

## **GUIDELINES ON DEALINGS IN UNLISTED DEBT SECURITIES BY UNIVERSAL BROKERS**

### **1. INTRODUCTION**

- 1.1 These Guidelines seek to provide guidance to universal brokers as to the various rules, codes and criteria which they must comply with in their primary and secondary market dealings in unlisted debt securities.
- 1.2 Unless otherwise stated in these Guidelines, various provisions in the SC's Guidelines for a Universal Broker and the Rules of Kuala Lumpur Stock Exchange (KLSE) which are relevant to dealings in unlisted debt securities, particularly Chapter 3 on "Conduct of Business by Member Companies" and Chapter 3A on "Organisation and Structure of Universal Brokers and Non-Universal Brokers", shall continue to be applicable to universal brokers for their dealings in unlisted debt securities.

### **2. INTERPRETATION**

- 2.1 In these Guidelines, the following words and expression shall have the meaning as follows:

"Bank Negara Malaysia" or "BNM" means the Central Bank of Malaysia established by the Central Bank of Malaysia Act 1958;

"Bond dealers" means individuals employed and authorized by universal brokers to deal in unlisted debt securities;

"Dealing in securities" has the same meaning as in the Securities Industry Act 1983;

"Debt securities" has the same meaning as the term debenture as defined in section 2(1) of the Securities Commission Act 1993;

"Executive Director Dealing" has the same meaning as assigned to that expression in the Rules of the Kuala Lumpur Stock Exchange

"Risk Management Committee" has the same meaning as assigned to that expression in the Rules of the Kuala Lumpur Stock Exchange;

"Risk Management Department" has the same meaning as assigned to that expression in the Rules of the Kuala Lumpur Stock Exchange;

"Stockbroking company" means a holder of a dealer's licence under the Securities Industry Act 1983;

"Unlisted debt securities" means debt securities which are traded in the unlisted bond market; and

“Universal broker” means a stockbroking company that has merged with or has acquired at least three other stockbroking companies and has fulfilled the necessary qualifying criteria as set out in the Securities Commission’s Guidelines for a Universal Broker.

### **3. PRIMARY MARKET DEALINGS IN UNLISTED DEBT SECURITIES**

3.1 A universal broker will be able to carry out all corporate finance activities in relation to unlisted debt securities as undertaken by advisers pursuant to the Commission’s Guidelines on the Offering of Private Debt Securities (PDS Guidelines) and Guidelines on the Offering of Asset- Backed Debt Securities (ABS Guidelines).

3.2 In accordance with the above, universal brokers are permitted to submit proposals to the Securities Commission (SC) on behalf of its customers for offers of private debt securities. Necessary modifications have been made by Bank Negara Malaysia (BNM) so as to ensure that the universal brokers’ roles as advisor, lead arranger and facility agent for offers of private debt securities are facilitated by virtue of membership in the following electronic systems:

- (i) Bonds Information and Dissemination System (BIDS);
- (ii) Fully Automated System for Issuing/Tendering (FAST); and
- (iii) Real Time Electronic Transfer of Funds and Securities (RENTAS) System.

3.3 For their full participation in the unlisted bond market, universal brokers are required to comply with the relevant provisions in the following rules and code of conduct:

- (i) Rules on BIDS as issued by BNM;
- (ii) Rules on FAST as issued by BNM;
- (iii) Rules on the Scripless Securities under the RENTAS System as issued by BNM;
- (iv) RENTAS System Participation and Operation Rules as issued by BNM;
- (v) RENTAS Member Rules as issued by the Association of Banks in Malaysia, Association of Merchant Banks in Malaysia, Association of Finance Companies of Malaysia, Association of Discount Houses in Malaysia and Association of Islamic Banking Institutions Malaysia; and
- (vi) Code of Conduct and Market Practices For the Malaysian Corporate Bond Market as issued by Institut Peniaga Bon Malaysia (“IPBM Code”).

- 3.4 Further, universal brokers shall at all times comply with the provisions in sections 6 and 7 of these Guidelines as well as the requirements stated in Part 8 of Chapter 3A of the Rules of Kuala Lumpur Stock Exchange (KLSE) with regard to corporate finance activities.

