving the objectives of growth and distribution." (Government of Malaysia, 1991, p. 4).

[15] Government of Malaysia (1991), p. 17.

[16] The National Agricultural Policy (1992-2010) stresses the role of market forces in agricultural development in this context imports have been liberalized to reduce inflationary pressures.

The SMP coincides with the first half of the Second Industrial Master Plan (IMP2). While the First Industrial Master Plan emphasized resource-based and labour-intensive industrialization, IMP2 emphasizes the development of human capital, capital-intensive, high-technology and knowledge-based industries.

Another major innovation of the Second Industrial Master Plan (IMP2) is its emphasis on the development of clusters of activities, as compared to the previous emphasis on selected sectors. IMP2 emphasises "moving beyond a focus on manufacturing operations to include R&D and design capability, development of integrated supporting industries, packaging, distribution and marketing activities".[17] IMP2 is implemented on the basis of a "rolling plan" approach which stresses the importance of the continuous processes of planning, implementation and review, conducted in active participation with the private sector as represented on advisory and review bodies (Chapter II(2)(iii)).

[17] Ministry of International Trade and Industry Malaysia (1996a), p. 10.

Table AIII.14
Non-financial public enterprises (NFPEs)[a], 1996

Company	Incorporated under the Companies Act or Statutory body
Cement Industries (Sabah) Sendirian Berhad	Incorporated
Felda Oil Products Sendirian Berhad	Incorporated
Golden Hope Plantation Berhad[b]	Incorporated
Keretapi Tanah Melayu Berhad (KTMB)	Incorporated
Kontena Nasional Sendirian Berhad	Incorporated
Kumpulan Guthrie Berhad[b]	Incorporated
Lembaga Letrik Sabah	Statutory body
Lembaga Pelabuhan Kuching	Statutory body
Lembaga Pelabuhan Sabah	Statutory body
Malaysia LNG Sendirian Berhad	Incorporated
Malaysian Rubber Development Corporation Berhad (MARDEC)	Incorporated
Malaysian International Shipping Corporation Berhad (MISC)[b]	Incorporated
Penang Port Commission	Statutory body
Perbadanan Kilang FELDA	Incorporated
Perbadanan Niaga FELDA	Incorporated
Perbadanan Pengangkutan dan Perusahaan Tabung Haji	Statutory body
Pernas Edar Sendirian Berhad	Incorporated
Pernas International Hotels and Properties Berhad[b]	Incorporated
Pernec Corporations Sendirian Berhad	Incorporated
Pernas Trading Sendirian Berhad	Incorporated
Perwaja Terengganu Sendirian Berhad	Incorporated
Petroliam Nasional Berhad (PETRONAS)	Incorporated
Petronas Carigali Sendirian Berhad	Incorporated
Petronas Dagangan Berhad[b]	Incorporated
Petronas Penapisan Sendirian Berhad	Incorporated
Sabah Energy Corporation	Statutory body
Sarawak Electricity Supply Corporation (SESCo)	Statutory body
Sebor (Sabah) Sendirian Berhad	Incorporated
Telekom Malaysia Berhad[b]	Incorporated
Tenega Nasional Berhad[b]	Incorporated
The Road Railer Services Berhad	Incorporated
Urban Development Authority (UDA)	Statutory body

a From the original 56 entities, the current list excludes 24 agencies which were privatized/sold during the 1988-95 period. In 1991, Fima Metal Box, Kedah Cement, Kumpulan Fima, MSE, PNSL, Pinang Shipbuilding and Sabah Shipyard were sold. In 1992, L.P. Keland and Sabah Gas Industries were sold. In 1992, L.P. Bintulu, L.P. Johor and Sabah Forest were sold. In 1994, Mas and Perak Hanjoong were sold. In 1995, Antara Steel Mill, Hicom and Proton were sold. In 1996, 31 NFPEs; Road Railers were sold.

b These companies were listed on the Kuala Lumpur Stock Exchange (KLSE) and the Government is still the majority shareholder.

Source: Information provided by the Malaysian authhorities.

Table II.1
Main trade-related functions of selected ministries and government agencies/statutory authorities, 1997

Ministry, agency, committee	Trade-related functions
Ministry of International Trade and Industry	Planning and implementation of foreign trade and industrial policies
Ministry of Foreign Affairs	Promotion of Malaysia's interests abroad, including the interest of Malaysians travelling or residing overseas
Economic Planning Unit, Prime Minister's Department	Formulation of strategies and programmes for development planning, privatization policy and monitoring the realization of the New Development Policy
Ministry of Finance	Formulation of monetary and fiscal policy, implementation of the budget including import and export tariffs, prohibitions and licensing
Central Bank of Malaysia	Implementation of monetary policy under the Ministry of Finance; banking and insurance supervision, including exchange control policy
Securities Commission	Monitoring and regulation of developments in the securities market
Ministry of Domestic Trade and Consumer Affairs	Facilitation of domestic trade, protection of consumers and formulation and implementation of policies for the protection of intellectual property rights
Malaysian Industrial Development Authority (MIDA)	Implementation and promotion of investment policies
Ministry of Agriculture	Formulation and implementation of agricultural (except forestry and tree crops) and fishery policies
Ministry of Primary Industries	Formulation and implementation of Malaysia's primary sector policies (forestry, tree crops, rubber, mining) including research and development, production, processing, marketing, and deliberation of international commodities issues
Ministry of Energy, Telecommunications and Post	Formulation and implementation of energy, telecommunications and post policies. The Ministry is also responsible for the formulation of a "convergence" law dealing with telecommunications, audiovisual and computer services.
Ministry of Transport	Formulation and implementation of road, maritime and air transport policies
Ministry of Culture Arts and Tourism	Formulation of tourism policies, implementation of these policies is shared with the Malaysia Tourism Promotion Board.

