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Other Financial Institutions

Discount Houses

In 2004, the operations of discount houses continued to expand, albeit at a slower pace. Total resources of discount houses increased by RM1.7 billion or 5.6% (2003: RM2.8 billion or 10.3%). The increase was due mainly to the 18.3% growth of total deposits during the year. Fixed deposits recorded a large increase of RM3.9 billion or 23.4% (2003: RM2.4 billion or 16.5%) with the bulk of the increase being in deposits for maturities of between one to nine months. Meanwhile, call deposits grew at a more moderate pace of 15.2% during the year (2003: 34.2%). Amidst the availability of large supply of funds from deposits, there was less reliance on the interbank market as a source of funds during the year. This was reflected in the RM2.9 billion decline in interbank borrowings.

There was a distinct shift in the uses of funds during the year. Investments in securities declined by RM4.1 billion due mainly to the reduction of holdings of private debt securities and Cagamas debt securities. This shift reflected the discount houses' preference for shorter-term placements in the interbank money market on expectation of higher future interest rates. The decline in PDS holdings also arose out of profit taking activity when yields trended downwards in the second-half year. As a result, the discount houses' interbank placements expanded by more than two-fold to account for 37.8% of the consolidated total assets (2003: 19.2%).

As part of the measures to promote a comprehensive regulatory and supervisory framework for financial institutions, two key prudential requirements were imposed on licensed discount houses in 2004 to safeguard their financial soundness amidst greater competition in the financial sector. Firstly, beginning from September 2004, discount houses' capital adequacy requirements would incorporate their market risk positions and comply with the minimum risk weighted capital ratio (RWCR) requirement of 8% under the revised RWCR framework and the Market Risk Capital Adequacy framework. Upon full compliance in the second quarter of 2005, the revised RWCR framework would align the counterparty risk weights of the existing discount houses' RWCR framework with that of the other licensed banking institutions. This would ensure a level playing field with respect to the provision of capital under the RWCR framework. Secondly, effective from 1 October 2004, discount houses were subjected to the Single Customer Credit Limit (SCCL) requirement under Section 61 of the Banking and Financial Institutions Act 1989 (BAFIA) with respect to all their investments in private debt securities (PDS). This would ensure that discount houses are not overly exposed to a single issuer in their holdings of PDS.

Table 8.1
Discount Houses: Sources and Uses of Funds

	Annual change		At end-2004
	2003	2004	
	RM million		
Sources:			
Approved capital funds	84	238	2,611
Deposits	3,847	4,344	28,094
Interbank borrowings	-1,169	-2,944	615
Others	46	57	564
Total	**2,807**	**1,695**	**31,885**
Uses:			
Investment in securities:	9	-4,146	19,109
Government debt securities	*-571*	*475*	*1,804*
MGS held	*-262*	*572*	*1,407*
Khazanah bonds	*123*	*-173*	*324*
BNM bills	*16*	*-365*	*0*
Private debt securities	*2,397*	*-3,033*	*10,897*
Bankers acceptances	*-2,752*	*822*	*4,059*
Negotiable instruments of deposit	*752*	*-289*	*559*
Cagamas debt securities	*610*	*-1,093*	*1,076*
Others[1]	*-567*	*-491*	*391*
Interbank palcements	1,921	6,230	12,039
Others	877	-389	738
	2002	**2003**	**2004**
Number of discount houses	7	7	7

[1] Includes Danaharta and Danamodal bonds.
Note: Total may not add up due to rounding.

During the year, discount houses' fee-based activity moderated in line with the lower PDS issuance in the capital market. The industry arranged, lead-managed and co-managed the issuance of PDS worth RM5.9 billion (2003: RM9.8 billion). Meanwhile, the total amount underwritten by the discount houses was RM1.4 billion (2003: RM2.6 billion) for 42 PDS issues (2003: 31 issues).