#### **4. SECONDARY MARKET DEALINGS IN UNLISTED DEBT SECURITIES**

- 4.1 A universal broker may trade in unlisted debt securities via a financial institution who is an authorised depository institution. Alternatively, a universal broker may wish to trade in unlisted debt securities directly without the need to go through a financial institution. In the event that a universal broker wishes to trade directly, the universal broker shall apply and obtain membership to the following systems operated by BNM, for the purposes of trading in unlisted debt securities:

- (i) Bonds Information and Dissemination System (BIDS); and
- (ii) Real Time Electronic Transfer of Funds and Securities (RENTAS) System.

- 4.2 A universal broker who is a member of BIDS and RENTAS for the purposes of trading in the unlisted debt securities is required to comply with the relevant provisions in the following rules and code of conduct:

- (i) Rules on BIDS as issued by BNM;
- (ii) Rules on Scripless Securities under the RENTAS System as issued by BNM;
- (iii) The Malaysian Code of Conduct for Principals and Brokers in the Wholesale Money and Foreign Exchange Markets as issued by BNM ("Malaysian Code of Conduct");
- (iv) RENTAS System Participation and Operation Rules as issued by BNM; and
- (v) RENTAS Member Rules as issued by the Association of Banks in Malaysia, Association of Merchant Banks in Malaysia, Association of Finance Companies of Malaysia, Association of Discount Houses in Malaysia and Association of Interest-Free Banking Institutions Malaysia.

- 4.3 Whether a universal broker trades in unlisted debt securities via a financial institution or directly, the provisions in sections 6 and 7 of these Guidelines shall continue to be applicable to a universal broker in all their secondary market dealings in the unlisted bond market.

- 4.4 Notwithstanding the prohibition in Rule 3A.8.2(2)(b)(vii) of the Rules of KLSE, a universal broker may either trade as principal or may solicit trade in unlisted debt securities to be issued or issued by the clients of its corporate finance department if sufficient Chinese wall and firewalls are maintained by the universal broker to separate the trading and corporate finance activities with an objective to prevent occurrence of any insider trading activities or other abusive conduct prohibited by the Securities Industry Act 1983.

- 4.5 Further, notwithstanding the prohibition in Rule 4.1.1(5) of the Rules of KLSE, a universal broker may allow its bond dealers to undertake proprietary trading as well as to deal on behalf of customers on unlisted debt securities provided that relevant provisions in the Securities Industry Act 1983 are complied with to protect the interest of its customers.

## **5. OTHER DEALINGS IN UNLISTED DEBT SECURITIES**

- 5.1 A universal broker who intends to undertake the role of a Tender Panel Member<sup>1</sup> or indirect bidder of the unlisted debt securities shall apply and obtain membership to the FAST system.

## **6. MINIMUM OPERATIONAL REQUIREMENTS FOR DEALING ACTIVITIES**

### **Risk Management**

- 6.1 Considering the distinct risk characteristics of debt securities as compared to equity instruments, a universal broker shall develop an appropriate risk management system to identify and control risks arising from dealings in unlisted debt securities. The nature of the risk management system that is put in place should be commensurate with the nature, size and complexity of a universal broker's dealing activities in debt securities.
- 6.2 The risk management requirements in this section shall apply to the proprietary trading activities, non-proprietary trading activities as well as primary market activities undertaken by a universal broker on unlisted debt securities. Risk management requirements on market risks and position taking, however, shall not apply to non-proprietary trading activities undertaken by universal brokers.
- 6.3 Essentially, a sound risk management system would comprise the following features:
- (i) appropriate and adequate level of oversight by the board of directors and senior management;
  - (ii) comprehensive risk identification, measurement and valuation methodologies;
  - (iii) detailed structure of limits and other parameters used to govern risk taking; and
  - (iv) independent control, monitoring and reporting of risk exposures.

