Chapter 1 – The Malaysian Financial System

Content Outline

Learning Objectives

What you should achieve after completing this chapter:

- Understand the importance of the Malaysian financial system;
- Be able to apply the relevant statutory and regulatory provisions governing the Malaysian banking system;
- Appreciate the functions and responsibilities of monetary and non-monetary institutions, together with non-bank financial intermediaries;
- Gain knowledge of the role of Bank Negara Malaysia; and
- Understand the scope of the regulatory framework within the Malaysian financial system.

1. The Banking System

1.1 Brief history of the Malaysian financial system

1.1.1 Evolution

Trade has been central to the evolution of the financial system. Therefore, it is good to examine when trade began.

Initially, man undertook all functions by himself as a generalist. There was no trade. As time evolved, the advantage of specialisation was realised. As a result, the barter trade system began. In this system, the buyer and seller undertook direct exchange of goods. It was a good start towards trade. But in no time, the disadvantages of the barter system became evident. There was the inability to strike right exchangeability between two sets of goods. Further, there was no incentive to work hard to save, as surplus goods could not be stored. Therefore, there was a need for a good medium of exchange.

Whilst many instruments were tested out and failed, as a medium of exchange, notes and coins called money finally matched the characteristics of a good medium of exchange and withstood the test of time.

With the advent of money, there developed two groups of people in the economy, called the **SURPLUS UNITS** and the **DEFICIT UNITS**. The former were groups who saved their surplus monies while the latter borrowed from the former to finance their deficits. Thus, started the practice of direct borrowing and lending between the deficit and surplus units respectively. But as time went by, the following problems were encountered in this practice; that is – meeting, amount, tenor and default risk.

Meeting – How is the deficit unit to know where the surplus unit is located? How are they to meet?

Amount – Even if the meeting takes place, the amount sought may not match. For example, the surplus unit may want to lend only RM10,000 while the deficit unit may need RM100,000. So, this leaves the deficit unit needing to look out for other lenders.

Tenor – Even if the amount matches, the tenor may not. The lender may only want to lend funds for one year but the borrower may want it for 5 years. So, there is another mismatch.

Default risk – Even if the meeting between the surplus unit and deficit unit takes place and the amount and tenor match, there remains the temporary deprivation of liquidity on the part of the surplus unit. Even if this can be waited out, there is no guarantee of repayment, that is – **default risk**. In other words, non-payment by the deficit unit will lead to surplus unit incurring losses.

To overcome all the disadvantages of direct lending and borrowing, there was a need for an intermediary, to enable the surplus unit to deposit monies and the deficit unit to borrow monies. This led to the development of **financial institutions**. It all started with the exchange banks, now called the commercial banks and the emergence of a whole lot of specialised institutions to bridge gaps in the financial system.

1.1.2 History

The first commercial bank to be established in the country was a branch of a British exchange bank called The Chartered Mercantile Bank of India, London and China (later renamed as the Mercantile Bank) in Penang in 1859. This was followed by The Chartered Bank establishing a branch in Penang in 1875.

The first domestic bank to be incorporated in Kuala Lumpur was the Kwong Yik (Selangor) Banking Corporation in July 1913. By 1917, branches of a Singapore-incorporated bank had established branches in Malacca and Muar. By the late 1920s and 1930s, businessmen and traders incorporated new indigenous banks.

The Currency Board was established in 1907 to issue currency and to protect its value. In 1955 following the World Bank Mission, which reviewed the country's economic situation and potential for development, a recommendation was made to form a Central Bank. This led to the establishment of the Central Bank of Malaya called Bank Negara Malaysia under the Central Bank of Malaya Ordinance, 1958 on January 26, 1959. Notwithstanding the formation of the Central Bank, the currency issuing powers remained vested in the Currency Board until June 1967 when the currency issuing authority was handed over to Bank Negara Malaysia.

Having gone through a full evolutionary cycle from 1950s to 2004, a new wave is now developing. Under the Financial Sector Master Plan (FSMP), the financial industry is now going through a phase of consolidation. Commercial banks are merging with their finance companies. This is to enable financial institutions to become one-stop financial centres to be more competitive and to be better prepared for the impending liberalisation of the financial services sector, which is expected to come on board from 2007 onwards. Besides, another round of mergers are expected among the ten anchor banks. Time and market forces will determine the numbers eventually. Readers are advised to track the developments in these areas by reading updates in the financial news updates.

1.2 The process of financial intermediation

The financial institution act as an intermediary for the savers called the **surplus units** and borrowers called the **deficit units**. Many deposit products have been developed to meet the surplus units' varying needs. Likewise, many loan products have been developed to meet the deficit units' varying needs.

Ask yourself as an individual – would you like to be a surplus or deficit unit? The response is most likely to be a surplus unit. Then, if countered by asking, that would you only save to buy a house costing, say – RM100,000? If so, how long would it take to save that much? By the time that much was saved, would the price of the house be the same? Wouldn't it have gone up due to inflation? Therefore, the better idea would be to borrow, wouldn't it?

Having understood the rationale, one would immediately like to be a deficit unit. Now to view it from both perspectives, when one opens a savings account, one becomes a surplus unit. When the same person takes a housing loan, then he becomes a deficit unit. Therefore in reality, a person could be the surplus and deficit unit at the same time or could be either one if he only deposits or borrows.

For this very important process of financial intermediation, financial intermediaries must be closely regulated to safeguard the interests of all stakeholders. Towards this end, various laws have been enacted in the country. One such legislation is the Banking and Financial Institutions Act 1989.

1.3 Introduction to the Banking and Financial Institutions Act 1989 (BAFIA)

The regulatory framework in which banks and financial institutions in Malaysia operate is primarily governed by the Banking and Financial Institutions Act 1989 (BAFIA) and the regulations made thereunder. The BAFIA is intended, *inter-alia,* to preserve the soundness and stability of the banking and financial system in the country. The BAFIA, which came into force on 1 October 1989, has its preamble as follows:

> *To provide new laws for the licensing and regulation of the institutions carrying on banking, finance company, merchant banking, discount house and money-broking businesses, for the regulation of institutions carrying on certain other financial businesses, and for the matters incidental thereto or connected therewith.*

The BAFIA repealed the Finance Companies Act 1969 and the Banking Act 1973. Notwithstanding the repeal, all regulations, orders, guidelines, circulars, licences and approvals issued or granted under both the Finance Companies Act 1969 and the Banking Act 1973 shall remain valid and binding unless expressly amended, repealed or varied under the provisions of the BAFIA.

The need to repeal of the Finance Companies Act 1969 and the Banking Act 1973 arose largely due to inadequacies in the law to prevent cooperatives and others, except banks, from taking deposits from the public. The deposit-taking cooperatives crisis in the mid-80s is a case in point. Following this, financial institutions were segregated into three groups and their roles were more clearly defined under the BAFIA.

