Financial Sector Masterplan

The implementation of the Financial Sector Masterplan (FSMP) is on track and on schedule. Another 14 recommendations of the FSMP were fully completed during the year, bringing the total number of fully completed recommendations to 45, which accounts for almost half of the recommendations with milestones. Another 28 recommendations are being implemented on a continuous basis, where initiatives are continuously being taken to attain the desired outcomes. Details of the completed recommendations are as listed in the accompanying table.

Completed Recommendations

	Banking Sector
R3.4	Liberalise restrictions on salaries and staff mobility in the banking industry to enable the industry to attract the best talent and reward them accordingly
R3.5	Uplift restriction on employment of expatriates to attract the best international talents to meet the demand for expertise in specific areas of banking
R3.6	Establish board committees, namely Nominating, Remuneration and Risk Management Committees to further enhance corporate governance standards
R3.7	Allow group rationalisation through cross-selling of products and consolidation of back-office processes as well as facilitate the merger of commercial banks and finance companies to further enhance efficiency and competitiveness
R3.9	Streamline the regulation of discount houses and merchant banks to enhance and allow fair competition among players
R3.12	Encourage outsourcing of non-core functions to gain greater strategic focus and efficiency
R3.14	Encourage the development of new delivery channels to increase the range of products and services to further enhance competitiveness
R3.15.1 and R3.15.2	Simplify the product notification process to provide incentive for the development of new and innovative products, and outline a set of guidelines providing criteria for product notification and specific product approval requirements
R3.16a	Introduce the New Interest Rate Framework to provide banking institutions with greater flexibility, thus promoting more efficient pricing of products
R3.18	Encourage participation of banking institutions in areas currently served by fringe institutions to promote a level playing field and preserve consumer protection and investors' interests
R3.21	Implement risk-based supervision with supervisory focus on high risk areas and greater attention on weak institutions
R3.22a	Incorporate market risk into the capital adequacy framework to introduce more risk sensitivity to the existing regulatory capital requirements
R3.23	Develop a formal and informal enforcement action framework to ensure banking institutions take remedial actions on weaknesses highlighted
R3.27	Increase efficiency and competition in the payments system to support the needs of the economy while maintaining its safety and integrity
R3.28	Allow market forces to shape developments in the payments system to promote greater competition and increase innovation in payments system
R3.33	Allow banking institutions to rationalise their branch network to improve the dispersion of their branches in the country
R3.37	Expand the role of the Banking Mediation Bureau with the establishment of the Financial Mediation Bureau to strengthen consumer protection framework and to widen avenues for consumers to seek redress
	Insurance Sector
R4.1	Remove restrictions on outsourcing to enable insurers to further develop core competencies and effective business strategies