Provident and Pension Funds

Total resources of the provident and pension funds (PPFs) surveyed by Bank Negara Malaysia expanded further by 9.3% to RM291.3 billion in 2004. The Employees Provident Fund (EPF), as the largest fund,

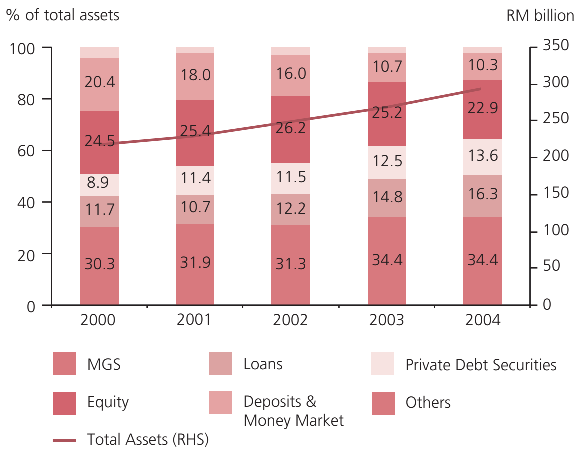
Table 8.2
Provident and Pension Funds: Selected Indicators

	2003	2004*p*
	RM million	
As at end		
Number of contributors ('000)	*20,698*	*21,152*
of which: EPF	*10,490*	*10,706*
: SOCSO	*9,997*	*10,239*
Accumulated contributions	240,334	262,584
Assets	266,538	291,331
of which: Investments in MGS	*91,596*	*100,317*
During the year		
Net new contributions	12,014	12,400
Gross contributions	*24,247*	*26,238*
Withdrawals	*12,234*	*13,839*
Dividends credited	9,324	11,391
Investment income	12,893	13,447

p Preliminary

Source: Employees Provident Fund, Pension Trust Fund, Social Security Organisation, Armed Forces Fund, Malaysian Estates Staff Provident Fund, Teachers Provident Fund and three other private provident and pension funds.

Graph 8.1
Provident and Pension Funds: Major Asset Composition



accounted for 82.5% of the total funds of PPFs. As at end-2004, the accumulated contributions, which accounted for 90.1% of the total resources of the PPF, increased by 9.3% (2003: 9.2%). The strong growth in accumulated contributions was mainly attributed to the significant increase of 22.2% in dividends credited in 2004 (2003: 15.7%). Meanwhile, net new contributions to the PPFs continued to grow, albeit at a slower rate of 3.2% in 2004 (2003: 16.2%). The slower growth was due to higher withdrawals during the year.

During the year, gross contributions of the PPFs surveyed increased by 8.2% (2003: 1%), in line with growth in the number of contributors. Withdrawals increased by 13.1% in 2004 (2003: -10.5%), attributable largely to withdrawals from the EPF for investment purposes, which increased by 47.9% in 2004 (2003: 8.7%). This increase was consistent with the higher sales of unit trust funds during the year. Withdrawals for housing purposes also grew strongly, by 10.9% in 2004 (2003: 2.1%), reflecting the robust demand for residential properties. Meanwhile, growth in EPF withdrawals by pensionable employees, which accounted for the largest share (36.8%) of total EPF withdrawals, moderated to 12.3% in 2004 (2003: 19.1%).

Higher investment income enabled the PPFs to distribute higher dividends to contributors in 2004. The EPF declared a dividend rate of 4.75% in 2004 (2003: 4.5%) as the investment income of the EPF grew by 7.1% to RM11.8 billion on the back of higher returns from investments in private debt securities and from its lending activity. Income from equity investments was also higher due to the stronger performance of the Malaysian stock market. In total, investments in debt and equity instruments contributed 52.2% of the total investment income of the EPF in 2004.

In terms of the asset composition of the PPFs, there was a marginal decline in the holdings of deposits and money market papers, given the low interest rate environment. Higher allocation was given for investments offering higher returns. Thus, the share of private debt securities and loans increased to 13.6% and 16.3% respectively, while the share of deposits and money market papers declined to 10.3% as at end-2004.

