

The Liberalization of the Malaysian Financial Services Industry

1.0 Introduction

The financial services sector, an integral component of the economy, is expected to have a greater role in facilitating and catalyzing economic growth to help fulfill Malaysia's aspiration to be a developed nation by 2020.

The liberalization of the financial services sector is aimed at ensuring that maximum benefits accrue to Malaysia. Through the enhancement of international linkages, the financial sector would be geared towards a new level of performance to provide world-class, high value-added financial products and services at competitive cost. From such change, it is expected that the growth of new economic sectors will be accelerated.

2.0 Evolution of the Malaysian Financial Sector

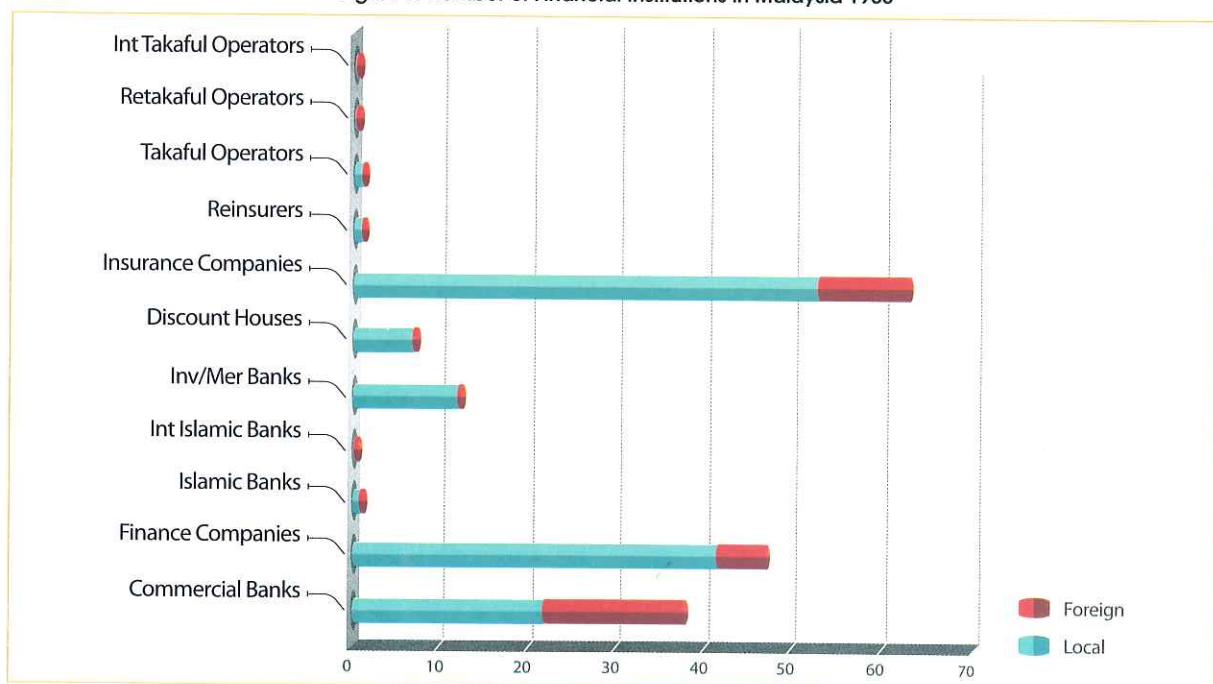
According to the Financial Sector Blueprint 2011-2020 (Bank Negara Malaysia, 2012), the Malaysian financial sector had a fragmented banking system during the 1997 Pre-Asian Financial Crisis, with 77 domestic banking institutions, a poorly developed bond market, over-reliance by corporations on the

banking system for financing, rigid and prescriptive rules-based regulations and supervision, limited prominence of Islamic finance, rigid price mechanisms, and gaps in access to financing.

In contrast, 2010 saw many key achievements such as the consolidation and rationalisation of the banking industry, diversification of the financial sector with a deep and liquid debt securities market and the strengthening of corporate governance and risk management practices. There were also strategic alliances with foreign institutions, efficient delivery channels for financial products and services, a robust surveillance, regulatory and supervisory framework, and a comprehensive consumer protection framework. Furthermore, with Malaysia's emergence as an international Islamic financial hub, there was enhanced access to financing especially for SMEs and micro-enterprises, greater market orientation, and strengthening of financial and economic linkages.

