

The Luncheon Hosted By Luxembourg Business Community

Luxembourg, 12 June 2002

I am very pleased to be here today with the distinguished members of the Luxembourg business community. I wish to thank the Chamber of Commerce and Industry Luxembourg, Luxembourg Bankers' Association and Federation of Industries of Luxembourg for hosting this luncheon for the members of my delegation and I.

2. During the pre-East Asian economic crisis years, Malaysia achieved a strong level of economic growth averaging more than eight per cent per annum. Although the Malaysian economy experienced a contraction of 7.4 per cent in 1998 due to the impact of the crisis, the economy recovered quickly to register positive growth rates of 6.1 per cent in 1999 and 8.3 per cent in 2000. In 2001 despite the effects of the global economic slowdown, Malaysia registered a real GDP growth of 0.4 per cent. The Malaysian economy is expected to register a higher growth rate of 3.5 per cent in 2002 and grow in tandem with global economic conditions in the years beyond.

3. Inflow of foreign direct investments into the manufacturing and related services sector has been instrumental in the transformation of Malaysia into a modern industrialising economy. Malaysia is a politically and economically stable country with strong economic fundamentals. The Malaysian government remains committed and has put into place the necessary infrastructure, incentives and administrative support to provide a conducive and cost-competitive environment for investors. The continued attraction of Malaysia is proved by the substantial level of foreign investments received even during the East Asian economic crisis years. Foreign investors have continued to look upon Malaysia positively as a profitable investment and business location in the East Asian region.

4. It has been generally perceived that the competitive process through deregulation, liberalisation and dismantling of barriers and controls are necessary to achieve a strengthened and efficient banking system. Malaysia recognises that it cannot escape the forces of globalisation and liberalisation. It will continue to suggest better ways for globalising so as to benefit more people. But we are nevertheless preparing our economy and its financial system in order to cope effectively with the challenges that we anticipate.

5. The liberalisation of the financial sector is not a new phenomenon to the Malaysian economy. We are used to having

numerous foreign banks operating profitably in our country. There may be some restrictions but these have not affected their performance. Malaysia's liberalisation process includes acceding to the World Trade Organisation (WTO) financial services undertaking, where Malaysia undertook substantial commitments to further liberalise the financial sector under the General Agreement on Trade in Services.

6. Contrary to popular belief, however, Malaysia has always been committed to the progressive liberalisation of the financial sector. For Malaysia, liberalisation is seen as a means to an end and is, therefore, appropriately undertaken for the benefit and in support of the development of the national economy as a whole. This can be seen even from the early days of the establishment of commercial banks in Malaysia, when branches of foreign-owned banks were set up in the major commercial centres of Malaysia like Kuala Lumpur, Penang and Melaka for the financing of external trade, specifically to facilitate the growing trade Malaysia had with Europe and the rest of the Far East. In fact, at that stage, the Malaysian banking sector was characterised by the dominance of the foreign banks. The first bank operating in Malaysia is a foreign bank branch.

7. Similarly, in the last round of WTO financial services negotiations, substantial liberalisation was undertaken in the areas that benefit the national economy and assist in the development of the domestic financial sector. Among these is the increase in the foreign equity limit in the insurance companies from 49 per cent to 51 per cent; the issuance of six new licences for life reinsurance and seven new licences for general reinsurance; permitting 100 per cent foreign equity in fund management companies; increasing the foreign equity limit from 30 per cent to 49 per cent in stockbroking and financial leasing companies; and liberalising the offshore investment banking, offshore insurance and offshore financial leasing sectors.

8. As a result of Malaysia's early liberalisation measures, a fact often overlooked is that foreign players already assume a very significant role in the domestic economy. At present, of the 25 commercial banks (including two Islamic banks), 13 are wholly foreign-owned. Foreign interest account for approximately 26 per cent of total assets, 25 per cent of total deposits and 25 per cent of total loans of the banking system. Meanwhile, foreign presence in the insurance industry is much more significant with the foreign market share of life insurance premiums amounting to 64 per cent and 39 per cent for general insurance premiums.

9. The Malaysian experience shows that the undertaking of liberalisation should never be solely about allowing greater entry of foreign players into the market. It should rightly be seen more as a means of strengthening and developing a country's financial system, as well as promoting the country's economic growth potential. This is especially so for Malaysia given the role of the financial sector as an enabler of growth, the crucial element which facilitates development and economic transformation of the country. The financial sector, therefore, is strategic and, more than ever, would need to remain effective and responsive in the face of an increasingly globalised domestic economy. Thus, liberalisation should always be considered in the context of developing the financial sector in support of the domestic economy.

