Executive Summary

10 years' insight on the SC's regulatory approach

The launch of the first publication of *The Reporter* was inspired by the enforcement strategy developed by the SC in 2008 to strengthen the SC's oversight and supervisory functions, and raise awareness on the SC's enforcement work to gain maximum impact and effect. Hence, initial editions of *The Reporter* were confined to covering significant supervisory and enforcement cases undertaken by the SC.

Over time, *The Reporter* has transitioned from a case reporting publication to a proactive communication platform that conveys the SC's insights on emerging issues and trends and regulatory expectations on issues that concern market intermediaries. Where relevant, *The Reporter* also highlighted the SC's concerns on matters relating to corporate governance practises of corporate officials and their advisers such as accountants, auditors, lawyers and other professionals who play an important gatekeeping role in the Malaysian capital market. These publications were communicated openly with focus and direction through thematic articles. The purpose was to help the SC achieve its strategic aim of promoting good practices and deter those who may be contemplating similar non-compliances. *The Reporter* marked its 10th anniversary in 2018.

To commemorate this milestone, the Editorial Board has decided to release a collection of past editions titled, *The Reporter – A Compendium from 2008 to 2018. The Reporter* has been a chronicler of the SC's supervision and enforcement cases and actions. Now as the publication embarks on its next decade, the Editorial Board presents to you this special edition that looks back on the SC's supervisory and enforcement activity in a decade.

There are two parts to the *Compendium*:

- Part A is a collection of summaries focusing on significant cases taken by the SC from 2008 to 2014; and
- Part B carries the SC's insights discussed through thematic articles from 2015 to 2018.

The Editorial Board wishes to acknowledge the contribution of colleagues who have assisted in the production of *The Reporter* since its first release. We are especially grateful to contributing writers from Supervision Division and Enforcement Division of the SC who have furnished case studies that have greatly enriched the content of all editions of *The Reporter*.

We hope the *Compendium* is beneficial to you. All views and comments can be directed with an email to reporter@seccom.com.my.

The Editorial Board

January 2019

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PART A

PART A

(2008–2014)

Bernas – First-time restitution for aggrieved investors

The handling of this insider trading case involving Padiberas Nasional Bhd (Bernas) shares was a "first" in the SC's civil enforcement programme. For the first time, aggrieved investors managed to recoup their investment losses from insiders who profited from insider trading.

Our surveillance picked up unusual price movement, volume surges, and irregular trading activities in Bernas shares prior to and during the rice importer's share buy-back exercise in 1998. The insider trading activities were found to emanate from a proprietary/investment account maintained by KL City Securities Sdn Bhd.

KL City Securities had obtained inside information of the impending force-sale of Bernas shares and the impending Bernas share buy-back scheme from Wan Azmi Wan Abdul Rahman, the General Manager of Bernas. Acting on this information, KL City Securities proceeded to acquire some five million Bernas shares over a period of five days. It then disposed of these shares soon after resulting in an overall profit of RM1.04 million.

We initiated civil enforcement in the High Court which led to the recovery of RM2.08 million from KL City Securities – twice the amount gained by the firm from the insider trading of Bernas shares. Civil penalties of RM300,000 and RM150,000 were also imposed on KL City and Wan Azmi respectively.

We set up a compensation scheme administered by KPMG to reimburse investors who had suffered losses. To date, close to 90% or 275 of the aggrieved investors have been successfully reimbursed.

Hwa Tai Bhd – Directors fined for failure to carry out fiduciary duties

The SC imposed fines amounting to RM500,000 on the directors of Hwa Tai Industries Bhd. The directors were found to be derelict in their fiduciary duty to ensure fair distribution of excess rights. This action by the SC highlights the heavy responsibility of directors to ensure minority shareholders of PLCs receive fair and equitable treatment at all times.

In Hwa Tai's rights issue with warrants exercise undertaken in April 2004, its directors had a duty to ensure a fair and equitable distribution of excess rights shares as required under the SC's *Prospectus Guidelines.* Out of the 1,494 applicants, one single shareholder enjoyed the allocation of 99.86% of the excess rights shares. This shareholder, who is also the chairman of the board, was in a position to influence the board in adopting the least equitable option as the basis of allotment of the excess rights shares, instead of the fairest and most equitable option to all shareholders.

This case illustrates the need to ensure that all directors, including independent directors, carry out their fiduciary duties to act in the best interests of shareholders.

Transmile executives prosecuted for misleading statements to stock exchange

In our continuing efforts to safeguard investor confidence in the Malaysian capital market, the SC has always adopted a proactive and strategic approach in ensuring that prompt enforcement actions are taken against transgressors of securities laws. Criminal prosecution remained at the forefront of our enforcement efforts, complemented by civil actions and administrative actions. In July and November 2007, we successfully initiated prosecution against five executive officers of Transmile Group Bhd for submission of material misleading statements in its financial report for year ending 31 December 2006.

Based on our investigative findings, the accounting irregularities in Transmile's financial statements revealed a significant inflation of its revenue which exceeded RM300 million. We acted swiftly and prosecuted the chief executive officer, chief financial officer and the executive director of Transmile. Two audit committee members of Transmile were compounded the sum of RM500,000 each for knowingly permitting the submission of misleading financial statements to the stock exchange although they knew of the accounting crisis raised by the auditors.

In mid-November 2007, the two audit committee members of Transmile were charged in the criminal courts after they failed to pay the compound.

Ocean Capital Bhd – Accountability of advisers

The SC's investigations revealed an unsubstantiated profit of RM7.7 million in Pasaraya Hiong Kong's accounts for the proposed restructuring scheme of Ocean Capital Bhd.

For this transgression, the SC publicly reprimanded the auditors and principal advisers for their failure to discharge adequate due diligence responsibilities on the corporate submission to the SC and also for their failure to inform us of a material change in circumstances which would have affected our consideration of its corporate submission.

We also imposed a sanction of non-acceptance of corporate submissions that had relied on the auditor concerned to be the reporting accountant for a period of six months.

Injunction obtained in Swisscash Internet Scam

The SC adopted a multi-pronged approach which entailed simultaneous administrative action, civil action and criminal prosecution being taken against securities offenders. This approach was undertaken with the aim of ensuring that persons responsible are deterred from causing future harm and at the same time, deterring others from committing similar crimes.

The Swisscash Internet Scam purported to offer investment schemes with a high return of up to 300% within 15 months of investment. Our investigations revealed the dimension of the scam – the transactions occurred across a number of countries and the Internet is used to attract investors from all over the world.

Our findings uncovered that while the web host and virtual office of Swisscash were in the US, investors' monies were parked in bank accounts all over the world. In the investigation, we received and granted assistance to eight other regulators worldwide who were also investigating this scheme. The eight regulators were Australia, Hong Kong, Isle of Man, Jamaica, Jersey, Singapore, Switzerland and the US.

In May 2007, the SC successfully blocked access to several websites promoting Swisscash. We filed a civil action against the perpetrators behind Swisscash for holding out as investment advisers and fund managers without a licence and for making misleading statements on their websites to induce the public to invest in Swisscash. We also sought injunctive orders requiring the offenders to cease activities and to restitute investors.

We obtained an international Mareva injunction to prevent the perpetrators' assets from being dissipated and to freeze Swisscash's bank accounts worldwide. Under the order of the Deputy Public Prosecutor, the SC froze bank accounts of the perpetrators in 22 local financial institutions containing approximately RM5 million of Swisscash's ill-gotten gains. In September 2007, we obtained another court order directing one of the defendants to transfer RM35 million held in overseas bank accounts to Malaysia.

Energro Bhd – The SC invoked whole range of enforcement tools

Energro Bhd was a vehicle used by the ailing Omega Bhd to inject a new business, i.e the marketing and distribution of Alfa Romeo cars in Malaysia.

However, the scheme's promoter failed to disclose to the SC in the corporate submission that the franchisor had terminated the distribution agreement. Upon discovering this, the SC directed that monies raised from the restructuring scheme be secured in trust accounts. This was to protect some RM31 million monies raised from Omega's shareholders and other investors who had bought Energro shares based on the corporate proposal submitted to the SC.

We then instituted a civil action against Energro. The application was a first for the SC. In April 2005, we obtained a court order against the defendants for repayment and restoration of RM10 million into a specified account, and for restitution to aggrieved persons.

Subsequently, the scheme's promoter, Wira Tjakrawinata (also known as Kenneth Chow) was charged, convicted, and sentenced to a jail term of one year by the Sessions Court. The High Court subsequently reduced the imprisonment term to one day and imposed a fine of RM2 million. Energro's statutory accountant, Ng Chee Loong, was also charged in the criminal court and the case against him is pending trial.

Hospitech – IPO subscribers take priority

Hospitech Resources Bhd voluntarily withdrew its plans to list on the MESDAQ Market after the SC commenced investigations into alleged false revenue figures disclosed in the company's prospectus. The prospectus was issued for the proposed listing of Hospitech's securities on the MESDAQ Market. We imposed a compound amounting to RM500,000 on Hospitech's Managing Director who was responsible for the inclusion of false revenue figures in the prospectus.

Following Hospitech's voluntary withdrawal of its plan to list its security, the SC took the necessary steps to ensure the public's application monies for the IPO were reimbursed in a timely and orderly fashion.

Powerhouse – investors fully restituted

Fund management – breach of licence conditions – s.47F *Securities Industry Act 1983* – Commission's power to freeze assets and accounts

Clients of Powerhouse Asset Management Sdn Bhd (Powerhouse), a licensed fund manager since 2005, managed to recoup their money from their investments in a structured product sold by Powerhouse.

Powerhouse was a fund manager licensed by the SC in 2005. It had solicited investments in the sum of RM12.8 million from 74 investors from February 2006 to May 2006 for a gold structured product outside the scope of what it was authorised to do. As a result, the amounts were frozen by the SC under section 47F of the *Securities Industry Act 1983* (SIA).*

The SC froze the clients' accounts and took immediate measures to restitute and refund the monies to affected investors. The SC's priority was to facilitate the return of clients' monies in an orderly manner. It issued a directive against Powerhouse to cease dealing with clients' monies and assets. An established trust company, UOB Trustee (Malaysia) Bhd, experienced in the dealing of gold was appointed to conduct independent verification of the various amounts invested by clients and to facilitate the return of monies and remaining gold to Powerhouse's clients. An operations centre was set up to answer queries from affected investors, the press, and the public.

As a result of such swift measures, cash from the sale proceeds of gold wafers and monies from Powerhouse's bank accounts were fully distributed to the clients in a fair and orderly manner. As for the shortfall of RM1.93 million, the SC commenced civil enforcement action in November 2007 against Powerhouse and its Managing Director, compelling them to repay the shortfall. In July 2008, Powerhouse and its managing director entered a consent judgment with the SC, agreeing to repay the shortfall within a week from the service of the sealed consent order.

* The SIA has been repealed on 28 September 2007 with the coming into force of the *Capital Markets and Services Act 2007* ("CMSA"). The corresponding provision of s.47F SIA in CMSA is s.125.

Sales proceeds frozen in the interests of shareholders

Injunction – s.100 SIA 1983 – to prevent dissipation of sales proceeds of land transactions – protection of shareholders

The SC obtained an injunction pursuant to its powers under s.100 of the SIA* on 6 September 2007 to prevent a public-listed company, The Ayer Molek Rubber Company Bhd (Ayer Molek) from disposing of or dissipating any of its assets in or outside Malaysia, including sales proceeds of several pieces of agricultural land up to the value of RM20 million pending its investigations. The SC obtained an injunction from the High Court within a week after it had received information that the sales proceeds from land transactions carried out without the shareholders' approval may be dissipated by Ayer Molek. The need for swift pre-emptive action was necessary to prevent the dissipation of assets in order to protect the interests of investors. The injunction was against Ayer Molek's solicitors, or agents holding the sales proceeds as stakeholders.

Based on the terms of the injunction, Ayer Molek was also required to furnish to the SC, within 10 days, detailed information and supporting documents on all its assets in or outside Malaysia as well as the manner and purpose of utilisation of the sale proceeds.

Task Force set up to combat Internet scams

Internet Scam – operator of illegal website charged – illegal proceeds frozen under *Anti-Money Laundering and Anti-Terrorism Financing Act 2001*

From January to May 2007, through its continuous surveillance, the SC detected a surge in the number of websites offering illegal investment schemes to the public. To combat them swiftly and effectively, we set up a special task force to co-ordinate effective operations between different departments within the SC and with other agencies.

Within six months, the task force attended to 1,889 queries and complaints about Internet investment schemes. In co-operation with Malaysian Communications and Multimedia Commission (the authority set up to regulate the Malaysian multimedia industry), 12 illegal websites offering investment schemes to the public were blocked from access in Malaysia. In addition, the SC posted alert notices about 69 suspicious websites on its own website.

The SC prosecuted the operator of the website, www.danafutures.com, Phazaluddin Abu on 29 February 2008 for holding out as a fund manager without licence, after freezing illegal proceeds amounting to RM467,865 under the *Anti-Money Laundering and Anti-Terrorism Financing Act 2001* (AMLATFA). He also faces three charges for money laundering.

As a result of a request for assistance from the Dubai Financial Services Authority and the Australian Securities and Investment Commission, access to the website of Cambridge Capital Trading at www.cambridgecapitaltrading.com was blocked and RM2.5 million of illegal proceeds transferred by foreign investors to a Malaysian bank were frozen. On 13 February 2008, a civil action was filed by the Attorney General's Chambers under the AMLATFA to forfeit the illegal proceeds.

* The corresponding provision for s.100 SIA in CMSA is s.360.

Megan Media's key executives charged for inflating revenue

Bursa's Listing Requirements – continuing listing obligations – directors charged for false statements submitted to the exchange – s.122B SIA 1983 – inflated revenue in quarterly financial statements

On 10 December 2007, the SC charged two executives of Megan Media Holdings Bhd (Megan Media), a public-listed company for making false statements to Bursa Malaysia under s.122B of the SIA 1983* pertaining to the company's revenue in its quarterly announcements. The two individuals were Kenneth Kok Hen Sen @ Kok Liew Sen, Megan Media's former Financial Controller and Dato' Dr Hj Mohd Adam Che Harun, Megan Media's Executive Chairman and Director.

Megan Media is principally involved in the business of manufacturing optical discs. The company was transferred to the Main Board of the exchange two years after it was listed on the Second Board in 2001. Investigation by the SC began after Megan Media announced to the exchange in May 2007 that two of its subsidiaries, Memory Tech Sdn Bhd and MJC (Singapore) Pte Ltd had defaulted in trade facilities amounting to more than RM47 million.

The SC charged the former Financial Controller for abetting Megan Media in furnishing the exchange with inflated revenue figures that are reported in Megan Media and its subsidiaries' financial statements for the year ended 30 April 2006, and in the company's quarterly financial statements for the years ended 31 July 2006, 31 October 2006, and 31 January 2007.

The Executive Chairman and Director of Megan Media was charged for furnishing a false statement on the inflated revenue in Megan Media's quarterly financial statements for the year ended 31 January 2007. Upon conviction, the two individuals are liable to a fine not exceeding RM3 million or to imprisonment of not more than ten years or to both under the securities laws of Malaysia.

In December 2007, the SC has sought the assistance of the Interpol to trace and serve a warrant of arrest on George Yeo Wee Siong, the Executive Director of Megan Media who is wanted for similar charges.

Directors of Welli Multi Corporation charged for furnishing misleading statements

Bursa's Listing Requirements – continuing listing obligations – submission of financial statements – Misleading revenue figures submitted – directors charged – directive to restate financial statements

On 15 April 2008, two former Directors of Welli Multi Corporation Bhd (Welli Multi) were charged in the Sessions Court for furnishing misleading statements to the SC and to Bursa Malaysia in breach of s.122B of the SIA.*

Welli Multi is an investment holding company with subsidiaries involved in the processing of palm kernel and trading of palm kernel oil.

Welli Multi's former Managing Director, Ang Sun Beng and former Executive Director, Ang Soon An, who were co-founders of the company, furnished misleading statements contained in Welli Multi's:

- Annual Report for 2005; and
- Quarterly reports for the financial periods ended 31 March 2006, 30 June 2006, and 30 September 2006.

The misleading statements were for Welli Multi's group revenue which was inflated to the sum of RM313.5 million.

Apart from criminal prosecution, the SC also compounded another Welli Multi's former Executive Director and Chief Executive Officer for RM100,000 for authorising the furnishing of a misleading statement to the exchange contained in Welli Multi's quarterly report for financial period ended 30 September 2006.

On 27 November 2007, the SC had directed Welli Multi to restate and reissue three of its quarterly reports which contained the misleading statements and its audited financial statements for year ended 31 December 2005. The audited financial statements were furnished to the SC on 20 June 2006 as part of Welli Multi's annual report for 2005.

Investigation into Welli Multi was initiated following a report lodged by its auditors, Deloitte KassimChan with the SC as required under section 320 of the CMSA. Following its audit findings, the auditors discovered that most of Welli Multi's trade debtors were either dormant, non-existent, or had ceased business.

* The corresponding provision of s.122B SIA in CMSA is s.369.

SC directs Talam to restate accounts

Non-compliance with FRC 101 – breach of SIA (Compliance with Approved Accounting Standards) Regulations 1999 – directive to reissue accounts – managing director compounded

In October 2007, the SC had directed Talam Corporation Bhd (Talam) to reissue its 2006 and 2007 financial statements, and to make the necessary announcement to Bursa Malaysia. This was the third time the SC had directed a public-listed company to reissue its accounts. Talam complied with the SC's directive immediately.

In failing to present fairly its financial position, financial performance and cash flows, Talam had failed to comply with the *Financial Reporting Standards 101* (FRS). Such non-compliance is a breach of the Securities Industry (Compliance with Approved Accounting Standards) Regulation 1999 – a serious breach as it results in the financial position of the company being inaccurately represented to the investing public.

The SC's investigations revealed that Talam had made adjustments to its financial statements for the year ended 31 January 2006 despite its auditors' inability 'to obtain sufficient appropriate audit evidence' to satisfy themselves of the adjustments. The adjustments meant that RM90 million of Talam's debtors were reclassified into property development costs, other liabilities, and retained profits brought forward.

On 11 April 2008, the Managing Director of one of Talam's subsidiaries paid a compound of RM500,000 to the SC for contravening the SC's approval condition for the subsidiaries' issuance of the Islamic bonds.

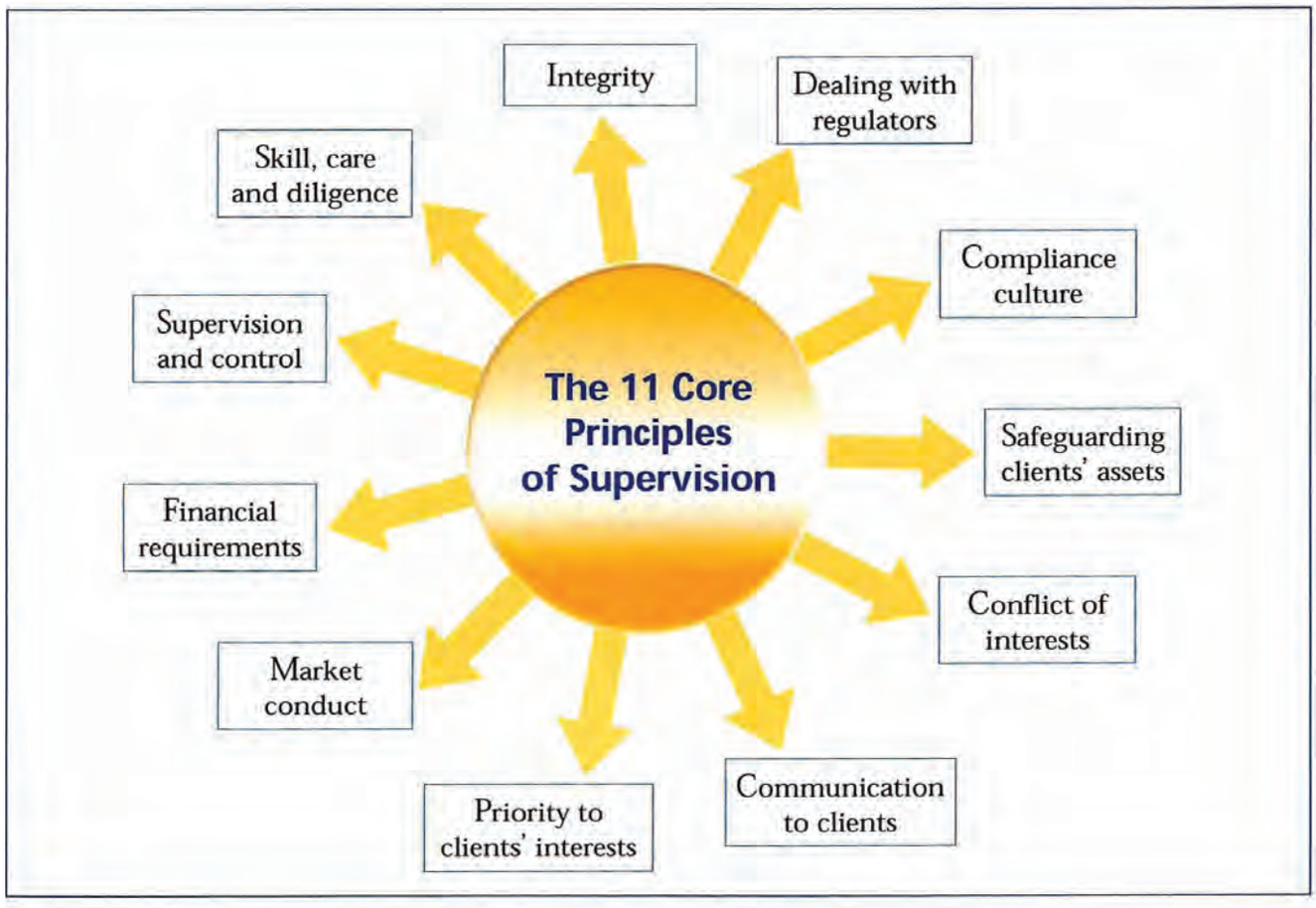
Launch of SC's Guidelines on Market Conduct and Business Practices

The SC introduced its *Guidelines on Market Conduct and Business Practices* on 8 April 2008. These guidelines which are aligned with international best practices, identify 11 core principles of supervision which stockbroking companies and their representatives must comply with. These guidelines would assist stockbroking companies strengthen their risk management, internal controls and elevating the overall prudential standards and ethical conduct of the stockbroking companies.

These guidelines would also serve as a standard that stockbroking companies and their representatives must aspire to. Any breach of these guidelines is seriously viewed by the SC which may take appropriate actions against them.

"We shifted to a principles-based approach to supervision. We believe prescriptive rules prevent capital market intermediaries from responding quickly and efficiently to changing market needs and add unnecessarily to their operating costs. We believe where intermediaries are able to demonstrate to us high standards of internal controls, compliance standards and market conduct, they should be subject to less regulatory intensity. To achieve this, we have reviewed and reduced rules extensively and now emphasize on principles of good conduct in supervising intermediaries."

Keynote address given at the MAICSA Annual Conference, Kuala Lumpur, July 16, 2007



Manipulation of Iris Shares: Licences of stockbroking companies and dealer's representatives suspended and revoked

Market manipulation – failure to supervise client's trading activities – civil enforcement action – dealer's representatives sanctioned

On 27 March 2008, the SC initiated civil enforcement actions against five foreign companies and five individuals for market manipulation, market rigging and fraud involving Iris Corporation Bhd (Iris) shares between the period of 13 March and 11 May 2006. During that period, the price of Iris shares rose from RM0.32 to RM1.38.

The SC's investigation showed that the defendants created an artificial perception of demand for Iris shares by simultaneously placing a maximum purchase order of 500,000 shares and for each order to be below the prevailing market price. In so doing, the defendants ensured that the orders were unlikely to be matched by corresponding sellers. This in turn portrayed a misleading appearance of the active demand for Iris shares to the investing public. During that period, purchase orders for approximately eight billion Iris shares were keyed-in by eight local stockbroking companies, with an average of 251 million shares keyed-in per day.