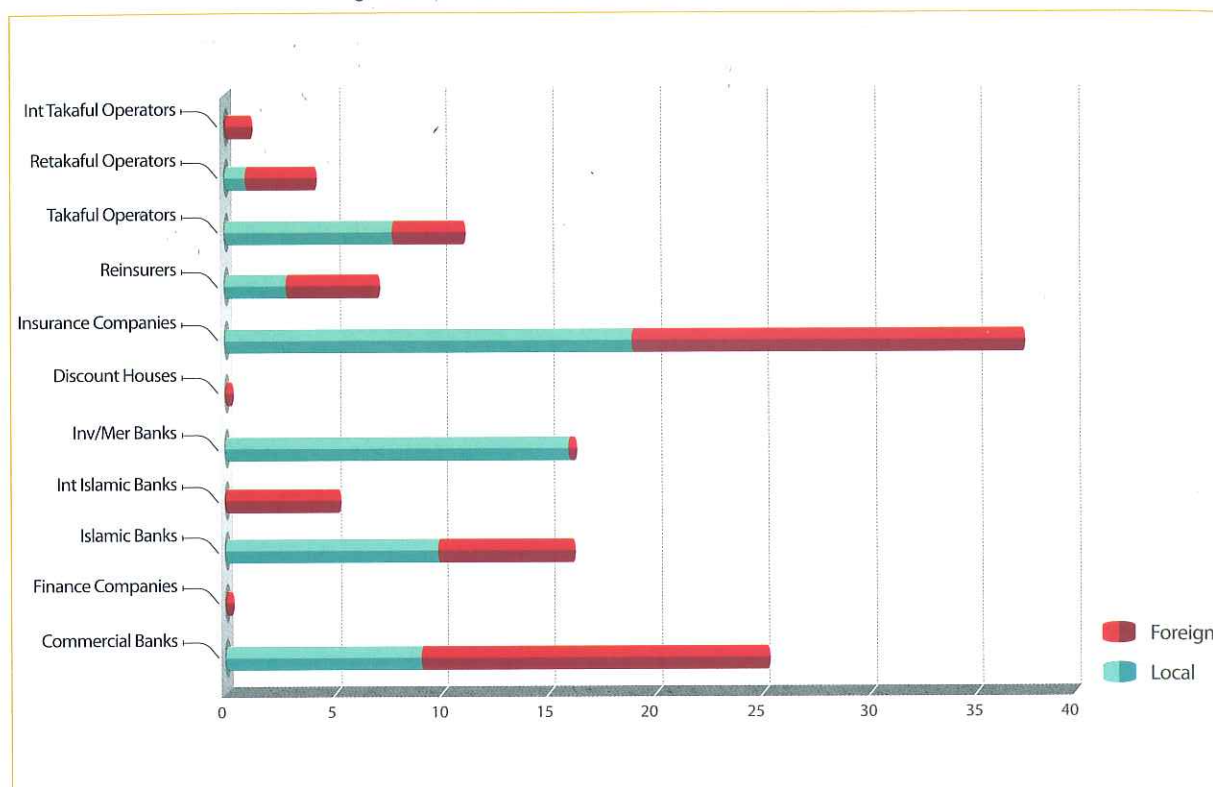
Figures 1 and 2 show the structural evolution of the Malaysian financial system, becoming less fragmented between 1986 and 2011 through consolidation and rationalization (BNM, 2012).

Figure 1: Number of Financial Institutions in Malaysia 1986



Source: Bank Negara Malaysia (BNM)

Figure 2: Number of Financial Institutions in Malaysia 2011



Source: BNM

From 77 domestic banking institutions and 55 domestic insurance companies in 1980s, the number was reduced to 34 domestic banking institutions and 37 domestic insurance companies in 2011. Institutional development and capacity building initiatives generated highly competitive domestic financial intermediaries.

3.0 Liberalizing Measures in the Financial Sector

Based on a press statement on the liberalisation of the financial sector by the Prime Minister, Dato' Sri Mohd Najib on 27 April 2009, the liberalization measures were aimed in enhancing Malaysia's linkages with international economies and promoting greater economic regional integration. This would provide greater access to consumers to a wider range of world class financial products and services, further strengthening Malaysia's competitive position in Islamic finance so as to become an international Islamic financial hub, and promoting Malaysia as a leading global shared services and outsourcing centre.

The thrust of the liberalisation package for the financial sector encompasses the issuance of new licences to strong and world-class players. In this regard, two new Islamic banking and five commercial banking licences have been approved. Flexibility is accorded to an increase

in the foreign equity limits, from 49% to 70% of investment banks, Islamic banks, insurance companies and Takaful operators. With regard to commercial banks, the foreign equity is maintained at 30%. Enhancing operational flexibilities to foreign institutions that operate in Malaysia will improve the outreach of financial products and services; they can increase their branches so as to achieve greater financial inclusion and insurance penetration in the country. Locally incorporated foreign commercial banks are allowed to establish 4 new full-fledged branches and 10 microfinance branches, that took effect from 2010 and 2009 respectively.

According to the press release of BNM on 30 January 2012, BNM announced more liberalization measures effective from 31 January 2012, in line with the Financial Sector Blueprint. The objectives were aimed at (a) spurring the domestic foreign exchange market through greater product innovation; (b) enabling licensed onshore banks to trade foreign currency against another foreign currency with a resident; (c) further deepening the domestic interest rate derivatives market, (d) enabling a licensed onshore bank to offer ringgit-denominated interest rate derivatives to a non-bank non-resident. To enhance the asset liability management of residents, flexibility is permitted for a resident to convert his existing ringgit or foreign currency debt obligation into a debt obligation

of another foreign currency. There is, however, no trading of foreign currency against the Malaysian ringgit.

