An assessment of the Malaysian financial services sector

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This assessment report, prepared for the International Labour Organization by Prof. Paresh Kumar Narayan, is intended to provide a rapid overview of the financial services sector in Malaysia and to stimulate discussions at the Tripartite Workshop to Promote Social Dialogue on Financial Services Reforms in Selected Asia and Pacific Countries (Jakarta, Indonesia, 5-6 August 2015).The views expressed in the report are not necessarily those of the ILO.

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Contents

1. Introduction

The report provides a rapid assessment of the Malaysian financial services sector. Specifically, the proposal consists of five sections. Section II provides the structure of the financial services sector. Section III discusses any potential effects of the global financial crisis. Section IV discusses sectoral social dialogue and collective bargaining, and Section V is about social protection measures. The final section summarizes and proposes key recommendations. This report is based on an extensive desk research and a complete list of data sources is documented in Appendix A.

2. Structure of Malaysia's Financial Services Sector

Malaysia's financial sector is well diversified. It comprises banking intermediaries, insurance companies and capital market intermediaries with overall assets of close to 400% of GDP as of end-2011[1]. There are 54 banking intermediaries, accounting for around 50.6% of the financial system's total assets. Bank Negara Malaysia (BNM)[2], supervises the banking system, which is composed of commercial banks, Islamic banks, and investment banks, respectively accounting for approximately 75%, 20%, and 5% of the banking system's assets.

Malaysia's current banking sector is a result of considerable consolidation. Of the 22 domestic commercial banks in 1986, only six survived by 2011. Finance companies were merged into commercial banking groups while discount houses, securities firms and merchant banks were consolidated into investment banks. Some analysts believe the consolidation had great benefits for the entire industry as it made institutions more stable and resilient, by rationalizing costs and realizing economies of scale. While the number of domestic commercial banks dropped, the average assets per institution grew from Malaysian ringgit (RM) 16 billion to 128 billion. In the same period, the number of foreign commercial banks increased from 13 to 17, bringing with them greater product innovation and knowledge.

A report from BNM (2011) states that Malaysia today is the world's third largest market for Islamic banking, *takaful* and *sukuk*[3]. The country's Islamic capital market tripled in size to a value of RM1.05 trillion over the past decade. The Islamic banking subsector has expanded from 6 to 22% of the overall banking sector while the *sukuk* market now accounts for 55% of the debt securities market. The country is the world's largest *sukuk* market and a leading centre for Islamic equity, Islamic fund management, Islamic banking, and *takaful*. It is also home for most of the key international financial

[1] International Monetary Fund (2013) Country Report No. 13/52. Malaysia: Financial Sector Stability Assessment. https://www.imf.org/external/pubs/ft/scr/2013/cr1352.pdf

[2] Malaysia has 23 commercial banks, 16 Islamic banks, and 15 investment banks.

[3] Bank Negara Malaysia, Central Bank of Malaysia (2011): Financial Sector Blueprint 2011–2020. www.bnm.gov.my/files/publication/fsbp/en/BNM_FSBP_FULL_en.pdf. *Takaful* is a type of Sharia-based Islamic insurance, where members contribute money into a pool in order to guarantee each other against damage or loss. *Sukuk* are Islamic bonds structured to generate returns without violating Islamic prohibition against *riba* (interest).

groups that offer Islamic financial products and services, and has focused on promoting global dialogue to facilitate international convergence of Sharia rulings and standards in the area of finance. In addition, Malaysia has participated actively in the formation of international institutions, namely the Islamic Financial Services Board (IFSB) and the International Islamic Liquidity Management Corporation (IILM), as part of the international collective efforts to promote financial stability in the Islamic financial system.

Malaysia's insurance sector accounts for around 6% of financial sector assets (IMF, 2013). Insurance penetration and density rates are relatively low, although both have been steadily improving, led by the life insurance sector. The general insurance industry remains very fragmented, although there is a clear trend towards consolidation. Cross-border operations of domestic insurers are small, at 0.5% of insurance industry assets in 2011, spanning four nearby countries.