The three groups of institutions segregated and governed by the BAFIA are as follows:

i. "Licensed institutions" namely, the commercial banks, finance companies, merchant banks, discount houses and money brokers;

ii. "Scheduled institutions" namely, building societies or those which carry on building credit business, factoring and leasing companies, and development finance institutions; and

iii. "Non-scheduled institutions" defined under section 2 include the following:

   - *any statutory body; or*
   - *any person, being an individual, or a body or organisation, not being a statutory body, whether corporate or unincorporate, whether or not licensed, registered or*

authorised under any written law, who or which is neither liable to be licensed under this Act, nor subject to the provisions of Part III.

Under section 122 of the BAFIA, it is provided that where there is any conflict or inconsistency between the provisions of the BAFIA and the Companies Act 1965 in their respective applications to the financial institutions in question, the provisions of the BAFIA shall prevail. On the other hand, section 123 of the BAFIA provides that nothing in the BAFIA shall in any manner affect, or derogate from the provisions of the Exchange Control Act 1953. In the event of any conflict or inconsistency between any provisions under the BAFIA and the Exchange Control Act, the provisions of the Exchange Control Act shall prevail.

The provisions of the BAFIA shall not apply to an Islamic bank. Examples of Islamic banks in Malaysia are Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad. This is provided for under section 124(6) of BAFIA. However, it is to be noted that any licensed institution carrying on Islamic banking or Islamic business shall not be deemed an Islamic bank, and hence is subjected to the provisions of the BAFIA. Most commercial banks in Malaysia carry on such Islamic banking activities but are not recognised as Islamic banks.

2. The Functions and Responsibilities of Monetary and Non-Monetary Institutions

2.1 Introduction

The banking system in Malaysia comprises the Central Bank, which is Bank Negara Malaysia, commercial banks including banking and finance companies and other financial institutions such as discount houses, merchant banks, the representative offices of foreign banks and the offshore banks in the International Offshore Financial Centre of Labuan.

Bank Negara Malaysia is at the apex of the monetary and banking system in Malaysia. With the exception of the offshore banks, Bank Negara Malaysia has been entrusted with the regulation and supervision of the banking system in the country. This is provided for under the BAFIA and the regulations made thereunder. This is to ensure that a sound and strong financial system is maintained, which is essential for a country's steady and balanced economic and social development.

As for offshore banks, they come under the purview and supervision of the Labuan Offshore Financial Services Authority (LOFSA).

2.1.1 Monetary and non-monetary institutions

The financial institutions can be divided into two categories, namely,

- **monetary** institutions which comprise Bank Negara Malaysia and commercial banks (including banking and finance companies); and
- **non-monetary** institutions which comprise finance companies, merchant banks and discount houses.

2.2 Bank Negara Malaysia

(a) The principal objectives of Bank Negara Malaysia as spelt out in the Central Bank of Malaya Ordinance 1959 [now the Central Bank of Malaysia Act 1958 (Revised 1994)] are:

i. To be the sole issuing and distributing authority of the currency in Malaysia, which is the "ringgit" and "sen". In addition, Bank Negara Malaysia maintains adequate external reserves to safeguard the value and stability of the currency.

ii. To be the banker and financial adviser to the government of Malaysia. As banker to the government, it advises the government on the issues of new types of securities, loan programmes and provides temporary advances to the government to cover any deficit in the budget revenue. In addition, it provides facilities such as cheques, acceptance of deposits, and effects payment on behalf of the government, which includes both the federal and state governments.

iii. To influence the credit situation to Malaysia's advantage.

iv. To lay down policies intended to promote sound monetary stability and a strong financial structure to enhance economic growth in Malaysia. In addition, these policies are also intended to maintain a high standard of banking and governance necessary to instil confidence in the banking system.

v. To act as a banker to commercial banks and other financial institutions in the country. It has always been recognised as the lender of last resort for these financial institutions.

vi. To recommend to the Minister, for issuance of licences to commercial banks, merchant banks, finance companies and discount houses in Malaysia. Under section 4 of the BAFIA, it is clearly provided that no one shall carry on banking, finance company, merchant banking, or discount house business unless Bank Negara Malaysia recommends and the Minister grants a valid license. Powers are also vested in Bank Negara Malaysia to recommend to the Minister to revoke such licences if it deems necessary under section 7 of the BAFIA.

(b) Bank Negara Malaysia has been given powers, under the BAFIA, to issue guidelines, regulations and directives, which are directly related to credit and lending.

For instance, section 67 of the BAFIA provides that Bank Negara Malaysia may specify limitations, terms and conditions in respect of the giving of any class, category or description of credit facilities to be given by any licensed institution. This is particularly with respect to financing the purchase of securities or shares, immovable properties and/or any derivative instruments.

In addition, section 126 of the BAFIA provides that Bank Negara Malaysia or the Finance Minister "may generally in respect of this Act, or in respect of any particular provision of this Act, generally in respect of the conduct of all or any of the licensed or scheduled businesses, issue such guidelines, circulars, or notes as the Bank or the Minister may consider desirable."

(**Note**: All references to the "Bank" under the BAFIA mean the Central Bank or Bank Negara Malaysia.)

2.3 Commercial banks

The commercial banks have always played a pivotal role in the banking system. They are the largest and most significant providers of funds in the banking system. Under the terms of the licence recommended by Bank Negara Malaysia, and granted by the Minister they enjoy the widest scope of banking activities and businesses. However, in an attempt to avoid unhealthy overlapping of banking activities with other financial institutions especially the finance companies and the merchant banks, commercial banks are generally not allowed to engage in hire-purchase and leasing, factoring and corporate advisory activities.

The functions and business of commercial banks in Malaysia are:

i. Providing facilities for savings through current, savings and fixed/time deposit accounts and other financial instruments;

ii. Providing facilities to effect payments on behalf of its customers;

iii. Providing loans and credit facilities, both to individual borrowers and corporations;

iv. Financing the government through the purchase of government securities and treasury bills; and

v. Providing a wide variety of other banking services such as remittances, facilitating foreign exchange transactions and the financing of both domestic and international trade.

Commercial banks have contributed immensely to the country's economic development. This is done through their vast network of branches throughout the country.

2.3.1 Dual licensing of financial institutions

A licensed financial institution is now permitted to apply for and hold two licences namely a licence to carry on banking business and one to carry on finance company business. An institution, which holds these licences, is defined as "a banking and finance company".

Therefore, pursuant to the Banking and Financial Institutions (Amendment) Act 2003, a bank with a dual licence is defined as – "banking and finance company" which means a person holding both a licence to carry on a banking business and a licence to carry on a finance company business, granted under section 6(4) of the BAFIA.

Commercial banks that have completed their merger exercises with their finance companies will come under this category.

2.4 Finance companies

A finance company is a company, which carries on finance company business. Section 2 of the BAFIA defines "finance company business" as follows:

i. the business of receiving deposits on deposit account, savings account or other similar account; and

- *giving of credit facilities;*
- *leasing business;*
- *business of hire-purchase, including that which is subject to the Hire-Purchase Act 1967; or*
- *business of acquiring rights and interests in a hire-purchase, leasing or other similar transaction;*

ii. *such other business as the Bank, with the approval of the Minister, may prescribe.*

Finance companies, in fact, constitute the second largest deposit-taking institutions in the country after commercial banks.

