



Suruhanjaya Sekuriti
Securities Commission
Malaysia

**GUIDELINES ON MARKET CONDUCT AND
BUSINESS PRACTICES FOR STOCKBROKERS
AND LICENSED REPRESENTATIVES**

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PART I

1.0 DEFINITIONS

AMLA	– refers to the <i>Anti-Money Laundering and Anti-Terrorism Financing Act 2001</i> . The term is used interchangeably with its acronym “AMLA”.
AML / CFT	– refers to anti-money laundering and counter financing of terrorism.
Bursa’s Rules	– Rules of Bursa Malaysia Securities Bhd.
CMSA	– refers to the <i>Capital Market and Services Act 2007</i> which introduces a single licensing regime for capital market intermediaries. It came into force on 28 September 2007.
CMSR	– means the <i>Capital Markets and Services Regulations 2007</i> .
CMSL	– means the Capital Markets Services Licence referred to in the CMSA.
CMSRL	– means the Capital Markets Services Representative’s Licence referred to in the CMSA. It is a licence issued to a representative of the holder of CMSL.
Employee	– refers to an employee of a stockbroking company.
Guidelines	– refers to this set of <i>Guidelines on Market Conduct and Business Practices for Stockbrokers and Licensed Representatives</i> .
Licensed persons	– in the context of these Guidelines, refers to a holder of CMSL or CMSRL for the regulated activity of dealing in securities.
Licensed representatives	– in the context of these Guidelines, refers to a holder of CMSRL of a stockbroker.
SC	– refers to the Securities Commission established under the <i>Securities Commission Act 1993</i> .
Stockbroking company	– means a holder of a CMSL for the regulated activity of dealing in securities. It is used interchangeably with the term “stockbroker”.
Stockbroker’s representative	– refers to the holder of CMSRL that relates to the holder of CMSL. It is used interchangeably with the term “stockbroking company’s representative”.

2.0 INTRODUCTION

This Guidelines set out 11 core principles of supervision applicable to stockbrokers and their representatives under the SC's principles-based regulation, and the elaborations on how established principles of AML/CFT measures, as in the *Guidelines on Prevention of Money Laundering and Terrorism Financing for Capital Market*, may be carried out. The Guidelines also set forth the standards expected of stockbrokers, their representatives and where applicable, their employees, in market and business conduct. As a matter of guidance, this Guidelines provide several examples and scenarios to illustrate conducts and activities which in the SC's opinion constitute market abuses and unethical business conduct.

The SC will be guided by the Guidelines in considering whether any stockbrokers or stockbrokers' representatives have taken reasonable steps to organise and manage their business affairs responsibly. The SC views any breach of the Guidelines as serious misconduct as breaches reflect adversely on the fit and properness of the licensed persons, which may result in the SC taking regulatory or other appropriate actions against them.

The Guidelines do not replace regulatory requirements and obligations provided under existing securities laws, rules, guidelines, or regulations applicable to stockbrokers, their representatives and where applicable, their employees.

PART II

3.0 CORE PRINCIPLES OF SUPERVISION

- (a) The SC is actively promoting a culture of compliance, professionalism, ethical standards and responsible conduct among stockbrokers and their representatives and employees. Towards this end, the SC has adopted principles-based regulation in supervision and set out below are 11 core principles which apply to stockbrokers:

Core Principles	
1. Integrity	A licensed person must conduct its business with integrity. (Example: Act in a fair and consistent manner, and treat all clients fairly, equitably and equally.)
2. Skill, care and diligence	A licensed person must conduct its business with due skill, care, and diligence. (Example: Ensure employees are suitably qualified for the positions in which they are employed, and there are sufficient resources to manage business activities and accommodate temporary absence of key personnel.)
3. Supervision and control	A licensed person must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management and supervisory system. (Example: Ensure key duties and functions are properly segregated. Establish a system of follow-up and review for delegated authority and responsibility. Ensure proper assessment and management of risks, and provision of timely and adequate information to senior management.)