The financial system has become highly interconnected through both funding sources and ownership (IMF, 2013). Banks, non-bank financial companies and mutual funds are linked through the wholesale funding market. Financial conglomeration has grown with major banks owning insurance and fund management companies and securities firms. Six financial conglomerates operate under a financial holding company (FHC) structure, while two are headed by licensed banking institutions. They account for 70% of total assets in the banking system.

The sector's current workforce is small, accounting for only around 2.5% of national employment from 2001 to 2008. However, the sector employs a pool of highly skilled personnel that receive above-average wages. Of new jobs created, 56% are expected to offer an average income of over RM 4,000 per month compared to the all industry average monthly income of RM 2,500[4]. The sector development plan states that expected growth in business opportunities will lead to a further 229,000 new jobs by 2020.

The sustained soundness and efficient functioning of the Malaysian financial services sector has been achieved at least partly as a result of reforms that have focused on: (1) BNM and Securities Commission Malaysia adopting appropriate supervisory techniques that reflect emerging best practices. These include risk-based capital requirements, stress testing, peer group comparisons and horizontal reviews. (2) Developing a regulatory and supervisory regime for banking and employing a risk-focused approach, supported by a comprehensive programme of onsite supervision and extensive off-site macro and micro surveillance. (3) Developing a national financial markets infrastructure (FMI, including RENTAS, the wholesale payment system).

[4]http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---sro-bangkok/documents/publication/wcms_325219.pdf

3. Potential effects of the Global Financial Crisis

Similar to other countries in East and Southeast Asia, the impact of the global economic and financial crisis on Malaysia has been felt largely through a contraction in aggregate demand caused by a collapse in exports, either directly or indirectly, to the United States (Abidin and Rasiah, 2009)[5]. GDP growth slowed down to 0.1% in the last quarter of 2008, and negative growth of -6.2% and -3.9%, respectively, were recorded in the first two quarters of 2009. As overall GDP growth declined, this was reflected in the slowdown in manufacturing activity. However, Malaysia did not experience any direct repercussions on its currency or capital markets from the crisis. This was mainly because it had little exposure to the financial derivatives based mainly on sub-prime mortgages. BNM, the Central Bank, also managed the financial services sector very well following its experience from the 1997 Asian financial crisis.

Exposure to foreign loans had been kept to a minimum and non-performing loans (NPLs) as a share of financial assets in the country had been one of the lowest registered among Asian economies for 2008 (World Bank, 2008). According to IMF (2013), Malaysia's financial system has responded to the financial crisis in a robust manner, helped by limited reliance of financial intermediaries on cross-border funding, a well-developed supervisory and regulatory regime, and a well-capitalized banking system. Reliance of financial market intermediaries on cross-border and interbank funding remains limited, as is the exchange rate exposure of the economy. Consolidation through mergers and acquisition has led to the emergence of a number of strong banking and financial groups as well as capital market intermediaries which are now able to expand into neighbouring markets. Furthermore, the authorities were proactive in responding to the global financial crisis, with pre-emptive measures by BNM including reductions in the policy rate, extension of access to its standing facility to insurance companies, temporary reduction of reserve requirement, and the extension of a Government Deposit Guarantee (GDG) on all ringgit and foreign currency deposits.

4. Sectoral Social Dialogue and Collective Bargaining

Table 1, below, summarizes the number of trade disputes reported to the Department of Industrial Relations Malaysia (DIRM) by reason of dispute in the period from 2008 – 2012. In 2008, there were 27 disputes that involved more than 51 thousand workers. From 2009 to 2011, the number of disputes increased, but the number of workers involved was lower than in 2008. In 2012, the number of disputes was 324 and the number of workers involved was twice that of 2008. The most common reason for industrial conflict was "disputes overs terms and conditions of contractive terms in collective agreement and other service contracts". This accounted for 21%-33% of total disputes, and 4%-22% of the total number of workers involved in disputes from 2008 to 2012.