It can be observed that the core business of finance companies is concentrated on consumer credit such as hire-purchase, leasing, factoring, block discounting, housing and personal loans. Finance companies are also allowed to provide money-changing facilities and performance guarantees.

Unlike commercial banks, and the banking and finance companies, the merchant banks and finance companies are not allowed to provide current account facilities to their customers.

2.5 Merchant banks

The functions of merchant banks are different from those of commercial banks. They provide more sophisticated and complex banking facilities. Whilst the commercial banks are focused on retail short-term credit and loan facilities for working capital and trade financing, merchant banks specialise in raising capital by way of syndication. They also provide corporate finance advisory services, arrange for the issue and listing of shares, and manage investment portfolios.

Under section 2 of the BAFIA, "merchant banking business" means:

i. *the business of:*
   - *receiving deposits on deposit account; and*
   - *provision of finance; and*

ii. *the business of:*
   - *providing consultancy and advisory services relating to corporate and investment matters; or*
   - *making or managing investments on behalf of any person; or*

iii. *such other business as the Bank, with the approval of the Minister, may prescribe.*

The corporate advisory services include listing of public companies, the underwriting of new issues of shares, mergers and acquisitions, and the restructuring of companies especially those under section 176 of the Companies Act 1965.

The income derived from these businesses is fee-based unlike that of the commercial banks, which is interest-based. Previously, at least 30% of the income of merchant banks had to be derived from such fee-based businesses or activities. That requirement, however, was lifted in December 1996.

Merchant banks also provide other banking services. For instance, project and bridging finances, which are normally granted by way of, revolving credit and term loan facilities, granting acceptance credits, leasing, block discounting and hire-purchase.

2.6 Discount houses

Traditionally, discount houses are set up to provide short-term money. They accept short-term deposits and funds from the banking sector, private sector and public authorities in the form of money at call, overnight money, and short-term deposits. In turn, such funds are reinvested generally in securities such as government bonds, treasury bills, banker's acceptances, negotiable instruments of deposit and Cagamas – notes and bonds. In many ways, the discount houses are recognised as keepers of liquidity for the banking system in the event of any liquidity strain in the system.

Section 2 of the BAFIA defines a "discount house" as a person that carries on discount house business. "Discount house business" means

i *the business of:*

- *receiving deposits on deposit account; and*
- *the investment of such deposits and other funds of the institution in Malaysian Government securities, Treasury bills or such other investments as may be prescribed by the Bank; or*

ii *such other business as the Bank, with the approval of the Minister, may prescribe.*

2.7 Islamic banks

Islamic banking was first introduced in Malaysia in 1983. The need arose from the fact that more than 51% of the population is made up of Muslims. Since the Muslims subscribe to Syariah principles, an alternative banking system is provided to operate along side the conventional banking system. To regulate Islamic banking, the Islamic Banking Act 1983 was legislated, and came into effect on April 7, 1983. The Act provides the Central Bank with powers to supervise and regulate Islamic banks. The Government Investment Act 1983 was also enacted to empower the Government to issue Government Investment Certificates, which are Government bonds issued on an Islamic basis. These certificates are liquid assets and are, therefore, eligible to comply with the liquidity requirement.

The chart below gives us a clear understanding, as to the source of the emergence of the Islamic Bank. As you can see, the economic and banking aspect emanates from the practice of **Muamalat.**

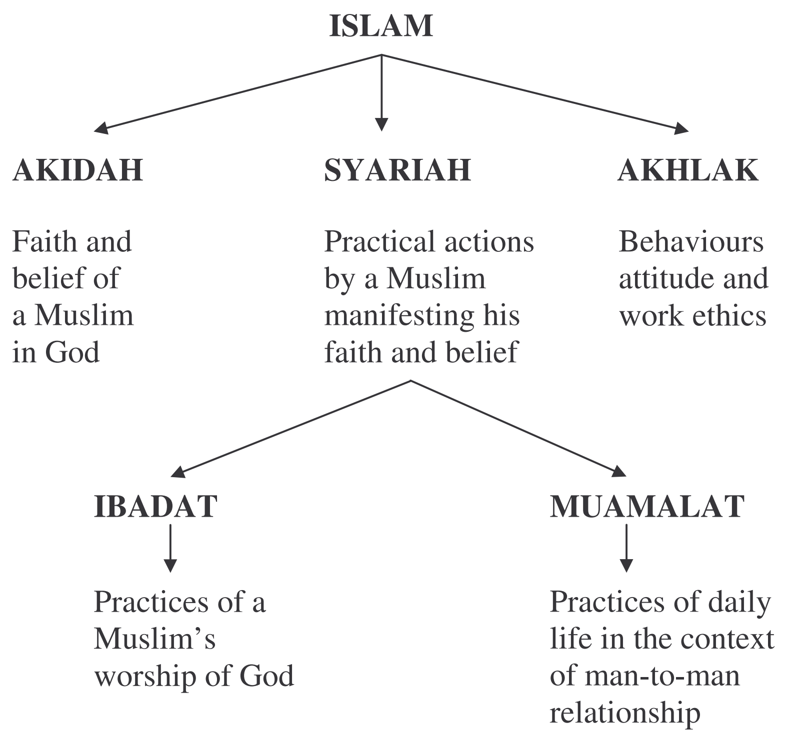

Figure 1.1

The Islamic banking system is not limited to Muslims only. It is open to both Muslims and non-Muslims alike. The spirit in Islamic banking lies in removing uncertainties, in that it speaks of profit sharing in the form of dividends rather than interest charges. Dividends are discretionary payments. This means only if profits are made, is a dividend declared. No profit, no dividend. Then, losses are shared according to predetermined ratios. On the other hand, interest payments are compulsory payments. This means whether or not profits are made, interest payments must be made. This becomes onerous on the part of the person who is liable to pay interest. Further in Islamic banking, the profit sharing rates are fixed. They are not subjected to fluctuations or variations. This removes uncertainties and enables cash flow planning to be carried out with more predictability.

In a rising interest rate scenario, cash flow planning can become unpredictable as finance costs can eat into profits. This spirit in Islamic banking must be clearly understood. A case in point was during the 1997/8 financial crises. The conventional banks' base lending rate escalated to about 12% per annum plus a spread of 2%, resulting in customers having to pay 14% per annum. The monthly instalments fixed were insufficient to even meet the monthly interest charge, let alone principal reduction.

Financial institutions had to revise instalment amounts upwards much to the displeasure of the customers. But during the same period, customers who had availed themselves of facilities under Islamic banking were not subjected to the vagaries of interest rate fluctuations at that time. The matter came to rest when measures were taken to bring down the base lending rate subsequently.

There are three full-fledged Islamic Banking institutions namely,

(i) Bank Islam (M) Berhad;

(ii) Bank Muamalat (M) Berhad; and

(iii) Bank Kerjasama Rakyat Malaysia Berhad.