<p>4. Financial requirements</p>	<p>A licensed person must maintain adequate financial requirements.</p> <p>(Example: Level of risk assumed by the stockbroking company must commensurate with its level of capital.)</p>
<p>5. Market conduct</p>	<p>A licensed person must conduct its business activities in a manner which contributes to the maintenance of a fair and orderly market.</p> <p>(Example: Implement policies and procedures to detect and prevent fraud, market rigging, and other improper activities.)</p>
<p>6. Priority to client's interests</p>	<p>A licensed person must give priority to the client's interest.</p> <p>(Example: Refrain from dealing for own account ahead of clients' orders.)</p>
<p>7. Communication with clients</p>	<p>A licensed person must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair, and not misleading.</p> <p>(Example: Must not deliberately mislead or attempt to mislead a client.)</p>
<p>8. Conflict of interests</p>	<p>A licensed person must manage conflict of interests fairly, both between itself and its clients, and between a client and another client.</p> <p>(Example: Ensure proper Chinese Wall policies and procedures are put in place to prevent the company or its employees from taking advantage of confidential price sensitive information.)</p>

<p>9. Safeguarding clients' assets</p>	<p>A licensed person must arrange adequate protection for clients' assets.</p> <p>(Example: Ensure clients' monies and properties are credited into a trust account, and conduct reconciliation of trust account balance as per company's records with bank statements.)</p>
<p>10. Compliance culture</p>	<p>A licensed person must inculcate good compliance culture.</p> <p>(Example: Board of directors must establish clear compliance policies and procedures that extend to all operations of the company.)</p>
<p>11. Dealing with regulators</p>	<p>A licensed person must deal with its regulators in an open and co-operative way.</p> <p>(Example: To promptly report information that is of material significance to the SC, and supply the SC with documents and information when requested and within the time limits of request.)</p>

4.0 PRIMARY ACCOUNTABILITY AND RESPONSIBILITY FOR COMPLIANCE

- (a) The 11 core principles set the level of regulatory standards in supervision that the SC seeks to achieve for licensed persons. Under principles-based approach, the SC will focus on the desired level of regulatory outcomes, instead of any specific process and procedure that a stockbroking company should undertake.
- (b) The SC will hold the Board of Directors and senior management of the stockbroking company primarily accountable and responsible in ensuring adequate policies, procedures, and resources are put in place to meet the core principles.

- (c) Being organised, ready and willing to abide by the core principles will be a critical factor in the SC's examination and assessment of the stockbroking company's level of compliance with the core principles.

5.0 CUSTOMER DUE DILIGENCE ("CDD")

- (a) CDD is a set of policies, procedures, processes, and controls to assist a stockbroking company evaluate, with reasonable certainty, the identity and risk profile of clients. CDD is crucial, as proper adherence to its processes would assist the stockbrokers in–

- detecting and reporting unusual transactions that would potentially expose the company to financial loss and reputation risk; and
- minimising unscrupulous persons from using or attempting to use the company's products and services for illicit purposes.

- (b) Key areas for compliance under CDD processes are:

(i) Adherence to Bursa's Rules on opening of accounts

- A stockbroking company should ensure that procedures in place for opening client accounts are in accordance with relevant Bursa's rules. A stockbroking company and its representative should not effect any transaction on behalf of a client unless the required CDD is conducted on the client.

(ii) "Know-your-client"

- A stockbroking company and its representative must comply with the "know-your-client" requirements in Bursa's rules, and the requirements on monitoring and reporting of suspicious transactions in both the *Anti-Money Laundering Act 2001* and *Guidelines on Prevention of Money Laundering and Terrorism Financing for Capital Market Intermediaries*.
- A stockbroking company and its representative must take all reasonable steps to establish client's identification, employment profile, financial background, investment experience and investment objectives.

- Where there is suspicion or doubt on a client's identity, the stockbroking company and its representative must undertake additional due diligence to identify the ultimate beneficial owner.