Through its investigations, the SC found that the stockbroking companies concerned had–

- demonstrated a total disregard for their obligations and duty in the maintenance of a fair and orderly market by allowing their clients to engage in aggressive and improper trading; and

- failed to establish any policies, procedures or systems within the company to ensure the maintenance of a fair and orderly market.

In addition, the stockbroking companies concerned also failed to supervise their client's trading activities and continued to allow such questionable trading strategy even after Bursa Malaysia and the SC had jointly raised their concerns.

The licences of two dealer representatives from Avenue Securities Sdn Bhd were revoked and suspended respectively when they were found to have abused five clients' accounts in the trading of Iris shares. During the 27-day trading period, Lee Hooi Li (Lee) had keyed-in purchase orders for Iris shares totalling approximately six billion shares using five of her clients' accounts without the necessary authorisation. Lee's dealer's representative's licence was revoked effective 23 May 2008. Lee's action displayed a total disregard of the regulatory controls put in place for clearing accounts as required under the rules of the stock exchange.

At the same time, Lee's supervisor, Patrick Taylor, had failed to exercise sufficient supervision so as to prevent the unauthorised trading conducted by Lee over the 27 days. His failure to discharge his supervisory duties led to the suspension of his dealer's representative's licence for six months effective 23 April 2008.

The SC's stern actions in this case highlights the high ethical standards and professional conduct expected of market intermediaries. Hence, dealer's representatives who abuse their clients' accounts violate their clients' trust and breach their fiduciary obligations towards their clients.

Failure to exercise competence and soundness of judgement in trade execution – licences of dealer's representatives suspended

Odd lot transactions – dealer's representatives' licences suspended – failure to discharge duties under securities laws

On the SC's investigation into several fraudulent odd-lot transactions executed through five stockbroking companies, three dealer's representatives namely Patrick Yap (Kenanga Investment Bank Bhd), Emily Gan (Kenanga Investment Bank Bhd) and Chia Chin Ee (CIMB Invesment Bank Bhd) had their licences suspended for four to eight weeks when they failed to discharge the duties required of them under the *Capital Markets and Services Act 2007* (CMSA).

These odd-lot transactions were pre-arranged at exorbitant prices and did not involve any change in beneficial ownership of the shares. The perpetrator controlled the accounts belonging to himself, his mother and his girlfriend, both at the buying and the selling side. In some instances, the prices of the odd lots transacted exceeded 9800% to 1,000,000% of the prevailing market price of the odd lots shares transacted. The perpetrator collected the sales proceeds at the selling broker and defaulted at the buying broker; thereby generating healthy profits for himself.

The SC found that the three dealer's representatives concerned had–

- allowed the perpetrator to use his mother's trading account to indulge in this scheme between 17 September to 17 October 2007 without her written authorisation;
- continued to allow the execution of these odd lot transactions when the prices quoted by the perpetrator for the purchase and sale of odd lot transactions were abnormal; and
- allowed the execution of the trades when they were aware that the transactions were pre-arranged.

In addition, two of the dealer's representatives concerned namely Patrick Yap and Emily Gan allowed an unlicensed trading clerk to carry out trading orders directly from the perpetrator. In fact, these dealer's representatives continued to execute purchase orders for the perpetrator on 17 October 2007, totalling RM395,989 at prices way above prevailing market price even though he had defaulted on earlier purchase contracts totalling RM236,411 on 17 and 18 September 2007.

Despite the unusual circumstances surrounding these trades, the dealer's representatives concerned did not alert their management nor did they take any action to prevent new trades from being executed.

One and a half months later, after "generating" approximately RM1,189,597 of sales proceeds, the scheme was uncovered when a vigilant remisier, Wong Pik Yee (Wong) of OSK Investment Bank Bhd (OSK), alerted her management on these abnormal transactions when the perpetrator was attempting to execute further purchases through his girl friend's account at OSK. The swift action by Wong of OSK is highly commendable.

In order to maintain a fair and orderly market, more remisiers with Wong's attitude are much needed. Licensed intermediaries have an obligation not only to their clients but to also ensure that they fulfil their role in maintaining market discipline by not engaging in or facilitating transactions which harm the best interests of the investing public and the integrity of the market.

Short selling: Dealer's representative suspended

Short selling – section 98 CMSA – dealer's representative suspended – failure to satisfy fit and proper criteria

In February 2008, the licence of a dealer's representative was suspended for one month for his involvement in naked short selling, a practice which is disallowed under section 98 of the CMSA. Naked short selling refers to the practice of selling securities that the seller does not own at the point of transaction. In Malaysia, as in many other jurisdictions, naked short selling is prohibited. However regulated short selling as prescribed in the business rules of Bursa Malaysia Securities is allowed.

On imposing the month-long suspension, the SC had found this particular dealer's representative to have acted improperly when he acted on the instructions of a fellow remisier and placed large volumes of sell orders through his clients' accounts without their authority and consent. The dealer's representative claimed that he had been misled into believing that the clients' accounts in question had sufficient securities. He failed to verify the instructions from the remisier concerned and ensure that there were sufficient securities in these accounts before executing the offending trades. Since there were insufficient securities in these accounts, the automatic buying-in mechanism of Bursa Malaysia Securities was triggered.

Dealer's representatives, as the custodians of their clients' accounts, are strictly forbidden to make unauthorised use of their clients' accounts and should aspire to demonstrate a high degree of probity, competence and soundness of judgment in all their dealings.

Unlicensed dealers: Stockbroking Company Fined

Unlicensed dealers – breach of licensing conditions

In March 2008, the SC imposed a monetary penalty of RM100,000 against a stockbroking company for various breaches on the its lack of internal controls and failure in carrying out its supervisory functions over its dealers' representatives.

The SC's findings revealed that the stockbroking company had allowed four of its trading clerks to accept orders directly from clients, a breach of its licensing conditions which requires the company to ensure that the carrying on of any licensed regulated activity on its behalf is performed by employees who are appropriately licensed. Besides this, the company was also found to have allowed one of its dealer's representatives to have access to the BFE terminal during a period when his licence was in the process of transfer. In terms of its overall internal controls, the company had failed to maintain adequate resources and put in place control systems and procedures required, as reasonably expected of a stockbroking company.

The weaknesses inherent in the company could pose a high regulatory risk since there was a high possibility that the interests of the company's clients could be compromised. Besides imposing a monetary penalty on the company, the SC also issued a directive requiring the Board of the stockbroking company to report to the SC on the remedial measures taken to address the breaches.

Fund manager fined and directed to restitute clients for wrongful receipt of rebates

Wrongful receipt of rebates – clause 4.05 Compliance Guidelines – fine – direction of rebates to clients

In September 2008, the SC's investigation revealed that a licensed fund manager had improperly retained rebates received from stockbroking companies which should have been channelled to its clients.

Such retention of rebates or soft commissions is against clause 4.05 of the SC's *Compliance Guidelines* which prohibits fund managers from accepting or receiving for itself, any rebate and/or commission from any dealer arising from transactions it enters into on behalf of its clients. Any rebate or commissions that the fund manager receives must be directed to the account of the relevant client. The retention of rebates or soft commissions by fund managers, without the express written consent of the clients is not allowed in other jurisdictions such as in Hong Kong.

In this instance, the SC imposed a monetary fine of RM100,000 and directed the fund manager to comply with clause 4.05 of SC's guidelines by channelling these rebates to the accounts of its clients.

Dialogue session with stockbroking companies

Raising awareness – stockbroking companies – minimum financial requirement – AML standards – internal control weaknesses

The SC held a dialogue session with all stockbroking companies and their representatives on 25 June 2008 to raise their awareness on the SC's supervisory concerns. One of the important concerns highlighted was the need for stockbroking companies to comply with all of the three specified minimum financial requirements at all times. The SC's *Licensing Handbook* stipulates that stockbroking companies are required to maintain the following minimum financial requirements at all times:

- Minimum paid-up capital of RM20 million;
- Minimum shareholders' funds of RM20 million; and
- Minimum capital adequacy ratio (CAR) of 1.2 times.

In this regard, stockbroking companies have a duty to closely monitor their company's financial requirements on a daily basis and ensure adequate systems are in place to ensure these minimum requirements are met at all times. Stockbroking companies who fail to meet their minimum financial requirements are barred from dealing in any stockbroking activities until they are fulfilled.

The dialogue also highlighted other shortcomings of stockbroking companies uncovered by the SC while carrying out its supervisory functions. Such weaknesses were mainly in the areas of non-adherence to regulatory requirements and a low level of anti-money laundering standards and control weaknesses found to be present within the organisations.

Audit oversight reform by SC

Rampant accounting irregularities – setting up of AOB – effective audit oversight framework

The SC's investigative findings into recent spates of corporate accounting shenannigans have highlighted that there is an urgent need to ensure that auditors of public-listed companies (PLCs) comply with established auditing standards when auditing the financial statements of PLCs. In this regard, it is critical that due compliance with auditing standards is strictly observed as such compliance is crucial to maintaining investor's confidence in the quality and reliability of audited financial statements of PLCs and public interest entities.

In order to address such weaknesses within the auditing profession, the Malaysian Government announced in the 2008 Budget that "a Board responsible to monitor auditors of public companies would be set up under the auspices of the SC". The primary objective of this board would be to promote and develop an effective and robust audit oversight framework for Malaysia.

To date, efforts towards the establishment of a strong, independent and robust Audit Oversight Board (AOB) are well underway. A High Level Task Force comprising representatives from the SC, Malaysian Institute of Accountants, Malaysian Institute of Certified Public Accountants, Bank Negara Malaysia, Bursa Malaysia and PLCs was instrumental in making recommendations to the Government of the appropriate audit oversight framework for Malaysia. Here are some significant features of the Task Force's recommendations–

- Remit of AOB to include a gate keeping function to ensure that only fit and proper persons are allowed to audit companies;
- AOB will comprise a majority of suitably qualified non-accounting practitioners, to ensure independent oversight over auditors;
- Regular and rigorous inspection by AOB on auditors of PLCs; and
- AOB to have the power to discipline errant auditors and audit firms of PLCs via a broad range of sanctions.

It is hoped that the Audit Oversight framework will be in place before end of 2009.

High Court struck out Nasioncom's application

Public reprimand – rectify financial statements – judicial review to quash SC decision – dismissed with costs

In February 2007, the SC had publicly reprimanded Nasioncom Holdings Bhd and directed the telecommunications services provider to rectify and re-issue its 2005 financial statements within a month.

The SC's administrative action against Nasioncom was taken after investigation findings revealed that the company's group revenue of RM194,984,186, which was reflected in its 2005 financial statements, included sales amounting to RM143,109,727 that were not transacted. These sales figures were reflected in the financial statements of two Nasioncom's subsidiaries, namely Nasioncom Sdn Bhd and Express Top-up Sdn Bhd.

Following the SC's directive, Nasioncom filed a judicial review action at the Kuala Lumpur High Court in April 2007. The application sought to quash the SC's decision on the grounds of *mala fide*, irrationality and breach of natural justice.

On 23 October 2008, the High Court ruled in favour of the SC and dismissed with costs Nasioncom's application for judicial review. In November 2008, Nasioncom filed an appeal to the Court of Appeal against the High Court's ruling.

Revision of the Malaysian Code on Corporate Governance: Key features

The *Malaysian Code on Corporate Governance* (Code) was introduced in 2000 as part of the nation's effort in raising the standards of corporate governance and creating awareness of its importance to the corporate sector. It was a first step towards recognising and adopting a set of "best practices" that reflect high standards of disclosure, transparency, accountability and timely and efficient reporting. The Code was incorporated as part of the listing requirements of the stock exchange and is applicable to all public-listed companies (PLCs).

The mandatory reporting of compliance with the Code has enabled shareholders and the investing public to assess the extent of compliance of corporate governance standards by PLCs.

While there have been significant improvements since its release in 2000, a timely review of the Code to further strengthen corporate governance practices was deemed necessary, to be in line with practices of international capital markets. Hence, at the 2008 Budget speech, the Prime Minister made the following announcement:

> "… the Code is being reviewed to improve the quality of the board of PLCs by putting in place the criteria for qualification of directors and strengthening the audit committee, as well as the internal audit function of PLCs… . To ensure the effectiveness of the audit committee of PLCs, executive directors will no longer be allowed to become members of the audit committee. In addition, the internal audit function will be mandated for all PLCs, and the board of directors will be responsible for ensuring the adherence to the scope of internal audit functions… ."

The Code was revised and came into effect in October 2007. The revised *Malaysian Code on Corporate Governance* has made improvements in the following areas:

- **Audit committee: composition, qualification, and frequency of meetings**

The audit committee is a critical component in a corporate governance framework, standing at the intersection of the management, external auditors, internal auditors, and the board. It plays a crucial role to ensure quality in the financial reporting process and thereby improve the confidence of users in the financial statements. Traditionally, the role of the audit committee has been to oversee, monitor, and advise company management and external auditors in conducting audits and preparing financial statements. In the wake of high profile corporate scandals, increasingly, it is looked upon as an internal control mechanism to mitigate corporate fraudulent practices.

To ensure independence of the audit committee, the revised Code

requires all members of the audit committee to consist only of non-executive directors. There is an additional requirement of financial literacy for the audit committee so that it can fulfil its role effectively. The revised Code states that at least one member of the audit committee should be a member of an accounting association. With audit committee members being equipped with financial literacy skills, they can provide a more effective review of the company's financial information.

To encourage greater exchange of views and discussions, the revised Code requires the audit committee to meet with external auditors (without the presence of the executive board) at least twice a year. It is hoped that through continuous engagement, relevant issues affecting the company can be brought to the attention of the audit committee in a timely manner.

- **Eligibility of directors**

An effective nominating committee provides the assurance to shareholders that directors have the necessary qualifications, skills and knowledge to carry out their duties effectively for the best interest of the company.

Thus, under the revised Code, the following criteria is required to be considered by the nominating committee when making recommendations on directorships:

- Skills, knowledge, expertise and experience;
- Professionalism;
- Integrity; and
- For independent non-executive directors, the nominating committee should also evaluate their ability to discharge the responsibilities/functions expected of them.

In order to ensure directors of PLCs commit adequate time and resources in meeting their responsibilities, Bursa Malaysia's listing requirements mandate that a director of a PLC may hold up to 25 directorships in companies. Of these 25 directorships, an individual must not hold more than 10 directorships in PLCs and not more than 15 directorships in companies other than PLCs.

- **Importance of the internal audit function**

To ensure independence of the internal audit function, the revised Code requires the head of internal audit to report directly to the audit committee. The internal auditor acts as the eyes and ears of the company to safeguard the company's assets and protect shareholders' value. With such a function, shareholders can be assured that there are proper internal controls and risk management procedures in the company. Thus, the revised Code recognises the importance of the internal audit function by requiring all companies to establish an internal audit function within the company.

Directors held accountable for defrauding company – Multi-Code director charged

On 13 March 2009, Toh Chun Toh and Datuk Abul Hasan Mohamed Rashid, two former directors of Multi-Code Electronics Industries (M) Bhd (Multi-Code) were charged for defrauding the company and committing criminal breach of trust for funds belonging to the company.

Toh Chun Toh was the former Managing Director of Multi-Code. He was alleged to have defrauded the company by using RM17.5 million of the company's funds to pay for the purchase of over 11 million units of Multi-Code's shares by another company in which he had a deemed interest. Datuk Abul Hasan, a former executive director of Multi-Code was charged for abetting Toh. Toh was alleged to have committed the offence under section 87A(b) of the *Securities Industry Act 1983* (SIA);[1] whereas Datuk Abul Hasan was charged under section 122C(c) of the SIA[2] read together with section 87A of the same Act.

At the same time, both Toh and Datuk Abul Hasan were each charged in the alternative for criminal breach of trust under section 409 of the Penal Code, in respect of RM26 million of Multi-Code's funds. The actions of Toh and Datuk Abul Hassan had greatly undermined the trust put in them by the shareholders of the company.

SC had initiated an investigation into this case in December, 2007 following Ernst & Young's qualification of Multi-code's audited financial statements for the financial year ended 31 July 2007. Thereafter Ernst & Young promptly submitted a report to the SC under section 320 of the *Capital Market and Services Act 2007(*CMSA) which requires an auditor to report possible breaches of securities laws as well as breaches of the rules of the stock exchange to the SC or to Bursa Malaysia. The diligence shown by the auditors in discharging their professional and statutory duties in this particular case is commendable.

Misleading financial reports with "inflated" revenue – Directors of Satang charged

Following an anonymous tip-off, the SC's investigations into Satang Holdings Bhd (Satang) revealed that Satang had, on four separate occasions, inflated its revenue figures which it announced to Bursa Malaysia in its quarterly financial reports for the financial period between 1 October 2006 and 30 September 2007.

The revenue for all the four quarters were inflated to the sum of RM18 million, RM31 million, RM43 million, RM67 million respectively. For the first three quarters, the directors allegedly committed offences under section 122B(b)(bb) of the SIA;[3] and for the last quarter, the offence was caught under section 369(b)(B) of the CMSA.

On 4 December 2008, the SC charged Satang's Executive Chairman and Managing Director, Jamaluddin Hassan, its former Executive Director, Gan Chin Sam and its Executive Director Hakim Sukirman in the Kuala Lumpur Sessions Court for furnishing false statements. The case is still pending in court.

In April 2008, Satang conducted an investigative audit and reversed approximately RM35.43 million revenue from its books.

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1 The SIA has been repealed on 28 September 2007 with the coming into force of the *Capital Markets and Services Act 2007* ("CMSA"). The corresponding provision of s.87A(b) SIA in CMSA is s.179(b).

2 The corresponding provision of s.122C(c) SIA in CMSA is s.370(c).

3 The corresponding provision of s.122B(b)(bb) SIA in CMSA is s.369(b)(B).

Duty to maintain fair and orderly market – Gensoil director pleads guilty to submitting false information and market manipulation

On 26 December 2008, Tan Soon Geok @ Tan Soon Leng, the Managing Director of General Soil Engineering Holdings Bhd (Gensoil) pleaded guilty to providing a false declaration to the SC in relation to a private placement exercise. Tan also pleaded guilty to the offence of market manipulation.

In December 1998, Gensoil undertook a private placement exercise involving 2.5 million new ordinary shares, which was earlier approved by the SC. The approval was subjected to several conditions, among others, a condition that the directors of Gensoil must not participate in the purchase of the private placement shares and would not stand to benefit from the proposed private placement. Tan signed a declaration stating that he had no interest whatsoever in the private placement of the shares.

Subsequent to the SC's approval, it was discovered that two of the private placees were nominees of Tan. He had funded the purchase of the shares, in contravention of his earlier declaration to the SC.

In August 1999, the SC detected unusual trading activites of Gensoil shares. Tan and his remiser, Esmail Naziadin had created a misleading appearance of active trading in Gensoil shares through the means of "wash trades" i.e. buying and selling of shares that did not involve any change in beneficial ownership through the use of two accounts.

The SC's investigation culminated in separate charges against Tan and his remisier for manipulating the share price of Gensoil, a contravention of section 84(1) of the SIA.[1] Tan was also charged for making a false declaration to the SC with regard to the private placement exercise which is an offence under section 122B(b)(aa) of the same Act.[2]

On 26 December 2008 the court fined Tan RM150,000. Gensoil's counter was earlier delisted from Bursa Malaysia's Second Board on 27 April 2005.

Allowing unlicensed persons to act as fund managers – Director convicted and fined

The SC's investigations revealed that Siti Mariam Berahim and Nublan Zaky Yusoff had marketed investment schemes and collected funds of approximately RM361,500 from the public without licences. These funds were collected on behalf of Perdana Technology Ventures (PTV), a fund management company.

Under section 15B(b) of the SIA,[3] a person may only act as a fund manager's representative if the person holds a licence.

The Managing Director of the fund management company, Dr Barjoyai Bardai was found to have allowed Siti Mariam and Nublan Zaky to act as his representatives in marketing "investment opportunites" and in collecting funds from members of the public while knowing that they were not licensed. The SC charged Dr Barjoyai Bardai under section 18(2) of the SIA,[4] read together with section 122[5] of the same Act, for breaching a condition of PTV's licence as a fund manager. He was found guilty and fined RM 240,000 by the court. He had failed to protect the interests of investors by allowing unlicensed persons to act as his representatives.

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1 The corresponding provision of s.84(1) SIA in CMSA is s.175(1).
2 The corresponding provision of s.122B(b)(aa) SIA in CMSA is s.369(b)(A).
3 The corresponding provision of s.15B(b) SIA in CMSA is s.59(1).
4 The corresponding provision of s.18(2) SIA in CMSA is s.61
5 The corresponding provision of s.122 SIA in CMSA is s.367

Directors of MEMS charged for misleading statements

On 16 April 2009, the SC charged Ooi Boon Leong, a substantial shareholder and non-executive director of MEMS Technology Bhd (MEMS), as well as Ronnie Tan Yeow Teck its then executive director and chief financial officer for knowingly authorising the provision of a misleading statement by MEMS to Bursa Malaysia.

The misleading statement was in relation to MEMS' reported revenue of RM73,416,000 in its unaudited Consolidated Income Statements for the twelve-month period ended 31 July 2007. MEMS' audited Income Statements for the same period was later announced on 24 April 2008 and it contained a disclaimer by the company's then statutory auditors, Messrs. KPMG.

The criminal charges were initiated under section 122B(b)(bb) of the Securities Industry Act (SIA) 1983.[1] If convicted, both Ooi Boon Leong and Ronnie Tan are liable to a fine not exceeding RM3 million or imprisonment for a term not exceeding 10 years, or both.

The SC views the provision of misleading information in income statements seriously as investors and other stakeholders rely on such statements to evaluate the profitability and performance of the company.

Following the charges against Ooi Boon Leong and Ronnie Tan, the SC also issued an administrative directive to MEMS in August 2009. The directive was for MEMS to rectify and re-issue its financial statements for the financial years ended 31 July 2007 and 31 July 2008 as well as its unaudited Condensed Consolidated Income Statements for the six months period ended 31 January 2009

Submission of false report to Bursa – United U-Li Corporation's director compounded and auditor charged

On 28 April 2009, William Yue Chi Kun, an auditor from Roger Yue, Tan & Associates was arrested and charged under section 122B(b)(bb) of the SIA 1983 for abetting United U-Li Corporation Bhd in submitting a false report to Bursa Malaysia.

U-Li's Annual Report and Financial Statements for the year ended 31 December 2004 contained an inflated profit before tax. The financial statements were audited by Roger Yue, Tan & Associates, where William Yue is a partner.

The SC's investigation revealed that fictitious sales amounting to RM4 million were recorded by U-Li and this in effect boosted its profit before tax.

Besides William Yue, U-Li's Managing Director James Lee Yoon Wah was also held accountable for contravening section 122B(b)(bb) of the SIA. In March 2008, James Lee admitted to the offence and paid a compound of RM200,000, while William Yue refused to pay the compound and was accordingly arrested and charged. The case is fixed for trial on 12–16 April 2010 at the Kuala Lumpur Sessions Court.

As with all market professionals, directors and auditors are subject to increasingly high levels of ethical and professional standards in view of the important impact their roles have on investor confidence.

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[1] The SIA was repealed on 20 September 2007 with the coming into force of the *Capital Markets and Services Act 2007* (CMSA). The corresponding provision of s122B (b)(bb) SIA in CMSA is s369(b)(B).

MIH officer convicted – S87A SIA 1983 – Fraudulent conduct in allotment of shares

On 25 March 2009, the Kuala Lumpur Sessions Court convicted and sentenced Ashari Rahmat, an operations officer from the Malaysian Issuing House (MIH) to three years imprisonment and a fine of RM1 million for his involvement in a scheme where successful IPO applications were switched for "phantom" applications.

MIH is a licensed entity under the CMSA. It provides issuing house services for companies who wish to issue securities to the public. Via MIH, investors can apply for an IPO by completing and submitting the necessary application forms and making the requisite payment for the shares applied for. MIH then conducts a balloting exercise in the presence of the directors of the IPO issuer and the external balloting auditors to determine the successful applicants for the shares.