R4.2	Allow eligible insurers to use the internet as a distribution channel to enhance competitiveness and efficiency of the insurance industry
R4.3	Promote the growth of bancassurance as a cost-effective alternative distribution channel by implementing a more flexible regulatory framework on remuneration structures governing bancassurance arrangements
R4.6	Relax the restrictions on employment of expatriates to accelerate the development of skills and expertise in the industry
R4.16	Increase the statutory minimum paid-up capital of insurers to enhance their financial resilience and ability to compete effectively in a more deregulated and liberalised market
R4.17	Strengthen 'fit and proper' regulations for board members and senior management of insurance companies, including minimum qualification standards and training requirements for directors, to promote sound corporate governance
R4.18	Establish board committees with specific responsibilities and enhance disclosure standards on compensation to directors and senior management to further strengthen governance structures and processes and promote greater transparency
R4.19	Raise the entry requirements for the agency force to uphold high standards of professionalism and competencies among insurance intermediaries
R4.20	Introduce additional compulsory exams as part of the continuing education programmes for agents to upgrade their knowledge and skills on an on-going basis
R4.21	Further strengthen performance-based supervision to maintain stability under more deregulated and competitive market conditions
R4.22	Develop an enforcement action framework to ensure timely and consistent supervisory intervention processes to address institutional risks
R4.25	Establish the Financial Mediation Bureau to strengthen the consumer protection framework and widen avenues for consumers to seek redress
R4.26	Introduce 'best advice' regulations to enhance consumer protection and professionalism in the sale of life insurance products by insurance intermediaries
R4.27	Strengthen regulations on unfair trade practices to ensure sound business practices and fair treatment of consumers
R4.29	Allow financial and non-financial institutions to acquire interests in direct insurers to create business synergies
Islamic Banking and Takaful	
R5.3	Build strong management through the establishment of board committees, benchmarking and employment of experienced and qualified staff
R5.5	Increase the number of Islamic banks to stimulate greater competition and accelerate international integration by issuing Islamic banking licences to qualified domestic and foreign banking institutions
R5.6	Increase the number of takaful operators to accelerate the expansion of takaful industry
R5.10	Establish a comprehensive legal infrastructure for consumers to seek legal redress arising from Islamic financial transactions
Development Financial Institutions	
R6.4	Introduce a systematic framework for sourcing funds to ensure appropriate and adequate funding for the operations of development financial institutions (DFIs)
R6.7	Establish a legislative framework to regulate and supervise DFIs to ensure that DFIs' policies and objectives are consistent with the national policy objectives
R6.8	Establish a single Regulatory and Supervisory Authority (RSA) to strengthen the supervision of DFIs

Alternative Modes of Financing	
R7.2	Establish a RM500 million venture capital fund to increase the availability of venture capital financing and stimulate new ventures
R7.3	Introduce further tax incentives for the venture capital industry to promote the growth of venture capital
R7.4	Liberalise the MESDAQ listing requirements to facilitate the exit of venture capital companies from their investments
R7.5	Establish two Islamic venture capital funds with a combined initial fund size of RM22.1 million
Labuan International Offshore Financial Centre	
R8.3	Adopt a consultative and market driven approach to create a conducive tax and business environment to enhance the competitiveness and attractiveness of Labuan
R8.6	Strengthen Islamic banking and finance as well as takaful to develop Labuan with a strategic focus on Islamic products and services
R8.7	Enhance Labuan International Financial Exchange (LFX) to be a one-stop financial exchange for residents and global companies

In the initial phase of the implementation of the FSMP, efforts were focused on enhancing the capability and capacity of domestic financial institutions. These efforts were continued in 2004 with further institutional development initiatives as well as measures to strengthen the regulatory and supervisory framework, and enhance the consumer education and protection framework.

Achievements

Measures implemented since the release of the FSMP four years ago, have yielded positive results and strengthened the respective building blocks of the financial sector. It has contributed towards enhancing the capacity and capabilities of domestic financial institutions, promoting a more efficient and stable payment systems infrastructure, providing a robust infrastructure to ensure overall stability of the financial sector as well as putting in place a comprehensive consumer protection infrastructure.

In the banking sector, domestic banking institutions have maintained their market share, despite a more competitive operating environment. As at end-2004, domestic banking institutions commanded 78% share of gross loans and 77% of total deposits (end-2003: 78.3% of gross loans and 77.9% of total deposits). Domestic banking institutions also maintained its position as the main financier for business enterprises with a market share of 78.7% (end-2003: 79%) and further enhanced its position as the main lender to small and medium enterprises (SMEs) with a market share of 84.8% (end-2003: 82.7%), particularly to the manufacturing sector where its market share increased from 76.3% in 2003 to 82% in 2004.

Financial performance of domestic banks continued to be strong. Return on average assets and return on average equity (excluding dividends received from banking subsidiaries) stood at 1.04% and 11.9% respectively (end-2003: 1.02% and 11.3% respectively). Initiatives taken to improve operational efficiency continued to show positive results. The cost to income ratio has declined marginally from 52.6% in 2003 to 51.9% in 2004. Better productivity levels were recorded, as exhibited by an improvement in pre-tax profit per RM employee cost, from RM1.49 in 2003 to RM1.55 in 2004. Customer service efficiency levels have also shown further improvements especially in the turnaround time for loan and credit card processing.