Source: Information provided by the Malaysian authorities.

Chapter IV

(4) Services

(ii) Financial services

(a) Overview

41. In 1996, financial services contributed around 12.2 per cent to GDP and around 5.5 per cent to total employment.[18] Value added per worker in financial services is thus more than double the national average. Although other sub-sectors also make a significant contribution to value added in financial services[19], the banking sector is the main manager of financial assets.[20] The market share of the Employees Provident Fund (EPF), which is based on compulsory contributions of employers and employees, has gradually declined, although total assets under its management have increased substantially. Insurance funds are less important as guardians of financial assets (Table IV.10). The Kuala Lumpur Stock Exchange and related securities exchanges have improved the efficiency of savings mobilization and investment allocation. Foreign institutions play a significant role in Malaysia's financial services sector. Since 1979, no new banking licences have been awarded to foreign or local investors.

Table IV.10
Share in total assets of the financial system by institution, 1970-96
(Per cent unless otherwise indicated)

	1970	1977	1985	1990	1991	1992	1993	1994	1995	1996
Total (RM million)	**11.6**	**37.5**	**166.1**	**309.1**	**372.2**	**436.6**	**570.5**	**628.2**	**733.0**	**915.2**
Shares in total (per cent)										
Bank Negara Malaysia[a]	20.8	20.7	9.9	12.1	12.0	14.4	17.6	14.8	12.1	10.5
Banking system	42.9	47.2	59.6	60.6	58.0	56.1	53.8	54.1	56.4	58.3
Commercial banks	38.4	37.8	45.1	44.2	41.2	40.2	39.4	38.6	40.3	39.6
Finance companies	4.6	7.0	10.7	12.8	13.2	12.6	11.1	11.7	12.5	13.1
Merchant banks	0.0	2.4	3.8	3.6	3.6	3.3	3.3	3.8	3.7	3.7
Provident, pension and insurance funds	27.2	21.8	19.7	18.3	18.8	18.6	17.3	18.9	18.9	18.2
Employees provident fund	19.5	15.6	14.9	15.1	14.3	14.3	12.7	13.5	13.4	12.9
Other provident funds	3.9	2.4	1.8	1.6	1.4	1.4	1.7	2.0	2.0	2.0
Life insurance funds	2.8	2.6	2.2	0.8	2.3	2.1	2.0	2.4	2.4	2.3
General insurance funds	1.0	1.2	0.8	0.8	0.8	0.9	0.9	1.0	1.1	1.0
Development finance institutions[b]	1.1	2.4	2.4	1.9	1.7	1.5	1.6	1.5	1.6	1.4
Savings institutions[c]	5.6	4.7	4.9	3.2	2.5	2.3	2.4	2.5	2.1	1.9
Other financial intermediaries[d]	2.4	3.3	3.5	3.9	7.0	7.1	7.3	8.4	8.8	9.7

a Includes Bank Negara Malaysia and Currency Board.
b Include Malaysian Industrial Development Finance Berhad (MIDF), Agricultural Bank of Malaysia, Borneo Development Corporation, Sabah Development Bank Berhad, Saban Credit Corporation, Development Bank of Malaysia, and Industrial Bank Berhad.
c Includes National Savings Bank, Bank Kerjasama Rakyat and the cooperative societies.
d Includes discount houses, unit trusts, building societies, Pilgrims Management Fund Board, Credit Guarantee Corporation and Cagamas Berhad.

[18] Such shares are not unusual, for example in 1995 the U.S. financial services sector employed 5.8 per cent of the work force and generated 17.1 per cent of GDP (WTO, 1997).

[19] For example value added by stock commodity and foreign exchange brokers increased from less than RM 0.5 billion in 1989 to RM 4.7 billion in 1994. During the same period employment increased from 4,100 to 11,500, suggesting a significant increase in value added per worker (Table AIV.8).

[20] Islamic banks do not pay or charge interest but may provide depositors with a share of the bank's profits. In addition to Islamic banking by specialized institutions, other financial institutions may also offer such services through their existing branches.

Source: Yusof, Zainal Azam, Awang Adek Hussin, Ismail Alowi, Lim Chee Sing and Sukhdave Singh (1996), "Financial Reform in Malaysia", in: Gerad Caprio, Jr., Izak Atiyas and James A. Hansen (eds.) Financial Reform Theory and Experience, Cambridge University Press, Cambridge, p.p. 276-320; and Bank Negara Malaysia (various issues), Annual Report, Kuala Lumpur.