(c) Enhanced CDD Processes

(i) Upon determining a client as "high-risk" (clients that may pose higher risk are referred to in paras 7.2.4 – 7.2.6 of *Guidelines On Prevention of Money Laundering and Terrorism Financing for Capital Market Intermediaries*), a stockbroking company and its representative company must undertake enhanced CDD processes on the client.

(ii) Enhanced CDD processes include–

- enquiring on the purpose for opening an account;
- enquiring the level and nature of trading activities intended;
- enquiring on the ultimate beneficial owners;
- enquiring on the source of funds;
- enquiring on the details of occupation/employment;
- obtaining senior management's approval for opening an account;
- procuring the following minimum documentation from clients:

For Individual	<ul style="list-style-type: none"> • IC or passport for foreigners • Address – residential and permanent address, if the two are different • Occupation • Latest three months' pay slip or latest income tax statement or bank statement
For Corporation	<ul style="list-style-type: none"> • Certification of Incorporation • Memorandum and articles of association • Board resolution on opening of account • Specimen signature of authorised signatories

	<ul style="list-style-type: none"> • Information on the nature of business and corporate structure • Latest audited financial statement and/or management financial statements • Latest three months' bank statement • Power of attorney (if applicable)
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(d) A stockbroking company and its representative are required to conduct ongoing monitoring of client's activity, either through manual procedures or computerised systems, upon the opening of client's account.

(e) Examples of suspicious situations, which a stockbroker and its representative must look into, are as follows:

- A client who wishes to engage in transactions that are void of commercial purpose or investment strategy;
- A client who shows unusual concern for secrecy, particularly in the identity of beneficial owner of the account, his employment/business or assets (e.g. a client who refuses to identify or fails to indicate a legitimate source of funds);
- A client who exhibits a lack of concern for risks, commissions, or other transaction costs;
- A client who is not able to describe the nature of his business or his employment;
- A client who authorises funds transfers from his account to other clients' accounts;
- A client whose account has a surge of unexplained or extensive wire activity when there had been few activity in the accounts previously;
- A client whose account has wire transfers to or from a banking secrecy-haven country or country generally known for money laundering risk;
- A client whose account indicates large or frequent wire transfers whose sums are immediately withdrawn;

- A client whose account shows active movement of fund activity with low level of securities trading transactions; and
- A situation where several clients' accounts carry identical correspondence addresses.

6.0 INFORMATION TO CLIENTS

- (a) Having regard to the information acquired about a client through CDD process, the stockbroker and its representative should ensure–
- that the advice, recommendation, or trading limit approval given to the client is suitable and reasonable, in accordance with the client's financial circumstances and risk profiles; and
 - that all necessary information is given to clients so they can understand the nature and risks of derivative products, including futures contracts and options.

7.0 DISCRETIONARY ACCOUNTS

(a) Discretionary Accounts

- (i) Before opening a discretionary account for a client, a stockbroking company must–
- obtain prior approval from senior management of the company;
 - provide adequate advice to the client on the risks in giving the company authority to operate a discretionary account; and
 - ensure that a **written agreement** is entered into with each client before providing any service, or carrying out transactions on a discretionary account.
- (ii) The written agreement in para 7.0(a)(i) above should include the following terms and conditions:

- Client's investment objectives and restrictions, risk profiles and instructions;
- Description of the nature of services to the client;
- Description of chargeable fees and commission, and other payments and the basis for such payments; and
- Mode and manner of reporting by the company to the client.

8.0 UNAUTHORISED USE OF CLIENT ACCOUNTS

- (a) Unauthorised use of client accounts is not permitted.
- (b) To prevent unauthorised use of client accounts, a stockbroking company must:
 - (i) Ensure there are adequate policies and procedures in place for changes to client's data. In particular, any request for change on a client's address and instructions on payments must be in writing, and all reasonable effort must be made (e.g. writing to both the old and new addresses to confirm the requests for changes, follow-up with the client, etc.) to ensure that such requests for changes are genuine;
 - (ii) Ensure all sale proceeds is made payable to the seller-client and no other person, unless the seller-client is present in person to authorise the stockbroker in writing to transfer the sale proceeds to a third party;
 - (iii) Monitor and aggregate, for risk profiling purposes, all the accounts where settlements for outstanding purchases are made or originate from one singular source; and
 - (iv) Constantly remind clients to make cheques in the <name of the stockbroking company> for <name of the client>, when issuing cheques to the company.