The SC's investigations found that it was during one such balloting exercise for the listing of UPA Corporation Bhd's shares where Ashari had switched a batch of successful IPO applications for a batch of "phantom" applications meant for the financial benefit of himself and his conspirators, thereby denying legitimate investors who had made their IPO applications in accordance with the proper procedures from being able to participate in the balloting exercise for UPA's shares.

Ashari has filed an appeal to the High Court against his conviction. The appeal is pending hearing and Ashari has obtained a stay of execution on serving his sentence until the final determination of his appeal by the High Court.

Metrowangsa's directors found guilty by criminal courts

Ghazali Atan and Mohamed Abdul Wahab, directors of Metrowangsa Asset Management Sdn Bhd (MAM), were found guilty on 1 April 2009 by the Kuala Lumpur Sessions Court under section 47C of the SIA[2] for mismanaging the trust account of MAM's corporate client, Lembaga Tabung Haji. For this offence, both Ghazali and Mohamed were fined RM200,000 each by the court.

MAM, a licensed asset management company received a total of RM200 million in investments from Lembaga Tabung Haji between 14 October 1999 and 14 December 2000. The SC's investigations revealed that unknown to Lembaga Tabung Haji, MAM had unlawfully withdrawn RM50 million from Lembaga Tabung Haji's trust account so that it could repay Mimos Bhd, another of MAM's corporate clients, who had earlier requested a withdrawal of its investments.

Ghazali and Mohamed were also charged under section 122B(b)(cc) of the SIA[3] for knowingly authorising misleading statements to be submitted to the SC. These misleading statements were in relation to MAM's failure to disclose investments made by both Lembaga Tabung Haji and Mimos Bhd, in its semi annual reports to the SC for periods ending December 2000 and June 2001. It is vital for such reports to contain accurate information, to enable the SC to effectively monitor the activities of fund managers. On this charge however, the Sessions Court decided to acquit and discharge Ghazali and Mohamed. The SC has appealed against the court's decision.

As for MAM's fund management and futures fund management licences, as well as the licences of Ghazali and Mohamed, all these licences were revoked by the SC in 2002, for their failure to ensure that clients' money was utilised in strict accordance with the laws, rules and regulations that apply to licensed intermediaries such as MAM.

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2 The corresponding provision of s47C SIA in CMSA is s122.
3 The corresponding provision of s122B(b) (cc) SIA in CMSA is s369(b)(C).

Licence of futures representative revoked for serious misconduct

On 29 May 2009, the SC revoked the licence of futures representative, Jimmy Chan Kim Meng. He was found to have committed a series of misconducts in his dealings with his clients.

Upon receiving complaints from Jimmy Chan's clients, the SC's enquiries into his conduct revealed that he had:

- not appraised his clients of the risks of trading in futures contracts and had instead represented to them that their loss will be limited to the initial amount invested only;
- proceeded to enter into trading transactions on behalf of his clients without obtaining their consent beforehand, regardless of the fact that these accounts were non-discretionary in nature; and
- focused on his clients with larger portfolios when rendering his services, rather than paying equal attention to all his clients, particularly the complainants, who were new investors and did not know the risks of trading in futures contracts.

Due to the market downturn in February 2007, the five complainants lost a total of RM125,779.

Licensed representatives, as custodians of their clients' accounts must not make any unauthorised use of their clients' accounts and should not misrepresent to their clients the risks associated with investing in any capital market product. It is incumbent upon the SC, to ensure only individuals of integrity are allowed to be licensed. As such, there is an expectation imposed on licence holders to act only in their clients' best interests at all times. It should be pointed out that any failure on the licence holder's part to meet such an expectation highlights the representative's inability to be licensed.

Dually-employed fund manager's representative sanctioned by the SC

In April 2009, the SC reprimanded a fund manager's representative who was, for a period of 11 months straddling positions in two fund managers. During this period, the representative in question continued in the employ of one fund manager (the first firm) as a Senior Vice President after accepting an appointment to become the licensed director of the other fund manager (the second firm).

Licensed representatives cannot be in the employment of more than one participating organisations at the same time. This results in licensed representatives being put in a position of conflict, by allowing themselves to be answerable to two separate participating organisations in the same industry and in direct competition with one another.

In this case, this representative had undeniably acted improperly in working with both fund managers at the same time. During his tenure with both companies, he represented both companies at meetings and had even introduced an existing client of the first firm to the second firm.

Besides reprimanding the licensed representative, the SC also disqualified him from serving as a director of the second firm for a period of one year.

Robust Audit Oversight in Malaysia with the Setting up of AOB

Efficient functioning of the capital market depends on the integrity of financial information. Past accounting scandals in the international and domestic arenas serve to emphasise the important role of external auditors in providing reliable and credible financial statements. The auditors involved in these scandals demonstrated a lack of compliance with auditing standards and procedures.

The AOB will carry out its mission through registration, inspection, inquiry, enforcement and standard setting programmes. In addition, it will provide education and awareness to the market on domestic and international auditing and quality standards.

Malaysia has taken a major step forward in terms of corporate governance by setting up the Audit Oversight Board (AOB). The AOB commenced its operations on 1 April 2010, following an amendment to the *Securities Commission Act 1993*. The government has appointed seven members to the Board, including the Executive Chairman. The other six members are non-executive.

The AOB's mission is to oversee the auditors of public-interest entities (PIEs), and to protect the interests of investors by promoting confidence in the quality and reliability of audited financial statements of PIEs.

The AOB will register and monitor auditors of PLCs and other PIEs, such as capital market intermediaries, banking institutions and insurance companies. The main objective of AOB is to promote and develop an effective and robust audit oversight framework for Malaysia. It is established as a means to–

- further strengthen the independent oversight of auditors;
- ensure only fit and proper persons are allowed to audit financial statements of PIEs; and
- carry out enforcement through a broad range of sanctions.

The AOB will carry out its mission through registration, inspection, inquiry, enforcement and standard setting programmes. In addition, it will provide education and awareness to the market on domestic and international auditing and quality standards.

The AOB is mandated to co-operate with other regulatory agencies, such as the Companies Commission of Malaysia, Bank Negara Malaysia, the Malaysian Institute of Accountants and various industry groups for wider regulatory and enforcement reach to all players in the industry and hence, increase robustness in its implementation of an independent audit oversight framework. The AOB will also enhance the SC's supervision over capital market intermediaries.

Swisscash-SC Restitutes Investors

On 8 April 2010, the SC obtained the approval of the High Court on the eligibility criteria for restituting Swisscash investors.

The restitution was made possible following a settlement on 6 November 2009 with two defendants, Albert Lee Kee Sien and Amir Hassan, in the civil enforcement action filed by the SC over the Swisscash scam. Following the settlement, PricewaterhouseCoopers Advisory Services Sdn Bhd (PwCAS), was appointed as the administrator to manage the restitution process.

The administrator processed close to 24,000 claims and assisted the SC in determining eligibility criteria for investors which were later approved by the court. A total of 20,659 claims meet the criteria for payout.

The more pertinent of the approved criteria are–

- date of investment;
- the claim must be supported by evidence of investment and proof of remittance or payment to the scheme; and
- a pre-condition that the claimant could not be involved as an upliner of the scheme.

Maintaining Fair and Orderly Markets

The SC adopts a risk-based approach towards market supervision to maintain fair and orderly markets and promote investor protection. A fundamental element in ensuring effective supervision resides in having timely, accurate and relevant information. Accordingly, engagements with stakeholders have been intensified to enhance co-operation and identify emerging risks.

In the past few months, routine examinations carried out by the SC had revealed breaches of regulatory requirements by two licensed intermediaries: a stockbroker and a futures broker. The examinations also revealed internal control weaknesses and inadequate oversight by the respective intermediaries.

Accordingly, the SC instituted formal disciplinary action, which included–

- the imposition of reprimands on the boards of directors; and
- the imposition of financial penalties ranging between RM125,000 and RM275,000.

In addition, administrative action was taken against a remisier for engaging in intra-day short-selling and for using another's account to execute the trades. The remisier's licence was suspended for four weeks and he was fined RM60, 000 and imposed an extra 10 CPE points.

Safeguarding Client Assets and Strengthening Oversight

SC shares supervisory findings with fund managers

As a part of its continuing supervisory efforts to enhance client asset protection, on 20 July 2010, the SC sent letters to the boards of directors and the chief executive officers of fund management companies, to share its supervisory findings and to reiterate its regulatory compliance expectations. The SC had concluded that the compliance framework and culture within a number of fund managers required further strengthening. Areas of focus included adequacy of policies and procedures, trading practices and maintenance of records.

The SC also emphasised the board's ultimate responsibility in ensuring that the company complies with all regulatory requirements. The board of directors is required to submit an undertaking to the SC that the company's policies, processes and practices are in compliance with regulatory requirements and expectations.

As a further measure, the SC has revised its submission requirements where all fund managers are now required to authorise their respective custodians, both domestic and foreign, to submit reports directly to the SC to provide confirmation on custodised clients' assets and compliance with regulatory expectations.

SJ Asset Management – SC revokes licence, appoints provisional liquidators

An examination of SJ Asset Management Sdn Bhd (SJAM) revealed that the company was in breach of requirements of the *Capital Markets and Services Act 2007* (CMSA) and the *Guidelines on Compliance Function for Fund Managers* in relation to the safeguarding of clients' assets. The SC also found that SJAM had furnished false and misleading information to the SC, and had engaged in deceitful and improper business practices.

Even before revoking the fund manager's license of SJAM, the SC had imposed conditions and restrictions on the activities that SJAM could carry out. SJAM was prohibited from soliciting new mandates and was directed to maintain and preserve all records in relation to clients' trades and payments. The conditions and restrictions were imposed soon after the SC found that SJAM's books, accounts and records had raised serious concerns with respect to SJAM's internal controls and compliance with client asset protection rules.

Consequently, on 23 July 2010, the SC revoked SJAM's fund management licence. As a further step to protect the clients and creditors of SJAM, on 27 July 2010, the SC also petitioned to the High Court for the winding up of SJAM pursuant to section 361 of the CMSA. The winding up order will enable liquidators to effectively deal with the rights and entitlements of all creditors including the clients of SJAM.

Pending the granting of the winding up order, the SC also applied to the High Court for the appointment of provisional liquidators which was granted by the High Court on 28 July 2010.

The SC is also working closely with the police and regulatory counterparts in other countries as part of its investigations into the affairs of SJAM.

Oasis Asset Management – Former director jailed

On 20 May 2010, Muhammad Khalid Ismail, former director of Oasis Asset Management Sdn Bhd (Oasis) was sentenced to imprisonment after he pleaded guilty to the offence of criminal breach of trust (CBT) and eight other offences under the *Securities Industries Act 1983* (SIA).

Muhammad Khalid was found guilty of CBT for misappropriating RM45 million funds received from Oasis' client. The court also found him guilty under the SIA for concealing records required to be maintained by Oasis in relation to the investment made by the client. He was also found guilty for submitting false statements to the SC in relation to the funds managed by Oasis as well as failing to maintain a trust account for the investment received from the client.

The Kuala Lumpur Sessions Court sentenced him to two years imprisonment for the CBT charge. Muhammad Khalid, who pleaded guilty to all the eight charges under the SIA, was sentenced to imprisonment of one year for each charge.

Investment scam – Operator jailed four years

The Kuala Lumpur Sessions Court sentenced Phazaluddin Abu to four years in jail after he was convicted of holding himself out as a fund manager through a website, www.danafutures.com, without a fund manager's licence.

The website operated by Phazaluddin claimed to be an asset management and investment group focusing on business and fund management. Phazaluddin falsely represented in the website that investments from the public would be invested in seven securities portfolios which generated profits. In total, he collected approximately RM65 million from 52,000 investors via the website.

Phazaluddin was also convicted of three charges under the *Anti Money Laundering and Terrorism Financing Act 2001* (AMLATFA) for taking part in money laundering activities involving a receipt of RM1.3 million from the illegal activities of the online investment scam. He was sentenced to two years imprisonment for each of the charges under AMLATFA. The court ordered the imprisonment term for all offences to run concurrently. A total of 29 witnesses appeared for the prosecution. The SC urged the court to impose a deterrent sentence taking into account the large amount of the investors' funds which was obtained illegally.

The court, in sentencing Phazaluddin said that "it would not be in the public interest if white collar offenders who perpetrated financial scams of this magnitude are not punished with substantial sentences to protect the investing community". It also said that "only a substantial custodial sentence will act as a deterrent sentence to potential offenders who might otherwise be willing to risk a monetary slap on the wrist if and when apprehended and charged."

The custodial sentence meted out by the court serves as a warning to offenders that financial scams will not be treated lightly by the regulators and the courts. The investing public are reminded to be extremely cautious of such of investment schemes.

FA Securities – Stockbroker reprimanded for failure to meet minimum financial requirements

On 28 June 2010, the Board of Directors of FA Securities was reprimanded for breach of section 67 of the CMSA for carrying out regulated activities without the SC's consent despite not meeting the prescribed minimum financial requirements.

FA Securities was initially directed to cease carrying out regulated activities in March 2009. The cessation order was uplifted on 28 June 2010 following its operational and financial improvements as well as commitment by the board to ensure future compliance and enhance its business activities.

Enforcing compliance on fund managers

A routine examination revealed compliance breaches by Mayban Investment Management Sdn Bhd (MIM). The examination also revealed that the fund manager had failed to put in place adequate measures to safeguard clients' assets as well as policies and procedures to address conflicts of interest. On 24 June 2010, the SC instituted formal disciplinary actions, which included the imposition of financial penalty of RM100,000. An appeal by MIM was rejected in September.

Licencees disciplined for engaging in short selling

On 12 November 2010, administrative action was taken against Mohd Azami Ghazali and Tan Kuan Choong of HwangDBS Investment Bank Bhd for engaging in intra-day short-selling. The former's licence was suspended for four weeks, he was fined RM60,000 and was imposed an extra 10 CPE points while the latter was fined RM2,000 and imposed an extra 10 CPE points. The heavier penalty for Mohd Azami reflected the larger volume of shares shortsold, number of counters involved and amount of profit made as well as the fact that he has been licensed for 13 years.

INIX Technologies – Directors charged in relation to false information

On 23 September 2010, the SC charged four individuals from INIX Technologies Bhd (INIX) for knowingly authorising the furnishing of false statements to Bursa Malaysia and providing false information to Bursa Malaysia.

Directors, Jimmy Tok Soon Guan, Mok Chin Fan, Cheong Kok Yai and senior finance executive, Normah Sapar were each charged under section 122B(b)(bb) Securities Industry Act 1983 (SIA) in relation to false statements in INIX's four quarterly reports on the unaudited consolidated results for the financial year ended 31 July 2006. The four were further charged under section 55(1)(a) Securities Commission Act 1993 (SCA) in relation to a false statement pertaining to the revenue contained in INIX's prospectus dated 29 July 2005. On conviction, they would be liable to a maximum fine of RM3 million and imprisonment for a term not exceeding 10 years for each charge.

In addition to the charges mentioned above, Normah was also charged under section 134(5) of the SCA for failure to comply with the SC's notice to provide a statement. Two others, Helen Soon Shiau Yen, a former accounts clerk of INIX and Chong Poh Ying, a supplier to INIX, were also charged with the same offence. On conviction, they would each be liable to a maximum fine of RM1 million and imprisonment for a term not exceeding five years.

All accused pleaded not guilty to the charges. Jimmy was released on bail of RM100,000, while Mok and Cheong were granted bail of RM80,000 each. Normah, Helen and Chong Poh Ying were granted bail of RM60,000, RM40,000 and RM30,000 respectively.

Pancaran Ikrab – Former director convicted for securities fraud

Lybrand Ngu Tieng Ung, the former director of Pancaran Ikrab Bhd (PIB) was convicted for two counts of securities fraud on 5 October 2010 after he pleaded guilty to the offence under section 87A of the SIA.

Ngu utilised RM15.5 million of PIB's funds in October 1997 to finance his purchase of the controlling shareholding in PIB. The money was used to purchase 4.25 million units of shares in PIB. PIB, an investment holding and management company, was a listed company on the Second Board of the then Kuala Lumpur Stock Exchange Exchange (KLSE).

Ngu also admitted that after he resumed the post of the director, he further transfered RM21 million out of the company. This amount was never recovered and was written off in the accounts of PIB. As a result, the company became financially distressed and its listing status on the stock exchange had to be taken over by DCEIL International Bhd in July 2004.

The amount misutilised by Ngu was never restituted to PIB.

The penalty for securities fraud is a minimum fine of RM1 million and imprisonment not more than 10 years. The Kuala Lumpur Sessions Court sentenced Ngu to one day imprisonment and a fine of RM1 million for each of the offence. The imprisonment term was ordered to be served concurrently. The SC has filed an appeal against the sentence imposed by the Court.

Welli Multi Corporation – Former directors convicted for reporting misleading information

On 11 October 2010, former executive directors of Welli Multi Corporation Bhd (WMCB), Ang Soon Beng and Ang Soon An, were convicted for furnishing misleading information to the SC. Both pleaded guilty to the charges under section 122B(a)(bb) read together with section 122(1) of the SIA.

The false revenue figures of over RM41 million was made in WMCB's audited financial statement for the financial year ended 31 December 2005. The misleading statement which was released to the market, made a significant impact on the market price of the company's shares. The share price dropped by 43% in 2008 when the news of the misleading statement was made public and when the financial statement of WMCB for 2005 was restated.

Brothers Ang Sun Beng and Ang Soon An were sentenced to one day jail and a fine of RM400,000 respectively. The court, in passing sentence, also took into consideration their admission to three other charges for submitting false statements in WMCB's quarterly reports for the first, second and third quarter of 2006. The SC has filed an appeal against the sentence imposed by the court.

Former Transmile directors to enter defence

With respect to their roles in the submission of misleading financial information to the stock exchange, four former directors of Transmile Group Bhd (TGB) are now required to enter their defence after the Court ruled that the Prosecution has successfully proven a *prima facie* case against them.

The four are Gan Boon Aun, Khiuddin Mohd, Chin Keem Feung and Shukri Sheikh Abdul Tawab. Gan and Khiuddin were executive directors of TGB at the time when the offence was committed while the other two, Chin and Shukri were members of the Audit Committee.

All four were charged in relation to a misleading statement in TGB's Quarterly Report on Unaudited Consolidated Results for the Financial Year ended 31 December 2006. This misleading financial statement was furnished to Bursa Malaysia and announced on 15 February 2007.

The case against Gan and Khiuddin

Gan and Khiudin were ordered by the Court on 16 March 2011 to enter their defence with respect to the alternative charge under section 122B(a)(bb) of the *Securities Industry Act 1983* (SIA) read together with section 122(1) of the Act. Both Gan and Khiudin, are said to have committed the offence when the company, with intent to deceive, furnished the 2006 unaudited financial statements containing a misleading statement to Bursa Malaysia.

The case against Chin and Shukri

Members of the Audit Committee of TGB, Chin and Shukri, were ordered to enter their defence on 22 March 2011. Chin and Shukri, who were also independent non-executive directors, were charged in relation to their roles in the release of the impugned 2006 unaudited financial statements. The charges against them were brought under section 122B of the SIA.

Court calls for defence on CBT charges with respect to transfer of Cold Storage funds

On 11 March 2011, a former director of Cold Storage (Malaysia) Bhd (CSM) and his business associate were ordered to enter their defence on an alternative charge of criminal breach of trust (CBT) for transferring out RM185 million belonging to CSM on 20 March 1998. After calling 23 witnesses, the court ruled that the prosecution had successfully proven a prima facie case against Dato' Chung and Dato' Yip.

Dato' Chung and Dato' Yip Yee Foo were charged on 24 September 2004. If convicted, they face a jail sentence of up to 20 years with caning and a fine.

The Court, however, acquitted both of them of the principal charge under section 87A(a)(a) of the SIA for defrauding CSM by using the company's money to finance their purchase of 26,724,337 units of shares via Excoplex Sdn Bhd and Fulham Finance & Trade Limited.

Jail sentence for furnishing misleading statements

The High Court allowed the SC's appeal on 11 January 2011 to enhance the sentence meted out by the Sessions Court against Ooi Boon Leong and Tan Yeow Teck, former directors of MEMS Technology Bhd (MEMS). The High Court upheld the original fine of RM300,000 but added to the fine, a six-month imprisonment term each.

Both were convicted in February 2010 after they pleaded guilty to an offence under section 122B(b)(bb) of the SIA for authorising the furnishing of misleading information to Bursa Malaysia. The misleading information was made in relation to MEMS' reported revenue of RM73.4 million contained in its condensed consolidated income statements for the twelve-month period ended 31 July 2007. The revenue was misleading as it included fictitious sales amounting to RM30.17 million which constituted 41% of MEMS' total revenue.

The High Court Judge agreed with the SC's submission that a fine alone was not a deterrent enough sentence for this type of offence. In delivering his decision, the Judge stressed that the capital market is the heart of the nation's economy and that its integrity is vital to sustain the confidence of investors, locally and overseas. Thus, the court held that the interest of the public should not be outweighed by the interest of the accused persons.

Ponzi scheme perpetrator jailed

The director of FX Capital Consultant and FX Consultant, Raja Noor Asma Raja Harun was sentenced on 10 January 2011, to an imprisonment term of five years and a fine of RM5 million (in default, six months imprisonment) for operating a ponzi scheme. The heavy custodial sentence meted out by the Court reflects the gravity of the offence.

Raja Noor Asma was convicted and sentenced after she pleaded guilty to four charges of employing a scheme to defraud investors and trading in futures contracts on behalf of others without a licence. The scheme had duped over 4,000 investors between February 2007 and May 2008 and more than RM100 million was collected from investors under the pretext that the money would be used to trade in crude palm oil futures. The investors were also promised an unusually high guaranteed return of 8% per week.

For taking part in money laundering activities, Raja Noor Asma was also convicted of 50 counts under the *Anti-Money Laundering and Anti-Terrorism Financing Act 2001* (AMLATFA) and sentenced to two years imprisonment for each of the AMLATFA charges, which are to run concurrently. The court ordered the two-year jail term to run consecutive to the five-year imprisonment imposed for the fraud charges.

On 14 April 2011, the Court ruled that 600 investors who had invested their monies with Raja Noor Asma were allowed to get their money back. In the ruling, the Judge stressed that, "...this Court does not suffer fools. Persons who are motivated by greed, avarice and promise of disproportionate returns have only themselves to blame if these investments go awry...".

The Judge, in her ruling also warned that it is not the function of the government to recover the investors' investments and as such, the Court may not be easily persuaded again to restitute investors. The Court's ruling is stayed pending the appeal filed by the Attorney-General's Chambers who was seeking to forfeit the monies.

Former remisier loses his appeal at the Court of Appeal

Haron Jambari, a former remisier at Arab Malaysian Securities Sdn Bhd lost his battle in court on 23 February 2011 after the Court of Appeal upheld the convictions and sentences imposed on him earlier by the High Court and Sessions Court. Haron was convicted and sentenced for deceiving his client in relation to the purchase of Petronas Dagangan Bhd shares in 1994 (PDB shares transaction) and for committing criminal breach of trust (CBT).

Haron was charged under section 87A of the SIA for making a false statement to his client in relation to the purchase of PDB shares. He was also charged under section 409 of the *Penal Code* for committing CBT by misappropriating RM2 million belonging to his client in connection with the said PDB shares transaction.

Haron was charged together with his client's accountant at the time, Nik Aziz Nik Mohd Amin. The latter was charged for abetting Haron both for the securities offence as well as for CBT. Nik Aziz was also charged under section 165 of the *Penal Code* for accepting RM130,000 without consideration from Haron while performing his duties as a public servant.

On 29 July 2002, the Sessions Court sentenced Haron to three years imprisonment and imposed a fine of RM1 million (in default two years imprisonment) for the securities offence, as well as four years imprisonment and two strokes of the cane for committing CBT. The High Court and Court of Appeal upheld this sentence.

Nik Aziz received similar sentences for the SIA and CBT offences, plus two years imprisonment in respect of the charge under section 165 of the *Penal Code*. However, the Court of Appeal only upheld the conviction and sentence for the CBT and section 165 *Penal Code* offences imposed on Nik Aziz but acquitted him on the charge of abetting Haron in making the false statement under the securities laws.