Government regulation

42. Banking and insurance services are primarily supervised and regulated by the Central Bank of Malaysia, while the Securities Commission is the main regulator of the securities sector. Since 1975, selected financial institutions have been required to satisfy minimum lending thresholds for social policy reasons.[21] The Employees Provident Fund (EPF) and other insurance funds are required to invest a minimum share of total investments in government securities. However, these minimum lending and investment requirements, for social reasons, have been relaxed during the 1990s.

43. Prudential regulation of the banking and insurance sectors is particularly important as no private or public deposit insurance exists. While no bank or insurance company has gone bankrupt since independence, the Bank Negara Malaysia did rescue three banks in the mid-1980s. A two-tier banking supervision system was introduced in December 1994 for commercial banks, in January 1996 for merchant banks, in April 1996 for finance companies, and a similar two-tier supervision system is under consideration for the insurance sector. Tier-1 institutions are assessed to be financially stronger than tier-2 institutions and thus subject to somewhat lighter regulation. Some foreign commercial banks have been accorded tier-1 status.[22] Recently, prudential requirements have been tightened in view of developments in real estate and stock markets.

(b) Banking services

44. The banking system experienced rapid growth during the 1990s as managed assets increased by over 50 per cent (Table IV.11), interest income more than doubled, pre-tax profits more than tripled and returns on equity increased by over 20 per cent (Table IV.11). As expected in a rapidly growing economy, the share of non-performing loans in total loans dropped from over 20 per cent in 1990 to under 4 per cent in 1995.

---

[21]Under 1996 Lending Guidelines all commercial banks are required to lend a minimum of 30 per cent of all loans to the Bumiputra community at market rates, provide a minimum RM 1 billion guarantee cover under the New Principal Guarantee Scheme for loans with a value of RM 500,000 and below, for which a maximum interest rate of the bank lending rate plus 2 per cent applies; and to provide housing loans for houses costing RM 100,000 and below for which a maximum interest rate of the bank lending rate plus 1.75 per cent or 9 per cent, whichever is lower, applies.

[22]Of the ten tier-one commercial banks, four are foreign-owned, while the other six are domestically owned.

Licensing

45. Banking services are provided by commercial banks, finance companies, merchant banks, discount houses and credit guarantee corporations. All suppliers of banking services, including branches and automatic teller machines are licensed by the Central Bank. In 1995 there were 37 commercial banks, 40 finance companies, and 12 merchant banks licensed in Malaysia.[23] All foreign banks are locally incorporated, as required by Section 4 of the Banking and Financial Institutions Act 1989.[24] The parent banks of such locally incorporated foreign-owned banks are allowed to continue holding 100 per cent interest in their Malaysian subsidiaries; in contrast to insurance institutions, their is no requirement for divestment of share-holding by the parent bank in favour of Malaysian interests. Foreign parties may also acquire up to an aggregate of 30 per cent equity interest in existing Malaysian-owned banks. For offshore banks in the Labuan International Offshore Financial Centre, there are no foreign-ownership restrictions. Entry can be in the form of a branch or a subsidiary.

Table IV.11
Performance of the Malaysian banking system, 1990-96
(RM million and per cent)

Financial year ending	1990	1991	1992	1993	1994	1995	1996[a]
Net interest income	4,115	4,832	5,658	6,973	8,868	10,392	13,389
Pre-tax profit	1,985	2,271	2,657	3,788	5,205	6,869	8,721
Average shareholders' funds and net working funds	9,250	12,872	15,853	18,736	21,532	26,215	31,687
Return on assets (%)	1.4	1.3	1.3	1.5	1.7	1.9	2.0
Return on equity (%)	21.5	17.6	16.8	20.2	24.2	26.2	27.5
Specific provisions/total loans (%)	5.3	3.6	3.4	3.2	2.2	1.6	1.0
General provisions/total loans (%)	0.7	0.9	1.1	1.3	1.6	1.6	1.9
Non-performing loans/total loans (%)	20.3	15.6	14.9	12.6	8.1	5.5	3.9

a Preliminary.

Source: Government of Malaysia (1996), Seventh Malaysian Plan, Kuala Lumpur; and data provided by the Malaysian authorities.

46. Out of a total of 37 commercial banks, 14 are foreign owned; in 1996 these foreign-owned banks managed 23 per cent of assets, granted 26 per cent of loans, managed 21 per cent of deposits and generated 33 per cent of total pre-tax profits in the sector. Since 1979, no new licences have been issued. However, offshore banking licences are issued to banks carrying out offshore banking business on the Federal Territory of Labuan. Although new branches and automatic teller machines are being authorized for domestic banks, foreign banks may not establish new branches, including off-site automatic teller machines. The latter, in particular, constitutes a major impediment to the expansion of foreign-owned banks, given the rapid growth of the branch and automatic teller machine network of domestically-owned banks. Of the total 40 finance companies, four are 100 per cent foreign owned, while six have some foreign equity participation. No new licences have been granted since 1984. Nine of the 12 merchant banks have some foreign participation. Although no new bank licences for on-shore banking have been granted in recent years, foreign institutions may enter the Malaysian market through

[23]Finance companies specialize in hire-purchase and housing loans while competing with commercial banks for savings and fixed deposits. The Credit Guarantee Corporation provides guarantee cover for commercial banks on loans to small businesses. Discount houses are financial intermediaries that mobilize short-term funds from other financial institutions with excess liquid funds which want to temporarily allocate them as earning assets. (Yusof et al., 1996 p.p. 281-82.)

