

The 22nd Annual Dinner Of The Association Of Merchant Banks In Malaysia

Shangri-La Hotel, Kuala Lumpur 12 October 2001

I wish to thank the Association of Merchant Banks, for inviting me to their Annual Dinner. Normally, on auspicious occasions like this, we ought to be celebrating our success and achievements over the past year. Today, however, we gather here in a rather serious mood as we struggle against the many problems currently assailing our country. It does not help that as we try to adjust to the changes of globalisation there should be an economic downturn in the US aggravated by the horrendous attack on the US financial and military centres. The far-reaching effects of the terrorist attacks could not have been foreseen by the perpetrators. They go beyond the US and cause economic disruptions worldwide. A worldwide recession is entirely possible. But for us the concern is for our own economy and the need to insulate it as much as possible.

2. Over a month ago we celebrated the 44th anniversary of our independence. We reminded ourselves how hard it was for our forefathers to gain independence for the country. We hoisted and waved the 'Jalur Gemilang', buoyed by a renewed sense of patriotism and unity. We planted the flags everywhere - on buildings, motor vehicles, trees and homes. But all of these would become meaningless if we are not able to insulate ourselves and maintain economic independence despite a world which has become too interdependent.

3. Despite the vicious attacks by the currency manipulators we have been able to regain our financial independence and strength. We had fixed our exchange rate against the U.S. dollar and contrary to the dire predictions of all and sundry our economy and our currency have not collapsed. The exchange rate has been sustained and there is no black market in the Ringgit. Unlike many countries all transactions in Malaysia are done in Ringgit including payments for hotel bills by tourists. Attempts to force the Government to devalue the Ringgit has failed. The strong Ringgit in relation to the currencies of the region has not affected our trade. The fall in the volume of trade is not confined to Malaysia, but the balance of payment remains in our favour.

4. Government borrowings are still manageable and within limits. Thus it is possible for the Government to pump money into public works etc in order to mitigate the effect of a downturn due to declines in exports and Foreign Direct Investments. It would not have been possible to do this if the Government had wasted money in the past. Contrary to the

allegation of Government detractors, the management of Government finances is actually conservative and prudent. We believe that we can continue to be conservative and prudent, the so-called mega projects notwithstanding. After this assertion there will be many who would like to see us fall flat on our faces.

5. But of course sound Government finance cannot be achieved and maintained if the economy and in particular the banking system are not themselves sound. As a small country we have had to protect our banks from competition with the foreign banks. Except for those British banks which were established during the colonial period and which have continued to operate branches all over the country, foreign banks are allowed to operate from only one office in Kuala Lumpur. They are therefore unable to enjoy as much local business as they would. Even then some of those foreign banks are already more profitable than local banks.

6. But the days when we can protect local banks seem to be numbered. With WTO, globalisation, borderless world and regionalisation of markets, foreign banks are going to operate in Malaysia more freely and enjoy the same status as national banks. Whether local banks survive or not depends on their ability to compete and their size. We have forced the mergers of local banks so that now there are only 10. But still they are not big enough. I am afraid that they will never be big enough unless they allow themselves to be a part of the giant multinationals. National identity would then be foregone.

7. This unfortunately will remove whatever economic clout the Government has. These huge international banks are not likely to accept Government directives to give more loans to small businesses, support housing and property development, give priority to certain industries, help bumiputera achieve economic parity, reduce lending to certain sectors etc. Instead they are likely to follow the dictates and policies of the countries they regard as their home base. And such policies can be detrimental to the growth strategies of our own country. In other words we will lose our financial and economic independence and with that we will for all practical purposes be a colony once again.

8. The challenge for us, the challenge for the Malaysian banking system, is how to survive and prosper as relatively small banks. Firstly the Malaysian banks must learn to survive without depending on Government protection. Skills will have to be developed particularly in the field of personal service.

9. Big banks are notorious for being very impersonal, for looking only at the bottom line, for snatching away the

umbrella when it rains, for being interested only in big clients. They don't care for their clients especially if they are small. It is of course dangerous to be too friendly with clients. It may result in your lending imprudently. But being friendly can mean giving good financial advice, warning the clients on their ventures and even helping them with their feasibility studies. If you do this the clients will be loyal to you and when they grow big they will not desert you and transfer their business to big foreign banks.