The Court also set aside the whipping as Nik Aziz is now over 50 years old. All sentences were ordered to run concurrently. The prosecution of Haron and Nik Aziz in 1995 was the first case instituted by the SC under section 87A of the SIA for using manipulative and deceptive devices in connection with a sale and purchase of shares. It also became, in 2002, the first case in which the SC secured upon conviction, a custodial sentence under that section.

Two directors jailed and fined over Suremax share manipulation

On 17 January 2011, the SC secured a conviction against Datuk Phillip Wong Chee Kheong and Francis Bun Lit Chun for their involvement in the manipulation of Suremax Group Bhd (Suremax) shares. The Sessions Court on 12 January 2011, sentenced Datuk Phillip to 24 months imprisonment and a fine of RM3 million (in default, six months imprisonment) and Francis to three months imprisonment and a fine of RM2 million (in default, six months imprisonment). The sentences were imposed upon their conviction under section 84 of the SIA for creating a misleading appearance of active trading in the shares of Suremax when they traded using nine accounts without any change in the beneficial ownership of the shares on the stock exchange.

Datuk Phillip and Francis were charged on 25 October 2005 and the trial commenced in 2007. The court heard testimonies from 38 witnesses called by the prosecution and the defence raised by both accused persons. The court rejected their defence that the manipulative trading activities conducted were done under the instructions of a third party and that they had no knowledge of the purpose of the trading.

In passing sentence, Judge Komathy SM Suppiah said "The Court has to set imprisonment terms as the new benchmark in securities cases. The securities market should be real and genuine. Market manipulation is a serious offence affecting the confidence of investors and thus an imprisonment sentence should be meted out."

Administrative actions against CMSRL holders for improper conduct

Intermediaries and their representatives are expected to display high ethical standards in order to maintain a fair, efficient and orderly market. They are required to comply with market and business conduct standards set out in securities laws and guidelines. Improper conduct is viewed seriously, leading the SC to institute administrative actions against a number of CMSRL holders.

Improper order placement

On 22 December 2010, two CMSRL holders were reprimanded and suspended for carrying out improper order placements when they had, during a pre-opening afternoon trading session, placed buy orders in large quantities at limit-up price and also sell orders in similarly large quantities at limit-down price and subsequently cancelled those orders within short intervals before the opening of the afternoon trading session. These actions gave the impression of demand for the stocks and could have influenced the theoretical opening prices. Chin Chee Nang of Hong Leong Investment Bank and Tan Phaik Yen of HwangDBS Investment Bank Bhd were suspended for four months and one month respectively. Chin was imposed a longer suspension period for using his client's account without the client's knowledge and authorisation for order placement of shares in seven counters. Tan Phaik Yen on the other hand had made improper order placement of shares in one counter.

Shortselling

On 24 February 2011, the SC suspended Zuridah Mohamed, a CMSRL holder with ECM Libra Investment Bank Bhd for failure to supervise a trading clerk. The trading clerk was found to have shortsold shares in seven counters in a client's account. Zuridah's licence was suspended for one month from 10 March 2011. Ho Sze Lip, who was at the material time a trading clerk at ECM Libra, was reprimanded for shortselling. He ceased to be employed as a trading clerk effective 15 December 2010.

Trading not in client's best interest

On 28 February 2011, the SC reprimanded a former CMSRL holder of AmInvestment Bank Bhd, Ng Chin Sing, for his failure to give priority to a client's order. The SC found that Ng had traded for a third party connected to him ahead of his client's order. Ng ceased to be a CMSRL holder effective 1 November 2010.

The SC reprimands valuer and valuation firm and bars submission from valuer for failing to comply with guidelines

On 2 February 2011, the SC reprimanded Noraini Jaafar Sidek and the valuation firm of Messrs Raine & Horne International Zaki & Partners Sdn Bhd (RHIZP) for making a submission to the SC that was in breach of the SC's *Asset Valuation Guidelines*. Noraini is the registered valuer and the director of RHIZP who signed the valuation reports for a corporate exercise submitted to the SC through AmInvestment Bank Bhd in 2010.

The SC, in reviewing the valuation reports, found several instances of non-compliance with the guidelines by both Noraini and RHIZP, including:

- Failure to ensure that the valuation was properly carried out and reviewed for quality control;
- Failure to ensure that the data applied in carrying out the valuation was properly verified and correctly analysed; and
- Adoption of adjustments that were inappropriate and unjustified.

On the whole, the valuation reports submitted by RHIZP demonstrated the firm's failure to exercise professionalism and due care. Professionals such as valuers, auditors, accountants and lawyers are expected to display high standards of professionalism and accountability. The Board of Valuers, Appraisers and Estate Agents were also notified of the sanction taken against their registered members.

Besides reprimanding Noraini and RHIZP, the SC will also not accept or consider any submissions by Noraini to the SC for six months, effective 2 February 2011.

Offeror fined and reprimanded for breaching creeping provision

In June 2010, the SC imposed a penalty of RM100,000 and reprimanded Ancom Bhd (Ancom) for breach of the creeping provision in the *Malaysian Code on Take-overs and Mergers 1998* (TOM Code). The breach was in relation to Ancom's acquisition of shares in Nylex (M) Bhd (Nylex).

Before the breach occurred, Ancom already owned a 39.41% stake in Nylex. Subsequently, on 17 March 2008, Ancom acquired an additional 2.65% in Nylex, thereby increasing its shareholding in Nylex to 42.06%. No mandatory offer was made in breach of subsection 6(4) of the TOM Code.

Subsection 6(4) of the TOM Code provides that a person and his concert parties who already hold voting rights between 33% and 50% in a company, will incur a mandatory offer obligation if they acquire more than 2% within a period of six months. This provision seeks to ensure that all shareholders in a company are treated fairly. The underlying principle is that if control of a company changes, a mandatory offer is made to other shareholders for their shares.

The sanction was meted out after taking into consideration, among others, the following:

- Ancom and its 100% owned subsidiary, Rhodemark Development Sdn Bhd, already had control of more than 50% equity of Nylex before the acquisition (i.e. *54.01%*)
- The acquisition did not result in a change in control over Nylex as Ancom and Rhodemark Development Sdn Bhd remained the largest shareholders of Nylex, controlling over 50% shares in Nylex before (i.e. *54.01%*) and after the acquisition (i.e. *56.66%*)

Corporate Governance Blueprint 2011

On 8 July 2011, the SC launched the *Corporate Governance Blueprint 2011* (CG Blueprint). The CG Blueprint is aimed at promoting excellence in governance in Malaysia and represents the first major deliverable under the Capital Market Masterplan 2. Among the CG Blueprint's strategic priorities and recommendations is enhancing the standards of board governance. Heightened focus on these standards is crucial, as attested to in this edition of *The Reporter*, which highlights actions taken against directors for failing to register a prospectus, for providing misleading information to Bursa Malaysia and other examples of corporate mismanagement.

The CG Blueprint, which will be implemented over the next five years, also covers ways to further enhance shareholder participation, ensuring equitable shareholder treatment, promoting greater diversity on boards of public listed companies, strengthening the role and accountability of gatekeepers and influencers and generally enabling more active stakeholder and market participants' accountability and participation to strengthen market and self-discipline.

The 35 recommendations contained in the Blueprint covers key areas namely shareholder rights, the role of institutional investors, the board's role in governance, disclosure and transparency, the role of gatekeepers and influencers as well as public and private enforcement. These recommendations were developed through extensive research, international benchmarking and intensive engagements to ensure that they are sufficiently robust to bring about positive changes to the Malaysian corporate governance landscape.

The Blueprint considers approaches aimed at strengthening self and market discipline, and promoting the internalisation of corporate governance culture to underpin the sustainable growth of corporate Malaysia. Most of the recommendations will be implemented through a new Malaysian Code on Corporate Governance as well as changes to the Listing Requirements. Others will be effected through amendments to the regulatory framework and the remaining recommendations will be driven by industry. A number of recommendations will need to be examined and further studied through the formation of taskforces and working groups expected to be driven by industry in collaboration with the SC.

A copy of the CG Blueprint can be downloaded at www.sc.com.my. The SC invites comments on the CG Blueprint. The consultation period will end on 15 September 2011. Comments could be e-mailed to CGblueprint@seccom.com.my or in writing to the SC.

Two directors charged for failing to register prospectus

On 21 April 2011, Chong Yuk Ming and Balachandran a/l A. Shanmugam were charged under section 232(1) of the *Capital Markets and Services Act 2007* (CMSA) for failing to register a prospectus with the SC in relation to the issuance of Bestino Group Bhd (Bestino)'s redeemable preference shares between 3 November 2008 and 16 June 2009. Chong and Balachandran were directors of Bestino at the material time.

If convicted they will be liable to a fine not exceeding RM10 million or to imprisonment for a term not exceeding 10 years or both. Chong and Balachandran were granted bail of RM300,000 with one surety. The court also impounded Balachandran's passport. The case has been fixed for trial from 11 to 14 October and 18 to 21 October 2011.

Jail sentence for unlicensed fund manager upheld

On 5 May 2011, the Kuala Lumpur High Court affirmed the conviction and sentence imposed against businessman Phazaluddin Abu for acting as a fund manager without a licence through the website, www.danafutures.com and for money-laundering activities of receiving a sum of RM1.3 million from the illegal activities of the online investment scam.

The Sessions Court, on 9 July 2010, convicted Phazaluddin under section 15A of the *Securities Industry Act 1983* (SIA) for acting as a fund manager without a licence. He was also convicted on three charges under the *Anti-Money Laundering and Anti-Terrorism Financing Act 2001* (AMLATFA) for dealing with the moneys collected via the unlicensed scam. Phazaluddin was sentenced by the Sessions Court to four years imprisonment under the SIA and two years imprisonment for each of the three convictions under AMLATFA.

The High Court maintained the conviction which found Phazaluddin as the mastermind behind the investment online scheme and that he had collected the moneys. The sentences imposed upon him were also upheld.

High Court Judge, Justice Dato Hj Ghazali Hj Cha directed Phazaluddin to serve his imprisonment sentence immediately as his request for a stay of execution pending appeal to the Court of Appeal was dismissed.

Trio charged for providing false statements to Bursa Malaysia

Two directors and an accounts manager of Kosmo Technology Industrial Bhd (Kosmo Tech) were charged for providing misleading information to Bursa Malaysia. One of the directors, Mohd Azham Mohd Noor and the accounts manager, Helen Lim Hai Loon were charged on 26 May 2011 while the group managing director, Dato' Norhamzah Nordin was charged on 7 June 2011. Kosmo Tech was listed on the Second Board of Bursa Malaysia on 30 May 2005 and was delisted in 2009.

Both directors were preferred with six charges under section 122B(a)(bb) SIA and two charges under section 369(a)(B) of the CMSA for submitting false statements in Kosmo Tech's eight quarterly unaudited consolidated results for the financial years 2006 and 2007. Helen Lim was charged for abetting Kosmo Tech in submitting the false statements in the same eight quarterly reports. If convicted they will be liable to a fine not exceeding RM3 million and imprisonment for a term not exceeding 10 years for each charge.

Mohd Azham and Helen Lim were released on bail of RM150,000 with one surety each. Dato' Norhamzah was also released on bail at RM300,000 with one surety.

The three accused will be tried jointly from 14 to 18 November and 21 to 25 November 2011.

Remisier imprisoned for short selling

On 23 June 2011, the Court of Appeal, presided by Justices Dato Hasan Lah, Datuk Hj Abdul Malik Hj Ishak and Dato Balia Yusof Hj Wahi, rejected an appeal by Lua Yik Hor against his conviction and a jail sentence of two-years. Lua, a former remisier at KAF Seagrott Campbell Sdn Bhd, was subsequently ordered to commence his jail sentence on the same day.

Lua is the first remisier to be jailed for a securities related offence.

Lua was charged on 21 May 1996 at the Kuala Lumpur Sessions Court for short selling 960,000 units of North Borneo Timber Bhd (NBT) shares on 27 March 1995. NBT was a company listed on the Main Board of the then Kuala Lumpur Stock Exchange at the material time. In 2000, after a full trial, Lua was convicted of all the 30 charges of short selling. He was sentenced to two years imprisonment on each charge, all to run concurrently.

Lua filed an appeal to the High Court against his conviction and jail sentence. However, the appeal was dismissed by the High Court in 2009. He then appealed to the Court of Appeal.

The SC has maintained that all the 30 charges were proper and lawful as there were 30 offences of short selling amounting to 960,000 units of NBT shares on that day. Each particular offence was completed when his order to sell matched on the market and at that material time he did not own such shares.

HwangDBS Investment Bank sanctioned

HwangDBS Investment Bank (HDBSIB) was reprimanded and fined RM250,000 for failure to comply with the SC's *Guidelines on Prevention of Money Laundering and Terrorism Financing For Capital Market Intermediaries* (AML Guidelines) and the *Guidelines on Market Conduct and Business Practices for Stockbrokers and Licensed Representatives* (Market Conduct Guidelines). HDBSIB was also directed to develop and implement a comprehensive anti-money laundering and anti-terrorism financing training programme for its staff to enhance their level of knowledge and compliance.

These sactions were imposed on HDBSIB for its failure to identify and report suspicious transactions and to take reasonable steps to minimise its exposure to money-laundering risk. In addition, HDBSIB had also failed to conduct enhanced customer due diligence as required by the AML Guidelines, on clients whose profile represents high risk in terms of money-laundering and anti-terrorism financing.

Licensed representative reprimanded and suspended

On 21 April 2011, the SC reprimanded and suspended Ranjit Singh a/l Nashter Singh of AmInvestment Bank Bhd for jeopardising the interest of his client when he amended the purchase orders of his client that were matched at a lower price, with purchase orders he made through his daughter's account, which were matched at a higher price, thereby disadvantaging his client and acting contrary to his client's interest. Ranjit's licence was suspended for three months from 6 May to 6 August 2011.

Court of Appeal upholds jail sentence on former directors of MEMS

On 4 November 2011, the Court of Appeal upheld a six-month jail term imposed by the High Court on two former directors of MEMS Technology Bhd (MEMS), for authorising the furnishing of a misleading statement to Bursa Malaysia in MEMS' Condensed Consolidated Income Statement for the 12-month period ended 31 July 2007.

Ooi Boon Leong and Tan Yeow Teck had in February 2010 pleaded guilty to charges of providing misleading statements to Bursa Malaysia in relation to the company's reported revenue of RM73.4 million which contained over RM30 million of fictitious sales. They were fined RM300,000 each by the Sessions Court upon which the Public Prosecutor appealed to the High Court on the ground that the sentence was manifestly inadequate.

In enhancing the sentence, High Court Judge Justice Dato Hj Ghazali Cha had cited public interest as a reason for the enhanced sentence, pointing out that the offence affected the integrity of the capital market. Ooi and Tan then appealed against the sentence.

The Court of Appeal agreed with the decision of the High Court judge to impose a six-month jail term as a mere fine did not adequately reflect the seriousness of the offence. In reaching its decision, the Court of Appeal emphasised that knowingly furnishing misleading information to the stock exchange is a serious offence as potential investors, both foreign and local, rely on such information in making investment decisions. In addition, the Court of Appeal stated that a custodial sentence was necessary to preserve investor confidence and deter potential wrongdoers.

Former Transmile directors jailed and fined for misleading disclosure

The Kuala Lumpur Sessions Court convicted two former independent directors of Transmile Group Berhad (Transmile) for having authorised the furnishing of a misleading statement to Bursa Malaysia in Transmile's Quarterly Report on Unaudited Consolidated Results for the Financial Year Ended 31 December 2006 under section 122B(b)(bb) of the *Securities Industry Act 1983* (SIA). They were each sentenced to a year imprisonment and a fine of RM300,000 (in default six months imprisonment).

The misleading statement was in relation to the unaudited revenue figures, which were reported to the stock exchange for both the fourth quarter of 2006, as well as the cumulative period of 2006.

Both directors, Jimmy Chin Kim Feung and Shukri Sheikh Abdul Tawab, charged in 2007, were also members of the Audit Committee of Transmile at the material time.

In passing the sentence, the Sessions Court Judge stressed that public interest is paramount, and that the audit committee is essential in the corporate governance of a company.

Two former directors of Multicode jailed and fined for CBT

Gordon Toh Chun Toh and Dato' Abul Hassan Mohamed Rashid, former directors of Multicode Electronics Industries (M) Bhd (Multicode), were convicted by the Sessions Court of committing criminal breach of trust (CBT) under section 409 of the *Penal Code* involving over RM26 million of funds belonging to the company.

Gordon was sentenced to 12 years imprisonment and a fine of RM1 million (in default two years imprisonment) while Dato' Abul received six years imprisonment.

The Sessions Court Judge stressed that the sentence must send a strong message to both offenders and potential offenders that crime does not pay. The Judge also pointed out that as a result of the offence, Multicode, a public-listed company lost millions which in turn caused its public shareholders to suffer as well.

Gordon and Dato' Abul Hassan had been charged at the Kuala Lumpur Sessions Court back in March 2009 with having engaged in an act which operated as a fraud on Multicode by causing the uplifting of fixed deposits belonging to the company, under section 87A of the SIA. A charge of CBT was also preferred in the alternative.

INIX's former CEO and directors fined for submitting false statements

The Kuala Lumpur Sessions Court convicted and fined the former chief executive officer, two directors and a senior executive of INIX Technologies Bhd (INIX) for providing false statements to Bursa Malaysia Securities Bhd.

Jimmy Tok Soon Guan, Mok Chin Fan, Cheong Kok Yai and Normah Sapar pleaded guilty to charges of providing false statements to the stock exchange in INIX's four quarterly reports for the financial year ended 31 July 2006 under Section 122B(b)(bb) SIA. The false statement was in relation to the revenue figures contained in the said quarterly reports. In addition, they were also convicted for the issuance of INIX's prospectus which contained false information pertaining to INIX's revenue for the six-month financial period ended 31 January 2005.

Jimmy, former CEO and Executive Director of INIX, was sentenced to a total fine of RM700,000 (in default between 12 to 18 months imprisonment) for four offences under section 122B SIA and RM400,000 (in default two years imprisonment) for the offence under section 55 of the *Securities Commission Act 1993* (SCA).

Mok, a substantial shareholder and former director of INIX and Cheong, former Executive Director and Chief Technical Officer of INIX, were both fined RM50,000 (in default six months imprisonment) each for the four offences under section 122B SIA and RM125,000 (in default one year imprisonment) for the offence under section 55 SCA.

Normah, an accounts executive of INIX, who was convicted for abetting Jimmy, was fined RM50,000 (in default six months imprisonment) each for the four offences under section 122B SIA and RM150,000 for the offence under section 55 SCA. She was also convicted and fined for failing to provide a statement to the SC in the course of the investigation into the offences committed involving INIX (see page 5)

Following the investigation into INIX's financial affairs, Normah, Chong Poh Ying and Helen Soon Shiau Yen were charged under section 134(5)(a) of the SCA for failing to appear before the SC's Investigation Officer to provide an oral statement. Normah and Helen were Accounts Executives of INIX at the material time while Chong was the sole proprietor of the company said to be the purported supplier of INIX. It is the SC's belief that all three individuals would be able to provide cogent evidence concerning fictitious sales recorded by INIX in its accounting records.

On 7 October 2011, Normah, Chong and Helen were convicted after pleading guilty to the said charges. Normah was fined RM25,000 each for two offences under the said section while Helen was fined RM20,000 for the offence. Chong was fined RM25,000 for the offence. This is the first time that the SC has pursued action under section 134 of the SCA.

Rantau Simfoni director charged for trading in futures contracts without a licence

On 28 October 2011, Zamani Hamdan, a company director was charged by the SC at the Kuala Lumpur Sessions Court for trading in futures contracts without a licence.

Zamani was charged under section 59(1) of the *Capital Markets and Services Act 2007* (CMSA), for holding himself out as a representative of an investment bank to trade in futures contracts without holding the requisite Capital Markets Services Representative's Licence (CMSRL). Alternatively, he was also charged under section 58(1), read together with section 367(1) of the same Act, for carrying on the business of trading in futures contracts without a Capital Markets Services Licence (CMSL) through his company, Rantau Simfoni Sdn Bhd.

The accused claimed trial to the charges and the court granted him bail of RM100,000, with the condition that he is to report to a police station periodically.

The charge under section 59(1) of the CMSA carries a maximum fine of RM5 million, five years imprisonment or both. A conviction under section 58(1) of the CMSA attracts a maximum fine of RM10 million, 10 years imprisonment or both.

Kenanga Deutsche Futures fined

Kenanga Deutsche Futures Sdn Bhd (KDF) was fined RM200,000 for failure to comply with the *Licensing Handbook* and the SC's *Guidelines on Prevention of Money Laundering and Terrorism Financing for Capital Market Intermediaries* (AML Guidelines).

The sanction was imposed on KDF for its failure to identify and report suspicious transactions when it facilitated the transfer of a client's funds to third parties, failure to put in place an effective system for detecting and reporting suspicious transactions, failure to provide adequate training on requirements of AML Guidelines and failure to conduct independent audit on its compliance programme. In addition to that, KDF had also allowed an unlicensed person to carry out regulated activity.

Investment bank reprimanded for failure as principal adviser

Affin Investment Bank Bhd (Affin IB) was reprimanded by the SC on 21 March 2012 for its failure to conduct proper due diligence as a principal adviser in relation to a conflict-of-interest situation, resulting in a material omission in a corporate proposal. In this regard, Affin IB was found by the SC to have breached section 214(1) of the CMSA which imposes an obligation on persons submitting information to the SC, not to submit any statements or information which contains a material omission.

In addition, Affin IB failed to immediately inform the SC of any material change or development in circumstances that would affect the consideration of the SC, and to submit a proposal to resolve, eliminate or mitigate such conflict-of-interest situation.

Landmark decision in market manipulation case

The recent decision by the Court of Appeal in the case of *PP v. Chin Chan Leong* has set an important precedent in terms of sentencing for market manipulation cases. In this case, the Sessions Court had originally sentenced Chin to a fine of RM1.3 million and one-day imprisonment for market manipulation involving Fountain View Development Bhd shares. The High Court affirmed the sentence meted out by the Sessions Court leading to the SC filing an appeal to the Court of Appeal. On 24 June 2012, the Court of Appeal enhanced the sentence against Chin by imposing a 12-month imprisonment term on him. In addition, the court upheld the fine of RM1.3 million that was earlier imposed by the Sessions Court.

This is the third conviction for market manipulation which the SC has successfully prosecuted. It serves as a strong reminder to the public not to engage in market misconduct (such as manipulation, market rigging and insider trading) which could severely undermine investor confidence in the Malaysian capital market.

Senior corporate lawyer charged for insider trading

Dato' Sreesanthan Eliathamby, a corporate lawyer who sits on the boards of several public-listed companies, was charged by the SC on 20 July 2012 with seven counts of insider trading in the shares of four listed companies between 2006 and 2008.

The charges involved three counts of insider trading in the shares of Sime Darby Bhd in 2006, ahead of the acquisition by Synergy Drive of companies within the Sime Darby, Guthrie and Golden Hope groups. The two counts of insider trading in the shares of Maxis Communications Bhd, which were preferred under the *Securities Industry Act 1983* (SIA), were alleged to have taken place during the privatisation of Maxis in 2007.

Two other charges were preferred for insider trading under section 188(2) of the CMSA involving the shares of UEM World Bhd and VADS Bhd in 2008. Dato' Sreesanthan's trades in UEM World were alleged to have been made with his knowledge of the corporate restructuring of the UEM group, while his trades in VADS allegedly involved his knowledge relating to VADS's proposed privatisation. The offences under both Acts carry a punishment of a fine of not less than RM1 million and imprisonment of a term not exceeding 10 years.

Dato' Sreesanthan claimed trial to the charges preferred and bail was set at RM300,000 with one surety. He was also ordered by the Court to surrender his passport.