4.0 Implications

With the liberalization of the financial sector, foreign competitors will be able to compete on par with local financial institutions. However, two questions remain: (1) Is this a good move that will benefit all parties in the long run? (2) Are Malaysian financial institutions prepared to compete in an open market?

It is believed that such a move will benefit all parties in the long run. Competition in an open market will improve efficiency and lower costs for all parties. For example, commercial banks in Malaysia saw improvements in financial performance on capitalization (RWCR), Asset Quality (net NPL ratio) and profitability (ROA and ROE) from 2000 and 2010 as indicated in the Financial Sector Blueprint by BNM (see Table 1). These are indications that Malaysian financial institutions are capable of competing in an open market.

Table 1: Performance Indicators of Commercial Banks

	Domestic		Foreign	
	2000	2010	2000	2010
Capitalization RWCR (%)	11.7	14.2	14.0	14.6
Asset Quality Net NPL Ratio (%)	9.2	2.6	5.7	1.2
Profitability ROA (%)	1.1	1.6	2.1	1.6
ROE (%)	13.3	16.7	26.4	19.6

Source: BNM

In their paper entitled "Does Financial Openness Lead to Deeper Domestic Financial Markets?" César Calderón and Megumi Kubota (2009) conclude that financial openness leads to expansion in private credit, bank assets, stock market development, as well as efficiency gains in the banking system.

According to the Centre for Research on Multinational Corporations (SOMO) financial sector report entitled "Critical Issues in the Financial Sector", M. VanderStichele, contends that domestic residents can diversify their investments in terms of assets issued by firms and financial institutions of other countries in addition to domestic ones. This could take place when financial markets open and foreign banks introduce new capital market products.

Stephen Woolcock of London School of Economics, in his paper entitled "Liberalisation of Financial Services", cited Wendy Dobson and Pierre Jacquet's study on "The Potential Gains from Liberalisation of Trade in Financial" to highlight the benefits for consumers i.e. households and investors who will enjoy cost savings as a result of more efficient banking and insurance services. In addition to the cost efficiency gains, Dobson and Jacquet also show quantitatively how consumers can benefit from an improvement in the quality of service.

5.0 Conclusion

The evolution of the Malaysian financial sector clearly shows the Malaysian financial system today has achieved the state of robustness and resilience. Its enhanced strength and stability enable it to perform its intermediation function, reinforcing its role as a key contributor of growth in the Malaysian economy. The liberalization measures, implemented in line with the Government's initiative to promote structural changes within the economy and diversification of sources of growth to drive economic expansion, would enhance competitiveness of the financial industry in the economy. This would further develop the domestic financial market.

Hence such liberalization initiatives should be viewed positively. Healthy competition and an open market will improve efficiency and lower the cost for all parties, including households and investors, in the long run. Furthermore, the improved performance indicators of commercial banks in Malaysia show that domestic financial institutions can compete in an open market. Analysts have highlighted the benefits of financial market liberalization, pointing out that it will benefit many parties in terms of expansion in private credit, diversification of investment in firm and bank assets, stock market development, efficiency of the banking system and insurance services, and cost efficiency gains from improved quality of service. Hence, the liberalization of financial services could be expected to benefit many parties.

References

- Bank Negara Malaysia (BNM). (2012). *Financial Sector Blueprint 2011-2020*. Retrieved from http://www.bnm.gov.my/index.php?ch=en_publication_catalogue&pg=en_publication_blueprint&ac=7&lang=en&eld=box1.
- BNM. (2012, January 30). *Press Release on Liberalization Measures of Domestic Financial Markets*. Retrieved from <http://www.bnm.gov.my/index.php?ch=8&pg=14&ac=2390>.
- Calderon, C. & Kubota, M. (2009). *Does Financial Openness Lead to Deeper Domestic Financial Markets?* Retrieved from <http://elibrary.worldbank.org/docserver/download/4973.pdf?expires=1355811698&id=id&accname=guest&checksum=98F401E4ECD4179D9CAE15768BDF69F6>.
- Prime Minister's Office. (2009, April 27). *Press Statement on Liberalization of the Financial Sector*. Retrieved from http://www.pmo.gov.my/?menu=news&page=1729&news_id=44&news_cat=4.
- Vander Stichele, M. (2005, April). *Critical Issues in the Financial Industry*. SOMO Financial Sector Report. Retrieved from http://somo.nl/publications-en/Publication_415.
- Woolcock, S. (1997). *Liberalisation of Financial Services*. London School of Economics. Retrieved from <http://www2.lse.ac.uk/internationalRelations/centresandunits/ITPU/docs/woolcockfinancialservices.pdf>.