10. Valid risks and concerns when liberalising the financial sector also cannot be ignored. Malaysia faces a continuous challenge in adopting strategies that can help to maximise the benefits of liberalisation, while at the same time minimising the risks associated with the changes. Of paramount importance is balancing liberalisation with developmental considerations and the preservation of not just financial stability but socio-economic stability too. Hence, more than anything else, Malaysia's aim is to develop an effective and dynamic financial system that assumes a crucial role in meeting the socio-economic agenda of the country. Rushing to liberalise without giving due consideration to this need would only risk financial and socio-economic instability in the medium term. As already observed in a number of instances, financial instability as a result of inappropriately sequenced financial liberalisation could spread into devastating socio-economic instability.

11. Recognising such risks of a more liberalised environment, Malaysia has constantly been taking steps to put in place the necessary institutional framework and establishing the required preconditions to ensure the smoothness of liberalisation measures. Indeed, for the past several decades, Malaysia has concentrated on establishing stable macroeconomic conditions, strong prudential and supervisory framework and the institutional framework to ensure the proper functioning of markets.

12. At the same time, Malaysia has always been pragmatic and policies are continually reviewed and adjusted so as to serve the best interest of the country. Malaysia has often undertaken unilateral liberalisation, in addition to liberalisation as negotiated under WTO standards. This unilateral liberalisation reflects Malaysia's strategy of liberalisation at a pace that is in accord with the capacity of the financial system to absorb changes without

destabilising implications. A gradual and progressive approach to liberalisation has been adopted, with account taken of the needs of the economy. Liberalisation is also viewed as part of the overall reforms in the financial sector that would bring about greater competitiveness and supportive of the transformation of the economy into one that is competitive and resilient.

13. Looking ahead, Malaysia will continue to be committed to further liberalisation of the financial sector. The pace of liberalisation would be in line with the financial sector development path charted in the Financial Sector Master Plan (FSMP). The FSMP is Malaysia's blueprint for the development of an effective, competitive, resilient and dynamic financial sector in the next 10 years. Presently, the focus is on strengthening the capacity and the capability of the domestically-owned financial institutions. This is aimed at enhancing their ability to compete with the foreign financial institutions on a more equal footing. Indeed, as part of the measures to further develop the financial sector, the FSMP has identified a number of liberalisation measures that will be undertaken over the next 10-year period.

14. Notwithstanding the FSMP, the burden of ensuring the success of liberalisation should not be left to Malaysia alone. Foreign interests that have been given access to Malaysia could assume more active role in developing the Malaysian financial sector, particularly through the offering of technical assistance in areas where local expertise is lacking. In this connection, foreign players could assist through the transfer of technology, knowledge and skills to enhance the capacity and capability of the domestic financial institutions. While Malaysia has found it necessary to limit foreign agency participation, we have always encouraged greater role of foreign players in the domestic financial sector. Such role will not only strengthen the Malaysian financial sector but also create more opportunities for businesses for foreign entities in Malaysia.

15. Malaysia has initiated efforts since the mid 80s to strengthen the institutional framework to enhance regulatory and supervisory capacity and this has enabled the banking system to be more resilient when facing crisis. This included the development of a more comprehensive legislative framework, risk-based management and supervisory practices, enhanced corporate governance and disclosure as well as measures which were implemented to enhance the competitiveness and efficiency of the banking system. Prudential reforms and regulations had been continually reviewed and enhanced, while efforts to deregulate the banking sector to promote competitions and

enhance efficiency of the industry were also gradually implemented.

16. The financial crisis of 1997 had necessitated quick action to be undertaken to deal with potential banking sector problems, to contain its severity and ensure market confidence, to ensure that the banking system continues to function and assume its role in the economy and does not suffer a breakdown that could jeopardise the prospects for economic recovery.

17. The institutional arrangement strategy adopted involved the setting up of an asset management corporation Danaharta, a special purpose recapitalisation vehicle Danamodal and the Corporate Debt Restructuring Committee (CDRC) to resolve the debt problems of the large corporations. The early action taken and the speed with which these efforts were implemented have contributed to lowering the upfront cost of the restructuring of the banking system.