Besides the above, there are 13 conventional banks and four development financial institutions offering Islamic banking windows.

The first to be incorporated was **Bank Islam Malaysia Berhad (BIMB)**, on July 1, 1983. On the basis of Syariah principles, Bank Islam offers all the conventional banking services such as accepting deposits, granting credit facilities, provision of safe keeping facilities and fund transfers.

On the prudential front, Bank Islam has to adhere to the same regulatory rules as other conventional banks such as minimum risk weighted capital ratio of 8% and maintain a statutory reserve account with central bank. In addition, to observe the liquidity reserve ratio against their eligible liabilities.

BIMB was given a ten-year period to develop Islamic banking and to establish branches throughout Malaysia. There was no competition for BIMB during this period and BIMB successfully developed Islamic Banking in Malaysia by going through an initial period of losses to profitability and obtaining listed status on the Kuala Lumpur stock Exchange (KLSE).

The second Islamic bank called **Bank Mualamat Malaysia Berhad** was formed in 2000, following the merger between Bank Bumiputra Malaysia Berhad and Bank of Commerce (M) Berhad in 1999.

The third Islamic financial institution is **Bank Kerjasama Rakyat Malaysia Berhad**. Since 1997, all banking facilities offered by Bank Kerjasama Rakyat Malaysia Berhad have been based on the Syariah principles.

The long-term objective of the Central Bank was to create an Islamic banking system to function on a parallel basis with the conventional system. Three ingredients are essential to qualify as a system. They are:

1. A broad variety of instruments;
2. A large number of players; and
3. An Islamic inter-bank market.

In 1993, after achieving a **broad variety** of Islamic financial instruments, it was time to move on to increase the number of players and to introduce some competition for BIMB. To provide a license at the recommendation of Bank Negara Malaysia for a new Islamic bank was an option to consider. Two other options were, one, to allow the existing financial institutions to set up subsidiaries to offer Islamic banking services and the next option was to allow existing financial institutions to offer Islamic banking services using their existing infrastructure and branches. But the shortage of labour, particularly, in the financial services sector that prevailed in 1993 together with high cost of setting up of branches, made BNM abort the idea of recommending the formation of a new Islamic bank and setting up subsidiaries by existing financial institutions.

Instead, the third option was adopted. A scheme within the conventional banks called "**Interest Free Banking (IBF)**" **or** "**Skim Perbankan Tanpa Faedah (SPTF)**" was introduced on March 4, 1993 on a pilot basis.

Initially, the three largest commercial banks, then, were given licenses to operate the "SPTF" scheme by having an Islamic banking window within the conventional bank. Soon, all conventional banks followed the trend.

The interest free banking scheme was replaced by a full-fledged Islamic Banking Division in all financial institutions in 1999. Today as it stands, all conventional banks continue to provide the full range of Islamic banking products alongside conventional banking products, as the market developed the full range of Islamic products equivalent to the conventional banking products with a large number of players.

End-1993 saw two out of the three requirements for a full-fledged Islamic banking system achieved. The remaining objective was to set up an Islamic inter-bank market to achieve a full-fledged Islamic banking system. It was implemented on January 3, 1994, covering the following aspects:

i. Inter-bank trading in Islamic financial instruments;

ii. Islamic inter-bank investments; and

iii. Islamic inter-bank cheque clearing system.

The Islamic money market developed provides a sound secondary market.

In the process of achieving a full-fledged Islamic banking system, Malaysia achieved a first in the world, in the following four areas:

i. To issue Government bonds on an Islamic basis

ii. To set up an Islamic inter bank money market

iii. To have a full fledged Islamic banking system

iv. To have implemented a dual banking system, i.e. **an Islamic banking system on a parallel basis with the conventional system**.

2.7.1 Advice of Syariah Advisory Council

The Islamic bank is to seek advice of the Syariah Advisory Council, established under section 16B of the Central Bank of Malaysia Act 1958, on Syariah matters in relation to its banking business and an obligation is imposed on the Islamic bank concerned to comply with the advice of the said Council.

2.7.2 Approval of Syariah Advisory Body

One of the criteria to be fulfilled for a company to be issued an Islamic banking licence under section 3 of the Islamic Banking Act 1983 (IBA) is that the applicant's Articles of Association must provide for the establishment of a Syariah Advisory Body to advise the applicant to ensure that its banking operations do not involve any element which is not approved by the religion of Islam. This provision has been amended so that the Syariah advisory body must now be one that is approved by BNM.

Details of Islamic banking products and principles are covered in Chapter 14.

3. The Functions and Responsibilities of Non-Bank Financial Intermediaries

3.1 Introduction

The role played by non-bank financial intermediaries is to complement those of other major financial institutions. They specialise in medium and long-term capital financing as this range of financial services is not normally provided by the commercial banks and finance companies.

3.2 Insurance companies

Insurance companies are incorporated under the Companies Act 1965, engaged in the business of insurance services. They design financial schemes to provide members and their dependants with a measure of security in the form of retirement, medical, death or disability benefits.

The insurance industry forms part of the financial industry. It is the government's objective to promote the growth of domestic insurers to establish a national insurance industry to cater to Malaysian needs.

The Government enacted the Life Insurance Act 1961, to govern the operations of insurance companies. After a comprehensive review, the Insurance Act 1963 was enacted to supervise both life and general insurance companies. Later reviews resulted in the Insurance (Amendment) Act 1975 with minor amendments in 1978 and 1979. The Insurance (Amendment) Act 1983 was enacted in January 1983 to further strengthen and consolidate the activities of the insurance industry.

Takaful Act 1984 established the Islamic Insurance business in Malaysia in accordance with Islamic laws and principles.

On May 1 1988, Bank Negara Malaysia assumed supervision of the insurance industry. The BNM governor was appointed Director-General of Insurance and Director-General of Takaful.

Insurance companies are run on commercial terms with profits as their motive. There are two main types of insurance companies namely life and general.

3.2.1 Life insurance companies

Life insurance business is concerned with the insurance of individuals' lives.

As a reward for taking risks, insurance companies receive income in the form of premiums. In a life insurance contract, the policyholder pays a periodic premium in return for a lump sum payment in the event of death, permanent disability or major illness or on maturity of the policy.

Premiums are computed on the basis of:

- Age;
- Health; and
- Sum assured together with any other benefits that accrue in the policy.

Life insurance companies offer three main types of policies namely:

(a) Whole life policy
Here, the insurance company will pay a fixed sum called the sum assured upon death or permanent disability.

(b) Endowment policy
Here, the sum assured is paid upon death, permanent disability, or maturity of the policy, whichever happens first. In this policy, there is a savings element mixed with protection. Relative to whole life, the premiums are higher.

Premiums paid for both policies are based on age, health and sum assured. Loans, too, can be obtained from insurance companies based on surrender values.

(c) Term Assurance
Here, the sum assured is payable only in the event of death or permanent disability within the term of the policy and no benefit is payable if the insured survives beyond the end of the term. No surrender value. Relative to the earlier two policies, lower premiums are charged based on age, health, sum assured and term.