As announced in the 2005 Budget, the EPF took steps to allocate RM800 million to external fund managers. Another RM1.75 billion per annum will be channelled over the next three years to local fund management companies. As a result, funds outsourced to local fund managers will increase to RM12 billion. This initiative is expected to enhance investment returns, as well as to promote the development of a larger pool of skilled investment management professionals to foster greater depth in the Malaysian fund management industry, as envisaged under the Capital Market Masterplan.

Venture Capital

The venture capital (VC) industry in Malaysia progressed further as a new source of financing for the economy in 2004. Further expansion was recorded in 2004, in terms of the total size of funds, total investments from both local and foreign sources, number of venture capital fund

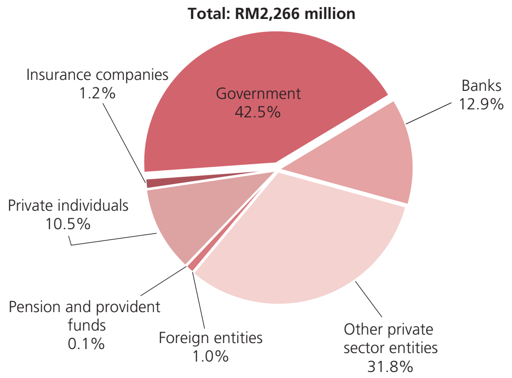
Table 8.3
Key Statistics on the Venture Capital Industry

	As at end-2003	As at end-2004
Venture capital funds (RM million)	2,118.1	2,266.0
Total investment (RM million)[1]	878.7	1,058.0
Local sources (RM million)	769.0	887.7
Foreign sources (RM million)	109.6	170.3
No. of venture capital companies/funds	43[2]	38
No. of venture capital fund management companies	31[2]	34
No. of investee companies	298	332
	During 2003	**During 2004**
Total investment (RM million)	227.2	289.3
Local sources (RM million)	192.5	248.4
Foreign sources (RM million)	34.8	40.9
No. of investee companies	115	139

[1] Including divestment activities
[2] Based on Bank Negara Malaysia's definition

Source: Securities Commission

Graph 8.2
Sources of Venture Capital
(% share, as at end-2004)



Source: Securities Commission

management companies and number of investee companies. Total available funds for VC investments grew by 7% to RM2.3 billion. While investment from domestic sources recorded an increase of 15.4%, investment from foreign sources recorded a significant growth of 55.4%. By the end of 2004, the total number of investee companies had increased to 332 companies, involving a total investment of RM1.1 billion.

The Government gave further support for the development of the VC industry. In the 2005 Budget, the Government announced that foreign VC players would now be allowed to own 100% equity participation in venture capital and venture capital fund management corporations in Malaysia. The move, among others, is expected to encourage higher inflows of funds and skilled workforce, as well as promote technology transfer.

The Cradle Investment Program (CIP), which was administered and managed by the Malaysia Venture Capital Management Berhad (MAVCAP), continued to provide pre-seed funding and entrepreneurial support to aspiring entrepreneurs with the commitment to develop and commercialise their ideas. As at end-February 2005, grants totalling RM7 million were given to 141 recipients. In terms of sectors, CIP investment was mostly concentrated in software (26.95%), consumer/business products (12.77%) and e-services (7.1%). In addition, CIP also collaborated with several key Government bodies to further tap the country's pool of budding entrepreneurs and innovators. CIP currently has 16 'community partners', which include Government Ministries and agencies, and private sector organisations. These 'community partners' are expected to support CIP's objectives through joint initiatives and activities, such as the entrepreneur development programme, and mentoring and commercialisation partnerships.

MAVCAP continued to offer financing to local high-growth information and communications technology companies throughout 2004. As at end-February 2005, MAVCAP had invested RM300 million and nurtured 60 companies.

