Learning curve

A series of reforms over recent years mean that Malaysia's buy-side is now positioned to catch up with international investors in their use of electronic trading tools and techniques.

Jill Wong

Malaysia is set to take centre stage among Asian markets as a new phase in financial liberalisation and an openness to electronic trading generates an unprecedented demand for trading technology by domestic investment institutions.

A number of initiatives designed to make Malaysian investment opportunities accessible to foreign investors are prompting local firms to upgrade their investment operations too.

Core to the country's success in gaining foreign investor confidence is the new Financial Services Act (FSA), which replaces several existing acts, including the Banking and Financial Institutions Act 1989 (Bafia), the Exchange Control Act 1953, the Insurance Act 1996 and the Payment Systems Act 2003.

The FSA complements the Financial Sector Blueprint in which the central bank, Bank Negara Malaysia, outlines its recommendations for the development of a financial sector that can meet the economic and financial realities of the new decade. The blueprint envisages that by 2020, the financial sector's contribution to nominal GDP will rise from 8.6% to 10-12%.

"There's been a lot of interest from international investors in emerging Asia that gained momentum last year and is continuing this year. With that, clients are looking for ways to execute efficiently," says Ofir Gefen, agency broker ITG's head of Asia-Pacific electronic brokerage and analytics.

Two-way flow

Bursa Malaysia introduced DMA to its derivatives market in April 2008 and rolled the functionality out to the equities market in November 2009.

But to date it is largely international institutions that have taken advantage of these capabilities. Changes to local investment rules in 2007 – which hiked the maximum net asset value of foreign currency investments by Malaysian unit trusts, fund management and insurance companies to 50% from 30% – have prompted only a limited overhaul of trading processes and counterparties.

Gradually, says Adrian Chua, agency broker Bloomberg Tradebook's head of APAC sales, appetite for and understanding of electronic trading tools is growing among Malaysian buy-side firms. "In the last two years, the move towards more usage of electronic trading has been helped by growing overseas investment levels by local fund managers, especially the more familiar markets in the ASEAN region," he comments. "At this point, the government-linked agencies are the ones leading the interest in overseas investments, followed by the larger domestic long-only funds, and to a lesser extent, the insurance companies."

Global brokers such as Bloomberg Tradebook have been the leading providers of outward DMA to Malaysia's buy- and sell-side as well inbound electronic trading services to offshore firms, but Chua suggests that local brokers are fast acquiring the resources and technology know-how to compete. "Mergers in the local brokerage industry may lead to greater economies of scale and more investment in institutional e-trading platforms, either developed in-house or by working with technology providers," he adds.

One local firm that has positioned itself to capture electronic order flow in Malaysia is CIMB Securities, a unit of the Kuala Lumpur-headquartered regional banking group.

CIMB agreed to pay US$140 million in April 2012 for some of the Asian assets of the Royal Bank of Scotland (RBS), including its cash equities businesses in Australia, Hong Kong and the China mainland and Taiwan, as well as two equities distribution divisions in New York and London.

Andrew Freyre-Sanders, Hong Kong-based head of equity execution services at CIMB and formerly global head of client electronic execution at RBS, says the firm has regional ambitions. "The priority for CIMB on the securities side is to continue to show its dominance and strength in ASEAN while proving its Asia-wide ability," he asserts.

"Malaysian firms have recognised that with greater volumes comes greater operational risk."

Nellie Dagdag, executive director of sales and solution delivery, Omgeo

Malaysia's buy-side is beginning to respond to the range of trading and execution options available to them. Since September 2010, two Malaysian investment firms owned by BNP Paribas Investment Partners have outsourced their local and overseas equity dealing to BNP Paribas Dealing Services Asia, the Hong Kong-based outsourced dealing arm of BNP Paribas Securities Services, under a dealing delegation agreement.

"Within Malaysia, where more and more assets under management are currently being built up, local players – asset managers and pension funds – are seeking diversification and need to invest beyond their borders," says Francis So, head of dealing, Asia, at BNP Paribas Dealing Services Asia.

BNP's So says access to algorithms and DMA is

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improving quality of execution in Malaysia, but calls for further market infrastructure innovation, such as a single settlement system for both cross trades and normal market trades. "This would be an opportunity to streamline and simplify processes, for both trading and settlement," he notes.

From fax to FIX

Automation of post-trade processes is firmly on the agenda in Malaysia, according to Nellie Dagdag, executive director of sales and solution delivery at Omgeo, whose central trade matching solution is used by a number of buy-side institutions in Malaysia.

A survey of post-trade practices in Malaysia, Indonesia and Thailand commissioned by Omgeo in 2009 found that 60% of respondents ordered and executed securities transactions by phone. Almost half of securities confirmations between Malaysian fund managers and brokers were sent by fax machine.

Since then, says Dagdag, "The Malaysian market and firms have recognised that with greater volumes comes greater operational risk which needs to be managed."

She is also encouraged by a current holistic regulatory review of Malaysia's financial infrastructure. "The government in Malaysia has been one of the more aggressive amongst emerging markets in terms of market reform and adopting global standards. Such comprehensive legislative reform is a good indication that Malaysia's regulators are very committed to this area," Dagdag observes.

Since introducing DMA, Bursa Malaysia has not let the grass grow under its feet, investing regularly in technology to compete on the world stage. The exchange recently introduced a market surveillance system to monitor equity and derivatives trading developed by MillenniumIT, a technology firm owned by the London Stock Exchange Group. During Q1 2014, Bursa is scheduled to deploy a new platform for trading equities, fixed income, exchange-traded funds and issuer warrants using Nasdaq OMX's X-Stream INET technology.