In addition, initiatives previously taken to enhance risk management capabilities have placed domestic banking institutions in a stronger position to compete more effectively with the foreign banks. With better risk management capabilities, domestic banking institutions are better equipped to price their products and services more competitively whilst ensuring that their risk exposures remained within reasonable levels. Better insight into their exposure levels and management capabilities also enable domestic banking institutions to be more innovative in their product and business development strategies. Furthermore, the mergers between commercial banks and finance companies have enabled domestic banking institutions to capitalise on synergies and economies of scale to further enhance cost-efficiency levels.

For the banking system as a whole, the introduction of the New Interest Rate Framework, which was aimed at promoting a more efficient pricing mechanism for interest-based products, provided banking institutions with greater flexibility in pricing their products and services. This flexibility is also expected to spur greater product innovation by the banking institutions to meet the growing demands of customers who value greater choices and customised financial products.

Similar to the banking industry, the insurance sector has also recorded performance improvements among domestic insurers. Domestic players maintained a strong market position with a market share of 72.7% (end-2003: 73.3%) in the general sector. In the life sector, domestic insurers have successfully leveraged on their comparative advantages to increase their combined market share to 35.8% of life premiums (end-2003: 31.8%) following the comparatively higher new business growth registered by domestic life insurers compared with foreign insurers.

The development of bancassurance as a major distribution channel has contributed significantly to the growth of domestic life insurers. Domestic life insurers controlled 82.9% (end-2003: 79.2%) of total premiums generated through bancassurance in 2004. Leveraging on effective bancassurance strategies, domestic insurers were also able to correspondingly increase their market share of the fast growing investment-linked insurance market which has enjoyed strong demand from consumers in recent years. Domestic insurers accounted for 44.8% of new investment-linked premiums generated in 2004, an increase from 33.6% in 2003.

The implementation of a more flexible policy on remuneration structures governing bancassurance arrangements in December 2004 is expected to provide appropriate incentives for the continued long-term development of bancassurance as a cost-effective distribution channel.

In line with efforts to strengthen Malaysia as an Islamic financial services centre and the growing popularity of Islamic financial services worldwide, Islamic banking has strongly emerged as an efficient and effective financial intermediation channel and has become an integral component of the overall Malaysian financial system. The Islamic banking sector continued to show strong growth, as assets grew to RM94.6 billion as at end-2004 to account for 10.5% of the total assets of the banking system (end-2003: 9.7% or RM82.2 billion). Islamic deposits and financing have increased to RM72.9 billion and RM57.9 billion respectively, to account for 11.2% and 11.3% of the deposits and loans of the banking system (end-2003: 10.4% and 10.3%). The takaful sector has remained stable with assets constituting 5.6% (RM5 billion) of the insurance and takaful industry's total assets, and accounted for 5.1% of total premiums and contributions of the industry.

Significant milestones have been achieved in the regulatory framework of Islamic banking and takaful to strengthen the institutional capacity and resilience of the players. The Revised Rate of Returns Framework is expected to enhance the capacity and efficiency of the Islamic banking institutions in managing their Islamic banking operations. Recognising that good corporate governance reinforces sound regulation and supervision as well as contributes towards maintaining market confidence, the new guidelines on directorship for both Islamic banks and takaful operators are expected to further strengthen transparency and accountability.

Additional measures to strengthen Shariah and legal infrastructure were also undertaken. To further enhance competitiveness, Islamic financial institutions are now exempted from any additional stamp duty and tax payment arising from instruments and transactions executed in fulfilling Shariah requirements to enable tax neutrality between Islamic and conventional finance. The Regional Centre for Arbitration in Kuala Lumpur was chosen to arbitrate cases for Islamic banking and takaful. This would complement the specialised High Court that is assigned to adjudicate all Islamic banking and finance cases. Following the amendments to the Central Bank of Malaysia Act 1958, the stature of the Shariah Advisory Council (SAC) has been elevated as the sole authority on Shariah matters pertaining to Islamic banking and finance that fall under the purview of Bank Negara Malaysia. The SAC will serve as the reference point by the court or arbitrator in the resolution of disputes that involve Shariah issues on Islamic banking and finance cases. The Guidelines on Governance of the Shariah Committee for the Islamic financial institutions were also issued to specify amongst others, the new structure, roles and functions of the Shariah Committees of the Islamic banks, the conventional banks participating in Islamic Banking Scheme and takaful operators, and the requirements for the appointment of Shariah committee members.