---

<sup>1</sup> As defined in the Rules on FAST as issued by BNM

**Oversight by the Board of directors and senior management**

6.4 As required under the Rule 3A.9.2 of the Rules of KLSE, it is necessary for the Risk Management Committee of a universal broker to establish a set of written risk management policies which govern universal broker's dealings in unlisted debt securities. The risk management policies of a universal broker must be duly endorsed and continuously reviewed by its board of directors. The board of directors and the Risk Management Committee should consider establishing the risk management policies on unlisted debt securities in the following areas:

- (i) establish the overall appetite of the universal broker for risk taking, which could be expressed in terms of the amount of earnings or capital which the universal broker is prepared to put at risk and the degree of fluctuation in earnings which it is prepared to accept, consistent with its business objectives, capital strength and management capability;
- (ii) approve the type of debt securities and dealings activities that the universal broker wishes to participate in and this should include setting minimum criteria on debt securities that could be invested by the universal broker;
- (iii) set out broad requirements on any new debt securities, products or activities that would be evaluated and considered by the board of directors or Risk Management Committee before these products or activities are offered or participated by the universal broker;
- (iv) ensure that the internal procedures and processes in relation to their dealings in unlisted debt securities are in compliance with all the requirements of these Guidelines;
- (v) establish clear and comprehensive limits to control risks and a set of procedures to deal with breaches of these limits;
- (vi) establish risk measurement methodologies which are consistent with the nature and scale of the activities;
- (vii) identify appropriate hedging instruments and mechanisms to be used to control excessive risk exposures;
- (viii) recognise the importance of market and cash flow liquidity and identify policies and processes to manage liquidity and cash flow positions;
- (ix) consider the impact of diversification of trading and customer activities to reduce risk and the importance of risk return trade-offs;
- (x) require stress testing of positions; and
- (xi) detail the type and frequency of reports which are to be made to the board (or committee of the board). The type of reports should

include those which indicate the levels of risk being undertaken by the institution, the degree of compliance with policies, procedures and limits, and the financial performance of the various dealing activities.

### **Comprehensive risk identification, measurement and valuation methodologies**

- 6.5 In implementing the risk management policies set out above, a universal broker must put in place processes and procedures for the identification of risks including credit risk, market risk, liquidity risk, operational risk and legal risk to which it is exposed in its dealing of the unlisted debt securities activities. Having identified the various types of risks, a universal broker should, as far as possible, attempt to measure and aggregate them across all the various activities in which it is engaged.
- 6.6 At the very least, the measurement process begins with the marking to market of exposures to debt securities save for investments intended to be held to maturity by universal brokers. This is necessary to establish the market value of positions and to record profits or losses in its books. In determining the market value, a comprehensive information system should be developed to capture the prevailing market price of these debt securities and where there is an absence of a reliable market value, an assessment of the market value taking into account the credit rating of the securities involved should be established. To achieve greater objectivity, the assessment of the market value which is provided by the dealing department should be agreed to by an independent department. A universal broker who is active in dealing or position-taking must mark to market its position on a daily basis.
- 6.7 Regardless of the methodologies and assumptions used to measure risks, a universal broker who is actively dealing or taking positions should conduct regular stress tests to evaluate the potential impact on the universal broker's earnings, liquidity and capital position, particularly those obligations arising from underwriting of unlisted debt securities, under the worst-case market scenarios. Stress tests need to cover a range of factors that could generate extraordinary losses in trading portfolios. The results of the stress testing should be reviewed regularly by the Risk Management Department and should be reflected in the policies and limits approved by the board of directors and the Risk Management Committee.

### **Detailed structure of limits to govern risk taking**

- 6.8 A set of comprehensive limits should also be established to control the market, credit and liquidity risks of universal brokers in unlisted debt securities. These should be integrated as far as possible with the overall institution-wide limits for these risks. For example, the credit exposure for a particular counterparty arising from dealings in unlisted debt securities should be aggregated with all other credit exposures for that counterparty and compared with the credit limit for that counterparty. The system of limits should include procedures for the reporting and approval of exceptions to limits. It is essential that limits should be rigorously enforced and that

significant or persistent breaches of limits should be investigated and reported by Risk Management Department to senior management.