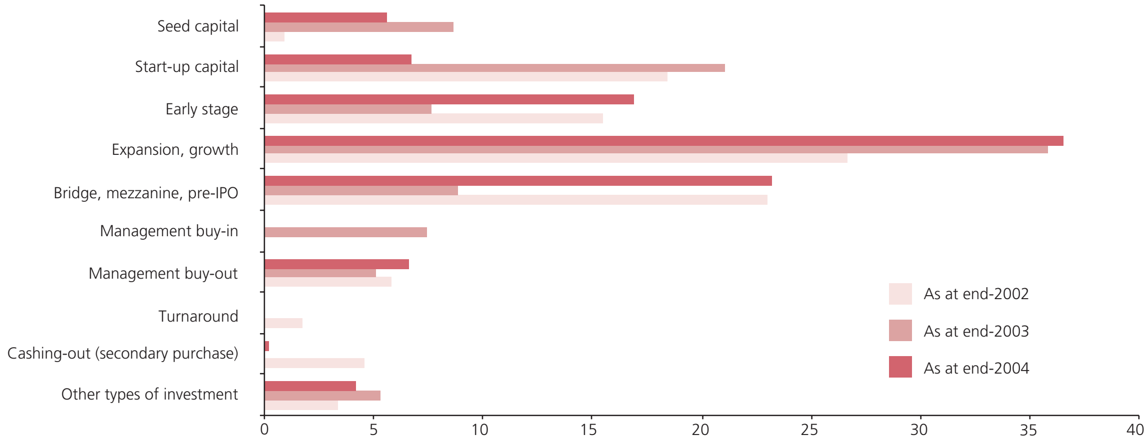
While funds from Government sources remained high, the contribution of funds for VC investments coming from domestic private sector entities recorded a significant increase of 35.1% in 2004. Funds from the insurance companies also increased substantially to RM27 million in 2004, from RM2.4 million in 2003. Funds available from foreign sources increased substantially to RM170.3 million. Funds

Table 8.4
Investment by Stages during 2004

No. of Investee Companies	139	
Business Stage	RM mil	% share
Seed capital	16.1	5.6
Start-up capital	19.3	6.7
Early stage	48.9	16.9
Expansion, Growth	105.8	36.6
Bridge, Mezzanine, Pre-IPO	67.2	23.2
Management buy-out	19.2	6.6
Management buy-in	…	…
Cashing-out (Secondary purchase)	0.6	0.2
Other types of investment	12.1	4.2
Total	**289.4**	**100.0**

Source: Securities Commission

Graph 8.3
Outstanding Investment by Stages (% share)



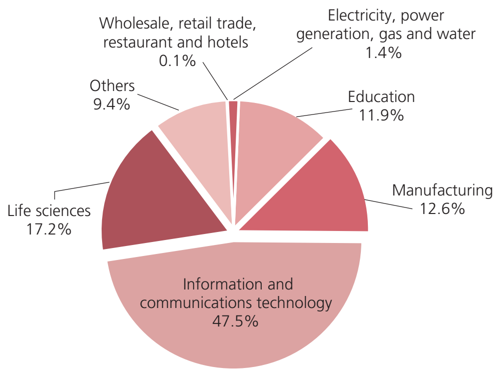
Source: Securities Commission

from Government sources constituted a lower share of 42.5% in 2004 (2003: 54.2%).

In terms of stages, VC investments, during the year, were mainly focussed on the expansion/growth, bridge/mezzanine/pre-IPO and the early stages. These investments represented 76.7% of all VC investments in 2004. Investments in the more risky stages, including the seed capital and the start-up capital stages, declined from 29.8% in 2003 to 12.3% in 2004. Investments in other stages also declined.

In terms of outstanding investments by stages, the expansion/growth, bridge/mezzanine/pre-IPO and start-up capital stages received the bulk of VC investments since 2002.