Examination, inspection and supervisory initiatives

Stockbroking companies and fund managers

During the period of January – June 2012, as part of its risk-based approach supervision, the SC had conducted a total of 12 risk-focused examinations on seven stockbroking companies and five fund management companies. In addition, two surprise inspections were conducted on stockbroking companies focusing on areas of significant compliance, operational and financial risks. Supplementing these examinations were on-site engagements with 10 fund management companies focusing on specific risk areas ranging from business operational to risk management framework.

Auditors of public-interest entities

The Audit Oversight Board (AOB) issued seven supervisory letters to registered auditors for breach of the MIA By-Laws on the five-year partner rotation rule.

Arising from regular inspection carried out by the AOB on UHY, an engagement partner, Alvin Tee Guan Pian was reprimanded on 12 July 2012 for failure to comply with relevant requirements of recognised auditing standards in Malaysia (the International Standards on Auditing) in the performance of an audit of a public interest entity for the financial year ended 31 July 2010. This is a breach of the AOB's registration condition imposed under section 31O(4) of the SCA whereby all registered individual partners are required to comply with the recognised auditing standards in the performance of an audit.

Credit rating agency examination

Credit rating agencies (CRA) play an important role in the development of corporate bond market in Malaysia. As credit ratings are used by investors, borrowers and issuers to make investment and financing decisions, it is important that CRAs conduct their credit rating activities in accordance with principles of integrity, transparency, quality and good governance.

On 30 March 2011, the SC revised and issued the *Guidelines on Registration of Credit Rating Agencies* (CRA Guidelines) to further enhance the independency and quality of ratings of the CRAs. Malaysian Rating Corporation Bhd (MARC) and RAM Rating Services Bhd (RAM) were subsequently registered by the SC.

Arising from the amendments to section 126 *Securities Commission Act 1993* (SCA) in October 2011, the SC has been granted powers to examine CRAs in line with the newly introduced IOSCO principle of securities regulation relating to the supervision of CRAs. Following this, the SC established an examination framework for CRAs and commenced on-site examination on MARC in May 2012. The examination framework encompasses key areas such as corporate governance, rating policies and procedures, transparency and disclosure, independence and conflicts of interest as well as operational capabilities.

The SC has recently commenced its examination on RAM on 6 August 2012.

Improper business practices by a licensed representative

Tye Lim Huat, a Capital Markets Services Representative's Licence (CMSRL) holder dealing in securities at Malacca Securities Sdn Bhd, was found to have facilitated the use of names and accounts of several Bumiputera individuals by another client of Malacca Securities Sdn Bhd for application of IPO shares. He was also found to have facilitated the transfer of sale proceeds of the IPO applications to that client's account. This constituted a breach of sections 65(1)(g)(iv) and 65(1)(l) of the CMSA for engaging in improper business practices and failure to carry out regulated activity in an honest and fair manner respectively. Such misconduct also contravened paragraphs 4.05(2) and 7.03(1) of the *Licensing Handbook* for failure to meet the minimum fit and proper criteria to be a CMSRL holder. The SC imposed a RM60,000 penalty against him and suspended his licence for one month from 6 July 2012 to 5 August 2012.

Illegal futures trading: SC recovers RM2.3 million from seven individuals

On 9 August 2012, the SC successfully obtained a judgment in the High Court against seven individuals for being involved in futures trading activities without licence. The seven individuals are Ahmad Nazmi Mohamed, Mohd Shahrul Firdaus Zakaria, Mohd Khalid bin Sujud, Fakhrul Arif Ahmad Husni, Fakhrul Mukmin Ahmad Husni, Fakhrul Razi Ahmad Husni and Ahmad Fauzi Ambran (the Defendants). The Defendants agreed to settle a sum of more than RM2.3 million, being the amount solicited from members of the public.

High Court judge, Justice Dato' Mary Lim Thiam Suan ordered that all amounts recovered by the SC are to be applied at its discretion to restitute investors. The Defendants were also ordered to pay costs to the SC. The consent judgment was recorded after the case had proceeded to trial where nine witnesses including seven members of the public had testified.

SC charges former remisier for market manipulation

On 4 September 2012, the SC charged a former remisier of SJ Securities, Dato' David Goh Hock Choy (Goh) under section 84(1) of the *Securities Industry Act 1983* (SIA) for market manipulation. He was charged for creating a misleading appearance of active trading of Lii Hen Industries Bhd (Lii Hen) shares by being involved in the sale and purchase transactions which did not result in any change of beneficial ownership. The trades were executed through 42 accounts at 9 stockbroking companies between March and October 2004.

Another individual, Siow Chung Peng (Siow), was charged with abetting Goh in the commission of the offence. Both Goh and Siow claimed trial to the charges. The trial date has yet to be fixed.

Market manipulation is prohibited in Malaysia and is punishable under Section 88B of the SIA (now Section 182 of the *Capital Markets Services Act 2007* (CMSA)) that provides for a fine of not less than RM1 million and an imprisonment not exceeding 10 years upon conviction.

Former director of LFE Corporation Bhd convicted and fined for furnishing false statements

On 10 October 2012, the Sessions Court found a former director of LFE Corporation Bhd (LFE), Alan Rajendram a/l Jeya Rajendram guilty on all four charges brought against him by the SC in June 2010. Two charges were made under section 122B of the *Securities Industry Act 1983* while another two charges were under section 369 of the *Capital Markets and Services Act 2007* for knowingly permitting the furnishing of false statements by LFE to Bursa Malaysia Securities Bhd. The false statements concerned LFE's unaudited financial results for financial year ended 31 December 2007.

The Court sentenced Alan Rajendram to one year imprisonment and a fine of RM300,000 for each offence and ordered the imprisonment term for all charges to run concurrently after hearing testimonies from 35 witnesses. In delivering her decision, Judge Puan SM Komathy Suppiah noted that the accused had failed to offer any credible explanation and held that the defence put forward by him only served to confirm and strengthen SC's case.

Alan Rajendram has appealed against the decision.

Engagement partner penalised for failure to comply with Malaysian Institute of Accountants by-laws and relevant International Standards of Auditing recognised in Malaysia

On 29 October 2012, the Audit Oversight Board (AOB) reprimanded and imposed a monetary penalty of RM5,000 against a partner of T.C. Liew & Co. for failure to comply with relevant requirements of the Malaysian Institute of Accountants by-laws (MIA) and the International Standards on Auditing (ISA). He was the engagement partner overseeing audits of PIEs.

PIEs include a public listed company, a financial institution licensed under the *Banking and Financial Institutions Act 1989*, an insurance company licensed under the *Insurance Act 1996*, a takaful operator registered under the *Takaful Act 1984*, an Islamic bank licensed under the *Islamic Banking Act 1983*, a development financial institution prescribed under the *Development Financial Institutions Act 2002*, a holder of the Capital Markets Services Licence for the carrying on of the regulated activities of dealing in securities and dealing in derivatives and fund management companies licensed by the SC.

Examination, inspection and supervisory actions

From August–December 2012, the SC issued four supervisory letters against licensed persons for breaching relevant requirements of the securities laws, rules and guidelines.

Out of the four supervisory letters, one was issued against an employee of an investment bank for giving advice on corporate finance before he was licensed to do so. Two supervisory letters were issued to two fund management companies separately for weaknesses in supervisory framework relating to operational risk and adequacy of internal control of the company.

Another supervisory letter was issued against an investment bank as a principal adviser of a corporate submission. The investment bank has failed to carry out adequate due diligence to ensure that conflict of interest issues were properly assessed, disclosed and addressed in the submission, as required under the *Equity Guidelines.*

High Court upholds conviction and sentence of former fund manager, Wahid Ali

On 14 January 2013, the High Court dismissed the appeal of Wahid Ali Kassim Ali, a former director and fund manager of Aiwanna Asset Management Sdn Bhd (Aiwanna), against his conviction and sentence for securities fraud which were committed between the year 2001 and 2002.

Wahid Ali was convicted by the Kuala Lumpur Sessions Court in October 2005 for three charges under section 87A(c) of the SIA for omitting to provide material facts in the statements of account to its client, Eastern Pacific Industrial Corporation Bhd (EPIC). For each charge, Wahid Ali was sentenced to one year imprisonment and a fine of RM1 million (in default of the total RM3 million fine, a one year imprisonment).

Between the period of 31 December 2001 and 11 March 2002, EPIC had received three monthly statements of account signed by Wahid Ali stating that EPIC's investment was placed in a bond fund, when in fact RM5 million of EPIC's monies had already been dissipated at the material time and was no longer managed by Aiwanna.

High Court Judge Dato' Mohd Azman Husin dismissed the appeal against conviction and sentence and upheld the decision of the Sessions Court. Pending appeal to the Court of Appeal, Wahid Ali was ordered to execute a bond of RM1 million to stay the execution of the sentences.

SC files a civil suit against RBTR Asset Management Bhd

On 23 January 2013, SC filed a civil suit against RBTR Asset Management Bhd (RBTR) and seven defendants following its investigations into the affairs of RBTR in 2009.

The seven defendants were Locke Guarantee Trust (NZ) Limited (LGT), Locke Capital Investments (BVI) Ltd (LCI), RBTR's directors, namely, Al Alim Mohd Ibrahim and Valentine Khoo (who also held Fund Manager's Representative Licences), Nicholas Chan Weng Sung and Joseph Lee Chee Hock (directors of LGT and LCI respectively) and Isaac Paul Ratnam who was an individual associated with the operations of these two companies.

Among the relief sought by the SC in the civil suit was for the defendants to make restitution of approximately RM13 million to the EDI Scheme investors who have not been repaid their investments and that the defendants' assets be traced and paid over to the SC for purposes of compensating the EDI Scheme investors.

SC's appeal against acquittal of former company chairman, Low Thiam Hock allowed

On 28 February 2013, the Court of Appeal overturned the decision of the High Court and Sessions Court in acquitting Low Thiam Hock, former executive chairman of Repco Holdings Bhd (Repco), for manipulating the price of Repco shares on the then Kuala Lumpur Stock Exchange (KLSE) on 3 December 1997.

Low was ordered to enter his defence against the charge of instructing a dealer's representative at Sime Securities Sdn Bhd to purchase Repco shares by taking up any offer price of the said shares offered by the sellers, which act was calculated to create a misleading appearance with respect to the price of Repco shares on the KLSE.

The Bench presided by Justice Dato Sri Haji Apandi Haji Ali, Justice Datuk Linton Albert and Justice Datuk Dr Haji Hamid Sultan Abu Backer allowed the appeal by the SC and unanimously held that the charge against Low, as it stood, is sufficient to describe and sustain the offence under section 84(1) of the SIA which carries a penalty of minimum fine of RM1 million and maximum jail term of up to 10 years.

The case is fixed for continued hearing on 31 July, 1 and 2 August, 24 September, 16, 17 and 18 October 2013.

Supervision measures by the SC

From January to April 2013, the SC issued six supervisory letters against market intermediaries and licensed persons for breaching relevant requirements of the securities laws, rules and guidelines.

Three supervisory letters were issued against corporate advisers for failure to discharge their duty when they failed to disclose material information and perform adequate due diligence on the proposal submitted to the SC.

One supervisory letter was issued against a company for non-compliance with the *Malaysian Code on Take-overs and Mergers 2010* (TOM Code) when the said company applied for exemption from undertaking a mandatory offer to the SC (if it is triggered). The TOM Code requires an application for exemption to be made to the SC before a mandatory offer is triggered.

Furthermore, a fund management company was issued a supervisory letter for weaknesses in supervisory framework relating to risk management and enhancements required on operational matters.

Another supervisory letter was issued against a licensed representative for facilitating unlicensed regulated activities to be carried out by a trading clerk.

ARTICLES

Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) Focus

- **TA Securities Holdings Bhd fined RM150,000 for breaching AML and Market Conduct Guidelines**

  On 25 April 2013, SC imposed a RM150,000 fine against TA Securities Holdings Bhd (TASH) for failure to comply with SC's *Guidelines on Prevention of Money Laundering and Terrorism Financing For Capital Market Intermediaries* (ML/TF Guidelines) and the *Guidelines on Market Conduct and Business Practices for Stockbrokers and Licensed Representatives* (Market Conduct Guidelines).

  The breaches committed by TASH were as follows:

  - failure to have and implement an effective system to detect and report suspicious transactions;
  - failure to provide adequate employee training and to conduct independent audit on compliance programmes; and
  - failure to have in place adequate customer due diligence processes.

  SC further directed TASH to take immediate remedial action to address the inadequacies in its supervisory policies and internal control procedures. The management of TASH is also required to intensify their awareness of regulatory responsibilities and ensure that these responsibilities are discharged effectively and efficiently.

- **Okachi (Malaysia) Sdn Bhd fined RM200,000 for breaching AML Guidelines**

  On 10 May 2013, the SC imposed a RM200,000 fine against Okachi (Malaysia) Sdn Bhd (Okachi) for its failure to comply with SC's ML/TF Guidelines, the *Licensing Handbook*, the *Compliance Guidelines for Futures Brokers* and the *Rules of the Bursa Malaysia Derivatives Bhd.*

  The breaches were in relation to:

  - inadequate CDD processes;
  - failure to develop an effective system to detect suspicious transactions;
  - failure to conduct adequate staff training; and
  - failure to perform independent audit on AML/CFT compliance programmes.

  SC further directed Okachi's Board of Directors (Board) and Compliance Officer to attend at least two AML/CFT training programmes within the next 12 months.

  SC views the compliance framework for AMLA in Okachi as inadequate given SC's earlier examination finding in 2010

  Okachi was also found to have breached the *Rules of the Bursa Malaysia Derivatives Bhd* when it failed to establish and maintain a proper system to supervise and achieve compliance with the said Rules.

OTHER ARTICLES

- **Conviction against a Managing Director and Chief Executive Officer of a company for unlicensed trading in futures contract**

  On 30 April 2013, the Sessions Court convicted Zamani Hamdan for carrying on the business of trading in futures contracts through his company, Rantau Simfoni Sdn Bhd without a Capital Markets Services License. He was sentenced to pay a fine of RM1 million (in default of one year imprisonment) under section 58(1) read together with section 367(1) of the CMSA.

  Zamani who was the Managing Director and Chief Executive Officer of the company committed the offence between March and April 2010 where he collected RM215,000 from 11 investors throughout this period. Zamani has since filed an appeal to the High Court against the conviction and sentence and the Prosecution has filed a cross appeal against the sentence.

- **The SC reprimands a bond trustee for failure to perform its duties as a trustee**

  On 15 July 2013, Universal Trustee (Malaysia) Bhd (UTMB), was reprimanded for not informing SC of the issuer's failure to remedy breaches of the trust deed and for not calling a meeting of bondholders and placing before such meeting, proposals for the protection of the bondholders and obtain their directions in relation to the same. In this regard, UTMB breached section 273(1)(d) and (e) of the CMSA.

Administrative fines imposed on Ranhill Energy and Tan Sri Hamdan Mohamad

The SC imposed a fine of RM200,000 on Ranhill Energy and Resources Bhd (Ranhill) and reprimanded as well as fined Tan Sri Hamdan Mohamad RM300,000 for failure to disclose to the SC material changes related to Ranhill's listing.

Both Ranhill and Tan Sri Hamdan, the latter being the Executive Director/President and Chief Executive of Ranhill, were found to have breached section 215(3) read with section 354(1) of the CMSA, for failing to immediately inform the SC about the suspension of the licence issued by Petroliam Nasional Bhd (Petronas) to Perunding Ranhill Worley Sdn Bhd (PRW), a company controlled by Tan Sri Hamdan. The notice of suspension was received on 17 July 2013.

Ranhill relies on PRW for contracts secured from Petronas. This contract represents a material contribution to the revenue of the Ranhill group of companies. The suspension of the licence was therefore deemed as a material change in circumstance as it posed potential adverse implications on Ranhill's oil and gas business. Under the circumstances, Ranhill and Tan Sri Hamdan were required to immediately inform the SC of the material change in circumstance under section 215(3) of the CMSA as the earlier disclosures in the listing prospectus of Ranhill would no longer be considered accurate or reflective of the prevailing circumstances, and potentially misleading.

The SC views timely and transparent disclosure of material information by companies and promoters seeking to raise funds via an initial public offering as fundamental to ensuring trust and confidence in the capital market. Companies, promoters and advisers are reminded to exercise vigilance in this regard.

Audit Oversight Board's administrative actions

In August 2013, Tan Chin Huat and Yeo Eng Hui of STYL & Associates, Wong Shan Ty of Ong & Wong (WST) and Dr Abdul Halim Husin of Wong Weng Foo & Co. were reprimanded for the breach of the AOB's registration condition imposed under section 31O(4) of the SCA.

The four individual auditors were sanctioned for failures to comply with the relevant requirements of the auditing standards in Malaysia, i.e. the International Standards on Auditing (ISA), in the performance of the audit of public-interest entities (PIEs).

AOB also reprimanded Cheah Choong Keong of C.K. Cheah & Co. (CCK) and Mohd Neezal Md Noordin of AljeffriDean for failure to comply with the relevant requirements of the recognised ethical and auditing standards in Malaysia, i.e. Malaysian Institute of Accountants' By-Laws and the ISA, in the performance of the audit of the PIEs. Monetary penalty was also imposed on the auditors due the severity of the breaches.

In September 2013, pursuant to section 31ZB of the SCA, CCK and WST appealed the decision made against them by the AOB Board. Their respective appeals were rejected and the sanctions imposed on them by the AOB were affirmed by the SC in October 2013.

In addition to the sanctions, AOB had also requested the respective auditors who continued to audit the respective PIEs to furnish evidences from their audit working papers to prove that all significant deficiencies were rectified in their subsequent year audit.

The publications of the sanctions are available in the AOB's website.

Silver Bird's former directors charged

SC charged two former directors of Silver Bird Group Bhd (Silver Bird), a manufacturer and distributor of bakery and confectionary products, for furnishing false information to Bursa Malaysia Securities Bhd (Bursa Malaysia) between 2010 and 2011.

Dato' Jackson Tan Han Kook, 59 and Derec Ching Siew Cheong, 51, were each charged with seven and eight counts respectively, of furnishing false statements relating to the revenue of Silver Bird in 2010 and 2011, to Bursa Malaysia. The charges under section 369(b)(B) of the CMSA were made following SC's investigation in relation to false statements contained in Silver Bird's eight unaudited quarterly financial accounts for the financial years ended 31 October 2010 and 2011.

Following the company's discovery of financial irregularities, Silver Bird announced in February 2012 that the company was deemed to be an affected listed issuer under Practice Note 17 of the *Listing Requirements*. Shortly after, the company removed both Tan and Ching from its board of directors.

Tan and Ching were each granted bail of RM250,000 with one surety each by Sessions Court Judge Tuan Murtazadi Amran and were required to surrender their passports to the Court.

If convicted, Tan and Ching will be liable to imprisonment for a term not exceeding 10 years and a fine not exceeding RM3 million.

SC succeeds in High Court on constitutional challenges

On 20 July 2012, the SC charged corporate lawyer, Dato' Sreesanthan Eliathamby (the accused) with seven counts of insider trading on the shares of four listed companies, namely Maxis Communication Bhd, Sime Darby Bhd, VADS Bhd and UEM World Bhd. The offences took place between 2006 and 2008 and related to various corporate proposals.

In an application which was filed in the Sessions Court on 19 September 2012, the accused mounted constitutional challenges to various laws, including the securities laws, comprising ten questions of constitutional law. The constitutional challenges questioned the validity of section 128 of the *Securities Commission Act 1993* (SCA) (affecting the SC's powers of investigation), section 134 of the SCA (affecting SCA's power to record statements from witnesses and determine who may be present during the recording of such statements), sections 172A and 172B of the *Criminal Procedure Code* (being recent amendments passed by Parliament in 2012 affecting pre-trial procedure) and section 376(3) of the same Code (relating to the power of the Attorney General to delegate the institution of criminal proceedings). Ultimately, the accused sought a declaration from the court that the relevant provisions of law were invalid and to acquit him of all charges of insider trading.

The SC successfully won the arguments on the constitutional challenges after the High Court heard submissions from the defence and prosecution. On 27 November 2013, the High Court decided in SC's favour by dismissing the constitutional challenges. The defence has since filed on appeal to the Court of Appeal against the decision of the High Court. The case is currently pending a hearing date at the Court of Appeal.

SC succeeds at the Federal Court against accused's application

On 13 September 2013, the Court of Appeal, after hearing submissions from the parties, dismissed the appeal filed by the second accused, Siow Chung Peng to quash the charge against him on the basis that he is provided with immunity from prosecution under the provisions of the *Whistleblower Protection Act 2010.* The Court of Appeal, in handing down its decision, affirmed the High Court's decision made on 5 February 2013.

On 14 October 2013, Siow's counsel filed an application for leave to appeal to the Federal Court against the decision of the Court of Appeal. On 13 January 2014, the Federal Court after hearing submissions from Siow's counsel and the Prosecution, decided in the SC's favour and dismissed Siow's application.

Siow, a businessman, was charged on 4 September 2011 under section 122C(c) of the *Securities Industry Act 1983* (SIA) read together with section 84 of the same Act for abetting former remisier, Dato' David Goh Hock Choy, for causing the creation of misleading appearance of active trading in Lii Hen Industries Bhd shares on Bursa Malaysia where he was indirectly concerned in transactions of the sale and purchase of Lii Hen shares that did not involve any change in the beneficial ownership.

Court of Appeal convicts Mohamed Abdul Wahab for misleading disclosure to the SC

On 13 December 2013, the Court of Appeal convicted Mohamed Abdul Wahab for the charges under section 122B(b)(cc) of the SIA.

Mohamed was sentenced to a fine of RM500,000 for each charge, making the total fine of RM1 million (in default of one year imprisonment) for authorising the furnishing of misleading statements to the SC in Metrowangsa's semi-annual report from 2000 to 2001. He was at the material time, a licensed fund manager and Executive Director of Metrowangsa Asset Management Sdn Bhd.

The offences under section 122B(b)(cc) of the SIA were in relation to misleading statements provided to the SC regarding the amount of funds managed by Metrowangsa in 2000 and 2001. During the material time, Metrowangsa had in its reports made to the SC, excluded funds received from two of its clients, Lembaga Tabung Haji and Mimos Bhd, amounting to RM134.2 million for the year 2000 and RM231 million for the year 2001.

Mohamed was charged in 2003 with two offences under section 122B(b)(cc) of the SIA for authorising the misleading statements to be made to the SC and one offence under section 47C(5) of the SIA for having abetted Metrowangsa in using RM50 million of Lembaga Tabung Haji's moneys to pay its other clients. On the charges under section 47C, he was convicted by the Sessions Court on 1 April 2009, together with Dr Ghazali Atan, the then Managing Director of Metrowangsa and ordered to pay a fine of RM200,000 (in default of one year imprisonment).

Penalty imposed on AmInvestment Bank

In January 2014, AmInvestment Bank Bhd (AIBB) was found to be in breach of paragraph 7.02(9) of the SC's *Licensing Handbook* for its failure to ensure that the carrying on of any licensed regulated activity on its behalf is performed by persons who are appropriately licensed. AIBB has allowed seven unlicensed persons to carry out regulated activities, such as soliciting fund management clients and receiving trading orders directly from such clients, which require a Capital Markets Services Representative's Licence from the SC. The SC thus imposed a RM100,000 fine against AIBB for the said breach.

SC charges former CEO for insider trading

On 10 January 2014, the SC charged Dato' Ch'ng Chong Poh, the former Chief Executive Officer (CEO) of Malaysia Pacific Corporation Bhd (MPAC) with 58 counts of insider trading of MPAC shares under section 188(2) of the *Capital Markets and Services Act 2007* (CMSA).

Dato' Ch'ng is alleged to have acquired the MPAC shares between 14 May 2008 and 20 August 2008, ahead of the entering into of a multi-million ringgit joint venture project between Oriental Pearl City Properties Sdn Bhd, a wholly-owned subsidiary of MPAC and Amanahraya Development Sdn Bhd (ADSB), a wholly-owned subsidiary of Amanah Raya Bhd. The project was entered into to undertake and manage several projects in the Iskandar Development Region in Johor. He claimed trial to all 58 charges and bail was set at RM300,000 with one surety. Dato' Ch'ng was also required to surrender his passport to the Court.