[24]A foreign bank is a banking institution which is not majority-owned (51 per cent) by Malaysian parties. Existing foreign banks in Malaysia are 100 per cent owned by their parent bank.

a representative office or through the acquisition of an existing institution.[25]

47. In view of the shortage of specialized staff with suitable experience, blanket approval is granted for banks to employ three expatriate specialists at any one time in each of four critical areas, namely trade finance, corporate finance, treasury products and information technology. In respect of foreign banks, these are in addition to two senior posts which can be filled by expatriates. It is noteworthy that domestic-owned banks are thus subject to more stringent regulations on hiring expatriates than foreign-owned institutions. For the employment of specialists or experts in non-critical areas, prior approval of the Central Bank is still required. Commercial banks must ensure that banking skills and technology associated with the employment of expatriates are transferred to local staff.[26]

Credit facilities

48. There is a limit of RM 5 million equivalent in aggregate on foreign currency borrowing by residents from non-residents and on-shore banks, whether Malaysia or foreign-controlled. Non-resident controlled companies (NRCCs) may borrow up to RM 10 million from domestic sources. The amount of credit granted by foreign-controlled banking institutions in Malaysia to NRCCs should not exceed 40 per cent of total credit facilities obtained by NRCCs from banking institutions. This requirement was introduced to counter anti-competitive collusion between NRCCs and foreign-owned banks which would exclude Malaysian-owned banks from providing credit to NRCCs. This rule is, however, implemented flexibly to ensure that NRCCs have ready access to banking facilities at competitive prices to meet their financial requirements. Malaysia is committed to increasing the percentage to 50 per cent of total credit facilities obtained by NRCCs in 2000. NRCCs account for 3.4 per cent of all bank loans suggesting that the market share of the foreign-owned banks incorporated in Malaysia is not significantly affected. Effective from 1 July 1996, all commercial banks are allowed to open foreign currency accounts for qualified residents. Prior to that date, only tier-1 commercial banks, whether Malaysian- or foreign-controlled commercial banks were allowed to provide such service.

Differences between foreign-owned and Malaysian-owned banks

49. At the end of 1996, foreign-owned commercial banks had a higher loan-deposit ratio than domestic-owned banks (0.977 compared to 0.870). The risk-weighted capital ratio of foreign-owned commercial banks was 10.7 per cent compared to 11.2 per cent for Malaysian-owned banks, both ratios were thus well above the Basel requirement of 8 per cent. Foreign-owned commercial banks employed proportionally less staff per deposit or loan than domestically owned banks. The authorities believe that some of these differences can be explained by a requirement that banks which open additional branches in urban areas are also required to extend their services to rural areas.

WTO commitments[27]

50. Under its GATS Schedule, Malaysia is committed to allowing 14 wholly owned commercial banks to remain wholly owned by their existing shareholder. A further commitment to allow entry is limited to up to 30 per cent equity participation by foreign banks in Malaysian banks.[28] This

[25] The maximum permissible share holding in a licensed institution is 10 per cent for an individual (domestic or foreign) and 20 per cent for other entities. Aggregate foreign share holding in a licensed institution is 30 per cent.

[26] Bank Negara Malaysia (1996b).

[27] WTO document GATS/SC/52/Suppl.1, 28 July 1995.

[28] Furthermore, there is no commitment to allow single or related non-Malaysian persons to hold more than 20 per cent of the equity of a Malaysian bank. The commitment allows only non-Malaysian banks to hold such equity in Malaysian banks.

commitment is subject to the following limitations. A foreign bank wishing to acquire more than 5 per cent of a Malaysian bank is required to contribute to the financial and economic development of Malaysia, and the country of origin must have significant trade and investment interest in Malaysia. In addition, the country of origin should not have significant direct representation in the Malaysian banking industry. An institution owned or controlled by a foreign government is not allowed to control a commercial or merchant bank in Malaysia. A commercial bank is not allowed to acquire a share in another commercial bank, but may do so in a merchant bank and *vice versa*. Persons are not allowed to acquire 5 per cent or more of the equity of a bank if they already have such a shareholding in another licensed financial institution. New services are subject to prudential criteria. Entry by foreign institutions through a representative office is allowed, but it may only undertake research, exchange of information and liaison services.

51. For banks, Malaysia is committed to allowing the entry of two senior managers for each institution with an aggregate foreign shareholding in excess of 50 per cent. Further commitments have been made to allow employment of foreign experts. Entry is limited to a maximum period of a five years. A commitment to allow the establishment of offshore banks is confined to Labuan.[29]

(c) Insurance

Overview

52. The Malaysian insurance sector experienced rapid growth during the period 1990-96. In line with rapidly rising GDP during that period, life insurance premiums more than doubled. Growth in general insurance premiums was slightly slower, with more than 20 per cent being reinsured abroad. The domestic retention rate of reinsurance premiums in Malaysia dropped gradually from over 77 per cent in 1990 to 73 per cent in 1995, but subsequently improved markedly to 78 per cent in 1996. The trend in insurance fund assets was broadly similar to that in premiums (Table IV.12).