(d) Others
Group policies are designed for organisations for the coverage of its employees against death, disablement and hospitalisation expenses.

3.2.2 General insurance companies

General insurance covers all risks except risk of life. It operates on the principle of pooling of risks by bringing together a sufficiently large number of people, who seek protection from any common risk of loss of property or income, arising from accidents, burglaries, fires or unexpected events.

In the event of a loss, the insured will be compensated for loss. The main economic function of general insurance is to narrow the area of risks borne by an entrepreneur, through the conversion of part of his risks into a contractual cost or premium, which forms part of pooled risk.

General insurances are usually for 12 months' duration and are renewable thereafter.

The premiums on general insurance business depend on the statistical probability of occurrence of loss causing events together with the type of risk and value.

At present, the major classes of general insurance in Malaysia are marine, aviation and transit (**MAT**), fire, motor and miscellaneous insurance. Of these, motor insurance is the most dominant.

General Insurance Association of Malaysia (Persatuan Insuran Am Malaysia or PIAM) provides statistics to justify future reviews of the tariffs to meet rising claims.

Sources of funds for general insurance companies emanates mainly from policy premiums and net investment income, while their major expenditure comprises mainly claims on policies, commissions and management expenses.

3.2.3 Reinsurance

Reinsurance concerns the spreading of risks by an insurer, who shares the risk of life or general business with other insurance companies.

The Malaysian National Reinsurance Berhad was formed in 1973 to undertake this business.

3.2.4 Takaful

To provide insurance cover to Muslims in conformity with Islamic principles, the Government established an Islamic insurance company called **Syarikat Takaful Malaysia Sdn Bhd** on

November 24, 1984 which began operations on August 1, 1985. The company registered under the Takaful Act 1984, operates both the family and general takaful business.

Under family takaful business, the company offers various family takaful plans, which provide investment returns to participants as well as cover or protection in the form of mutual financial assistance in the case of untimely death.

The general takaful business operates in line with co-operative principles that are, shared responsibility and mutual help. The participants have agreed at the outset that the company shall pay from the general takaful fund, compensation or indemnity to fellow participants who have suffered a defined loss, consequent upon the occurrence of a catastrophe or disaster. Any surplus (profit) arrived at after deducting compensation or indemnity to fellow participants and other operational costs, will be shared between the participants and the company, provided the participants have not incurred any claims and that no takaful benefits have been paid to them.

3.3 Development finance institutions (DFIs)

These are specialised financial institutions, established by the Government to promote investments in the manufacturing and agriculture sectors. Their emergence, as in most developing countries, are to fill the gap in the supply of financial services, which are not usually covered by the established financial institutions.

Commercial banks traditionally focus on short-term lending to finance working capital and are not equipped to appraise projects involving complex industrial and agricultural technology. As a result, many new ventures without previous track records would find it difficult to obtain financing.

The prime objective of development finance institutions in Malaysia is to provide long-term funds tailored to the need of borrowers. Both Federal and State Governments provide funding in the form of equity participation and low interest loans.

As the name suggests, development finance institutions are to develop specific sectors in the economy.

The **Development Finance Institutions Act 2002, (DFIA)** was enacted and made effective on 15th February 2002 to provide a comprehensive regulatory and supervisory framework to ensure safe and sound financial management of the DFIs.

Six institutions now come under the purview of Bank Negara Malaysia. They are Bank Pembangunan dan Infrastruktur Malaysia Berhad, Bank Industri & Teknologi Malaysia Berhad, Malaysia Export Credit Insurance Berhad, Export-Import Bank of Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad and Bank Simpanan Nasional which have been gazetted as “prescribed institutions” under subsection 2(1) of the DFIA.

One of the main aspects of the DFIA is to ensure that DFIs roles, objectives and activities of the DFIs are consistent with the Government’s national objectives and these mandated roles are effectively and efficiently implemented. For this purpose, the DFIA requires DFIs to submit their proposed business and development activities and projected sources of funding to Bank Negara Malaysia on an annual basis. Further, the DFIA also provides a mechanism to monitor the management of Government allocated funds to ensure that the funds are utilised as specified.

Now, let’s take a look at the various types of development finance institutions.

3.3.1 Malaysian Industrial Development Finance Berhad

The **Malaysian Industrial Development Finance Berhad (MIDF)** was incorporated as a public company in March 1960 and to provide term financing to promote industrialisation in the country.

The **MIDF**’s main activity is to provide medium- and long-term loans for financing new industrial ventures and expansion, modernisation, diversification or relocation programmes of existing enterprises.

It is common for **MIDF** to provide term loan financing for their fixed assets while commercial banks provide working capital financing. Following this, securities are commonly shared by MIDF taking the first charge and the commercial bank taking the second charge.

Its wholly owned subsidiary, the **Malaysian Industrial Estates Sdn Bhd** (**MIEL**), assists small and medium scale industries by designing and constructing factory buildings in the various industrial estates for sale and rental.

The **MIDF Consultancy and Corporate Services Sdn Bhd (MIDFCCS)** provides services relating to share registration, share issue, underwriting and consultancy services.

The **MIDF Investment Holdings Sdn Bhd (MIDFIH)** is the Group's investment holding company, responsible for medium and long-term investment of the group's cash resources in the local stock market.

3.3.2 Bank Pembangunan dan Infrastruktur Malaysia Berhad

This bank, also called the Development and Infrastructure Bank of Malaysia, was established in 1973 with the objective to increase Bumiputera participation in business and industry through financing and equity participation.

In 1998, this bank was entrusted with another important role, that of providing financing for infrastructure projects, particularly Government projects.

In 2002, this bank received an "exempt dealer status' from the Ministry of Finance, allowing it to offer corporate advisory, corporate financing and underwriting services to companies which are engaged in developing infrastructure projects.

3.3.3 Bank Industri and Teknologi Malaysia Berhad

This bank, also called the Industrial and Technology Bank of Malaysia, was established to undertake development banking activities, with the objective, to provide financial support and advisory services to the transportation, manufacturing, export and import, and selected services sectors.

To achieve its objective of providing long-term financing to capital intensive and high technology industries, this bank focused its lending activities on companies engaged in the shipping, shipyard, marine-related and manufacturing industries

This bank has three subsidiaries, namely:

i. Malaysia Export Credit Insurance Berhad (MECIB);

ii. Export-Import Bank of Malaysia (EXIM); and

iii. Global Maritime Ventures (GMV).

(i) Malaysia Export Credit Insurance Berhad (MECIB)

MECIB was established with the main objective to support and strengthen export diversification and expansion by providing credit insurance and guarantee facilities. It also provides overseas investment insurance to facilitate overseas investment. As an export credit agency, MECIB provides protection to and indemnifies the policyholders from non-payment losses arising from either **buyer risk** or **country risk.**

For **buyer risk**, MECIB provides cover for losses arising from insolvency, default and repudiation of contracts by the importers. For **country risk** the cover is for losses arising from blockages and delays in transfer of foreign exchange, war and civil disturbance, import bans, cancellation of import licenses and government buyer default.