High Court upholds conviction for manipulation of shares

On 18 March 2014, the High Court dismissed the appeals by Dato' Phillip Wong Chee Keong and Francis Bun Lit Chun and affirmed the convictions imposed by the Sessions Court for their involvement in the manipulation of Suremax Group Berhad (Suremax) shares, between 24 November 2004 and 22 March 2005.

Dato' Phillip and Francis Bun, who were charged in 2005, were convicted by the Sessions Court in 2011 under section 84 of the *Securities Industry Act 1983* (SIA) for creating a misleading appearance of active trading in Suremax shares on Bursa Malaysia. They were found to have executed trades in nine accounts that did not involve any change in the beneficial ownership of the said shares.

The High Court maintained the sentence of two years' imprisonment and a fine of RM3 million against Dato' Phillip Wong Chee Keong, but reduced the imprisonment sentence against Francis Bun from three months' imprisonment to one day, whilst maintaining the fine of RM2 million. The SC has filed an appeal against the sentence imposed by the High Court against Francis Bun.

Audit Oversight Board sanctions

The Audit Oversight Board (AOB) in February 2014, publicly reprimanded two registered auditors, Lim Kok Beng of Ong Boon Bah & Co and Chan Kee Hwa of Khoo Wong & Chan for failing to comply with the International Standards on Auditing (ISAs) while auditing the financial statements of public-interest entities (PIEs).

The two auditors were also found to have breached the registration conditions imposed by the AOB under section 31O(4) of the *Securities Commission Act 1993* (SCA).

In addition to the reprimand, a monetary penalty of RM10,000 was imposed on Lim Kok Beng of Ong Boon Bah & Co. The AOB had also requested the audit firm (which continued to audit the PIE) to furnish evidences from the audit working papers to prove that all significant deficiencies were rectified in the subsequent year audit.

The two auditors are the first to be reprimanded by the AOB in 2014 and AOB had in previous years taken action against eight individual auditors for failing to comply with auditing and ethical standards. The AOB emphasises that the reprimands do not necessarily suggest that the financial statements of the affected PIEs contained any material error or their financial reporting controls are weak.

The details of the sanctions are available at the SC's website.

Application for judicial review filed against SC

In January 2014, an application for leave for judicial review was filed against the SC by Crowe Horwath. The application for leave for judicial review (herein referred to as the "First Application for Judicial Review") was in respect of AOB's inquiry against Lee Kok Wai of Crowe Horwath. AOB is in the midst of conducting an inquiry against Lee in his capacity of engagement partner in the audit of Silver Bird Group Bhd's financial statement for the financial year ended 31 October 2010.

The Court on 8 February 2014 dismissed the 1st Application for Judicial Review. Subsequent to this, Crowe Horwath and Lee filed another application for leave for judicial review against the SC in the High Court on 20 March 2014 (herein referred to as the "Second Application for Judicial Review"). On 7 April 2014, the High Court dismissed the second Application for Judicial Review with costs.

Crowe Horwath and Lee have appealed against the decisions of the Court with respect to both the first and second Application for Judicial Review. The Court of Appeal is scheduled to hear the appeal on 7 July 2014.

Following this, Crowe Horwath and Lee have also filed an application with the Court on 23 April 2014 for stay of AOB's inquiry, decision and notification of the decision of the said inquiry pending their appeal.

Prima facie case made out against external auditor for disclosure offence

On 9 January 2014, the Kuala Lumpur Sessions Court held that the prosecution had established a prima facie case against William Yue Chi Kin, and ordered him to enter his defence on the charge of abetting United U-li Corporation Bhd (United U-li), a public-listed company in making a misleading statement to Bursa Malaysia in the financial statement of the company for the year ended 31 December 2004.

William Yue was charged at the Kuala Lumpur Sessions Court in 2009 and he was at the material time the engaging partner of the Roger Yue, Tan & Associates which audited financial statements of United U-li for the year ended 31 December 2004. United U-li, was at the material time, a public-listed company.

The SC called 15 witnesses to prove its case and the court is currently in the midst of hearing the accused's testimony.

Corporate surveillance

Following its pre-emptive surveillance activities over PLCs, the SC has conducted 13 engagement sessions with directors of eight PLCs from the period of 1 September to 31 December 2014.

The key message conveyed during the above engagement sessions is the need for PLC directors to be constantly mindful of their fiduciary duties so as to ensure that all transactions undertaken by the PLCs are above board and in the best interest of its shareholders.

Administrative action

Directives imposed on Capital Dynamics Asset Management Sdn Bhd, 29 September 2014

On 29 September 2014, Capital Dynamics Asset Management Sdn Bhd (CDAM), a Capital Markets Services Licence holder carrying out fund management activity was found to be in breach of section 356 of the *Capital Markets and Services Act 2007* (CMSA) for failure to comply with the SC's *Guidelines on Compliance Function For Fund Management Companies,* for non-disclosure of the deferred performance fees chargeable annually in the statements issued to its clients. The SC thus directed CDAM to disclose to its clients by 31 December 2014 the chargeable performance fees in accordance with Paragraphs 7.01 and 7.03 of the *Guidelines on Compliance Function for Fund Management Companies.*

Enforcement Action

SC charges four individuals for insider trading

In December 2014, the SC charged Stanley Thai Kim Sim, Tiong Kiong Choon, Tan Bee Geok and Tan Bee Hong for insider trading offences under section 188 of the CMSA.

Thai, who was the Chief Executive Officer of APL Industries Bhd (APLI) at the material time, was charged with one count of communicating non-public information to Tiong. The non-public information was in relation to the audit adjustments proposed by APLI's auditors for the financial year ended 30 June 2007 and the classification of APLI as a PN17 company. Tiong was charged for disposing 6,208,500 APLI shares whilst in possession of this non-public information. He disposed the APLI shares via accounts belonging to his mother-in-law, and his mother on 26 and 29 October 2007.

Tan Bee Geok, who was at the material time the Group Executive Director of APLI, was also charged with one count of communicating the same inside information to her sister, Tan Bee Hong, between 23 October 2007 and 31 October 2007. One charge was also preferred by the SC against Tan Bee Hong for disposing, on 31 October 2007, 350,000 units of APLI shares held in her account while in possession of the inside information.

All four accused persons claimed trial to the respective charges preferred.

Regulatory Settlements

MyEG Services Bhd

On 26 September 2014, Wong Thean Soon entered into a settlement with the SC in the sum of RM7,000,000 when he agreed without admission or denial of liability, to settle a claim that the SC was proposing to institute against him and 13 other individuals for the manipulation of MyEG Services Bhd shares between 16 January 2007 and 24 April 2007, contrary to section 84(1) of the *Securities Industry Act 1983* (SIA). The settlement was reached following a letter of demand sent by the SC pursuant to its civil enforcement powers.

Metacorp Bhd

On 3 October 2014, both Siva Kumar a/l M.Jeyapalan and Dato' Azmil Khalili Dato' Khalid entered into a settlement with the SC in the sum of RM782,839.17 and RM249,750.00 respectively when they agreed without admission or denial of liability, to settle claims that the SC was proposing to institute against them for insider trading in the shares of Metacorp Bhd (Metacorp) between 14 and 22 February 2008, contrary to section 188(2) of the CMSA. The settlement was reached following letters of demand sent by the SC pursuant to its civil enforcement powers under the securities laws. In accordance with the provisions of section 201(7) of the CMSA, the amount recovered from them will be used first to reimburse the SC for all costs of investigations and proceedings. Any remaining amount if available will be used to compensate the sellers who sold their Metacorp shares before the information became generally available.

PART B

(2015–2018)

Recent regulatory initiatives

LODGE AND LAUNCH FRAMEWORK

In line with regulatory proportionality, the Lodge and Launch Framework (LOLA Framework) for wholesale products[2] was brought into effect on 15 June 2015. The removal of approval requirement for the wholesale market marks a major reform in the SC's product approval regime. This approach seeks to balance business efficiency and investor protection.

The LOLA Framework enhances business efficiency by enabling wholesale products to be launched once the required information is lodged with the SC. Product issuers no longer need to seek the SC's prior approval before making available products to investors – a process that would previously have taken 14 to 21 days under the previous regime.

Table 1

Comparison between previous and new regime

	Approval Regime	LOLA Framework
Approval Process ▶	Approval Required	No approval
Time Charter ▶	14 – 21 days	0 days

ENABLERS

To implement the LOLA Framework, a new exemption from section 212 of the *Capital Markets and Services Act 2007* (CMSA) for wholesale products was introduced in Schedule 5[3] of the CMSA.

In line with the introduction of the LOLA Framework, SC embarked on a major legislative review process involving five existing guidelines. The review exercise consolidated these guidelines where similar requirements for wholesale market are found to simplify the process for issuers, distributors and investors seeking to identify and understand the regulatory requirements for the wholesale market.

SC embarked on a major legislative review process involving five existing guidelines

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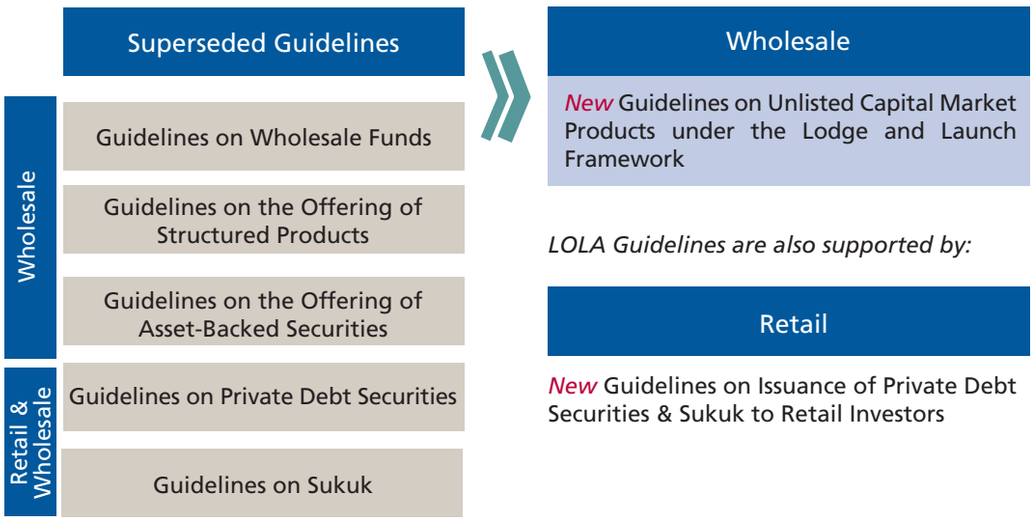
2 'Wholesale products' under the LOLA Framework refers to unlisted capital market products comprising wholesale funds, structured products, bonds, sukuk and asset-backed securities, which are offered to sophisticated investors only.

3 Schedule 5 of the CMSA provides a list of corporate proposals exempted from SC's approval requirement. Amendments were made to Schedule 5 via the *Capital Markets and Services (Amendment of Schedules 5, 6, 7 and 8) Order 2015*. Fees in relation to the LOLA framework were introduced via the *Capital Markets and Services (Fees) (Amendment) Regulations 2015*.

The new *Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework* (LOLA Guidelines) which came into effect on 15 June 2015 superseded the five guidelines as illustrated in Diagram 1.

Diagram 1



Note: Guidelines for the Offering, Marketing and Distribution of Foreign Funds are not affected by the new LOLA Framework

In removing the approval requirement for unlisted wholesale products, the SC is mindful of the need to enhance its ability to conduct post-lodgement monitoring of these products based on the analysis of information submitted to the SC by product issuers. As such, timelines stipulated in the LOLA Guidelines for submission of the required documents and information will be strictly enforced by the SC. A daily penalty of RM1,000 will be imposed for any delay.

INVESTOR PROTECTION

A key component of investor protection in the LOLA Framework is the reliability, completeness and accuracy of information provided to investors in the disclosure documents. To ensure that the dispensation of product approval under the LOLA Framework does not in any way erode investor protection, the SC will continue to monitor and take action against any person who is responsible for preparing a disclosure documents containing false or misleading information. As such, issuers and advisers are expected to conduct the required due diligence to ensure the accuracy and completeness of information lodged. They should immediately alert the SC if they become aware of any material changes to these information or documents.

A key component of investor protection in the LOLA Framework is the reliability and accuracy of information provided to investors in the disclosure documents.

Table 1

Relevant statistics relating to the Lodge and Launch Framework from 15 June to 30 November 2015

Companies and Users Registered on the LOLA Submission System	
502 Registered Users (administrators, key contact persons, lodgement users and finance users of registered companies)	**89** Registered Companies (fund management companies, qualified banks, qualified dealers and principal advisers)

Lodgement					
New PDS / Sukuk	Post Issuance Notice for PDS / Sukuk	New Wholesale Fund	New Structured Products Programme	Existing Structured Products Programme	Post Issuance Notice for Structured Products
16	**13**	**28**	**4**	**110**	**245**

AML/CFT: REALIGNMENT OF SUPERVISORY FOCUS TO RISK

Background: Outcome of Malaysia's Mutual Evaluation Exercise

Malaysia underwent a Mutual Evaluation Exercise in November 2014, during which the Asia/Pacific Group on Money Laundering[4] (APG) and the Financial Action Task Force on Money Laundering[5] (FATF) jointly assessed the country's Anti-Money Laundering and Counter-Financing of Terrorism (AML/CFT) framework. The assessment involved the following:

- a comprehensive evaluation of Malaysia's AML/CFT legal framework for technical compliance with the FATF 40 Recommendations[6], and
- an evaluation of the effectiveness of Malaysia's competent authorities, law enforcement agencies and reporting institutions in combating money laundering/terrorism financing (ML/TF) activities.

Central to the assessment is the compliance of the updated FATF 40 Recommendations and the FATF Methodology, which emphasise the concept of risk. The new focus on risk is intended to ensure that Malaysia as a country including its sector regulator such as the SC and other institutions, are able to identify, assess and understand the ML/TF risks to which they are exposed and take the necessary AML/CFT measures commensurate to those risks to mitigate them.

Key Findings of the Assessment in Relation to Reporting Institutions in the Financial Industry

The assessors found that Malaysia has a strong legal and regulatory framework for preventive measures. However, reporting institutions which include investment banks, stockbroking and derivative broking firms and fund management firms demonstrate only a moderate level of effectiveness in applying AML/CFT preventive measures and require major improvements in AML/CFT compliance.

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4 The Asia/Pacific Group on Money Laundering is an international organisation which is committed to the effective implementation and enforcement of internationally accepted standards against money laundering and the financing of terrorism, in particular the 40 FATF Recommendations.

5 FATF is an inter-governmental body which sets standards and promotes effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

6 The FATF 40 Recommendations are a set of standards introduced in 2012 to promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorism financing and the financing of proliferation of weapons of mass destruction.

(i) Risk-based approach and understanding of ML/TF risks and AML/CFT obligations

The assessment found that some reporting institutions were still in the process of shifting from a rules-based to a risk-based approach.

While the risk-based approach requires reporting institutions to assess the ML/TF risks associated with their businesses, conduct customer due diligence (CDD), profile the client's risk and apply the necessary countermeasures, reporting institutions that apply the rules-based approach tend to classify clients based on their status alone without assessing other ML/TF risk factors associated with these clients. For example, reporting institutions tend to automatically classify foreign clients as 'high-risk' clients and consequently subject them to enhanced CDD measures. As a result, preventive measures are not applied on a risk-sensitive basis.

(ii) Obligations in relation to beneficial owners and politically-exposed persons

The assessors concluded that the identification of beneficial owners as well as close associates and family members of both foreign and domestic politically-exposed persons (PEPs) remains a challenge, though it was acknowledged that larger players in the securities sector did utilise a combination of commercial databases and customers' self-declaration for PEP screening.

(iii) Reporting of suspicious transactions

Generally, reporting institutions appear to meet their obligations in reporting suspicious transactions. However, it was noted that the number of suspicious transaction reports (STRs) filed within the securities sector is relatively low when compared to the risk profile of the sector. It was also highlighted that terrorism financing-related STRs are low.

Mutual Evaluation Report and Moving Forward

Following the assessment, the National Co-ordination Committee to Counter Money Laundering (NCC) developed a strategic plan to strengthen Malaysia's AML/CFT and counter proliferation financing regime. The SC is committed in raising the compliance standard of reporting institutions by providing guidance and organising awareness programmes; focusing on areas highlighted in the assessment, namely, the application of the risk-based approach, PEPs and targeted financial sanctions in relation to terrorism and proliferation financing. To achieve this, the boards of directors of reporting institutions are expected to play a bigger role in ensuring effective AML/CFT compliance is consistent with the requirements of the SC's *Guidelines on Prevention of Money Laundering and Terrorism Financing for Capital Market Firms.*

Full results of the assessment are published in *Malaysia's Mutual Evaluation Report*, which was tabled and adopted at the FATF Plenary meeting in June 2015 and APG Plenary meeting in July 2015. The report is available at *http://www.fatf-gafi.org/publications/mutualevaluations/documents/mer-malaysia-2015.html*

Client's Assets Protection – emerging risks involving third party receipts

Overview

On 26 January 2015, the SC issued a reminder to intermediaries to strengthen procedures and controls regarding third party receipts[7] as follows:

- Verifying the identity of the cheque issuer by requiring the submission of a photocopy or image of the client's cheque together with the direct bank-in form;
- Matching the transferor's name with the trading account for interbank fund transfer. Where the transferor's name does not match, intermediaries are required to conduct further verification;
- Tagging of client's bank account(s) to the intermediaries' settlement system for all receipts and payment transactions;
- Prohibiting the practice of crediting payment from one client into the accounts of several other clients;
- Prohibiting representatives from receiving payments from their clients either in cash, cheque or any other form of payment into their personal bank accounts; and
- Prohibiting representatives from making payments on behalf of their clients.

As a long-term measure, intermediaries are required to make an arrangement with their banks to allow clients to key in their name or identity card number for payments made into the intermediaries' designated bank accounts.

Follow-up Review

Following the issuance of the reminder to strengthen procedures and controls, the SC engaged with seven intermediaries to determine the progress of their implementation measures.

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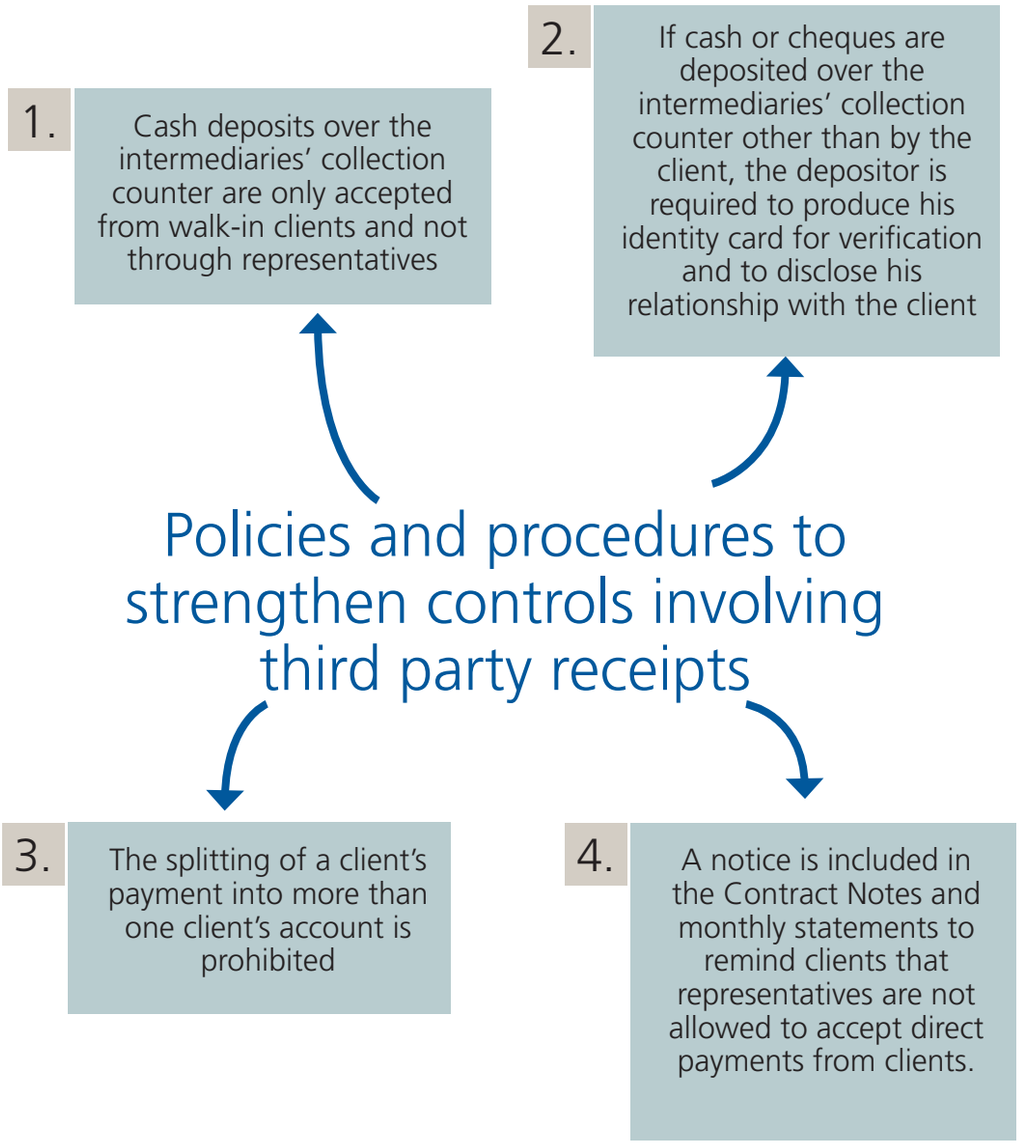
[7] Refers to payments made by one party to designated bank accounts of intermediaries which are subsequently allocated to the trading account of another party.

We wish to commend an intermediary for its swift implementation of tagging clients' bank accounts to its settlement systems. We believe this arrangement will reduce the risk of mismanagement or misappropriation of clients' funds.

These seven intermediaries have put in place policies and procedures to strengthen controls involving third party receipts as follows:



Message to Intermediaries

Vigilance

Intermediaries should always ensure that requests or instructions by representatives to allocate monies into a client's account are verified before they are carried out, especially the source of funds and the trading account for which the funds are intended.

Intermediaries should conduct ongoing monitoring of its customers throughout the course of their business relationship. Some *red flags* that intermediaries must immediately address are as follows:

1. Amount of deposits and volume of transactions that do not commensurate with the profile of the client.
2. Monies deposited and withdrawn from an account which has minimal or no trading transaction.
3. Sudden increase in the number of transactions of an inactive trading account.
4. Large or frequent wire transfers or deposits into a trading account where monies are immediately withdrawn.

Supervision of Representatives

Intermediaries are also reminded to adequately supervise their representatives in the performance of their duties to ensure adherence to internal processes and controls. Intermediaries often overlook the fact that these representatives are carrying out regulated activities on their behalf.

Some intermediaries have even contracted out their responsibility for the actions of their representatives in the Standard Remisier Agreements. Intermediaries have sought to rely on such agreements to avoid liability when sued by clients who suffer losses as a result of misappropriation by the representatives. In many of these cases, investors have been left in a lurch.

In order to provide clarity on the relationship between an intermediary and its representative, the CMSA has been amended to include a new section 59A[8]. The new section 59A provides that a representative is deemed to be an agent of the intermediary when he engages in any conduct or makes any representation within his authority as a representative of the intermediary. With this new provision, any agreement entered into by the intermediary to remove, exclude or restrict its obligation or liability as the principal of its representative shall be void.