Table IV.12
Overview of the Malaysian insurance sector, 1990-96

	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**
Number of registered companies							
Direct life insurance	4	3	5	5	5	5	5
Direct general insurance	39	39	40	41	40	40	40
Direct composite insurance	135	15	14	13	13	13	13
Reinsurance	1	1	1	2	3	4	7
Insurance brokers	46	44	36	36	37	34	37
Loss adjusters	43	45	43	42	42	43	43
Life insurance agents	37,373	45,716	54,370	68,531	80,615	93,881	92,018
General insurance agents	14,456	12,607	15,206	17,478	19,139	21,552	25,222
Total premium (RM million)[a]	3,170.1	3,854.7	4,578.9	5,326.7	6,501.1	7,818.5	9,317.1
Per cent of GNP	2.9	3.1	3.3	3.5	3.7	3.8	4.0
Life insurance (RM million)	1,643.1	2,030.3	2,408.6	2,957.4	3,653.7	4,525.5	5,098.5
General insurance (RM million)	1,979.1	2,401.1	2,896.0	3,235.2	3,940.7	4,512.3	5,378.0
General reinsurance placed outside Malaysia	452.1	576.7	725.7	865.9	1,093.4	1,219.3	1,159.4
Retention rate of reinsurance (per cent)	77.2	76.0	74.9	73.2	72.3	73.0	78.4
Insurance funds assets (RM million)	9,498.1	11,325.1	13,658	17,025.3	20,905.1	24,831.4	30,048.9
Life insurance assets (RM million)	7,097.2	8,323.3	9,793.8	12,118.7	14,862.2	17,358.1	20,467.2

[29] Offshore banks in Labuan are permitted to accept foreign currency deposits only.

General insurance assets (RM million)	2,400.9	3,001.8	3,864.2	4,986.6	6,042.9	7,473.3	9,581.7

a Net of reinsurance outside Malaysia.

Source: Bank Negara Malaysia (1995 and 1996), 32nd and 33rd Annual Reports of the Director General of Insurance, 1995 and 1996, Kuala Lumpur; and data provided by the Malaysian authorities.

53. As of 31 December 1995, 65 insurance companies operated in Malaysia, of which 13 were incorporated abroad, including six foreign insurers. The latter, which accounted for 55 per cent of all total life premiums, are significantly larger than Malaysian-incorporated companies.[30] The insurance industry employed 19,480 people in 1996 (excluding insurance agents): 8,368 at managerial/supervisory level, 9,843 at clerical level and 1,269 at non-clerical level. Forty-eight non-Malaysians were employed at the managerial/supervisory level, but none at other levels.

54. The insurance industry is regulated by the Insurance Act 1996, administered by the Bank Negara Malaysia. Bank Negara places emphasis on the restructuring of the insurance industry to promote effective Malaysian participation. Between 1975 and 1996, a total of 44 foreign-incorporated insurers had restructured their operations in Malaysia into 34 Malaysian-incorporated insurers in which Malaysian participation is gradually increasing (Table IV.13).[31] Foreign participation in insurance brokers and loss adjusters is lower than that in insurance companies.

Table IV.13
Distribution of paid-up capital of Malaysian-incorporated insurers, 1992-96
(Per cent of total unless otherwise indicated)

	1992	1993	1994	1995	1996
Total paid-up capital of Malaysian incorporated insurers (RM million)	884.7	1,153.2	1,229.1	1,450.3	1,742.9
Held by Malaysians	66.3	66.2	67.1	69.0	67.7
Bumiputra	36.9	37.9	38.5	36.8	37.1
Non-Bumiputra	29.4	28.3	28.6	32.2	30.6
Held by non-Malaysians	33.7	33.8	32.9	31.0	32.3

Source: Bank Negara Malaysia (1996), 33rd Annual Report of the Director General of Insurance 1995, Kuala Lumpur; and data provided by the Malaysian authorities.

55. Except for six foreign-incorporated professional reinsurers, which are not subject to the requirement of local incorporation, the remaining seven foreign insurers are required to incorporate locally by 30 June 1998. The Government has committed in its WTO GATS Schedule to allow these branches of foreign insurance companies to retain up to 49 per cent foreign-held equity if they restructure ownership by that date. Companies which restructure their ownership after that date are subject to a maximum foreign ownership share of 30 per cent. No new insurance companies are being licensed except for reinsurers. Foreign equity in locally incorporated insurance companies is normally limited to a minority stake (usually 30 per cent), although the Central Bank sometimes grants exceptions.

56. In addition to incentives to promote Malaysian ownership, tax incentives are available to the insurance sector.[32] Some of these incentives are conditional upon local ownership of the companies. For example, sums received by way of annuities granted under annuity contracts issued by Malaysian

[30] Bank Negara Malaysia (1996c).