In line with Malaysia's aspirations to become the leading Islamic financial centre, the Labuan Offshore Financial Services Authority (LOFSA) has continued with its efforts to develop the Labuan International Offshore Financial Centre (IOFC). Currently, there are two full-fledged Islamic banks, three Islamic investment banks and one full-fledged takaful/retakaful operator that operate in Labuan IOFC. To further strengthen Islamic financial services in Labuan IOFC, LOFSA has established various working groups comprising market experts to assist in formulating strategies to develop and promote Islamic capital market, international Islamic trust and waqf, Islamic fund management, Islamic insurance or takaful and Islamic trade finance. In addition, there is greater co-operation and collaboration amongst regulatory agencies in the area of financial markets and takaful to meet the requirements of Islamic banking and financial institutions. Labuan IOFC's reputation as an offshore Islamic financial centre was further enhanced following secondary listings of two sukuks from the Middle East, which were listed on the Labuan International Financial Exchange (LFX). To pave the way to further develop Islamic capital market with an enhanced global reach, the LFX signed a Memorandum of Understanding with the Bahrain-based International Islamic Financial Market (IIFM) in 2004 to set a framework for greater cooperation between LFX and IIFM. This is to capitalise on the potential to expand the investor base for the investment of funds mobilised from OIC countries.

To complement the role of the banking and insurance sectors in supporting the national economic development objectives, the DFIs have continued to perform their intermediation role as niche providers of funding and ancillary services to targeted sectors. In line with the recommendations of the FSMP, initiatives remained focused on enhancing the efficiency and effectiveness of the industry, through capacity and capability building efforts, to ensure that DFIs continue to be able to provide financial and advisory support to their respective targeted sectors.

As part of the efforts to ensure that DFIs remain focused in their respective roles, Bank Negara Malaysia had conducted a review on the mandated roles and activities of DFIs. Following the Bank's proposal, the Government has announced the merger of the Export-Import Bank of Malaysia Berhad and Malaysia Export Credit Insurance Berhad, as well as the rationalisation of the roles and functions of Bank Pembangunan dan Infrastruktur Malaysia Berhad and Bank Industri & Teknologi Malaysia Berhad. This would enable these DFIs to be more focused, thus more effective in serving the targeted sectors.

Efforts were also undertaken to enhance the capacity and capability of DFIs in providing non-financial services to their targeted clients. A joint project between Bank Negara Malaysia and the Japan International Cooperation Agency to enhance the advisory capabilities of selected major DFIs for SMEs commenced in October 2004. It is envisaged that the provision of advisory services can be used to supplement the financial assistance available to SMEs, thus enhancing the effectiveness of the DFIs in developing and nurturing SMEs. To enable Bank Negara Malaysia to effectively monitor the performance of the DFIs, a computerised online reporting system known as Development Financial Institutions Statistical System (DFISS) has been developed, thus enabling the DFIs to submit statistical data electronically. The system enables Bank Negara Malaysia to obtain accurate information in a timely manner to facilitate the monitoring of DFIs' performance. In order to address the unique features of each DFI, DFISS captures both generic and specific information relating to their businesses.

The initiatives undertaken thus far have resulted in the creation of a financial sector which is stronger, more resilient and in a better position to face greater competitive pressures. The ability of domestic banking institutions and insurance companies to continue recording strong financial performance despite the increasingly competitive operating environment, is testament to the fact that they have grown in strength and capabilities. In addition, the regulatory framework has been further enhanced to cope with the challenges of the increasingly complex financial market. Financial institutions have adopted better risk management practices in their business operations, which have also provided them with greater ability and flexibility to respond to the increasing demands and expectations from customers. The achievements and the narrowing of the performance gaps between the domestic and foreign-owned institutions provide a platform for further liberalisation and deregulation as envisaged under Phase 2 of the FSMP.