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[8] Section 59A was inserted by amendment of the CMSA vide the *Capital Markets and Services (Amendment) Act 2015* which came into force on 15 September 2015

Examples of scenarios on how third party receipts can be abused

Scenario 1
Unlicensed Person Posing as a Representative

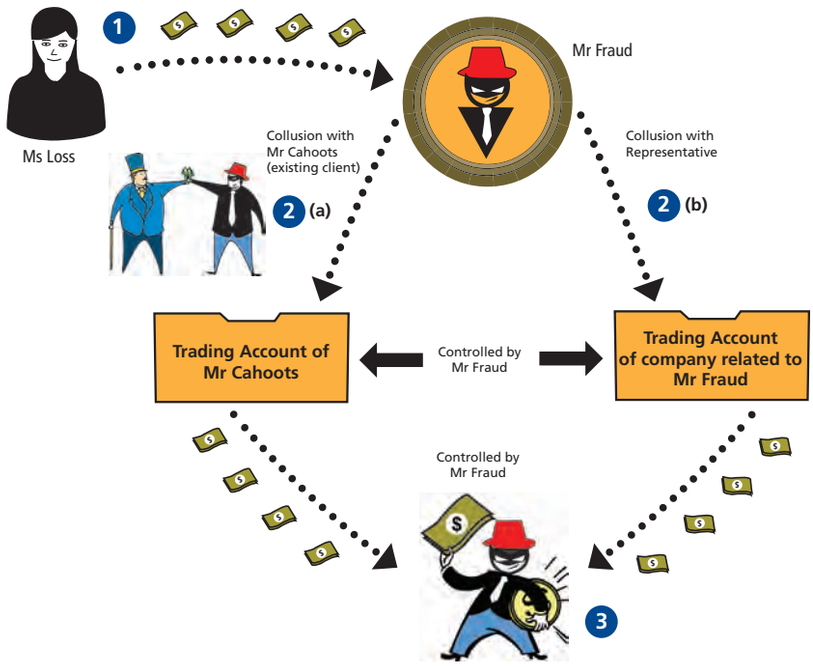
An individual, Mr Fraud, posing as a representative of an intermediary, persuades a victim, Ms Loss to place monies (cash or cheque) with the intermediary for share trading or other capital market investments [1 in Illustration 1]. Attracted by the guarantee of high returns, Ms Loss either deposits monies, directly or through Mr Fraud, into the intermediary's designated bank account. Mr Fraud then issues forged receipts or certificates to convince Ms Loss that the monies have been received by the intermediary and that the investment is genuine.

The monies deposited will then be allocated into either the trading accounts of existing clients or representatives of the intermediary:

- *Where Mr Fraud colludes with an existing client, Mr Cahoots. Mr Fraud instructs Ms Loss to provide him with the deposit details. Mr Fraud hands over the details to Mr Cahoots, who then instructs the intermediary to allocate Ms Loss' deposits into his account [2(a) in Illustration 1]*
- *Where Mr Fraud colludes with a representative of the intermediary, Mr Fraud instructs the representative to allocate the monies deposited into the trading account of a company related to Mr Fraud [2(b) in Illustration 1].*

The monies in accounts controlled by Mr Fraud will then be withdrawn or used by Mr Fraud for his own purpose such as settling his own losses or that of his nominees [3 in Illustration 1]. Ms Loss will only realise her losses when there is no return on her "investment" or when Mr Fraud cannot account for the "missing investment".

Illustration 1



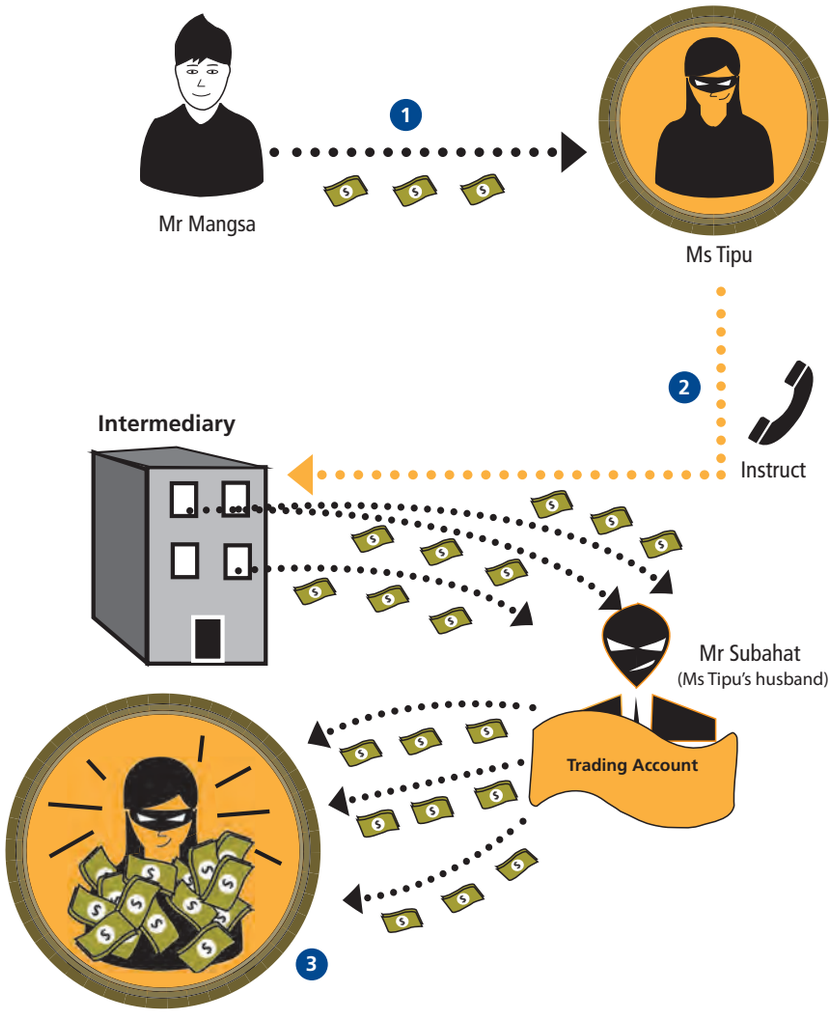
Scenario 2
Rogue Representative

A representative of an intermediary, Ms Tipu, persuades a victim, Mr Mangsa to deposit monies with the intermediary for share trading or other capital market investments [1 in Illustration 2].

Instructions are then given by Ms Tipu to the intermediary to allocate the monies deposited by Mr Mangsa into the account of another client, Mr Subahat, who is Ms Tipu's husband [2 in Illustration 2]. The monies in Mr Subahat's account will be withdrawn later by Ms Tipu for her own use [3 in Illustration 2].

While Scenario 2 illustrates a situation where the representative has defrauded her client, mismanagement or misappropriation of investors' monies can also occur when a representative fails to supervise the activities of his assistant. This may create an opportunity for the assistant to instruct the intermediary to allocate clients' monies into accounts related to the said assistant.

Illustration 2



Message to Investors

Investors should be vigilant and monitor their investments closely. There are steps that investors can take to protect their interests when making an investment:

1. If you are approached by any person offering services in relation to trading in securities, check whether the person is licensed by the SC to carry out the said activity. Refer to the 'Public Register of Licence Holders' on the SC's website – www.sc.com.my.
2. Do not issue cheques in the representative's name to settle trading transactions.
3. Do not pay cash or bank in monies directly into the representative's personal bank account.
4. Instruct the intermediary to send transaction documents (contract notes, receipts and monthly statements) directly to your personal address. If you do not receive these, immediately contact the intermediary.
5. When in doubt, immediately verify the information in the transaction documents with the intermediary, especially where there are handwritten amendments or discrepancies in the documents.
6. Do not allow a representative or any other person to use your trading account other than for your own transaction.
7. If you have any complaint against an intermediary or your representative, contact the SC's Investor Affairs and Complaints Department at +603-6204 8999 or e-mail aduan@seccom.com.my.
8. If you have made any monetary claim which cannot be settled by the intermediary, refer the matter to the Securities Industry Dispute Resolution Center at +603-2282 2280 or via https://sidrec.com.my/lodge-a-claim/

Equity crowdfunding – A new and innovative mechanism for market-based financing

Crowdfunding has disrupted capital markets by enabling ordinary investors to participate in a wealth creation dimension that was previously within the domain of the affluent – venture capitalists (VCs) and angel investors. Easier access to capital has also benefitted entrepreneurs and small businesses.

The World Bank estimated[1] that the global market opportunity for crowdfunding could be up to US$96 billion by 2025, with the East Asia and Pacific region[2] contributing US$7 billion to the total estimated value. In 2014 alone, crowdfunding platforms raised US$16.2 billion, up 167 per cent from US$6.1billion in 2013[3].

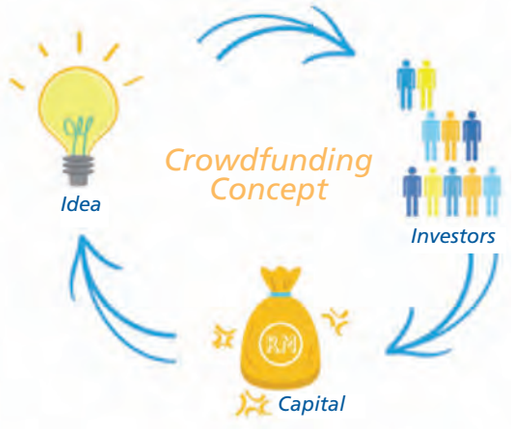
As Malaysia becomes the first country in the Asia–Pacific region to set up the legal framework for ECF, access to start-ups and high-growth small and medium enterprises (SMEs) in exciting and innovative sectors are now open to all Malaysians.

The introduction of ECF marks an important milestone in our effort to democratise finance and promote inclusivity in the Malaysian capital market. Under this initiative, regulatory reforms were undertaken to allow private companies to offer their shares to the public. This has enabled start-ups and SMEs to access alternative funding sources to grow their businesses.

What is ECF and why does it matter?

Crowdfunding is a form of fundraising where multiple individuals pool together money, usually on an online platform, to fund a business venture, project or a cause. The concept is really an extension of borrowing or raising money from family and friends in support of an idea or business venture that resonates with their own values and interests. However, the internet has enabled crowdfunding to be extended to the global community at large.

In Malaysia, our ECF framework will enable start-ups and SMEs to access market-based financing through a platform registered with the SC.



1 *Crowdfunding's Potential for the Developing World*, a 2013 report published by the World Bank. URL: http://documents.worldbank.org/curated/en/2013/01/18806928/crowdfundings-potential-developing-world

2 World Bank categorisation of East Asia and Pacific region comprises more than 20 countries including Malaysia, Japan, Korea, Singapore, Thailand and Indonesia.

3 *2015CF Crowdfunding Industry Report* published by Massolution, a research firm specialising in crowdsourcing and crowdfunding industries.

The ECF framework will provide start-ups and SMEs with:

- **An alternative source of funding**
  ECF provides start-ups and SMEs quicker access to capital at a lower cost compared to traditional banks.

- **Opportunities to gain market traction**
  By harnessing the power of the crowd on the internet, start-ups can gauge market reception of their product from response received on the ECF platform as well as gain better understanding of the target demographics. Start-ups (and even SMEs) hosted on the ECF platform can gain market traction and have the opportunity to pitch their business to VCs and angel investors.

The ECF framework will provide investors with opportunities to:

- **Diversify their investments** beyond traditional asset classes. For example, CrowdPlus.Asia currently hosts 'Curren$eek' – a developer for a currency exchange application.

- **Invest in young start-ups** with business ventures that may have the potential to scale up and eventually list on the exchange. If the start-up has a novel technology or business model, it may even attract the attention of VCs, which could provide further funding to grow its business. This may lead to an eventual exit opportunity for early investors at a premium.

We launched the ECF framework in February 2015[4] and subsequently announced six registered ECF platforms at the Synergy and Crowdfunding Forum (SCxSC) in June. The six registered platforms are Alix Global, Ata Plus, Crowdonomic, Eureeca, pitchIN and Propellar Crowd+. These platforms are expected to start operations by the first half of 2016.

Who can operate an ECF platform?

A person who wishes to operate an ECF platform must be registered with the SC as a Recognised Market Operator. In assessing the operators, we take into account, among others, the fit and properness of the operator's directors and its ability to operate an orderly, fair and transparent market. The operator must ensure that companies[5] hosted on its platform comply with the platform rules which are approved by the SC.

One of the most important roles of an operator is to determine the suitability of companies to be hosted on the platform. This entails conducting due diligence on the prospective companies and the projects for which funding is sought. The operator is also required to safeguard investors' funds in a trust account until the funding goal is met.

Six registered platforms are Alix Global, Ata Plus, Crowdonomic, Eureeca, pitchIN and Propellar Crowd+. These platforms are expected to start operations by the first half of 2016.

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4 The legal framework for ECF can be found in the *Guidelines on Recognized Markets* at http://www.sc.com.my/legislation-guidelines/recognisedmarkets/

5 In the *Guidelines on Recognized Markets*, only locally incorporated private companies (excluding exempt private companies) may be hosted on the ECF platform. In the Guidelines, these companies are referred to as 'issuers'.

Who can seek funding on the platform?

Private companies are generally prohibited from offering their shares to the general public[6]. However, the *Capital Markets and Services Act 2007* (CMSA) was amended to create a safe harbour[7] for locally incorporated private companies[8] to offer their shares to the public through an ECF platform that is registered with the SC.

A company may only be hosted on one ECF platform at any one time, and is subject to the following limits:

1. A company is only permitted to raise up to RM3 million within a 12-month period, regardless of the number of projects.

2. A company can only utilise the ECF platform to raise a maximum of RM5 million in capital[9], after which it can no longer seek further funding on any ECF platform.

Who can invest on an ECF platform?

While investment opportunities are open to all investors, certain safeguards have been put in place given the high-risk nature of start-ups. The following investment limits have been imposed:

6 Section 15(1)(c) of the *Companies Act 1965*.
7 Section 40H of the CMSA
8 Companies incorporated under the *Companies Act 1965*.
9 This does not include the company's own capital contribution or any funding obtained via private placement.
10 Persons referred to in Part I of Schedules 6 and 7 of the CMSA.
11 For the purpose of SC's ECF framework defined in the *Guidelines on Recognized Markets* as 'an investor that is accredited by the Malaysian Business Angels Network as an angel investor'.
12 Persons who are not sophisticated investors.

Message to investors

Know the risks of your investments

1. Given that you are investing in shares of a private limited company, you may not be able to sell your shares easily on the secondary market. As such, you may not be able to recoup your investment within a short period of time.

2. Given that your investments are made in start-up companies, there is a risk that the project for which the funding is sought may not succeed. As such, you may not see any returns on your investment, or worse, lose all the monies you have invested.

3. There is also the risk of fraud. No amount of legislation can completely eliminate the risk of fraud. As such, you must stay vigilant.

Know the company you are investing in

1. One of the ways to minimise the risk of being defrauded is to know the company you are investing in and obtain as much information about its business.

2. Although platform operators are required to conduct due diligence on prospective companies, you should always read the disclosure documents of the company before investing and conduct your own due diligence, such as–

   - whether the operator is registered with the SC;
   - whether the company exists and what is the nature of its business; and
   - how the company plans to use the money raised.

Know your rights

1. The money you have invested will be placed in a trust account and should be returned to you in the following circumstances:

   - The company fails to raise the targeted amount. This means that if the company seeks to raise an amount of RM100,000 within 30 days but only managed to raise RM50,000, the company would be deemed to have failed to reach the target amount. In this situation, the entire RM50,000 must be returned to investors;

   - There is a material adverse change affecting the company or the project for which funding is sought. Examples are:
     - Changes in the company's key management;
     - Material change in the company's business plan; and
     - Discovery of a false or misleading statement submitted by the company.

2. After you have made your investment, you have at least six business days within which you can pull out from the investment (cooling off period).

3. You are entitled to obtain all relevant information pertaining to the company or the project such as key characteristics of the company, purpose of the fund raising, business plan of the company and its financial information.

4. Fees, charges and other expenses relating to your investment must be disclosed to you by the operator.

5. If you have any complaints regarding your investment, you may refer the matter to the operator or the SC.

Enhancing Quality of Financial Reporting by PLCs

Overview

High quality financial reporting by PLCs is crucial for Malaysia to establish itself as a strong and vibrant market. Financial reporting failure can have widespread ramifications as seen by the highly publicised corporate collapses around the world. More than ever, local and global investors are asking for reliable and timely financial statements in order to obtain a more accurate picture of the business in making investment decisions, whether in terms of generating value or understanding the risks involved.

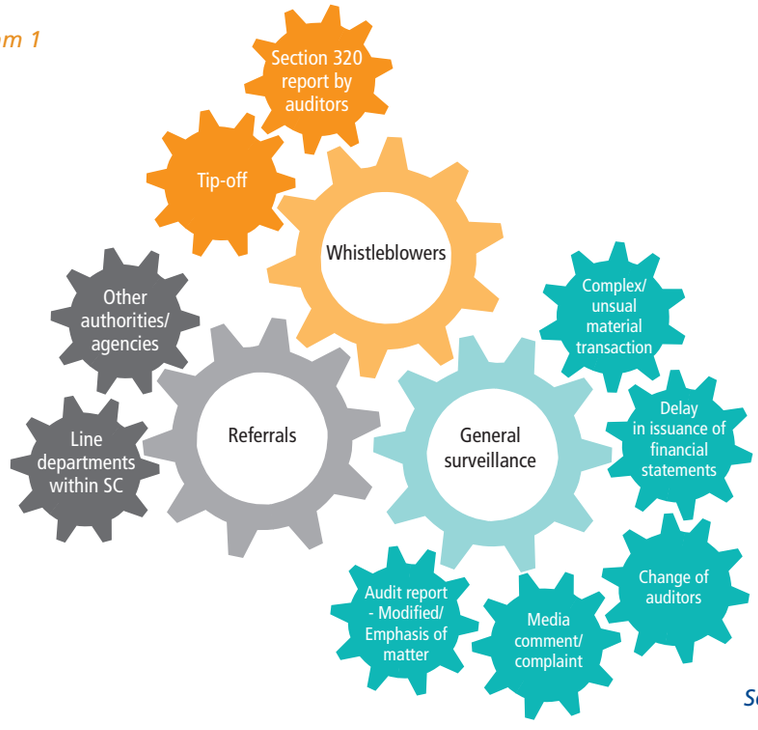
One of our key focusses is to continue to monitor PLCs' compliance with approved accounting standards as mandated under the *Securities Industry (Compliance with Approved Accounting Standards) Regulations 1999* (SIR 1999).

Surveillance of financial reporting

We work closely with the Audit Oversight Board to ensure financial statements continue to serve its wide audience in particular the investing community and build confidence in our market. We maintain continuous surveillance on PLCs through our Corporate Surveillance Department, which includes reviewing financial statements as a means of detecting financial irregularities and non-compliances with approved accounting standards.

General sources of information relating to non-compliances with accounting standards are as follows: (Diagram 1)

Diagram 1



Source: SC

Where potential accounting issues are detected, we have taken the following steps:

1. Engage with the PLC's management, directors and/or auditors to further understand the rationale and justification of accounting policies adopted and accounting treatments applied in relation to the potential non-compliance issues detected;

2. Request for written explanation and documentary evidence in relation to the issues under review; and

3. Determine the breach and take appropriate enforcement action.

Observations and findings

Malaysia's accounting standards has converged with the International Financial Reporting Standards (IFRS) since 1 January 2012, with the exception of certain entities falling within the definition of Transitioning Entities (TEs)[13]. It is our observation that PLCs have generally coped well with this transition. Nevertheless, we continue to detect instances of non-compliance in our surveillance function.

Some areas of non-compliance include:

- Classification of loans between long-term liabilities and current liabilities
- Measurement of liabilities arising from financial guarantees
- Recognition of contingent assets
- Consolidation – determination of control
- Accounting for change in accounting policies
- Presentation and disclosures
- Impairment of assets

We are particularly concerned with issues relating to impairment of assets as breaches of the relevant approved accounting standards governing impairment of assets are concentrated in the following areas:

- Low level of understanding in the definition and in determining what constitutes a cash generating unit (CGU)[14];
- Using assumptions which are overly aggressive and unsupported in determining value in use based on cash flow projections;
- Using inappropriate discount rate in computing net present value of projected cash flows; and
- Inadequate assessment of cash flow projections.

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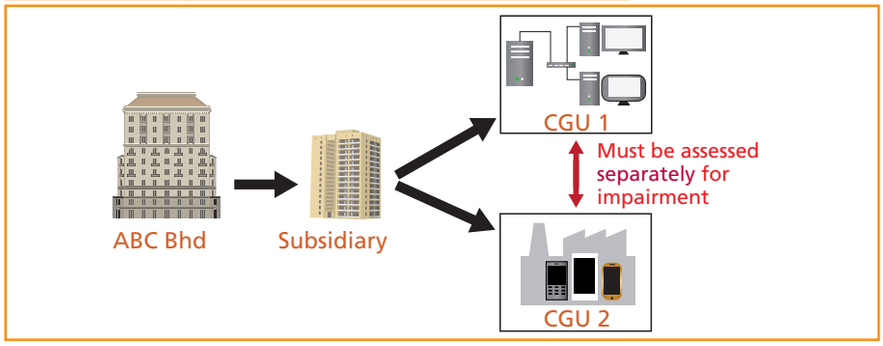
[13] TEs comprise entities that are within the scope of MFRS 141 Agriculture and/or IC Interpretation 15 *Agreements for the Construction of Real Estate*, including the parent, significant investor(s) and joint venturer(s).

[14] *Paragraph 6 MFRS 136 Impairment of Assets*: A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

The following illustrate some of our findings in this area:

Scenario 1

Understanding the definition and determining what constitutes a CGU



ABC Bhd has acquired a subsidiary with two CGUs and proceeded to recognise goodwill on consolidation in the amount of RM8 million. The goodwill was then allocated to the two CGUs which generate cash flows that are largely independent of each other.

In performing impairment assessment on the goodwill, ABC Bhd aggregated the two CGUs in computing the recoverable amount instead of assessing them separately. Accordingly, no impairment was recognised by ABC Bhd on the basis that the overall carrying amount of RM38 million (for both CGUs) did not exceed the aggregated recoverable amount of RM39 million, as shown in Table 1.

Table 1

ABC Bhd's impairment assessment – with the two CGUs aggregated

Cash generating unit (RM million)	Carrying amount			Recoverable amount	Impairment loss
	Allocated goodwill	Identifiable assets	Total		
Subsidiary (Aggregation of CGU 1 and CGU2)	8	30	38	39	–

Had the two CGUs been assessed separately, as shown in Table 2, an impairment loss of RM5 million would have been recognised for CGU 2 because the carrying amount of CGU 2 has exceeded its recoverable amount by RM5 million.

Table 2

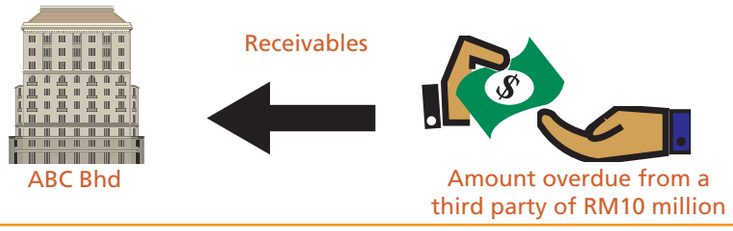
Correct impairment assessment – with the two CGUs assessed separately

Cash generating unit (RM million)	Carrying amount			Recoverable amount	Impairment loss
	Allocated goodwill	Identifiable assets	Total		
CGU 1	3	10	13	19	–
CGU 2	5	20	25	20	5

In this scenario, ABC Bhd has failed to comply with *MFRS 136 Impairment of Assets.*

Scenario 2

Asesssment of assumptions and estimates used in cash flow projections



ABC Bhd has an amount receivable from a third party of RM10 million which is overdue. The directors held the opinion that the amount was recoverable despite the lack of evidence to support the opinion, and on that basis chose not to recognise any impairment loss. The opinion was formed by relying on cash flow projections provided by the third party in computing the net present value of the amount receivable which was higher than the said RM10 million.