(ii) Export-Import Bank of Malaysia Berhad

This bank was established to promote international trade by facilitating the export of goods and services through export credit, financing of capital investment and providing business information and services. The bank provides medium to long-term credit to promote exports with emphasis on non-traditional markets.

In addition, the bank provides financing to promote "project exports" such as construction and infrastructure projects and services.

EXIM bank is the designated agency to manage the Export Credit Refinancing (ECR) scheme funded by the Government and Bank Negara Malaysia. The scheme's primary objective is to promote exports by offering competitive rates on lending to exporters to banks participating in the ECR scheme. It must be made clear while funding comes from EXIM bank, the credit risks are underwritten by the lending bank. Facilities are extended in the form of pre- and post-shipment financing to eligible direct and indirect exporters, either on an order based or certificate of performance method.

(iii) Global Maritime Ventures

This company was established to promote the shipping industry.

3.3.4 Bank Pertanian Malaysia

This bank also called the Agriculture Bank of Malaysia was established in 1969, to promote sound agricultural development in the country, through the provision of loans and advances. The main function of the bank is to co-ordinate and supervise the granting of credit facilities for agricultural purposes/ventures and mobilises savings, particularly from the agriculture sector and community.

Funding is sourced through deposits, like commercial banks, except for current account deposits, through its branch network.

3.3.5 Credit Guarantee Corporation Malaysia Berhad

Credit Guarantee Corporation (CGC) was established in 1972 by Bank Negara Malaysia and the commercial banks to assist Small and Medium Scale Enterprises (SMEs) gain access to credit facilities from financial institutions. Besides providing guarantees for loans to SMEs, CGC also acts as administrator of special funds set up by the Government to assist SMEs.

3.3.6 Sabah Development Bank

This bank was established in 1977 by the Sabah State Government to undertake development banking functions and to act as the Sabah State Government's financial intermediary. The bank provides advisory services to the Sabah State Government, raises funds for State Government projects as well as manages the State's surplus funds.

The primary role of Sabah Development Bank is to act as the mobiliser of financial resources in the state of Sabah and to facilitate economic development and investment in the state.

3.3.7 Sabah Credit Corporation

Sabah Credit Corporation (SCC), wholly owned by the Sabah State Government was incorporated in 1955 as the North Borneo Credit Corporation but was renamed as Sabah Credit Corporation in 1972. The SCC's main objective is to provide financing facilities for investment in agriculture, industry, rural and urban housing, building and public utilities and amenities with a view to promote Sabah's economic development.

3.3.8 Borneo Development Corporation

Borneo Development Corporation (Sabah) Sdn Bhd was established in 1992, as a state enterprise, wholly owned by the Sabah State Government. The main objective is to provide financial assistance in the form of mortgage loans to the public to enable home ownership. The principal activities of the company are property development and provision of loans to buyers of properties developed by the corporation. A total of four subsidiary companies were actively involved in property development, construction, hotel management and educational training.

The main source of funding is borrowings from financial institutions. Others are shareholder funds, sale of housing loans to Cagamas and borrowings from the State Government.

3.3.9 Borneo Development Corporation (Sarawak) Sdn Bhd

Borneo Development Corporation (Sarawak) Sdn Bhd was incorporated as a wholly owned business enterprise of the Sarawak State Government. The objective is to undertake property development and construction activities and to provide end financing facilities.

Funding is sourced from shareholder funds and through borrowings from financial institutions.

3.4 Savings institutions

Savings institutions exist in the country to complement the commercial banks and finance companies as the major deposit taking institutions. The main savings institutions are the National Savings Bank and the co-operative societies.

These savings institutions promote savings among middle and lower income groups in the rural areas that are not adequately served by the commercial banks and finance companies.

3.4.1 Bank Simpanan Nasional

The National Savings Bank (NSB) was established through the National Savings Bank Act 1974, through a reorganisation of the former Post Office Savings Bank system.

The National Savings Bank's principal activity is to carry out the functions of a national savings bank, namely to accept deposits and to provide retail loans to small borrowers. **The Government guarantees all deposits.** Funds raised through the premiums savings certificates are unique to this bank. Attractive prizes for lucky draw winners and payment of dividends contributed to the growth of these deposits.

Other deposit products are savings deposits, fixed deposits and Giro deposits and save-as-you-earn deposits. The Giro savings scheme is attractive due to its features, which enables depositors to remit funds and make payments while earning an interest.

Lending is channeled to housing, credit cards, hire-purchase and corporate loans.

3.4.2 Co-operatives Societies

The co-operative movement was first introduced in the country in 1922. In the same year, the Department of Co-operative Development was also established. Co-operatives are organisations of consumers or producers who voluntarily pool their resources together to meet common objectives. The Co-operative Societies Ordinance 1948 defines a co-operative society as “society which has its objective of promotion of economic interest of its members in accordance with co-operative principles”. Therefore, the aim is to provide opportunities for its members to save, invest and participate in economic interests. Collectively, members can be a force to be reckoned with as they have a better bargaining power. Co-operatives can be classified as single purpose or multi-purpose.

Comprehensive guidelines under the National Co-operative Policy are a framework and guide to eradicate poverty, create jobs and business and to improve quality of life. Todate, there are 4,330 co-operatives with a membership of 5 million members.

3.4.3 Bank Kerjasama Rakyat Malaysia Berhad

Bank Kerjasama Rakyat Malaysia Berhad was established in 1954, under the Co-operative Ordinance 1948. On 6 January 1973, its name was changed to Bank Kerjasama Rakyat Malaysia Berhad following a broadening of its scope of activity. As a co-operative, the main objectives of Bank Kerjasama Rakyat Malaysia Berhad are to improve the standard of living through the provision of financing and financial and advisory services in the commercial, industrial, agricultural and other sectors, and to encourage savings among its members.

The principal activities of Bank Kerjasama Rakyat Malaysia Berhad are providing personal, property, education and other financing, including pawn broking to members of the public and co-operatives. Since 1997, all banking facilities offered by Bank Kerjasama Rakyat Malaysia Berhad are based on the Syariah principles.

3.5 Unit trusts

Unit trusts serve as a medium through which small individual investors can acquire a share in a diversified portfolio of corporate securities. It is a trust established by a trust deed. There are three parties to a trust deed namely, the managers, investors and trustees.

(a) The managers

They are the promoters of the fund, in the form of a management company. It must be a subsidiary of a financial institution under the jurisdiction of the Central Bank or any other institution, which the authorities may permit. Full details can be obtained from the prospectus they issue. The management company charges the investors an annual fee based on a small percentage of the value of units held by the investor as well as a commission on purchase and sale of units.

(b) The investors

These are the beneficiaries, who invest their funds with the managers, after scrutinising the prospectus. In return, the investors expect dividends and capital appreciation of the price of their units. Investors hold unit trust certificates as evidence of their investment, just as how shareholders are given share certificates.
They can be individuals, companies or institutions.