- 6.9 Market risk limits should be established at different levels within the universal broker organisation, (i.e. at overall level, trading desk head level and individual trader level) in dealing with unlisted debt securities. Other commonly used market risk limits include stop loss limits and value-at-risk limits. In general, the overall amount of market risk being run by a universal broker is best controlled by value-at risk limits. These provide senior management with an easily understood way of monitoring and controlling the amount of capital and earnings which the universal broker is putting at risk through its trading activities.

### **Independent control, monitoring and reporting of risk exposures**

- 6.10 The responsibilities of controlling, monitoring and reporting risk exposure should rest with the Risk Management Department and/or a department or unit independent from dealings activities which should perform the following risk control functions:
- (i) monitoring of market risk exposures against limits and the reporting of exceptions to management;
  - (ii) marking-to-market of risk exposures and reconciling positions taken and profit/loss between the front and back offices;
  - (iii) preparation of management reports, including profit/loss results and gross and net positions on a regular basis; and
  - (iv) monitoring of credit exposures to individual counterparties against limits and the reporting of exceptions to Risk Management Committee (if it is not performed by the credit department).

### **Investment Committee**

- 6.11 To the extent a universal broker carries on both fund management activities as well as primary and secondary market dealings in debt securities, the universal broker must establish an investment committee which should meet regularly to perform the following responsibilities:
- (i) To review the capital and liquidity positions of the universal broker in relation to its exposure to debt securities;
  - (ii) To formulate investment and funding strategies for the universal broker's dealing in debt securities; and
  - (iii) To regularly review market and regulatory developments that affect investment strategies of universal brokers in dealing in debt securities.

### **Expertise and Infrastructure**

- 6.12 Given the competitive trading environment, it is pertinent for a universal broker to acquire a sufficient level of expertise and sound auxiliary computer and information systems critical in discharging fiduciary duties to its customers and facilitating its own investment in unlisted debt securities. In this regard, a universal broker should ensure that only suitably qualified persons are employed as bond dealers for its debt market activities. Where a universal broker is trading in the unlisted bond market, its bond dealers must be duly certified by the Persatuan Pasaran Kewangan Malaysia prior to the commencement of its dealing activities in order to promote professionalism of the universal broker.
- 6.13 Where a universal broker is dealing directly in unlisted debt securities, it is also important for the universal broker to ensure that its trading, clearing and settlement systems, where applicable, are capable of satisfying system and operating requirements of electronic systems serving the unlisted bond market i.e. the BIDS, FAST and RENTAS system, Hence, there should be sufficient manpower and system resources allocated by the universal broker to these areas to ensure smooth system operations in the unlisted bond market.

### **Others**

- 6.14 Universal brokers should implement sufficient internal controls as prescribed in the Rules of the KLSE.
- 6.15 The universal broker shall ensure that all the necessary requirements outlined in these Guidelines have been complied with prior to its dealings in unlisted debt securities. To provide a reference to universal broker that such criteria have been satisfied, a checklist for universal broker's readiness in relation to dealings in unlisted debt securities is attached in the Appendix.

## **7. BEST BUSINESS PRACTICES**

### **Confidentiality**

- 7.1 It is essential that strict standards of confidentiality are maintained for customers' information and that the relevant employees of universal brokers should exercise due care to prevent information from their dealings or transactions with customers from being overheard, disseminated or transmitted through any communications systems or in the public domain. The standard of confidentiality as provided for in the Malaysian Code of Conduct and Rule 3A.8.2(3) of the Rule of KLSE with regard to trading activities and corporate finance activities respectively on unlisted debt securities should be adhered to. The standards should, among others, be imposed on employees involved in corporate finance, trading and back office functions relevant to unlisted debt securities.