[5] Abidin, M., and Rasiah, R., (2011) The Global Financial Crisis and the Malaysian Economy: Impact and Responses. UNDP. Retrieved from http://www.undp.org.my

Table 1. Industrial Disputes Reported to the Department of Industrial Relations Malaysia (DIRM) by Reason for Dispute, 2008 - 2012

	2008		2009		2010		2011		2012	
Reason for Dispute	No. of Disputes	No. of Workers Involved	No. of Dispute	No. of Workers Involved	No. of Dispute	No. of Workers Involved	No. of Disput e	No. of Workers Involved	No. of Dispute	No. of Workers Involved
Refusal to enter into collective bargaining	26	2,898	24	1125	36	701	28	2,731	16	1,371
Deadlock in collective bargaining	75	17,606	114	7719	69	4,385	78	8,338	74	13,022
Disputes overs Terms and conditions of contractive terms in collective agreement and other service contracts	89	16,445	72	3383	73	2,267	67	4,214	68	4,465
Retrenchment and lay-off	4	1,488	7	100	0	0	4	1,027	16	201
Promotion, allocation of duties, transfer and other management prerogatives	22	881	18	127	42	572	25	1,379	12	3,503
Demotion, suspension, warning letter and other disciplinary actions against workers	20	2,465	11	487	19	395	14	124	8	15
Non-compliance of labour standards statutory provision related to amenities and facilities and other non-monetary benefit	4	34	9	27	3	177	8	182	16	784
Infringements of worker's rights/ unfair labour	0	0	11	15	34	1,191	7	803	6	83
Others	27	9,991	64	752	68	1,606	80	9,256	108	78,627
Total	267	51,808	330	13,73 5	344	11,294	311	28,05 4	324	102,071

Table 2, on the following page, presents the number of industrial disputes reported to the Department of Industrial Relations Malaysia by industry from 2008 to 2011. Manufacturing had the highest share of 16 industries covered, accounting for 42%-55% of the total number of disputes. The number of disputes for the financial services sector was between 14 and 32, representing approximately between 5% - 12% of the total. The main message is that while the total number of disputes have risen following the global financial crisis, it is not clear to what extent the crisis contributed to this trend.

Table 2. Industrial Disputes Reported to the Department of Industrial Relations Malaysia (DIRM) by Industry, 2008-2011 (MSIC-2000)

	2008	2009	2010	2011
Agriculture, Hunting and Forestry	32	25	33	22
Fishing	2	1	0	0
Mining and Quarrying	2	3	3	9
Manufacturing	114	181	165	132
Electricity, Gas and Water Supply	7	11	4	1
Construction	0	0	1	0
Wholesale and Retail Trade, Repair of Motor Vehicles, Motorcycles, Personal and Household Good	3	4	9	10
Hotel and Restaurant	18	21	10	19
Transport, Storage, and Communication	38	49	91	72
Financial Intermediation	32	14	17	30
Real Estate, Renting, and Business Activities	4	5	4	5
Public Administration and Defense, Compulsory Social Security	10	0	0	0
Education	0	0	0	0
Health and Social Work	5	2	2	3
Other Community, Social and Personal Service Activities	0	0	0	0
Ex-Territorial Organisations and Bodies	0	0	0	0
Total	267	330	344	311

Table 3, below, reports on the outcome of claims for recognition by trade unions handled by the Department of Industrial Relations. This data is categorized by industry for the 2008-2011 period. There are four types of outcomes: Accorded Voluntarily, Recognition, Not Recognition, and Rejected/Withdrawn/Not Eligible. The “Rejected/Withdrawn/Not Eligible” outcome was the highest, followed by the “Not Recognition” and “Recognition”. For the financial services sector, there were 5 “Accorded Voluntarily” outcomes, 5 “Recognition” outcomes, none of “Not Recognition”, and 8 “Rejected/Withdrawn/Not Eligible” outcomes from 2008 to 2011.