10. Assuming that you are now upgrading your skills and developing a new philosophy, I would like to point out that under current economic conditions where growth will come from domestic sources, bank financing is crucial to lubricate the economy. Banks must, therefore, ensure that credit is appropriately channeled to stimulate consumption and investment. Given the ample liquidity and the relatively low interest rates, banks should not have difficulties in providing credit. Monetary policy will continue to provide a conducive environment for economic activity.

11. To achieve this, Bank Negara Malaysia has instituted a host of measures to improve and strengthen the capacity and capability of the local players. As I have mentioned, the merger programme of the banking institutions has been virtually completed with 52 out of 54 domestic institutions being consolidated into 10 banking groups. To instill greater synergy into their operations, these banking groups have been allowed to cross-sell financial products and services of their subsidiaries. Banking institutions should fully utilise the flexibility to conduct cross-selling and to market new products to customers.

12. To complement the merger programme, the minimum amount of capital funds unimpaired by losses was raised to RM2 billion for domestic banking groups and RM300 million for the locally incorporated foreign banks. With the enlarged capital base, the Malaysian banking sector is in a relatively better position to face future challenges and absorb further shocks.

13. The ability of banks to absorb losses is not unlimited. Therefore, certain other key elements need to be in place, such as the need to practise good corporate governance. Also there must be effective risk management. We have already witnessed banks that had failed owing to negligent management and excessive risk taking. As custodians of public funds, banks have a duty to develop an adequate regime of in-house surveillance and proper system of internal controls. If the Government seems unduly strict with banks it is because bank failures are very costly for the people and the Government.

14. As you are well aware, earlier this year, we had unveiled the Financial Sector Masterplan. The objective is to develop a more resilient, competitive and dynamic financial system with a core of strong and forward looking domestic financial institutions that are ready to face the challenges of liberalisation and globalisation. Banking institutions should strategise as to how they can achieve the objectives of the Financial Sector Masterplan. The Board of Directors and management must ensure that the necessary infrastructure comprising processes, systems and people, is in place.

15. As envisaged in the Financial Sector Masterplan, all domestic banking institutions, including the merchant banks, would from 2004 onwards have to compete with the foreign institutions already operating in Malaysia. By the year 2007, those foreign institutions who are not here yet will also be in the contest. The attempt to put off this eventuality may not succeed. So it is better to be prepared.

16. In the world of banking and finance, level playing field is not enough. Even if all are subjected to the same regulations, those which are big in terms of financial resources, technological sophistication, world wide branch networks, innovative products and the experience of operating in different environments will prevail over the small and the weak. Where money is concerned customer loyalty and patriotism is not going to count for much. But with skill and sympathetic service the locals can still hope to survive. Benchmarking yourself against the foreign banks from now on, you may be able to maintain your institutions and hold out.

17. Looking around for a competitive advantage, we see Islamic banking as an area in which we have developed certain expertise. Islamic banking is not likely to replace conventional interest-based banking but there are signs that Islamic banking is beginning to be generally accepted even by non-Muslims. Islamic bankers must continuously think up new and innovative products. The Government strongly backs Islamic Banking and in order to expand Islamic Banking Malaysia is bidding to be the permanent base for the proposed Islamic Financial Services Organisation (IFSO). The primary purpose of IFSO is to develop and disseminate uniform prudential, disclosure and regulatory standards to govern risks in Islamic financial products. The setting and harmonisation of such standards would not only promote a level playing field and foster industry development, but would also enhance the basis for more effective supervision of institutions offering such products and improve the prospects for better risk management. In essence, Islamic banking is being developed to be in tandem and operate on par with conventional banking.

18. For merchant banks, as outlined in the Financial Sector masterplan, the next important step is for you to forge mergers with the stockbroking companies and discount houses and evolve into full-fledged investment banks whose businesses can be enhanced through synergies between investment banking and securities activities. The merchant banks should thus gear themselves to complete the transformation process into investment banks successfully so that they will be able to play a more meaningful role in the development of our economy.

19. With the enormous challenges ahead and urgent tasks at hand, we must start bridging the huge gaps between our country and the developed nations. Needless to say, the stakes are very high. If we are prepared to work hard, success has its just rewards. Thank you very much for your attention.