9.0 HANDLING ERROR TRADES

- (a) Error account should be used solely for the purpose of amending a bona fide trading error.
- (b) Error accounts must not be abused by stockbrokers or its representative to camouflage unlawful, illegitimate, or unauthorised transactions.
- (d) The stockbroking company must put in place internal procedures on handling error trades, which must include–
 - justification to book trades into an error account;
 - written approval from senior executive for using an error account;

- maintaining proper documentation on handling error trades; and
- monitoring requirements on frequency of error trades by any client or stockbroker's representatives.

10.0 MANAGING CONFLICT OF INTEREST

- (a) A stockbroking company or its representative must ensure that–
- (i) they disclose all potential conflict of interests to the clients; and
 - (ii) they do not provide rumours, or information that has no reasonable basis, or speculative statements concerning any securities to the clients.
- (b) A stockbroking company must put in place supervisory and internal controls, procedures and systems to ensure that–
- (i) analysts' research and recommendations are not compromised or subject to undue influence of issuers, institutional investors or other parties.
 - (iii) non-public information are not shared with unauthorised persons who stand in a conflict position, e.g. personnel in the dealing department.

11.0 REPORTING BREACHES

- (a) A stockbroking company must–
 - (i) monitor and review the company's operations to ensure compliance with securities laws, rules and regulations;
 - (ii) maintain efficient disciplinary processes, and apply them fairly and consistently, in accordance with principles of due process;
 - (iii) upon becoming aware of possible occurrences of breaches of securities laws, the Head of Compliance must immediately commence internal investigations and report the outcome of the investigations to the Board of Directors for further actions. He must notify the SC as soon as possible; and
 - (iv) extend full co-operation to regulatory authorities.

12.0 MARKET ABUSES AND UNETHICAL BUSINESS CONDUCT

- (a) A stockbroking company or its representative must not carry out or facilitate any transactions that would affect the fair and orderly operation of the market.
- (b) A stockbroking company or its representative must not directly or indirectly assist or abet clients in activities which would lead to market abuse or unethical business conduct and/or breaches of securities laws or Bursa Rules. Below are examples of these activities:
 - (i) Execute orders which would potentially manipulate the price of a particular security;
 - (ii) Execute purchase orders at or near the close of market at successively higher prices;
 - (iii) Execute sell orders at or near the close of market at successively lower prices;
 - (iv) Execute "Contango trades", where the transfer of trades takes place between two or more parties acting in concert;

- (v) Key-in buy orders at prices lower than the previous offers and withdrawing the orders before they are matched;
 - (vi) Key in sell orders successively at prices higher than previous bids and withdrawing the orders before they are matched;
 - (vii) Execute an order ahead of house research reports that would influence investors' view on a security in anticipation of the issuance of the research reports; and
 - (viii) Post rumours or information recklessly about corporate activity on Internet bulletin board or chat room without a care on the truth of such information or rumours.
- (c) Please see Part III for further illustrations on activities and conduct which in SC's opinion constitute market abuses and unethical business conduct.

13.0 GENERAL PRINCIPLES AND BEST PRACTICES TO COMBAT MONEY LAUNDERING AND TERRORIST FINANCING

- (a) As stockbrokers are among the statutory reporting institutions named in AMLA, the SC has introduced the *Guidelines on Prevention of Money Laundering and Terrorism Financing for Capital Market Intermediaries* to provide guidance on compliance with the provisions of AMLA. Set out below are examples to illustrate how established principles on AML/CFT measures may be carried out:

1. Commitment from senior management	<p>Senior management should ensure that the company–</p> <ul style="list-style-type: none"> • maintains an effective AML/CFT internal control structure, including monitoring and reporting of suspicious activity; • regularly reviews the policies and procedures on prevention of money laundering and terrorist financing to ensure their effectiveness; • adopts client acceptance policies and procedures which are sensitive to the risk of money laundering and terrorist financing; and • undertakes client due diligence measures to minimise the risk of money laundering and terrorist
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	<p>financing depending on the type of client, business relationship or transaction.</p>
<p>2. Establish AML/CFT risk assessment framework</p>	<p>In establishing AML/CFT framework the company should identify the following risk factors:</p> <ul style="list-style-type: none"> • Products and services [E.g. products and services that may pose higher risk: <ul style="list-style-type: none"> – Margin financing; and – Lending activities, particularly securities borrowing and lending]. • Clients and their geographic locations [E.g. of clients that may pose higher risk are referred to in paras 7.2.4 – 7.2.6 of <i>Guidelines on Prevention of Money Laundering and Terrorism Financing for Capital Market Intermediaries</i>].
<p>3. Formulate AML/CFT policies, procedures, processes and controls</p>	<p>The AML/CFT compliance framework must be documented, approved by the board of directors, and must include the following minimum requirements:</p> <ul style="list-style-type: none"> • Controls to ensure ongoing compliance; • Independent testing by internal auditors or other external parties; • Appointment of an individual responsible for managing compliance; • AML/CFT training programme, which should include regulatory requirements and the company's internal AML/CFT policies, procedures, processes and controls; and • Customer due diligence processes.
<p>4. Appointment of a person responsible for managing AML/CFT framework</p>	<p>The mere appointment of a compliance officer is not sufficient. The person appointed must have the expertise and knowledge of AML/CFT requirements and all related regulations and is given sufficient authority and resources to administer an effective AML/CFT compliance programme.</p> <p>The board of directors must ensure that the compliance officer regularly apprise the board and senior management of ongoing compliance with AL/CFT</p>

	requirements.
5. Detecting and reporting suspicious activity	<p>The company must have appropriate processes in place which allow for the identification of unusual pattern of activities or transactions, which comprise, among others, the following:</p> <ul style="list-style-type: none"> • Process in identifying suspicious transactions (e.g. screen payment instructions against the lists provided by Financial Intelligence Unit to identify potential terrorists); • Process and timeline for filing Suspicious Transaction Report (STR); • Steps in filing STR; • Procedure for follow-up and review of exceptions reports; and • Justification to file or not to file STR.
6. Regular review of policies and procedures	<p>It is a sound practice for the company to periodically reassess and evaluate its AML/CFT policies, procedures and controls in order to ensure effectiveness of its compliance programme and measures taken to comply with AMLA requirements at least on an annual basis.</p>

PART III

14. EXAMPLES OF MARKET ABUSES AND UNETHICAL BUSINESS CONDUCT

Illustration 1 – Action based manipulation

Company A engages PLC B to undertake certain projects. Company A then short sells securities of PLC B and subsequently cancels the contract with PLC B, causing the security price to drop significantly.

Illustration 2 –Trade-based manipulation

Mr. X hires Mr. Y as consultant to provide public relations and assist his company in realising the value of its stocks. As compensation Mr. X pays Mr. Y RM50,000 cash per month and gives him a warrant to purchase 100,000 shares from the company at RM1 per share.

Mr. Y along with three other accomplices, i.e. the brother-in-law, secretary, and a clerk opens 10 separate margin accounts at 10 different brokers. Accounts are opened under a variety of names including dormant companies that Mr. Y controlled in order to hide Mr. Y's identity.

Mr. Y and his accomplices engage in an aggressive series of wash trades and match orders. Trading is done between the accomplices at successively higher price to move the market price up. Mr. Y is also personally touting the securities to stockbrokers and other investors.

The security which now carries an inflated price is utilised to secure additional margin facility. The cycle is repeated several times. At a certain stage, Mr. Y dumps or sells all securities under his control, causing the price of the securities to plummet.