## Dealing with Customers

- 7.2 As elaborated in Rule 3.4.3 of the Rules of KLSE on transaction for buying or selling of securities, similar policies should be set out by universal brokers to address the issues of selection and appraisal of counterparty, risk disclosure and handling of disputes and complaints for their corporate finance activities on unlisted debt securities. The objective of such policies and procedures is to protect a universal broker against the credit, reputation and litigation risks that may arise from a counterparty's inadequate understanding of the risks of the unlisted bond transaction. Such a counterparty may not fully understand their risks and obligations in relation to transactions involving unlisted debt securities and therefore may be unable to anticipate and plan for the risks these obligations entail. This may give rise to a higher than normal risk of default and a greater potential for litigation and damage to the universal broker's reputation.
- 7.3 In this regard, a universal broker should:
- (i) analyse the expected impact of the proposed transaction on the counterparty;
  - (ii) identify whether the proposed transaction is consistent with the counterparty's policies and procedures with respect to unlisted debt securities, as they are known to the universal broker; and
  - (iii) ensure that the terms of the contract are clear and assess whether the counterparty is capable of understanding the terms of the contract and of fulfilling its obligations under the contract.
- 7.4 On the other hand, an adequate disclosure of market information should be made to the customers to facilitate their decision-making process in dealings in unlisted debt securities. Universal brokers should take reasonable steps to ensure that customers have adequate information and understanding with regard to valuation, fees and charges as well as terms and conditions of transactions involved and where requested, risk and return information should be provided and explained to them.
- 7.5 Where a universal broker considers that a proposed transaction is inappropriate for a counterparty, it should inform the counterparty of its opinion. If the counterparty nonetheless wishes to proceed, the universal broker should document its analysis and its discussions with the counterparty to lessen the chances of litigation in case the transaction proves unprofitable to the counterparty. Where the above actions are taken, the final decision on whether to proceed with a deal should be at the sole discretion of the customer. Nevertheless, if the institution considers that the counterparty may be financially incapable of meeting its obligations, the universal broker should consider carefully whether it should enter into the transaction.

- 7.6 To guard against the possibility of misunderstandings, particularly when it is acting as advisor to customers for issuance of unlisted debt securities, all significant communications between the universal broker and its customers should be in writing or recorded.
- 7.7 Where a transaction involves the trading of Government debt securities (e.g. Malaysian Government Securities, Treasury Bills and Government Investment Certificates), a universal broker who acts as dealer and authorized depository institution shall adhere to all legal requirements on the provision of relevant documents such as confirmation advices, acknowledgement receipts and monthly statements to its customers or their authorised depository institution in accordance with the legal provisions stated under the Loan (Local) Act 1989, the Treasury Bills (Local) Act 1989 and the Government Investment Act 1989.

## **8. COMPLIANCE OF RULES AND CODES OF CONDUCT**

- 8.1 Surveillance would be conducted by BNM, as the operator of the BIDS, FAST and RENTAS system, to ensure compliance by universal brokers on the provisions of the rules and codes of conduct set out in paragraph 3.3 and paragraph 4.2 of these Guidelines.
- 8.2 Any enforcement action for non-compliance of the said rules and codes of conduct, as set out in paragraph 3.3 and paragraph 4.2 of these Guidelines, by a universal broker will be taken by the SC against the universal broker concerned. Nevertheless, where a universal broker has breached a provision in the said rules and codes of conduct which would affect the clearing and settlement process during the day, BNM may take remedial action, pursuant to the above-mentioned rules and codes, against the universal brokers concerned and/or their settlement bank in order to ensure the integrity and soundness of the national payment system. Where such non-compliance takes place, universal brokers must immediately notify the SC.

## Checklist for Universal Broker's Readiness in Dealings in Unlisted Debt Securities

Type of requirements	Areas to be implemented or complied with prior to universal broker's dealing activities	Applicable to (i) primary market dealing activities	Applicable to (ii) direct secondary market dealing activities	Applicable to (iii) secondary market dealing activities conducted via a financial institution
Operational	<ul style="list-style-type: none"> <li>• A universal broker must satisfy the following requirements specified in the Malaysian Code of Conduct:               <ul style="list-style-type: none"> <li>❑ The universal broker (UB) is aware of its responsibilities as principal and agent for bond transactions and that it will be held responsible for the actions of their staff</li> <li>❑ The UB must ensure that its dealers are aware of the best practices in dealing with customers such as requirements to preserve confidentiality, requirement to prevent conflicts of interest and to know your customers</li> <li>❑ Taping device has been installed for dealers and staff in the back-office</li> <li>❑ Appropriate measures, including formulation of a checklist or manual, have been taken to ensure that the dealers would conduct trading activities in accordance with the principles, procedures, market terminology and conventions as stated in this Code</li> </ul> </li> </ul>		√	