Policy Thrusts in Phase 2

As outlined in the FSMP, the operating environment will be gradually deregulated and liberalised to develop a financial sector that is more efficient, dynamic and capable of supporting the changing needs of the economy effectively and in the most efficient manner. Competitive pressures will be progressively infused into the banking and insurance industries so as to elevate the delivery of service and overall performance of the financial sector.

Nevertheless, efforts to enhance the capacity and capability of the domestic institutions will continue to ensure that they remain competitive in a more liberalised environment. In tandem with efforts to promote greater efficiency and competitiveness, emphasis will also be focused on further enhancing resilience and stability of the financial system that will contribute towards overall economic growth and development. Regulatory frameworks will continue to be revised to ensure that they remain relevant and responsive to the changing financial landscape, and to keep in tandem with the developments in the international markets. Consumer education initiatives will continue to be pursued to promote better informed and active consumers, which will play an increasingly important role towards attaining a world-class financial system in Malaysia.

With the strong interconnectedness between the financial sector and overall economic development, policy initiatives will continue to be focused on improving access to financing in order to support further economic growth. This include specific focus towards strengthening the infrastructure and access to financing for the SMEs and new growth areas such as the agriculture and agro-based sectors.

i) Banking Sector

Phase 2 of the FSMP implementation will see more efforts channelled towards infusing greater competition into the banking sector. This will be gradually undertaken through the levelling of the playing field between domestic and incumbent foreign banking institutions and, in the process, enhance the quality of banking services and provide customers with the opportunity to choose from a wider array of products and services. In order to ensure that a core group of domestic banking institutions continues to remain strong and capable to compete effectively in a more liberalised operating environment, capacity and capability building initiatives will continue to be undertaken. At the same time, initiatives will continue to be taken to further enhance the regulatory framework so as to provide a more conducive platform for the market to function effectively and efficiently while preserving the resilience and stability of the financial sector. Recognising the role that can be played by consumers in instilling greater sense of market discipline, consumer education programmes will continue to be pursued. Under a more market-oriented operating environment, it is important to ensure that the necessary infrastructure for consumer protection is well in place, including the presence of an effective mechanism to monitor and prevent collusive behaviour amongst banking institutions. Therefore, anti-trust regulations for the banking sector will be developed over the long-term, which will define the guiding approaches to address anti-competitive behaviour and unfair practices of banking institutions, and the remedies for dealing with such behaviours.

As a participant in the global financial system, the Malaysian banking system is expected to operate at international standards. Attestation by an independent third party will add credibility to the institution concerned and, in the process, promote discipline through market forces. However, to achieve this objective, there needs to be an enhanced level of consumer awareness and understanding of financial information. Another prerequisite is the transparency and accountability of rating agencies that undertake the assessment to ensure that the ratings given are based on a comprehensive and consistent methodology.

As the financial market becomes increasingly complex, the need for a more comprehensive and responsive risk management system becomes critical to ensure the soundness of each banking institution and the resilience of the banking sector as a whole. In this regard, a more sophisticated and differentiated treatment of different risk classes will be developed to take into account the risk profile of loan exposures to different sectors of the economy, in addition to the incorporation of market risk into the capital adequacy framework. This measure is aimed at ensuring that the capital of each institution supports the type of risk to which it is exposed. A more detailed and robust capital adequacy framework will enable banking institutions to effectively manage their risk and capital held. All these measures will be undertaken as part of the implementation of Basel II.