In Malaysia, redundancies and mass layoffs are regulated. Redundancies are regulated by the Code of Conduct for Industrial Harmony, which was entered into by the Ministry of Labour and Manpower, the Malaysian Council of Employers Organization, and the Malaysian Trade Unions Congress on 9 February 1975. The Code lays down certain guidelines for carrying out a retrenchment exercise and is deemed to embody the principles of fair labour practices that have been agreed to by employer and worker representatives. Retrenchment by reason of redundancy is viewed by the courts as the employer's last resort. The employer is under an obligation to consider and carry out alternatives that may assist the situation, such as a reduction of overhead expenses, working hours, or other solutions, before embarking on the retrenchment exercise[6]. Employees who are dismissed on redundancy grounds are entitled to termination notice (as prescribed in their contracts) and fair severance benefits which, for employees who fall within the Employment Act (EA), must be no less than the minimum termination notice period and termination benefit prescribed by the EA.

[6] The Code includes several provisions on cost-cutting that parallel the less drastic measures that American- and EU-based businesses also are taking before initiating layoffs: Limiting recruitment; restricting overtime; restricting work on the weekly rest day; reducing the number of shifts or days worked a week; reducing the number of hours of work; retraining; transferring to other departments.

Table 3. Outcome of Claims for Recognition by Trade Unions Handled by the Department of Industrial Relations Malaysia (DIRM) by Industry and Mode of Settlement, 2008 – 2011 (MSIC – 2000)

	Accorded Voluntarily				Recognition				Not Recognition				Rejected/Withdrawn/Not Eligible			
	‘08	‘09	‘10	‘11	‘08	‘09	‘10	‘11	‘08	‘09	‘10	‘11	‘08	‘09	‘10	‘11
Agriculture, Hunting and Forestry	2	1	2	1	5	2	4	1	1	2	5	2	0	3	4	4
Fishing	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Mining and Quarrying	0	2	0	1	0	2	2	1	0	7	6	1	0	8	4	3
Manufacturing	5	1	4	8	10	2	11	20	7	2	10	8	18	2	21	18
Electricity, Gas and Water Supply	0	1	0	0	1	1	0	0	0	4	1	0	0	0	0	2
Construction	0	0	0	0	0	0	0	0	0	0	4	1	0	0	0	0
Wholesale and Retail Trade, Repair of Motor vehicles, Motorcycles, Personal Household Goods	1	0	0	2	0	6	2	3	1	2	1	0	3	6	0	9
Hotel and Restaurant	0	0	0	1	4	6	0	3	0	0	4	1	2	6	0	1
Transport, Storage, and Communication	0	1	0	2	6	6	3	3	2	2	4	1	8	8	5	4
Financial Intermediation	1	2	0	2	2	0	3	0	0	0	0	0	1	2	1	4
Real Estate, Renting, and Business Activities	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0
Public Administration and Defences, Compulsory Social Security	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0
Education	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0
Health and Social Work	0	0	0	0	0	2	0	0	0	0	0	0	0	1	0	0
Other community, Social and Personal Service Activities	0	1	0	0	0	1	0	0	0	4	0	0	1	0	0	0
Private Household with Employed Person	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Ex-Territorial Organisations and Bodies	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	9	9	7	18	28	28	25	31	11	23	35	14	33	37	35	45

Even though the courts have consistently maintained that the Code is not legally binding, employers are encouraged to consider its provisions in the interest of industrial harmony and to demonstrate that a retrenchment is undertaken only after other options are no longer viable. Finally, prior to undertaking a retrenchment, employers must notify the Labour Department by filing a Termination Form (PK Form), which does require them to indicate whether any other alternative cost-cutting measures had been considered and/or undertaken prior to the retrenchment exercise. Businesses in Malaysia are further encouraged to institute a voluntary separation scheme (VSS) before undertaking any mandatory retrenchment. The primary objective of a VSS is to reduce, on a voluntary basis, the surplus staff. A company will either invite all employees to apply for VSS or limit the invitation to only the employees engaged in the categories affected by the reorganization. Regardless, a company carrying out a VSS must not pressure any employee into opting for the VSS as he or she may reluctantly agree, and then allege afterward that he or she was coerced into doing so. If the employee is then successful in establishing the coercion, the Court likely will hold the termination to be unfair.