(c) The trustees

Assets invested by the fund managers are registered in the name of the trustee. As there would be many investors in the fund, the trustee act as the neutral person to hold the assets on behalf of all the investors.

The trustee charges a custodian fee on the unit trust for services rendered.

Generally, unit trust funds are ‘open-ended’ funds, whereby the manager of the unit trust can sell as many units as there are purchasers. At the same time, the fund manager is obliged to repurchase the units from those unit holders who wish to withdraw from the trust fund at the prevailing buying price.

Unit trusts come under the purview of the Securities Commission. The size of a unit trust shall not exceed 500 million units. To exceed this limit, an application must be made to the Securities Commission who will be mindful of the fund manager's experience and resources.

Financial intermediaries' unit trusts play an important role in the development of the private capital market as funds are mobilised from small savings for active participation in the corporate securities market.

Returns will depend on the risk assumed by the investor. The higher the risk, the greater the potential return.

The following are types of unit trusts according to ascending order of risk profile:

(i) **Money market funds**
Investing in money market instruments.

(ii) **Bonds funds**
Investing in Government stocks and bills.

(iii) **Balanced Funds**
Investing in a mixture of bonds and stocks.

(iv) **Income funds**
Investing in high yielding dividend stocks.

(v) **Growth and income funds**
Investing in index-linked stocks.

(vi) **Growth funds**
Investing in stocks of companies with better than average growth prospects.

(vii) **Aggressive growth funds**
Investing in companies or industries that are risky but with great potential to yield good returns.

Advantages of unit trusts are as follows:

- The trust is able to get a better spread of risk than the unit holders would be able to get by themselves individually.
- Professionals who are knowledgeable in investment matters manage the unit trusts.

- The investor makes only one investment and saves much administrative work and time to monitor the investments.
- The cost of the manager's fee is chargeable and tax exemption allowed within the fund.
- The unit holders individually may not be able to afford the services of professionals to look after their investments.
- There is a market for the units. The investor is able to sell the units at any time to the fund manager.
- Units can be offered as security for loans.

Improving awareness and understanding of the value of professionally managed funds and the long-term investment benefits of unit trusts as savings instruments have led to their growth. In line with this growth are the Islamic unit trust funds.

3.5.1 Property trusts

It is a form of unit trust in which capital pooled from various investors is used to acquire real properties or estates. The regulatory guidelines are as laid down by the Securities Commission.

The pre-requisite requirements to set up management companies for property trust funds are basically the same as those for unit trust funds. The minimum paid-up capital of the company should be at least RM500,000.

3.6 Housing credit institutions

The objective of the Government's housing policy is to ensure sufficient home ownership for the country's population to satisfy their basic needs in terms of shelter. The demand for housing credit in the private sector is met by commercial banks, finance companies and two housing credit institutions namely, Malaysia Building Society Berhad (MBSB) and Borneo Housing Mortgage Finance Berhad (BHMF).

The two housing credit institutions, MBSB and BHMF, were the pioneer institutions to provide housing loans.

MBSB is funded mainly by loans from the Employees Providend Fund, shareholders funds and deposits by the public, including institutions.

The operations of BHMF are parallel to those of MBSB, although its activities are confined to Sabah and Sarawak.

3.7 Cagamas Berhad

The national mortgage corporation, Cagamas Berhad, was established in December 1986, to ensure a steady flow of funds to the housing industry as well as to develop a secondary mortgage market.

Cagamas issues notes and bonds to raise funds. Notes are short term, with maturity dates being less than one year. Bonds are long term, having maturity dates of more than one year. Financial institutions invest in these notes and bonds. Having raised these funds, they are mainly used in two areas.

Firstly, Cagamas, together with other institutions, provides funding to the Housing Loans Division of the Treasury, which in turn provides housing loans to civil servants in the public sector.
Secondly, to provide a secondary market, Cagamas purchases housing loans from the primary lenders of housing loan, thus acting as an intermediary for long-term investors. It can be observed, since the inception of Cagamas, financial institutions are able to provide longer repayment tenors for housing loans. Prior to 1986, housing loans were not extended for more than ten years. Now, tenors are extended to 25 years. This is largely made possible by Cagamas, as financial institutions liquidity positions can be adjusted by sale of housing loans to Cagamas. Also, it must be made clear that banks sell their housing loans and not the houses to Cagamas. The legal owners of the houses are the chargors. The banks merely sell their interest in the property by way of a sub-charge.

3.8 Leasing companies

Leasing companies constitute a relatively small but growing sub-sector of the Malaysian financial sector. Under the third schedule of the BAFIA 1989, leasing business is a scheduled business, whereby the Central Bank has the power to regulate and supervise the businesses.

Leasing companies source their funds from shareholder funds, borrowings from financial institutions and inter company borrowing. Leasing companies, from which 70% of their business is in leasing, can be called “PURE-LEASING” companies.

Leasing finance of the pure leasing companies is channelled mainly to the manufacturing, transport and storage, finance, insurance and business services, general commerce and agriculture sectors.

3.9 Credit token companies

With effect from January 1, 2004, the regulation of credit token business (including credit cards and charge cards business) will come under the purview of the **Payments Systems Act 2003** which came into force on November 1, 2003. As such all provisions in the BAFIA which relate to this business have been deleted.

4. Other Institutions / Bodies

4.1 Issuing houses

There are two issuing houses in Malaysia. MIDF Consultancy and Corporate Services Sdn Bhd (MIDFCCS) was the first to be incorporated while Malaysian Issuing House Sdn Bhd (MIH) was the second to be incorporated in 1993. Both issuing houses undertake and provide share issuance facilities for Initial Public Offerings (IPOs) and consultancy services.

4.2 Stockbroking houses

These are licensed stockbrokers who are members of the Kuala Lumpur Stock Exchange (KLSE). They provide stock trading services on the KLSE. These stockbrokers engage the services of remisiers to act as agents to buy and sell shares on behalf of investors, for a commission.

4.3 Bursa Malaysia (formerly Kuala Lumpur Stock Exchange)

In Malaysia, the buying and selling of shares and stocks started in 1870. A stockbrokers' association, called the Malayan Stockbrokers Association, was formed in 1937. Public trading of stocks and shares was undertaken in 1960 on the initiative of the Central Bank. In the same year, the Association was reorganised and became the Malayan Stock Exchange. In 1963, the Exchange was reorganised and renamed as the Stock Exchange of Malaysia. It was later renamed as the Stock Exchange of Malaysia and Singapore in 1965 and finally, the Kuala Lumpur Stock Exchange (KLSE) in 1973. Throughout this period, only the Main Board was in place for bigger companies to raise equity on the stock market. On November 11, 1988 the Second Board was launched to facilitate viable smaller companies to raise funds on the stock market.

In November 1992, the KLSE introduced the Central Depository System (CDS). This is a scripless trading system to improve the efficiency of the trading and settlement system as well as to enable the KLSE to handle a much larger volume of trading. The CDS aims to help reduce the incidence of theft, forgery, tampering and misplacement of scripts. Therefore, individuals are allowed to open securities accounts with appointed Authorised Depository Agents (ADA). Only stockbroking companies have been appointed as ADAs.

