

Financial Services Committee position paper:

With the global economic crisis stabilising, Asian governments, including Malaysia, are moving away from fighting recession to re-establishing their long-term competitive edge. As the West continues to embark on a long-drawn recovery process, we have already seen more integration amongst emerging markets in trade and financial cooperation, such as the implementation of the Chiang Mai Initiative Multilateralisation and an extended use of Chinese yuan as trade settlement currency.

This implies that most, if not all Asian economies are already devising their medium term strategy. In Malaysia, Prime Minister Najib Razak kicked off his administration with liberalisation on 27 services sub-sector, financial sector and the capital market. In his Budget Speech on 23 October 2009, personal income tax rate is reduced and pledges were made to reduce crime and corruption. The country looks forward to the implementation of the New Economic Model, as announced on 30 March and more details.

The Malaysian financial sector has weathered the global financial system well. The banking sector has been able to maintain profitability, as well as adequate level of capital and liquidity during the worst of times. Years of financial reform since the financial crisis have served the industry well.

Now that the ship has been tested in the rough seas, is it ready to set sail in the ocean? Malaysia does face a tough battle in expanding its financial services beyond its own shore. Singapore and Hong Kong have already claimed the top spots as the region's financial hubs. Hence, Malaysia will need to seek niche segments to develop.

Islamic finance has already been earmarked as an area that Malaysia has an inherent advantage in. It is estimated that global Islamic banking asset under management could reach USD 1trn (source Mckinsey) by 2010 and Malaysia can play a key role in the standardisation of rules and regulations in

this industry. The launch of the Bursa Al-Sila, the world's first Shariah compliance trading platform for commodity murabahah transaction, and the development of Shariah parameters, help to position Malaysia as a leader in the field of Islamic finance globally.

A key challenge going forward is that most markets that Islamic banking has become popular in recent years have been traditionally served by conventional banking. While Islamic banking will be keenly supported by the Muslim world on religious ground, it will need to provide financial and other incentives to capture greater market share from conventional banking. It can also capture business opportunities from the non-Muslim world if the pricing and service quality is right. Talent is another area where more can be done to enhance the product offering and customer service.

Another strength of the Malaysian economy is commodities. While agriculture and commodity production may seem less glamorous than manufacturing of computers or professional services, it is nonetheless an important element in the global economy. In particular, the development of emerging markets, such as China and India, are offering commodity producers fresh reasons to be optimistic. For financial industries, these trade links are offering new opportunities, such as the start of trade settlement in Chinese yuan, and the opportunity to extend into other non-major currencies.

Malaysia-EU opportunities

There are potential opportunities in Islamic finance in the European Union. Out of the 500mil. people in the European Union, over 10mil., or 3%, of them are Muslims and with France having the largest Muslim population in Europe (3.5mil.). French Finance Minister Christine Lagarde, has already expressed desire to open France up to Islamic finance to provide additional support to Paris as a financial centre. The ability to establish standard and rules will give Malaysia some advantage in helping Europe to develop the Islamic finance industry. Malaysia's aspiration should be the Asia centre of Islamic finance in the network alongside with the Middle East and Paris.

Source: http://fra.europa.eu/fraWebsite/attachments/Manifestations_EN.pdf

Issues within the Insurance sector for Foreign/European companies operating in Malaysia

In April 2009, Bank Negara announced a financial sector liberalization plan aimed at fostering stronger ties with other economies. (up to 70% Equity, New Family Takaful License).

Key issues

European insurers moving toward Market Consistent Disclosures

Challenges likely to be felt would be:

- Lack of depth in the Capital Markets, especially long dated government bonds critical to backing insurance type liabilities makes it hard to price/value and this then causes foreign players to take margins in pricing, making it harder to compete on price with local players.
- More frequent re-pricing: may not be on same playing field as local players.
- Fair Value reporting and IAS 39 implementation.
- There is limited access to market data to develop fair value measurements.

Understanding the local market

Understanding the local market/culture especially in trying to build a distribution force that meets the “Independent Financial Advisory” norms practiced in more developed financial markets in the west. So the push from the regulator to develop this would probably result in a contraction in the industry rather than a deeper penetration.

Joint venture structures are often challenging

Finding the right local partner and getting sufficient local talent with good insurance knowledge.

Capital requirements (Solvency II implementation for European players due soon full implementation in 2012) – RBC/ICAR in Malaysia.

Following the global economic crisis, capital is scarce and expensive. Shareholders look at ROEC (Return on Economic Capital).

Recommendations

Capital requirements need to be set at levels comparable to other economies and very much linked to the risk levels/appetite of the business. We are competing with other growth engines in Asia like India and China and we need to keep an eye out on what’s happening in these two economies especially from a Insurance/Takaful perspective.

High CAR levels are good

High CAR levels are good – reflection of sound Regulation and Supervision, but as Capital is expensive and greater Governance costs more, credit for good Risk Management practices should be awarded through allowance in Capital Charge. (Operational Risk Charge should be linked to Risk Controls and events in the business. Currently, it is based merely on size of assets) and ICAR setting, hence making Malaysia attractive to foreign players with good governance and practices.

- Standard Comprehensive and Robust Risk Management systems to be enforced throughout the Industry (Local and Foreign players).
- Operating Expenses – More Governance means higher expenses/investment. This means that products become more expensive.