The increasingly complex operating environment translates into greater challenges for regulators to effectively perform their oversight functions. With the changing dynamics of risk characteristics, inter-linkages between risk exposures and the development of specialised products, the tools with which regulators conduct the surveillance function are continuously being updated. The use of technology will also be further assimilated into the regulatory function to provide Bank Negara Malaysia with integrated real-time information. Robust surveillance models will promote a better understanding of the impact of specific movements in the market on the stability of the financial sector and the economy. Through an early warning system, Bank Negara Malaysia will be better able to take corrective actions early and thus prevent extensive adverse effect on the financial sector. Such detailed information will also facilitate the analysis and policy formulation process by providing an assessment of the possible impact of any particular change in risk factors on the overall stability of the banking sector.

A key component of the efforts to ensure financial stability is the development of deposit insurance. As part of the financial safety net, a Deposit Insurance Scheme will be introduced to protect depositors in the event of a bank failure. The deposit insurance system will cover both conventional and Islamic banking institutions.

ii) Insurance Sector

The implementation of Phase 2 in the insurance sector will focus on consolidating the capacity building initiatives in order to achieve the desired outcome of a core of strong domestic market leaders that will be well-positioned to compete effectively in a progressively more liberalised environment. This will be undertaken through strategies that provide both the appropriate incentives for performance improvements, as well as a sound supporting framework for financial and market stability.

Following the capacity building measures implemented under Phase 1, a gradual levelling of the playing field between domestic and foreign insurers will be implemented in Phase 2. This will encompass both the gradual removal of remaining operating restrictions applicable to foreign insurers, as well as further deregulation across the board in key areas that will allow insurers greater flexibility to individually pursue innovative business strategies. The deregulatory measures to this end are expected to drive increased competition in the market, thereby accelerating performance improvements among domestic insurers.

More importantly, the development of the necessary supporting infrastructure as well as adjustments to the prudential regulatory and supervisory framework will be simultaneously undertaken to ensure that insurers continue to adopt sound financial and business practices in the more deregulated environment envisaged under Phases 2 and 3 of the implementation of the Masterplan. This will include the strengthening of reserve requirements and the risk management framework governing the significant activities of insurers, establishing an institutional framework to support sound pricing policies following the progressive deregulation of price tariffs for motor and fire business, and enforcing higher standards of disclosure and fair practices in the sale of insurance products.

To achieve a more efficient utilisation of capital, a Risk-Based Capital Framework is being implemented to better align the solvency regime with the risk profiles of individual insurers. Implementation of the framework will provide insurers with substantially greater flexibility to implement appropriate investment strategies that would improve performance and at the same time, achieve better asset-liability matching of insurance funds to support the long term viability of life insurers.

The supporting framework for more effective performance-based supervision will also continue to be strengthened in Phase 2. This includes the implementation of a more rigorous and risk-focused supervisory framework with effect from 2004. The Bank's surveillance capabilities with respect to key risks and trends in the industry will also be further strengthened with enhancements to reporting requirements and the more effective integration of global developments into domestic market analyses and projections to identify trends that may have an impact on the stability of the domestic market.

iii) Islamic Banking & Takaful Sector

The focus for Islamic banking and takaful under Phase 2 will be to enhance performance and upgrade the infrastructure of the Islamic banking and takaful industry. The strengthening of these components will provide the foundations for future sustainable progress in the building of an intermediation system that is robust, resilient, and competitive. Bank Negara Malaysia will continue to focus on a three-pronged strategic initiative where efforts will be focused on positioning Malaysia as a leading centre for educational excellence in Islamic banking and finance, establishing Malaysia as a leading name in Islamic banking and takaful consultancy; and positioning Malaysia's financial institutions as global Islamic financial players.

Given the structure of Islamic banking, the design of the regulatory framework for Islamic banking accords emphasis to full financial disclosure, prudent risk management and adherence to Shariah principles. This will also serve as a firewall to prevent the transmission of risks from investment deposits to demand deposits thus enhancing transparency, depositors' protection and systemic stability.