4.3.1 Demutualisation of the KLSE

On January 5, 2004, the KLSE became a public company limited by shares as opposed to a company limited by guarantee previously. Arising from this, the KLSE vested and transferred its stock exchange business to its wholly-owned subsidiary, Malaysia Securities Exchange Berhad (MSEB). The demutualised KLSE became the exchange holding company, known as Kuala Lumpur Stock Exchange Berhad (KLSE Bhd).

Demutualisation refers to the conversion of the KLSE from a non-profit 'mutual' entity limited by the guarantee of its members into a public company limited by shares.

Further, the demutualisation benefits the KLSE in the following ways:

(a) enable the KLSE to enhance its corporate, organisational and governance structures to respond to the challenges of globalising and an increasingly competitive capital market.

(b) place the KLSE in a better position to respond to the collective interests of its broader stakeholders and as a result, be more customer-driven and market-oriented.

(c) help in improving liquidity resulting in a more attractive market place for the trading of securities, thereby benefiting all market participants.

(d) broaden market access to encourage direct participation from domestic and international investors and intermediaries who can direct new or more trading volume to the market.

The principal beneficiaries are the Government, the economy and the capital market comprising issuers and investors' intermediaries (stockbrokers and remisiers and the Exchange).

Listing of the Exchange will depend on the timing and prevailing market conditions.

KLSE Bhd has an authorised share capital of RM500 million comprising one billion ordinary shares of 50 sen each. Its paid up capital is RM250 million, made up of 500 million shares of 50 sen each. The Capital Market Development Fund, Minister of Finance, Inc and licensed stockbroking companies will each hold a 30%

stake or 150 million shares. The remaining 10% or 50 million shares will be held by eligible remisiers.

On April 20, 2004 KLSE Bhd was renamed as Bursa Malaysia Berhad, while MSEB was changed to Bursa Malaysia Securities Berhad. The companies under the Bursa Malaysia Group are:

- Bursa Malaysia Derivatives Berhad.
- KLSE Information Services Sdn Bhd.
- KLSE Technology Sdn Bhd.
- KLSE Training Sdn Bhd.
- Labuan International Financial Exchange Inc.
- Malaysian Central Depository Sdn Bhd (MCD).
- Malaysian Derivatives Clearing House Bhd (MDCH).
- Securities Clearing Automated Network Services Sdn Bhd (SCANS).
- Yayasan BSKL.

Note: In 1998, the Australian Stock Exchange Ltd was demutualised to become one of the first exchanges in the world to be listed on its own market. This was followed by the exchanges of Singapore in 1999, Hong Kong in 2000 and Tokyo in 2002.

4.4 Malaysian Exchange of Securities Dealings and Automated Quotations (MESDAQ)

MESDAQ specialises in bringing growth and knowledge-based companies to the public. Such companies have difficulty obtaining bank loans due to absence of a track record. MESDAQ was approved as a stock exchange under section 8(2) of the Securities Industry Act 1983 on October 6, 1997.

MESDAQ's Business Rules provide for the establishment of various committees to perform functions the Board assigns. They are the listing committee, business rules committee, disciplinary committee, emergency committee and compensation fund committee.

The Securities Commission (SC) performs an oversight function in relation to MESDAQ to ensure that the exchange operates in a fair and orderly manner and properly enforces both its rules and the Malaysian securities laws.

MESDAQ's self regulatory framework gives market intermediaries direct participation in the formulation and enforcement of rules, regulations practices and procedures that govern the operations of the market. This will not only ensure that the market develops in accordance with commercial needs but is the best guarantee for compliance. Rules regulating the conduct of members and other market intermediaries are contained in the Business Rules and Listing Rules of the exchange.

Companies listed on MESDAQ have three modes of allocating shares, namely through a public ballot, private placement or a combination of both.

MESDAQ's trading is based on a system of competitive market-making. Each company has to appoint a minimum of two designated market makers, who have a positive obligation to quote continuously and make a market by agreeing to buy and sell a minimum number of units of securities at their quotes. The market making system's transparency and integrity are upheld through the implementation of a set of quote display rules.

Companies may be admitted as market makers if they fulfil the admission criteria, which include:

- A minimum paid up capital of RM5 million;
- Holding a dealer's license under the Securities Industry Act 1983;
- A minimum 51% Malaysian (inclusive of 30% Bumiputra) shareholding;
- At least two registered dealer's representatives who are registered with MESDAQ;
- Passing the MESDAQ market maker readiness audit; and
- Having a compliance officer.

4.5 Securities Commission (SC)

The Securities Commission was set up on March 1, 1993, following the promulgation of the Securities Commission Act, 1992. It is regarded as the "market watch dog" as the capital market is growing in complexity and sophistication. Its establishment was also opportune as the rapid pace of economic growth required greater avenues for financing investments.

New innovative instruments were emerging in the market, all of which required monitoring and supervision to protect savers and investors' interests. The SC is responsible for the regulation and development of the securities industry, financial futures and option markets, unit trust and property trust schemes, and company takeovers and mergers.

The function of the SC relating to futures contracts under the Securities Commission Act 1992, does not include commodity futures contracts, which will remain under the purview of the Ministry of Primary Industries and governed under the Commodities Trading Act 1985.

The SC has powers to administer the following legislations:

- Securities Industry Act 1983;
- Securities Industry (Central Depositories) Act 1991;
- Futures Industry Act 1993 and Securities Commission Act 1993.

With the SC supervising the broad capital market, the Central Bank supervises the broad banking system and money market.

5. Summary and Conclusion

Regulation of the financial services industry is of paramount importance to ensure orderliness and discipline in this sector. This will in turn maintain the public's trust. Therefore, the role of the regulators such as Bank Negara Malaysia and the Securities Commission is clearly spelt out.

The role of the various players in this sector is also explained. Islamic banking has been elaborately written on to clearly show how it evolved from a scheme to a full-fledged system.

As the world's financial markets are moving towards liberalisation, regulations in the banking sector are set to move in tandem with these changes. Once again, readers are advised to keep abreast of changes highlighted in the financial news update.

Practice Questions

1. Explain the process of financial intermediation.

2. What is the main purpose of the Banking and Financial Institutions Act 1989 (BAFIA)?

3. Does the Banking and Financial Institutions Act 1989 (BAFIA) apply to all financial institutions in Malaysia?

4. Discuss briefly, the functions and responsibilities of Bank Negara Malaysia.

5. Discuss briefly, the types of businesses conducted by the following:
    (a) Commercial banks;
    (b) Merchant banks;
    (c) Finance companies; and
    (d) Discount houses.

6. Briefly explain how Islamic banking evolved from a scheme to a full-fledged banking system.

7. Explain the difference between a life insurance company and general insurance company.

8. Briefly explain the role of Syarikat Takaful Malaysia Sdn Bhd.

9. How do development financial institutions differ from commercial banks?

10. What do you understand by demutualisation of the Stock Exchange?

11. Define the role of the Securities Commission.