This report finds no evidence that layoffs in the financial services sector in Malaysia were a result of the global financial crisis.

5. Summary

Malaysia's financial sector is well diversified. It comprises banking intermediaries, insurance companies and capital market intermediaries with overall assets of close to 400% of GDP. The negative effect of the global financial crisis on economic growth was experienced by Malaysia over the short-term. The economy recovered quickly. Moreover, the financial services sector, like most of Asia, had been extremely resilient to the crisis. This resilience has been built around the experiences and ensuing reforms undertaken as part of the 1997 Asian financial crisis. There is no evidence of any direct effects of the recent global financial crisis on the Malaysian financial system. This is not to say that firms and organizations have not been impacted. They must have, but this report has not been able to identify any of this. Therefore, there is a need for further studies to explore in detail not only the effects of the crisis on Malaysian firms/organizations but also on how the effects were handled by employers and trade unions, and what exactly were the gender effects of the crisis.

Appendix A. Data sources

Relevant information	Name of documents	Sources
1. Structure of national financial services sector and its development.	Malaysia: Financial Sector Stability Assessment	https://www.imf.org/external/pubs/ft/scr/2013/cr1352.pdf
	Financial Sector Blueprint 2011–2020	www.bnm.gov.my/files/publication/fsbp/en/BNM_FSBP_FULL_en.pdf
	Labor and human resources statistic	http://www.mohr.gov.my/docz/StatistikPerburuhan2012latest.pdf
	Sectoral Activities Department – **Malaysia - ILO**	http://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---sector/documents/publication/wcms_161284.pdf
	Decent Works in Malaysia	http://www.ilo.org/wcmsp5/groups/public/---dgreports/---integration/documents/meetingdocument/wcms_144773.pdf
	Financial Deepening in Malaysia	http://www.imf.org/external/pubs/ft/sdn/2015/sdn1508.pdf
	IMF Country Report - Malaysia	http://www.imf.org/external/pubs/ft/scr/2015/cr1558.pdf
2. Effects of global financial crisis and recent financial reform	The Global Financial Crisis and the Malaysian Economy: Impact and Responses	http://www.undp.org.my
	Financial sector blueprint 2011–2020	http://www.bnm.gov.my/files/publication/fsbp/en/BNM_FSBP_FULL_en.pdf
	IMF Country Report - Malaysia	http://www.imf.org/external/pubs/ft/scr/2015/cr1558.pdf
3. Sectoral social dialogue and collective bargaining in the country	Labor and human resources statistic	http://www.mohr.gov.my/docz/StatistikPerburuhan2012latest.pdf
	Doing business in Malaysia	http://www.pwc.de/de/internationale-maerkte/assets/doing-business-in-malaysia.pdf
	IMF Country Report - Malaysia	http://www.imf.org/external/pubs/ft/scr/2015/cr1558.pdf
	Financial sector blueprint 2011–2020	http://www.bnm.gov.my/files/publication/fsbp/en/BNM_FSBP_FULL_en.pdf
4. Redundancy, Layoffs and Social protection	Doing business in Malaysia	http://www.pwc.de/de/internationale-maerkte/assets/doing-business-in-malaysia.pdf
	Implementing Downsizing and Layoff Decisions During the Global Recession – How Multi-National Companies are Grappling with the Current Economic Crisis	http://www.buse.de/tl_files/publikationen/downsizing_and_layoff_Decisions_2010-10-26.pdf
	Labor and human resources statistic	http://www.mohr.gov.my/docz/StatistikPerburuhan2012latest.pdf
	Addressing talent scarcity in Islamic finance	http://www.faa.org.my/article/addressing-talent-scarcity-in-islamic-finance