It has become increasingly evident that, in the long run, dedicated standards need to be promoted for the development of Islamic investment vehicles as well as a robust Islamic capital market. The Islamic Financial Services Board will develop the prudential regulatory and supervisory standards for Islamic banking operations to guide Islamic banking operations, promote disclosure-based principles, enhance transparency, and help nurture the development of the Islamic capital market. In addition, the Malaysian Accounting Standards Board will also set the accounting standards for Islamic financial business.

iv) Development Financial Institutions Sector

DFIs will continue to play an important role in supporting the development strategies of the nation by complementing the banking sector to meet the changing financing requirements of the economy. In this regard, it becomes increasingly important for DFIs to be effective, efficient and dynamic in response to the demands of identified target growth sectors. Efforts that were undertaken in Phase 1 to build the capacity and capability of the DFIs will be continued in Phase 2. Greater emphasis will be placed on strengthening the financial and operating conditions as well as enhancing the corporate governance, risk management practices and human resource development of the DFIs. This is aimed at ensuring that the financial intermediation process, through the DFIs, will operate effectively and efficiently to support Malaysia's economic transformation.

v) Labuan International Offshore Financial Centre

Labuan IOFC has demonstrated positive and encouraging results in every sector of offshore business covering offshore banking, insurance and insurance-related activities, leasing and capital market activities, and is positioning itself as a leading integrated offshore business centre. Going forward, LOFSA will continue to promote and diversify further the financial players and activities in the IOFC. Business development programmes will be undertaken, aimed at expanding offshore financial services opportunities from other regions. LOFSA will continue to promote and enhance global awareness on Labuan IOFC's position as an attractive and cost-efficient offshore business centre. Most importantly, LOFSA will promote the development of Islamic banking and retakaful business to cater for the growing demand for Islamic finance products. Further development to build a sustainable, progressive and efficient Islamic financial centre will continue to reinforce Malaysia's current potential as a leading Islamic financial centre. In addition, LOFSA will continue to direct efforts to strengthen the capital market, e-commerce and the ancillary activities. Also important is the development of an active secondary market for both conventional and Islamic financial instruments listed on the LFX.

vi) Alternative Mode of Financing - Venture Capital and Credit Enhancements

The development of venture capital financing will continue to be promoted in view of its importance in nurturing new growth areas as well as to serve as an alternative source of financing in the economy. Further efforts will be directed towards greater capacity building in terms of skills upgrade and access to private sector financing. To accelerate the development of the venture capital industry, a network of business angels, diversified sources of funds and a large pool of highly skilled knowledge workers are required. In addition, constraints in the supply of innovations need to be addressed with the improvement of deals flows through the development of a critical mass of high growth-potential investees. In order to assist the cultivation of better entrepreneurship culture, further concerted efforts will aim at providing the necessary business and regulatory environment, ensuring access to financing at earlier stages of innovation and reviewing existing policies relating to commercialisation of ideas.

Another area of focus is the credit enhancement initiatives to facilitate lending, especially in the agriculture sector. Initiatives are being taken to enhance financing activities to include the provision of guarantees on agriculture-related loans granted by the banking institutions to high risk but commercially viable ventures, as well as increasing the range of ancillary services deemed essential for sound development of the agriculture sector. In addition, agriculture insurance could play an important role in transforming the agriculture sector into a modern and dynamic commercial sector. The availability and range of insurance products being developed by the insurance industry aim to provide multiple benefits to the farmers including enhanced access to financing, stability in farm income as well as improved risk management practices and farming technologies.

Moving Forward

The key emphasis of the FSMP is to move towards a more diversified and balanced financial system with strong institutional framework, comprehensive market infrastructure, world-class best practices and conducive regulatory environment. As the financial system transitions into Phase 2 of the FSMP, the thrust of initiatives in 2005 will be two-pronged – to continue the efforts to strengthen the institutional development of domestic financial institutions to be well-positioned in a more liberalised and deregulated environment; and to review the current policies and regulatory framework in order to level the playing field between the various market players. Equally important is for institutions to be able to adapt, adjust and respond to changing economic conditions in particular to support new areas of growth. Having robust financial institutions that are able to withstand any potential shocks and have the agility and adaptability to embrace future challenges are key in ensuring long-term sustainability in a more competitive environment as well as the preservation of financial stability.