[31] Bank Negara Malaysia (1996c).

[32] "Tax reductions and exemptions were also provided to encourage the development of the insurance industry which has the potential to contribute to growth and mobilise long-term savings to support the nation's industrialisation drive". (Bank Negara Malaysia, 1996b.)

insurers, which were defined in the 1996 budget as life insurers whose ownership or membership are held in majority by Malaysian citizens.[33]

Reinsurance

57. The relatively small size of Malaysian-incorporated insurance companies has led to an increasing reliance on reinsurance. In 1996, 21.6 per cent of written premiums in the general insurance sector were placed with reinsurance companies outside Malaysia. By comparison more than half of marine, aviation and transit reinsurance premiums were placed outside Malaysia, which was substantially higher than corresponding reinsurance premiums for fire and motor vehicles (Table IV.14). The authorities continue efforts to "optimise" national retention.[34] In April 1997, the first life reinsurance company was licensed to provide reinsurance in Malaysia. The company is a joint venture between members of the Life Insurance Association of Malaysia and a foreign reinsurer.

Table IV.14
Malaysian reinsurance premiums, 1990-96
(Per cent unless stated otherwise)

	1990	1991	1992	1993	1994	1995	1996
Marine, aviation and transit (RM million)	179.5	218.5	230.5	308.8	382.5	400.2	412.0
Placed in Malaysia	51.6	37.3	37.3	34.4	33.5	35.8	41.7
Placed outside Malaysia)	48.4	62.7	62.7	65.6	66.5	64.2	58.3
Fire (RM million)	405.4	461.4	590.6	684.4	851.8	940.8	1,002.6
Placed in Malaysia	53.1	53.3	54.0	55.9	53.6	55.1	59.9
Placed outside Malaysia	46.9	46.7	46.0	44.1	46.4	44.9	40.1
Motor (RM million)	156.3	210.7	324.2	331.1	375.7	461.0	498.7
Placed in Malaysia	80.8	78.0	68.4	69.6	72.6	74.3	82.0
Placed outside Malaysia	19.2	22.0	31.6	30.4	27.4	25.7	18.0
Miscellaneous (RM million)	313.4	377.3	451.0	493.3	636.2	785.1	864.8
Placed in Malaysia	53.4	52.8	54.1	47.1	46.4	45.9	50.5
Placed outside Malaysia	46.6	47.2	45.9	52.9	53.6	54.1	49.5

Source: Bank Negara Malaysia (1996), 33rd Annual Report of the Director General of Insurance 1995, Kuala Lumpur; and data provided by the Malaysian authorities.

[33]Bank Negara Malaysia (1996c).

[34]Bank Negara Malaysia (1996c).

WTO commitments[35]

58. Malaysia is committed to allowing a maximum of 30 per cent aggregate foreign shareholdings in existing locally incorporated insurance companies.[36] No commitment has been made to grant new licences. However, as mentioned above, a commitment has been made to allow an aggregate foreign shareholding of 49 per cent in existing branches of foreign insurance companies (and partly foreign-owned insurance companies which are locally incorporated) which incorporate locally and restructure their shareholding so that foreign shareholding shall not exceed 49 per cent by 30 June 1998. Subsequent disposal of the 49 per cent or any part thereof after 30 June 1998 shall be made to a Malaysian party and aggregate foreign shareholding shall not exceed 30 per cent. Further, Malaysia has committed itself to issuing seven new licences for non-life reinsurance within ten years ending 30 June 2005.[37] Entry as an offshore reinsurance company is confined to Labuan.

(d) Securities trading

[35]WTO document GATS/SC/52/Suppl.1, 28 July 1995.

[36]Acquisition by a foreign insurance company of an aggregate shareholding of more than 5 per cent in a locally incorporated Malaysian insurance company is subject to conditions regarding the ability to contribute to Malaysia's development and the existing level of representation of the country of origin of the foreign insurance company. There are also restrictions on the acquisition of interests by insurance companies or persons that already hold interests in Malaysia.

[37]For the seven new licences, entry will be through branches or locally incorporated joint ventures. In issuing these licences, priority will be given to: the foreign reinsurers or joint ventures of the top 100 reinsurers who meet certain criteria; those who are intending to base their regional headquarters in Kuala Lumpur and have plans to operate regionally through joint ventures; and those who comply with the objectives of, *inter alia*, optimum retention of local risks. Aggregate foreign shareholding in the joint ventures will not exceed 49 per cent and priority will be given to joint ventures with local partners which have certain characteristics of size and strength.