Graph 8.4
Investment in 2004
(% share of total)



Total Investment: RM289.4 million
Number of Investee Companies: 139

Source: Securities Commission

In terms of investments by sector, the information and communications technology (ICT), life sciences and manufacturing sectors continued to receive most of the financing. In total, the amount of VC investment in these three sectors constituted 77.3% of total investment made in 2004. In terms of the outstanding size of funding at end-2004, the sectors which received most of the VC investment were the ICT sector (42.2% of total), the manufacturing sector (25.4%) and the life sciences sector (18.4%). The three sectors accounted for RM910.1 million or 86.0% of total funds invested. During the year, domestic VC funds were concentrated in ICT (48.7%), education (13.8%), and manufacturing (12.9%) sectors, while foreign VCs mainly invested into life sciences (49.9%), ICT (39.8%) and manufacturing (10.2%) sectors. Compared with 2003, there was an apparent shift in investment preference as the bulk of

Table 8.5
Outstanding Venture Capital Investment by Sectors

	As at end-2004	
	RM mil	**% share**
Information and communications technology	446.2	42.2
Manufacturing	269.2	25.4
Life sciences	194.7	18.4
Education	38.4	3.6
Electricity, power generation, gas and water	17.4	1.6
Wholesale, retail trade, restaurant and hotels	10.3	1.0
Financing, insurance, real estate and business services	6.8	0.6
Construction	0.1	0.0
Transport, storage and communications	0.0	0.0
Others	74.9	7.1
Total	**1,058.1**	**100.0**

Source: Securities Commission

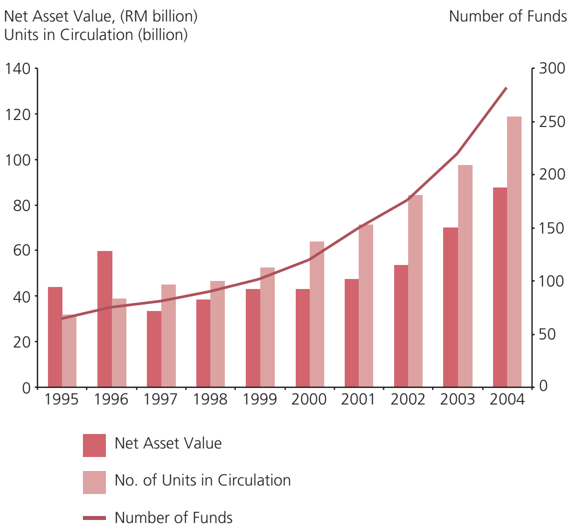
the domestically-sourced VC investments were more focussed on the ICT sector, a move away from the previous focus on the manufacturing sector, while foreign VCs shifted their preference from the ICT sector to the life sciences sector.

The development of VC financing will continue to be keenly promoted in view of its significance in nurturing new growth areas as well as to serve as an alternative source of financing to the economy as a whole. Further efforts will be directed towards greater capacity building in terms of skills upgrading and access to private sector financing. To accelerate the development of the VC industry, a sound network of business angels, diversified sources of funds and a large pool of highly skilled knowledge workers are being developed. Constraints in the supply of innovations would be addressed with the improvement of deal flows through the development of a critical mass of high growth-potential investees. In order to assist the cultivation of better entrepreneurship culture, efforts are being directed at providing the necessary business and regulatory environment, ensuring access to financing at the earlier stages of innovation and reviewing existing policies relating to the commercialisation of ideas.

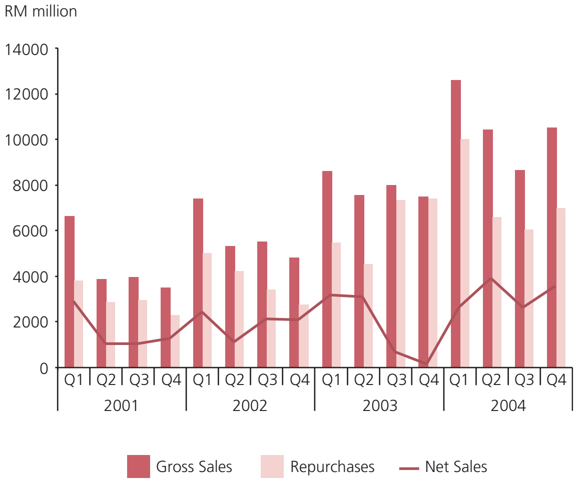
Unit Trust Industry

The unit trust industry experienced significant growth in 2004, reflecting the growing acceptance of unit trusts as an important investment vehicle for the public. During the year, a total of 62 new unit trust funds were launched (2003: 44), bringing the total number of funds to 281 as at end-2004 (end-2003:

Graph 8.5
Unit Trust Industry - NAV, Units in Circulation and Number of Funds



Graph 8.6
Unit Trust Industry - Gross Sales, Repurchases and Net Sales



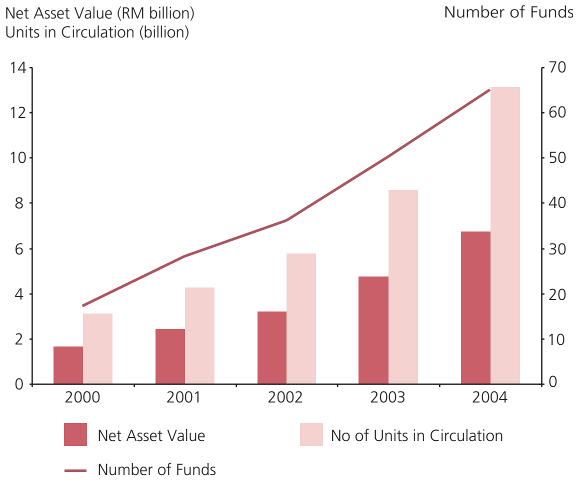
219). The level of gross sales was consistently high throughout the year, resulting in total gross sales for the year rising by 33.4% (2003: 37.5%). While repurchases were also generally higher compared with previous years, the industry nevertheless registered its strongest annual net sales of RM12.6 billion (81.9% higher than in 2003).

One of the main factors contributing to the growing demand is the availability of a greater variety of unit trust funds, which cater to the diversified risk and return requirements of different investors. The funds approved by the Securities Commission (SC) in 2004 ranged from general equity and bond funds, to funds that invest significantly in more risky securities/ instruments. In addition, there were also funds designed exclusively for institutional investors which carried a higher minimum initial investment amount. Other new unit trust funds introduced included those differentiated by investment strategy, asset allocation, level of risk and distribution policies.

Reflecting stronger investor demand for Islamic financial products, the Islamic unit trusts industry continued to grow at a rapid pace. In 2004, 15 new Islamic funds were launched (2003: 14), bringing the total number of Islamic funds to 65. The net asset value (NAV) of Islamic funds, which grew by 42.3% in 2004, accounted for 7.7% of total NAV of the unit trust industry as at end-2004 (end-2003: 6.8%).

Real estate investment trusts, or REITs (previously known as property trust funds), were first established and launched in Malaysia in 1988. Recognising the

Graph 8.7
Islamic Unit Trusts - NAV, Units in Circulation, and Number of Funds



potential of REITs as an alternative investment vehicle to facilitate financial planning by Malaysian investors, as well as its potential in enhancing liquidity in the local property market, the Government undertook a series of measures in 2004 to spur the development of REITs. These measures included favourable tax treatment as announced in the 2005 Budget, and the introduction of the Guidelines on Real Estate Investment Trust by the SC to attract new players and enhance awareness amongst local industry players and property owners/developers on the benefits of establishing a REIT.

There remains great potential for the Malaysian unit trust industry to expand further despite its significant growth in the last few years. The penetration level, as measured by the ratio of the net asset value of the unit trust industry to equity market capitalisation, remains low in Malaysia relative to countries with more mature financial systems, such as the United States and United Kingdom. Greater investor awareness and knowledge of financial planning and available financial products is essential for more rapid development of the unit trust industry. Towards this end, the authorities, in collaboration with industry players and associations, have undertaken continuous education programmes such as seminars, workshops and road shows on financial planning, and on unit trust investments in particular.

In addition, efforts to widen the distribution channels, such as through the introduction of the Guidelines on Online Transactions and Online Activities in Relation to Unit Trusts to enable the use of the internet and other electronic mediums for promoting, distributing and providing information to investors, would also help to spur further expansion of the Malaysian unit trust industry.