18. To date, significant progress has been achieved by these agencies in their respective operations. The loan rights and management activities of Danaharta resulted in the successful carving out of about 40 per cent of the banking sector's Non-Performing Loans (NLPs) at an average discount rate of 55 per cent. The acquisition process was completed within a period of just over a year, enabling Danaharta to focus its activities on the management of loans and assets within its administration. To date, Danaharta has dealt with 99.9 per cent of the total loan rights acquired and managed under its portfolio, with an envisaged recovery rate of 56 per cent. Based on its surplus recovery sharing arrangement, Danaharta has distributed US\$8 billion in cash to the banking institutions from its recovery efforts.

19. In the case of Danamodal, the recapitalisation process was completed by December 1999. As the capital position of the banking institutions strengthened, it had enabled the banking institutions to repay Danamodal. The conducive economic environment also provided Danamodal with the opportunity to divest its investment in one of the banking institutions under the merger programme. As a result, as at end-2001, the outstanding amount of recapitalisation was reduced to US\$2.1 billion from a total of US\$7.1 billion since its inception.

20. The corporate debt restructuring efforts undertaken under the purview of CDRC was initially slow. However, progress has since accelerated under a revised framework introduced in August 2001. To date, CDRC has resolved over 69 per cent of the cases that were accepted with debts amounting to US\$37.8 billion. The remaining outstanding cases are expected to be

resolved by July this year. With the resolution of these outstanding cases, the NPL of the banking system can be expected to decline further. More importantly, the operational restructuring that was undertaken together with the debt restructuring would ensure these large corporate entities continue to remain viable in the longer term.

21. The positive results yielded from the efforts that were undertaken to manage the crisis had provided the opportunity to push through and accelerate structural reforms to address fragmentation in the domestic banking sector. Given the mounting pressures of globalisation and liberalisation, it was necessary to develop financially strong institutions that had sufficiently large capital size to undertake business expansion and which will contribute to the overall resilience of the banking sector. The consolidation therefore, was required to lay the initial but crucial foundation for the development of a more resilient, efficient and competitive banking system.

22. A merger programme was initiated to consolidate the 54 domestic banking institutions into 10 banking groups together with an increased capitalisation requirement effective end-December 2001. The consolidation exercise represented a major structural enhancement of our banking system and has facilitated the emergence of a core of domestic banks whose interests are aligned to that of the Malaysian economy. The consolidation and rationalisation process following the merger was successfully completed with minimal impact on the provision of banking services. To date, all domestic banking groups have completed their operational integration process, involving rationalisation of overlapping branches, mapping of different job grades and pay structures and the harmonisation of computer systems.

23. Malaysia launched the International Offshore Financial Centre or IOFC in October 1990. As an integrated IOFC, the island of Labuan offers a wide range of offshore financial products and services to customers worldwide, namely offshore banking and investment banking, offshore insurance, trust business, fund management, investment holding, company management services, capital market activities and Islamic financing.

24. The financial infrastructure in Labuan is well developed as it has more than 3,200 companies comprising 50 offshore banks including three Islamic banks, 103 insurance entities including one Islamic insurance operator, 12 fund managers, 24 leasing companies, supported by 18 trust companies and 41 other service providers. Offshore business activities in Labuan are governed by an independent set of offshore

legislation that are conducive to business activities and administered by the Labuan Offshore Financial Services Authority or LOFSA.

25. The Labuan IOFC will further expand its activities, with the establishment of the Labuan International Financial Exchange (LFX). The exchange is market driven. It provides listing and trading facilities for a wide range of financial and non-financial products as well as Islamic products including mutual funds, bonds, derivatives, insurance linked products and intellectual properties. Its rules are flexible to allow dual listings as well as investors and companies from other jurisdictions to tap capital. Currently there are 8 listings on the board, comprising 2 primary and 6 secondary listing. There is scope for financial instruments listed on the Luxembourg Stock Exchange to have secondary listing on the LFX to tap the huge market in the Asia Pacific region.

26. Labuan will be the window to the liberalisation of the Malaysian financial market. Banks and other financial institutions in Labuan would have preference in tapping the domestic market. I understand that institutions from Luxembourg have not made their presence in Labuan yet although five of the secondary listings in LFX have primary listing in the Luxembourg Stock Exchange.

27. Finally, on behalf of the Government, the people of Malaysia and the Malaysian business delegation members with me here, I would like to express my sincere appreciation to the Government of the Grand Duchy of Luxembourg for the very warm welcome and hospitality extended to my delegation and I.