59. The Kuala Lumpur Stock Exchange (KLSE), the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE) and the Malaysian Monetary Exchange (MME) are Malaysia's stock and derivatives exchanges. At the end of March 1997, market capitalization of the Kuala Lumpur Stock Exchange was RM 793 billion. Futures contracts of the Kuala Lumpur Composite Index were launched when trading began on KLOFFE on 15 December 1995. Three-month Kuala Lumpur inter-bank offered-rate (KLIBOR) futures began trading on 28 May 1996. Trading volume on the Kuala Lumpur Commodities Exchange (KLCE) was, in 1996, confined to the trading of crude palm oil (CPO) futures.[38]

60. The Malaysian Securities Commission (SC) is the main regulatory authority covering activities on all stock exchanges.[39] The Commission is responsible for the enforcement of the Securities Commission Act 1993, the Futures Industry Act 1993, and the Securities Industry (Central Depository) Act 1991 and, together with the Registrar of Companies, the Securities Industry Act 1983 (Table AII.1).[40] In addition, two other agencies are involved: the KLSE (a self-regulating private sector organization), and the Foreign Investment Committee.

Licensing of stockbrokers

61. Trading in securities is carried out by member companies incorporated in Malaysia. However, a "member company" cannot be a "member of the KLSE"; members of the KLSE can be either natural persons or corporations who are shareholders of a member company. A natural person must, *inter alia,* be a Malaysian citizen of at least 21 years of age with relevant qualifications and work experience. A corporate member is required to acquire at least 51 per cent of a stockbroking company and have minimum shareholder funds of RM 100 million. If the corporation is a financial institution, it must obtain the appraisal of the Bank Negara Malaysia to apply for membership. Foreign companies can usually own no more than 30 per cent of the equity in an existing local stockbroking company, but Malaysia has made a commitment in its WTO GATS Schedule to allow foreign stockbroking companies up to 49 per cent equity participation by the year 2000. There are at present 60 licensed stockbroking companies in Malaysia, of which ten have foreign participation.

[38]Contracts declined from 525,889 lots in 1995 to 498,118 in 1996 (equivalent to 12.5 million tonnes of crude palm oil in 1996). Reflecting the decline in trading volume, the average daily turnover was 2,004 lots or 50,098 tonnes in 1996 as compared to 2,160 or 53,996 tonnes in 1995. The decline in turnover was due to less volatile movements in crude palm oil prices during the year (section (2)(iii)(b)). (Bank Negara Malaysia, 1997b).

[39]The Securities Commission Act of 1993 established the Securities Commission consisting of an Executive Chairman, who is entrusted with day-to-day administration of the Commission, four members representing the Government, and four other members. The functions of the Securities Commission are to: advise the Minister of Finance on all matters relating to the securities and futures contracts industries; regulate the issuance of securities; regulate the designation of futures contracts; regulate the take-overs and mergers of companies; regulate all matters relating to unit trust schemes; be responsible for supervising and monitoring the activities of any exchange, clearing house and central depository; take all reasonable measures to safeguard the interests of persons dealing in securities or trading in futures contracts; promote and encourage proper conduct among members of the exchanges and all registered persons; suppress illegal, dishonourable and improper practices in dealing in securities and trading in futures contracts and in the provision of investment advice or other services relating to securities and futures contracts; consider and suggest reforms of the law relating to securities or futures contracts including changes to the constitution, rules and regulations of any exchange and its clearing house; encourage the development of the securities and futures markets in Malaysia; and perform any functions conferred by or under any other act. (Ministry of Finance, 1995).

[40]The Securities Commission has issued, *inter alia*, Policies and Guidelines for Issue/Offer of Securities, Guidelines on Asset Valuation for submission to the Securities Commission, Guidelines on Unit Trust Funds (revised on 26 May 1997), Guidelines on Property Trust Funds and the Malaysian Code on Take-overs and Mergers 1987. The Malaysian Code on Take-overs and Mergers 1987 has the force of law by reason of the existing provisions of the Securities Commission Act 1993.

62. There are three categories of membership of the Malaysian Monetary Exchange (MME); Broker Membership, Non-broker Membership and Local Membership. Broker and Non-broker Membership is open to companies incorporated in Malaysia which fulfil the published criteria. A foreign stockbroking company applying for membership can hold a maximum of 49 per cent equity in an existing Malaysian stockbroking company and must comply with all requirements as applied to local companies. MME is prepared to assist a non-resident applicant in the application for a work permit upon formal admission as a local member if the applicant undertakes to work a minimum period of two years as a local, gives a full commitment for regular attendance on the MME trading floor, and trades a quarterly average of 300 lots per month.

63. Membership of the KLOFFE consist of trading members, local members and other classes of members as created by the Exchange. Trading members must, *inter alia*, be incorporated under the Companies Act 1965 and fulfil certain financial requirements. A foreign stockbroking company applying for membership can only hold a maximum of 49 per cent equity in an existing local stockbroking firm. Local members are individuals who have passed the relevant examination or been granted an exemption from this requirement. KLOFFE is prepared to assist non-residents who wish to become members of the Exchange in obtaining work permits upon formal admission to the Exchange. Upon nomination by trading members, the Exchange also offers trading permits to individuals.