According to Lars Ottersgård, senior vice president of market technology at Nasdaq OMX, robustness of trading infrastructure and regulatory framework are both key to a market's international credibility.

"The technology is part of your brand. It can be a barrier to entry if an exchange has a very peculiar trading platform instead of a globally well-known, trusted and proven platform. For certain types of traders, the capabilities of the platform are particularly important, like the performance and latency. But in the end, it's all about having a transparent, fair, well-regulated and stable market. The platform is just one component for the market to get to that stage," he says.

A major contribution to the take-up of electronic trading by Bursa Malaysia's members could be the retirement of its trading terminal, the Winscore Broker Front-End (BFE), which was not equipped to handle algorithmic trading. AmInvestment Bank, a Malaysian investment bank, replaced Winscore with FlexTrade Systems' Mottai solution early last year and the firm now counts several Malaysian retail brokers or remisiers among its client base.

Bertrand Rassat, principal, Asia, at FlexTrade Systems, is confident that adoption of electronic trading by smaller asset managers and local brokers will rise over time. For now, many Malaysian asset managers are still not using FIX and continue to pass orders over the phone, Rassat notes.

"Many asset managers don't want to do DMA because they are not willing

The buy-side view: George Molina,

head of Asian trading, Franklin Templeton Investments

The TRADE Asia: Is Malaysia doing enough to help international investors trade its market?

Molina: We are very happy with Bursa Malaysia's progress as it keeps up with its neighbours across the region and embraces the electrification of the market. In addition, its latest proposal to replace its trading engine by the end of the year is a sign of commitment to keep the infrastructure current to cope with potential increase in liquidity. Its work on the ASEAN Trading Link has been noted as we closely monitor its development and potential liquidity opportunity. I also applaud the exchange reaching out to the investor community abroad through their road shows and meetings on how we can work together to facilitate the trading of Malaysian securities.

The TRADE Asia: What else should Malaysia do to be more investor-friendly?

Molina: I'd recommend three areas:

- Liquidity is a major obstacle for international investors; capital markets need to increase free float and encourage local pension funds to diversify further to allow for volumes to increase. The MSCI Asia X-Japan weightings have fallen from a high of around 23% in the early 1990s to currently under 4%. In the last three years, volumes in Malaysia have decreased. In contrast, volumes in Indonesia and Thailand specifically have almost doubled;
- Lower transaction costs to make Malaysia more competitive with regional markets, e.g. reduce/eliminate stamp duty and clearing fees (currently stamp duty is about 0.1% cap at RM200 and the clearing fee is at 0.03% cap at RM1,000);
- Stock borrow/shorting – even though shorting of securities was legalised five years ago, it has not taken off at all due to a severe lack of inventory. Bursa Malaysia says it is actively talking to stakeholders to participate in this program but little progress has been made so far. But this is not to be dismissed, as it's one of a series of steps that forms part of the effort to increase liquidity in the market place.

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to take the trading risk," he says, adding that regulatory or competitive impetus is needed to stimulate growth of algorithmic trading. "If Malaysia embraces best execution, the domestic buy-side will have massive requirements for new technology," says Rassat. "But it's still going to take time to assess the impact it will have on their execution process. The buy-side will have to be more competitive and adopt best practices, but it will be a slow process because there's no regulatory pressure."

Political risks

Malaysia is hoping to reap long-term benefits from its membership in the ASEAN Trading Link, which aims to provide a single entry-point for accessing southeast Asia's stock markets. In September 2012, Bursa Malaysia and the Singapore Exchange (SGX) became the first markets to be connected to the ASEAN Trading Link. The Stock Exchange of Thailand joined in October.

Increased intra-regional flows and liquidity are predicted but some reservations persist.

David Jenkins, head of Asian business development for technology provider Fidessa, says the need to clear transactions locally means there is unlikely to be major flows through the ASEAN Trading Link until a single clearing platform materialises. "The ASEAN Trading Link is a first step towards a pan-ASEAN exchange, but its not compelling enough on its own to make people want to go there," he notes.

Flextrade's Rassat adds, "The ASEAN Trading Link only really makes sense for the retail clients. Right now there does not seem to be huge demand from the retail clientele in Malaysia to trade international markets. If they want to trade outside Malaysia, it would probably not be Thailand but the US market or the UK market. I am not convinced that it is going to change things dramatically in the short term."

With the World Bank forecasting 5% GDP growth this year, Malaysia is likely to remain popular with international investors.

Bursa Malaysia traded RM34.2 billion (US$11 billion) worth of securities in January 2013, of which 46.8% was attributed to local institutional investors, 27.5% to foreign institutional investors, 14.12% to local retail investors and 8.16% to local nominees.

The main risks to continued international investment growth could be political. Expectations are high that general elections scheduled for 27 June will be the ruling Barisan Nasional coalition's most challenging ever. Barisan Nasional returned in the 2008 general elections with 140 seats, its worst result since 1969. Anwar Ibrahim's Parti Keadilan Rakyat, the largest opposition party, is expected to win much more than the 14% of parliamentary seats it gained in 2008.

Political risk aside, players remain optimistic that Malaysia will continue to blaze down the reform trail and the market will see volumes grow significantly in the coming years as the benefits of reforms, enhanced market microstructure, increased foreign capital inflows and membership in the ASEAN Trading Link take hold.

"There's a high level of interest in the ASEAN markets because the region's economies are more buoyant than the rest of the world and people are looking to gain access as part of their execution fabric," says Fidessa's Jenkins.