Illustration 3 – Painting the tape

Stockbroker A issues false trade reports for immediate publication to give an impression of activity or active trading in a counter to encourage investors to participate in order for SBC A to offset an unprofitable risk position.

Illustration 4 – Unethical trades

“Arrangers or Introducers”, were verbally engaged by stockbroker C to assist and facilitate SBC C in obtaining pre-placement bond trades, with SBC C seen ostensibly as facilitating the bond transactions between different companies or financial institutions.

Four parties were involved, namely Company A, Company B, stockbroker C and Company D. Company A sold bonds to Company B, who then sold them to stockbroker C. stockbroker C then sold them to Company D, who finally sold them back to Company A. The transactions were carried out at the same value date but at different price levels.

The bond transactions mentioned above would result in Company A incurring an “opportunity loss”, which accrued to the other parties involved. In other words, the other parties profited at the expense of Company A.

Profits from the bond trades would then be shared between stockbroker C and the “Introducers”, where the “Introducers” received significant profits from the bond trades.

In this case, stockbroker C is used as a conduit or “middle person” to take advantage of opaque two-way quotes in bond trades to benefit its clients by executing the deals at the expense of the initial bond buyer/seller where the latter did not get the best price.

Illustration 5 –Rollover

SBC A executed several married deals where the purchase and sale of securities did not involve any change in the beneficial ownership. The married deals were performed to give clients a deferment on settlement time for outstanding purchases (rollover).

The quantity and price of the securities transacted would be similar to the initial contract. However, the settlement period (due date) had been extended and additional brokerage was charged on clients for each rollover executed by the company.

Hence, the deals were transacted through the sales and purchases of securities without any change in beneficial ownership of the said securities.

Illustration 6 – Third party payment

Stockbroker A was instructed by Client A to purchase 10 million units of PLC P’s securities on behalf of Client B from Client C. At settlement, Client A instructed

stockbroker A to utilise Client C sales proceed to set-off against the purchases made by Client B.

The sale of PLC P's securities may not have involved a change in beneficial ownership of securities, as Client A had an interest in the securities before the purchase, and Client A had control over or was able to exert influence on Client B and/or Client C over the securities.

Illustration 7 – Marking the close

A remisier of stockbroker A assisted several clients by placing orders at the close of trading day, which caused the price of securities to move higher than the prior sales price. Simultaneously, orders at prices which are higher than the previous bid or lower than the previous offer were entered, and withdrawn before they could be executed, in order to give a misleading impression that there was demand for or supply of the securities at that price.

Illustration 8 – Front running

Dealer's representatives handling accounts of several big institutions/retail clients executed trades for their individual clients or accounts of related persons prior to the execution of trades of the big institutions/retail clients, with the view to front run and make quick profits.

Illustration 9 – Conflicts

A person with knowledge of a favourable or unfavourable research report purchases or sells securities in advance of the report being released.

Illustration 10 - Scalping

The person trading is also responsible for giving buy or sell recommendations, e.g. purchases a security before recommending the security, and then sells the security at a profit upon the rise in the market price following the recommendation.

Illustration 11 – Spoofing

A person submits a large but not marketable limit order that raises bid price of a security and/or greatly increases the quoted size at or around the current best bid price. The large order causes market participants to match or better the price of the order. The

person then cancels the large order and enters (virtually at the same time) a sell order that matches the buy order of other investors at a higher price.

This is manipulation by “spoofing”. By temporarily manipulating the bid price upward, and causing other bids and trading interest at that level, the person receives a better price for his security than what would have been the prevailing market price and/or volume if the person’s large order had not been entered.

Spoofing is also used to manipulate the opening price of a security; e.g., via entry and immediate cancellation of lower priced sell orders with the objective of creating a more favourable buying opportunity for the manipulator.

Illustration 12 – Pump and dump

A person takes a long position in a security and disseminates misleading information about the security to inflate its price then disposes it at a higher price.

Illustration 13 – Trash and cash

A person takes a short position in a security and disseminates misleading negative information about the security to depress its price and to buy it at a lower price.