64. There are three categories of membership of the Kuala Lumpur Commodity Exchange (KLCE); members (brokers and non-brokers), local membership and trade affiliates. Members are Malaysian companies of good business integrity who fulfil the financial requirements. The maximum number of members is 130 and all are fully subscribed[41]; membership may be obtained through a secondary market, which is administered by the KLCE. Local membership is open to residents of Malaysia who pass a proficiency test on trading, register as "sole proprietor" and are guaranteed/qualified by a clearing member and satisfy listed financial requirements. The qualifying clearing member must be a registered dealer under the Futures Industries Act 1993. A local may trade on the floor of the Exchange on his own account or that of his clearing member. Trade affiliates are open to any Malaysian or overseas company fulfilling the financial requirements. Trade affiliates have no floor access, but enjoy lower brokerage fees. A trade affiliate can trade on its own account or on the accounts of overseas clients through a member.

65. Representative offices of foreign brokerage firms are permitted to undertake research, information and liaison services only, and must be incorporated under the Companies Act 1965 and obtain an investment adviser's licence. Representative offices are not permitted to publish or circulate research work in Malaysia.

66. Foreign fund management companies (FFMCs) with a foreign equity share of 100 per cent do not have access to local funds. FFMCs with a minimum local equity participation of 30 per cent have access to local institutional funds provided they manage, or undertake to manage, funds from outside Malaysia up to the amount of US$100 million and the amount of each fund sourced from within Malaysia must be at least RM 10 million. In addition, the first ten joint venture FFMCs will be allowed to manage local unit trusts, subject to certain criteria and conditions. Both fully and partially foreign-owned FFMCs are eligible for a tax exemption in respect of income derived from the management of funds held outside Malaysia. All FFMCs are required to be licensed as fund managers under the Securities Act 1983.[42]

[41]Corporate members may have more than one membership of the KLCE.

[42]Companies incorporated under the Offshore Companies Act 1990 may offer fund management services to residents of Malaysia. Companies intending to offer fund management services to residents must comply with onshore requirements.

Firms listed on the stock exchange

67. Proposals for the issue of securities and/or listing on a stock exchange must be submitted to the Securities Commission.[43] Foreign-based companies seeking a listing on the Kuala Lumpur Stock Exchange must have a substantial Malaysian interest.[44] Malaysian public companies wishing to offer their securities abroad or list their securities on a securities exchange outside Malaysia are required to seek the approval of the Securities Commission.[45]

68. In 1990, the central bank encouraged the establishment of the Rating Agency of Malaysia (RAM) to provide credit ratings of firms issuing bonds and commercial paper and to provide potential investors with the necessary financial information on which to base investment decisions. Since its inception in 1990, RAM has issued 326 corporate ratings of which 58 during the first eight months of 1996.[46] In line with Malaysia's aspiration of becoming a regional capital market, a second rating agency, the Malaysian Rating Corporation Berhad (MARC), was launched by the Minister of Finance on 5 September 1996.[47]

Quantitative restrictions applied to firms investing on the Malaysian stock exchanges

69. A number of statutes place investment restrictions on funds established by an Act of Parliament.[48] For example, the Employees Provident Fund (EPF) is required to have invested 70 per cent of its total funds in Malaysian Government Securities (MGSs) and to invest 50 per cent of its new funds in these securities. The EPF can invest up to 15 per cent of total funds on the KLSE. Insurance companies are required to invest a minimum of 20 per cent of their fund in low risk assets classified as "authorized assets" (i.e. securities, bills or certificates issued by the Federal Government or Bank Negara Malaysia and Cajama Tier one Notes and Bonds) and may not invest more than 25 per cent in corporate bonds, of which no more than 10 per cent is allowed for unsecured issuers.

WTO Commitments

70. Promotion in Malaysia of Malaysian stocks requires approval and provision of advisory services, which in turn requires commercial presence. Commercial presence for security brokerage is limited to recognized foreign stockbroking companies through equity participation in stockbroking companies, or establishment of a locally incorporated joint venture with a Malaysian stockbroking company. At present, aggregate foreign shareholding can not exceed 30 per cent but, subject to conditions, it may be increased to 49 per cent with effect of 1 July 2000. Entry of recognized foreign stockbroking companies is also permitted through a representative office. Malaysia has reserved the right to limit the issuance of new licences in accordance with "economic needs" tests.

71. Malaysia notes in its GATS Schedule that trades on any Malaysian commodity futures

---

[43]Section 32 of the Securities Commission Act 1993.

[44]A foreign-based company is considered to have "substantial Malaysian interests" if: more than 50 per cent of the issued and paid-up capital of the company is beneficially held by Malaysian shareholders resident in Malaysia having management control; or the single largest shareholder of the company is Malaysian and resident in Malaysia, having management control and beneficially holding not less than 33 per cent of the issued and paid-up capital of the company at the time of application to offer securities under these guidelines.

[45]Securities Commission Act 1993, Section 32.

[46]Ministry of Finance (1996).

[47]Ministry of Finance (1996).

[48]Examples are the Employees Provident Fund Act 1991, the Employees Social Security Act 1969, the Insurance Act 1996, the Armed Forces Fund Act 1972, and the Pension Trust Fund Act 1991.

exchange must be conducted through companies incorporated in Malaysia which are members of the exchange. Foreign participation in any locally incorporated joint venture company is limited to 30 per cent, or any higher percentage as determined by the relevant authorities. Representative offices are permitted to undertake research, information and liaison services only. The presence of natural persons may be confined to one management post per establishment.