Type of requirements	Areas to be implemented or complied with prior to universal broker's dealing activities	Applicable to (i) primary market dealing activities	Applicable to (ii) direct secondary market dealing activities	Applicable to (iii) secondary market dealing activities conducted via a financial institution
Operational (contd.)	<ul style="list-style-type: none"> <li>❑ Where a UB engaged in a repurchase agreement (repo) or securities borrowing and lending (SBL) transaction via the RENTAS system, the UB must be aware of the respective requirements set out in the BNM's Guidance Notes on Repurchase Agreement Transactions and Guidelines on Securities Borrowing and Lending Programme under RENTAS</li> <li>• A universal broker must satisfy the following requirements specified in the RENTAS System Participation and Operation Rules:               <ul style="list-style-type: none"> <li>❑ UB has installed a front-end system (FES) and a emergency backup FES and has formulated disaster recovery plans</li> </ul> </li> <li>• A universal broker must satisfy the following requirements specified in the IPBM Code:               <ul style="list-style-type: none"> <li>❑ UB must be aware of the duties and responsibilities of various capacities it participates in any offers of PDS</li> <li>❑ UB has reviewed the legal implications from signing various legal documents related to the offers of PDS such as depository and paying agency agreement, trust deed and indemnity agreement</li> </ul> </li> </ul>	<p style="text-align: center;">√</p>	<p style="text-align: center;">√</p>	

Type of requirements	Areas to be implemented or complied with prior to universal broker's dealing activities	Applicable to (i) primary market dealing activities	Applicable to (ii) direct secondary market dealing activities	Applicable to (iii) secondary market dealing activities conducted via a financial institution
Operational (contd.)	<ul style="list-style-type: none"> <li>• A UB must satisfy the following requirements specified in the above Guidelines issued by the SC:                             <ul style="list-style-type: none"> <li>❑ A set of risk management policies has been formulated by the Risk Management Committee and duly endorsed by the Board of Directors;</li> <li>❑ Detailed processes and procedures in relation to (a) risk identification, measurement and valuation, (b) setting up of detailed structure of limits and (c) independent control, monitoring and reporting of risk exposures, as outlined in the risk management policies, have been developed;</li> <li>❑ Appropriate and adequate administrative controls and mechanisms including segregation of front and back-office as well as an effective internal audit program have been formulated;</li> <li>❑ Appropriate procedures are imposed to separate employees engaged in origination activities from dealings activities;</li> <li>❑ Clear policies are established to deal with customers including policies to address selection and appraisal of counterparty, risk disclosure to counterparty and handling of disputes and complaints</li> </ul> </li> </ul>	√	√	√

Type of requirements	Areas to be implemented or complied with prior to universal broker's dealing activities	Applicable to (i) primary market dealing activities	Applicable to (ii) direct secondary market dealing activities	Applicable to (iii) secondary market dealing activities conducted via a financial institution
Regulatory	<ul style="list-style-type: none"> <li>• Bond dealers of universal brokers have been duly certified by the Persatuan Pasaran Kewangan Malaysia prior to the commencement of its dealing activities</li> <li>• Settlement bank has been engaged to perform settlement functions on behalf of the universal broker in relation to securities transactions</li> </ul>	√	√	√
Technical/ System	<ul style="list-style-type: none"> <li>• UB has obtained membership from BNM for the following electronic systems and has put in place the necessary trading, clearing and settlement system and manpower capable of meeting technical, security and operating requirements of these electronic systems:                             <ul style="list-style-type: none"> <li>❑ Bonds Information and Dissemination System (BIDS);</li> <li>❑ Fully Automated System for Issuing/Tendering (FAST); and</li> <li>❑ Real Time Electronic Transfer of Funds and Securities (RENTAS) System</li> </ul> </li> <li>• A set of standard formulae used in calculating payments for interest/profit, proceeds and other parameters for various types of instruments and transactions has been adopted by UB and computerized, where possible</li> </ul>	√	√	√