Our surveillance revealed the following:

1. The assumptions used were overly aggressive and unrealistic in that revenue growth was projected to be 40 per cent per annum year-on-year, which was significantly higher compared to historical trend and there was no evidence to support such projection;

2. The projected costs did not increase in tandem with the projected revenue growth, resulting in a gross profit margin that was significantly higher compared to industry norm; and

3. The expected repayments by the third party in earlier years were never materialised.

In this case, ABC Bhd accepted the cash flow projections at face value without challenging the assumptions used in the computation of projections. Had the cash flow projections been properly assessed, an impairment loss would have been recognised.

Therefore, ABC Bhd has failed to comply with *MFRS 139 Financial Instruments: Recognition and Measurement.*

Consequences of non-compliance

The failure to comply with approved accounting standards is deemed serious as it impacts the reliability and quality of financial statements of the PLC. While the subsequent restatement of the financial statements may be made by the PLC (on a voluntary basis or as directed by the SC) in most occasion, investors, lenders, creditors and other stakeholders may have been affected as investment decisions had been made based on the earlier defective financial statements. Hence, PLCs are expected to exercise greater discipline when preparing financial statements. This is important to ensure that financial statements are reliable in a principle-based environment.

It is therefore imperative that all PLCs, especially the board and senior management, exercise diligence and professional judgement in preparing financial statements and ensure full compliance with approved accounting standards, in both form and substance.

Enforcement actions

A PLC that fails to comply with approved accounting standards is in breach of Regulation 4(1) of the SIR 1999. We will continue to apply the various enforcement tools to address cases of non-compliance.

A. Administrative actions taken

The range of administrative sanctions that we may impose ranges from reprimand, issuance of directive and fines against the PLCs and their board of directors. In 2015, a PLC and its board of directors were sanctioned for non-compliance with approved accounting standards.

Please refer to pages 17 and 18 for more details of the actions taken.

B. Infringement notices issued

In 2015, we issued four infringement notices for minor breaches as follows:

MFRS 101: Presentation of Financial Statements

- Failure to classify defaulted loans or loans due within 12 months as current liabilities.
- Failure to disclose a material item of income as a separate line item on the face of the Statement of Profit and Loss.
- The use of the term 'Other Expenses' repeatedly in the financial statements when in essence they did not represent the same items.
- Failure to properly cross reference Notes to Financial Statements to items in the Statement of Profit and Loss.

MFRS 108: Accounting Policies, Changes in Accounting Estimates and Errors

- Failure to apply retrospective application following a change in accounting policy for its investment property.

MFRS 116: Property, Plant and Equipment

- Failure to disclose accurate accounting policies in relation to its 'Long–Term Leasehold Land'.

Message to PLCs and directors

PLCs and its directors are accountable for the accuracy and reliability of financial statements. They must exercise due care in the preparation of the company's financial statements:

PLCs

- PLCs are expected to take an active role in ensuring full compliance with approved accounting standards.
- PLCs should exercise due care to ensure that there is no error in the presentation of financial information or the use of incorrect accounting treatments.
- PLCs should place additional attention on areas that require significant judgement and estimates.
- PLCs should invest in human capital and ensure that they have in place a competent financial reporting team who are up to date with accounting knowledge.
- PLCs may consider enlisting the help of specialists to provide technical accounting advice in areas that are complex to ensure proper accounting treatments.

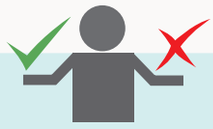
Directors

- Directors should always remember that under the law, directors are accountable for the preparation of financial statements.
- The audit committee's (AC) role is to safeguard the integrity of financial reporting. Hence, members of the AC are expected to be financially literate. This, however, does not absolve other directors (who are not members of the AC) from their responsibilities.
- Directors should review financial statements carefully and with rigour based on sound understanding of the business.
- Directors of PLCs should equip themselves with the ability to ask management the right questions.
- Directors should take notice of issues raised by auditors as good feedback on areas of concern and not rely on auditors to prepare financial statements.

Message to auditors

Investors, regulators and other stakeholders rely on auditors to ensure high quality financial reporting practices by PLCs as they are the only party outside the PLC who has full access to a PLC's documents and records. Therefore, auditors have a duty to conduct their audit in an independent and professional manner. They must exercise appropriate diligence and professional scepticism in arriving at their audit opinion.

In meeting the above expectations, auditors should:



- Evaluate the audit fee regularly to ensure auditors are appropriately remunerated for the work done.
- Ensure the engagement team is staffed with sufficient resources of the right experience and skills.
- Avoid unwarranted reliance on management representations and exercise professional scepticism and judgement in performing the audit.
- Maintain objectivity and independence at all times during the audit even if there is a possibility of losing a client.
- Report in writing under section 320 CMSA upon detecting any breaches and non-performance of any requirement or provision of the securities laws, including non-compliance with the SIR 1999 arising from non-compliances with the approved accounting standards.

Message to investors

Financial statements is a critical tool for investors in making informed investment decisions. Therefore, investors must be vigilant in extracting relevant information from a company's financial statements. The following are some approaches which an investor can take when perusing financial statements:

- Investors must have some knowledge about the components of a set of financial statements, what a qualified audit opinion entails and the rationale of special audits in order to be able to ask the right questions.
- Investors should exercise their rights by asking questions on a PLC's financials or corporate activities during a PLC's general meetings. At other times, queries to the PLC may be sent to its investor relations unit, corporate communications unit or company secretary.
- If investors feel that they need assistance in understanding the financial statements, they should seek professional advice.
- Investors must scrutinise auditors' report to obtain relevant information, especially when there is a modified audit opinion, emphasis of matter or any matter of concern highlighted as key audit matters[15] in the auditors' report.
- Investors should be aware and keep tabs on key developments in the companies in which they have invested.
- Investors may visit investor education events organised by SC under its InvestSmart™ initiative, as well as obtain articles and other information resources online at www.investsmartsc.com.my and www.facebook.com/investsmartsc.my
- Should investors believe that the financial statements are inaccurate or misleading, they should bring the matter to the company's attention, if the company fails to address the matter, investors may raise it to SC's Investor Affairs and Complaints Department at +603-6204 8999 or aduan@seccom.com.my.

Disclaimer:
The scenarios as illustrated in this article should not be read in isolation without reference to the applicable approved accounting standards. The reader should bear in mind that the accounting outcome may vary from case to case based on different facts and circumstances.

[15] *ISA 701, Communicating Key Audit Matters in the Independent Auditor's Report* will be effective for audits of financial statements for periods ending on or after 15 December 2016.

Promoting Trust and Confidence through Good Corporate Governance

In April, the SC issued a public consultation paper, seeking feedback on the proposed draft of the Malaysian Code on Corporate Governance (MCCG) 2016. Bursa Malaysia had also amended its listing requirements to raise the standards of disclosure and corporate governance, for example, through the introduction of poll voting and sustainability reporting. These initiatives reinforce SC's continued emphasis and efforts in promoting and enforcing corporate governance in the capital market.

Trust and confidence form the bedrock of the capital market as they provide assurance to investors that the market operates in a fair and orderly manner. Governance processes and procedures are essential in:

- Building safeguards against fraud, corrupt practices and corporate misconduct;
- Providing the public with the necessary confidence that capital market intermediaries and corporations are well-managed institutions to which investors and lenders can confidently commit their funds;
- Embedding principles of good corporate governance to ensure a sustainable business model that contributes towards wealth creation and preservation; and
- Managing and mitigating conduct risk.

> "Corporate governance values such as fairness, transparency and accountability are vital in shaping culture."

Post the global financial crisis, regulators and international standard setting bodies have taken various measures to rebuild investors' trust, which was severely eroded by, among others, mis-selling of complex financial products and bad business practices by banks. Regulations were put in place to align sales practices with investors' interests and risk profiles, promote greater transparency in opaque markets, and encourage higher standards of corporate governance among those managing the affairs of companies.

In advocating higher standards of corporate governance, there has been a renewed emphasis on the roles and responsibilities of board members, given their role in shaping the company's culture. Culture in this context is the underlying mindset of a company – shaping and influencing attitudes and behaviours towards investors as well as compliance with rules and standards.

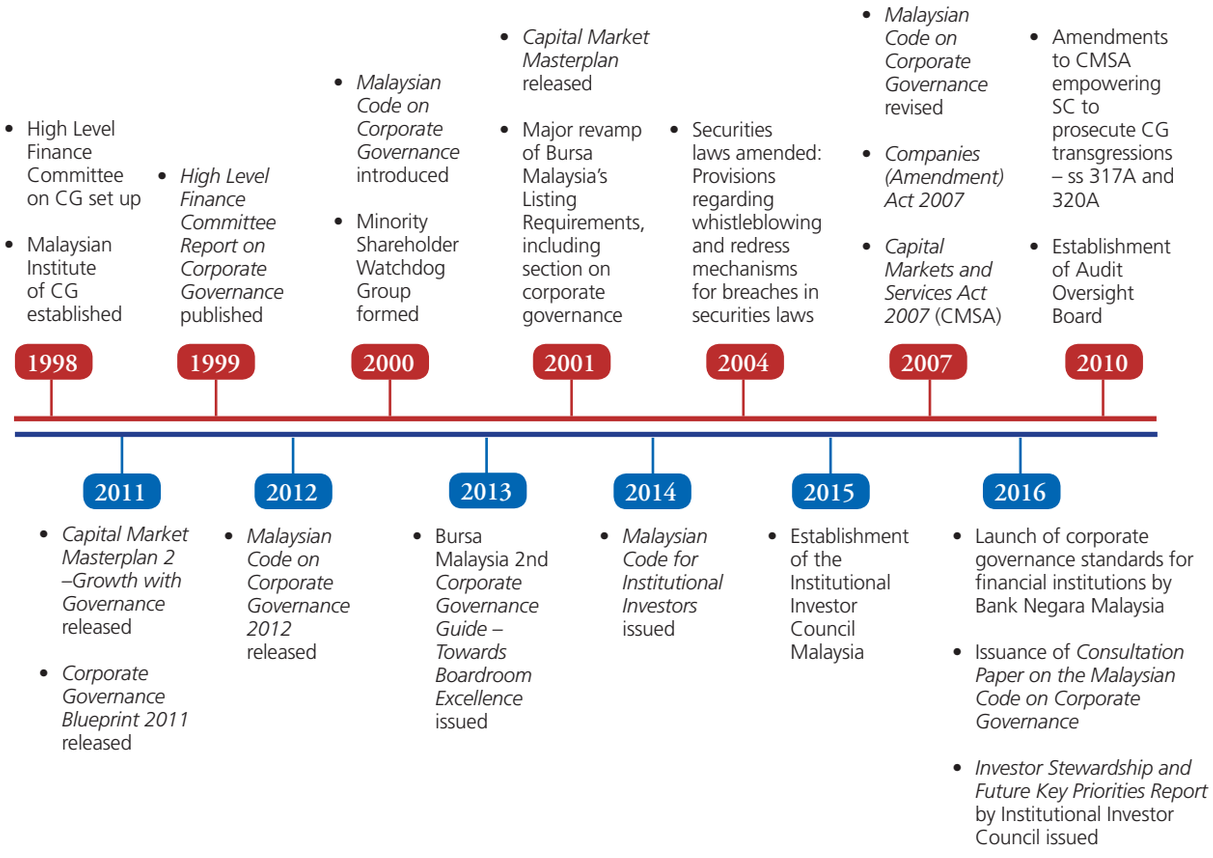
Corporate governance values such as fairness, transparency and accountability are vital in shaping culture. When these values are practised by companies, the risk of abuse of power is mitigated and stakeholders' interests are prioritised over the interests of those in control of the companies' affairs. This in turn will enhance the companies' value and brand image, making them more attractive in the eyes of investors.

Building a Strong Foundation for Corporate Governance

In promoting and regulating corporate governance, SC has undertaken various initiatives together with the industry since 1998 to continuously enhance corporate governance standards in Malaysia. These include the issuance of the *Malaysian Code of Corporate Governance* (MCCG) in 2000 and 2012, *Corporate Governance Blueprint 2011* (CG Blueprint) and the *Malaysian Code for Institutional Investors* in 2014.

Diagram 1

Malaysia's Corporate Governance Journey



In 2011, SC published the CG Blueprint to provide a roadmap for the next phase of our corporate governance efforts[1]. It sets out the strategic directions and specific action plans with 35 recommendations to be implemented over a 5-year period. To date, 89 per cent of the recommendations have been implemented.

[1] To understand the in-depth discussions of SC's CG efforts in 2000-2010, refer to *The Reporter*, June 2010 edition on the www.sc.com.my.

The remaining recommendations have been deferred after receiving industry feedback. Those recommendations will be reviewed in our multiyear reform of the capital market regulatory framework.[2]

The CG Blueprint leaves behind the aged approach of looking at corporate governance through compliance with rules. Instead, it seeks to ignite the internalisation of good corporate governance by encouraging practices that change attitudes and behaviours. To achieve this, the CG Blueprint lays down principles to deepen trust between companies and their stakeholders by clarifying board's role in governance, requiring disclosure of reliable and timely information, and emphasising the stewardship role of institutional investors.

As the first major deliverable of the CG Blueprint, the MCCG was revised in 2012 to reflect the changing market dynamics and international developments to ensure that the Malaysian corporate governance framework remains relevant and effective.

From Compliance to Culture

While regulators, including the SC, have laid down the foundation for corporate governance, the next phase requires proactive participation by all stakeholders to ensure a sustainable development and inculcation of corporate governance culture.

Enhancing the role of institutional investors

Due to their substantial shareholding, institutional investors are in a unique position to influence the corporate governance practices of their investee companies. This can be done through the exercise of their voting power at general meetings and by taking their concerns directly to the board.

“Due to their substantial shareholding, institutional investors are in a unique position to influence the corporate governance practices of their investee companies.”

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[2] Remaining recommendations:

- **Recommendation 6**
  Enable companies to provide information directly to beneficial owners of shares.
- **Recommendation 29**
  Explore extending whistleblowing obligations to corporate advisers and company secretaries.
- **Recommendation 31**
  Establish a responsibility sharing arrangement for corporate advisers in advising on corporate transactions.
- **Recommendation 35**
  Study whether the SC should be empowered to initiate action for oppression and unfair prejudice.

In 2014, the SC and the Minority Shareholder Watchdog Group (MSWG) launched the *Malaysian Code for Institutional Investors* (the Institutional Investor Code) to promote greater leadership in governance and responsible ownership by institutional investors. The first of its kind in Southeast Asia, the Institutional Investor Code sets out broad principles of effective stewardship by institutional investors such as their disclosure of stewardship policies, monitoring of and engagement with investee companies and management of conflict of interests.

This industry-driven code, which was one of the recommendations of the CG Blueprint, was collectively developed with Malaysia's largest institutional investors namely:

- Employees Provident Fund (EPF);
- Permodalan Nasional Bhd (PNB);
- Kumpulan Wang Persaraan (Diperbadankan) (KWAP);
- Social Security Organisation (SOCSO);
- Lembaga Tabung Angkatan Tentera (LTAT); and
- Lembaga Tabung Haji (LTH).

Though the Institutional Investor Code is voluntary, institutional investors are encouraged to be signatories to demonstrate their commitment to adopt these best practices. To date, eight institutional investors have become signatories:

To shape and influence a wider sphere of corporate governance culture among investee companies, the Institutional Investors Council (IIC) was established in 2015. This year, the IIC released the *Investor Stewardship and Future Key Priorities Report 2016* which outlines six key strategic priorities from 2016 to 2020.

Promoting self-governance among directors

To accelerate the adoption of self-governance among directors, the Institute of Directors (IoD) will be established. The IoD will drive the efforts to professionalise corporate directors in Malaysia and provide a platform for directors to promote corporate governance practices among peers. As an independent body with membership comprising corporate directors, the IoD will be managed by members for members and designed to be self-sustaining.

Review of the *Malaysian Code of Corporate Governance 2012*

This year, the SC initiated a post-implementation review of the MCCG 2012 and subsequently issued a public consultation paper containing proposals for the review of several principles and practices. The proposed changes will address several key issues such as remuneration, risk management, disclosure, board diversity and stakeholder engagement.

The public consultation received a total of 82 responses from a cross-section of public-listed companies (PLCs), local associations, accounting firms as well as international bodies and investors such as:

- The World Bank;
- Asian Corporate Governance Association;
- International Corporate Governance Network;
- Hermes Investment Management; and
- Blackrock.

Enforcement of Corporate Governance Standards

Besides putting in place a robust framework for corporate governance, the SC also enforces corporate governance standards through its surveillance, supervision and enforcement actions.

Pre-emptive actions

In conducting corporate surveillance, we scrutinise corporate transactions as well as financial and non-financial disclosures to deter misconduct and take pre-emptive action. We also regularly engage directors of PLCs, auditors and advisors to review corporate transactions that raises concern.

Over the years, the SC has successfully taken action to pre-empt PLCs from implementing corporate transactions which are detrimental to shareholders' interests. Examples of the actions taken are as follows:

Preventing dissipation of assets

- SC took a court injunction to prevent a PLC and its director from dealing in the proceeds of sales of the company's assets, as the transaction was carried out without shareholders' approval.

Stopping questionable transactions

- Pre-empted questionable asset acquisitions at inflated prices, e.g. acquisition of shares at significant premium without obtaining control over the investee.

- Pre-empted disposal of landed properties by PLCs at undervalued prices.

- Pre-empted questionable business disposals where the sale consideration was not properly justified, and the disposal appeared to be benefitting certain parties at the expense of the PLC and its shareholders.

- Pre-empted a fundraising exercise which was premeditated with the intention of siphoning out the proceeds from the PLC.

- Issued a public statement which resulted in the withdrawal of a questionable takeover offer.

Restitution of monies to PLC

- As a result of SC's inquiries, monies which were earlier paid by a PLC without proper justifications and disclosure were refunded to the PLC.

Requiring shareholders' approval

- Required PLCs to subject transactions to their shareholders' approval in cases where the PLCs deliberately avoided seeking shareholders' approval.

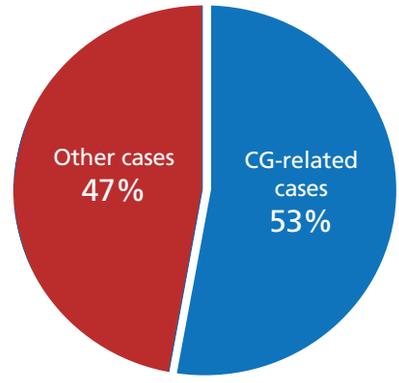
Criminal and civil actions

The SC applies dissuasive sanctions to achieve credible deterrence where there are serious corporate governance transgressions. From 2011 to August 2016,

- 53 per cent of the total criminal charges filed were for corporate governance-related breaches. Actions were taken against CEOs, executive directors, non-executive directors, advisers and auditors for various offences including insider trading, inflation of profits, market manipulation and misappropriation of company's funds. As a result of the SC's enforcement actions, these individuals have been convicted and sentenced to imprisonment terms ranging from three months to five years and a fine of up to RM5 million; and

Chart 1

Criminal charges filed between 2011 and August 2016



- SC also instituted civil actions against 25 individuals and three companies for offences such as fraudulently inducing the public to invest in securities, trading on inside information and providing fictitious and grossly inflated sales figures in the prospectus. Out of the 28 civil suits, five involved key persons in the PLC, including the Executive Chairman and directors. In the same period, SC reached 32 regulatory settlements relating to insider trading and market manipulation offences, seven of which involved directors. Of the total RM18.2 million in settlement amount, RM9.5 million (52 per cent) in illegal proceeds were disgorged from these seven directors.

Apart from directors of PLCs, SC also expects directors of capital market intermediaries such as Capital Markets Services Licence (CMSL) holders and auditors to demonstrate good corporate governance practices. In 2013, SC filed a civil suit against two directors of a fund management company (who were also holders of the Capital Markets Services Representative's Licence (CMSRL) for fund management) for fraudulently inducing investors to deal in securities. In October 2015, a licensed audit partner was sentenced to one-year imprisonment for abetting a PLC in inflating the PLC's profit before tax, causing the PLC's financial statements to be false or misleading.

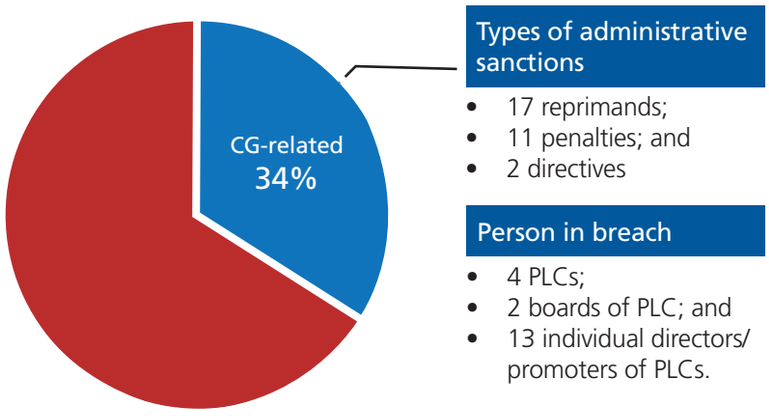
Administrative actions

Apart from taking criminal and civil actions, SC also addresses corporate governance transgressions through imposition of administrative sanctions. Out of 89 administrative sanctions imposed from 2011 to August 2016, 30 were in relation to corporate governance-related matters, including penalties amounting to RM1.03 million collectively.

> "SC also expects directors of capital market intermediaries such as CMSL holders and auditors to demonstrate good corporate governance practices."

Chart 2

Administrative Actions from 2011 to August 2016



Administrative sanctions were imposed for the following breaches:

- **Non-compliance with approved accounting standards by PLCs**, where a PLC and its directors failed to measure its obligations under several corporate guarantees on bank borrowings by its former wholly-owned subsidiary, contrary to the *Financial Reporting Standards 139*[3];

- **Submission of false or misleading information**, where a PLC and its board of directors reported a lower impairment loss in the revised version of its audited financial statements, which was found to be false or misleading;

[3] FRS 139 – Financial Instruments: Recognition and Measurement.

- **Failure to inform SC of any statement or information that may be false, misleading or materially incomplete** in relation to an application which was pending SC's approval. The PLC and its promoter failed to inform SC of a suspension of licence to carry out an activity; and

- **Disposal of assets by a PLC without obtaining shareholders' approval** subsequent to an announcement of a possible takeover offer.

Corporate governance: What good looks like

Good corporate governance consists of a multitude of components. In this illustration, we have identified several important traits[4] which should be more visible in our corporate governance ecosystem.

1. Directors demonstrating professionalism, competency, ethics and integrity.
2. Independent directors being wholly and truly independent.
3. Shareholders' interests being put above the personal interests of those who control the company.
4. High quality and meaningful disclosure of corporate reporting.
5. Shareholders exercising their rights at shareholder meetings and in courts.
6. Diversity on boards and at senior management level.

[4] The traits are not exhaustive.

SC's Fit and Proper Requirements for Licensed Representatives and Employees of Financial Institutions

Our regulatory framework seeks to ensure that only fit and proper persons are licensed or registered to carry out regulated activities[1] in the capital market. Conduct requirements are imposed on such persons to ensure that they treat investors fairly and always act in a manner that promotes a fair and orderly market.

SC licenses both the principal (the entity) and their representatives, each holding the Capital Markets Services Licence (CMSL) and the Capital Markets Services Representative's Licence (CMSRL) respectively. Under section 59A of the CMSA, a CMSRL holder is considered to be an agent of the principal when he is, for example, approaching clients or investors to deal in securities. As an agent, he is deemed to be acting on behalf, and with the authority, of the principal.

Under Part 1 of Schedule 4 of the CMSA, financial institutions (FIs) are deemed to be registered persons[2] for the purposes of the CMSA and are permitted to carry out regulated activities specified in the same Schedule. Registered persons are required to comply with all guidelines issued by the SC in relation to the relevant regulated activity carried out by them.

In order to ensure parity between employees of FIs carrying out regulated activities and holders of the CMSRL, the *Guidelines on Investor Protection* were jointly issued by SC and Bank Negara Malaysia in 2010. Pursuant to these Guidelines, employees of FIs carrying out regulated activities are required to meet similar fit and proper requirements as a CMSRL holder for that regulated activity. Employees of FIs are required to pass the requisite licensing examinations and comply with similar conduct requirements on an ongoing basis.

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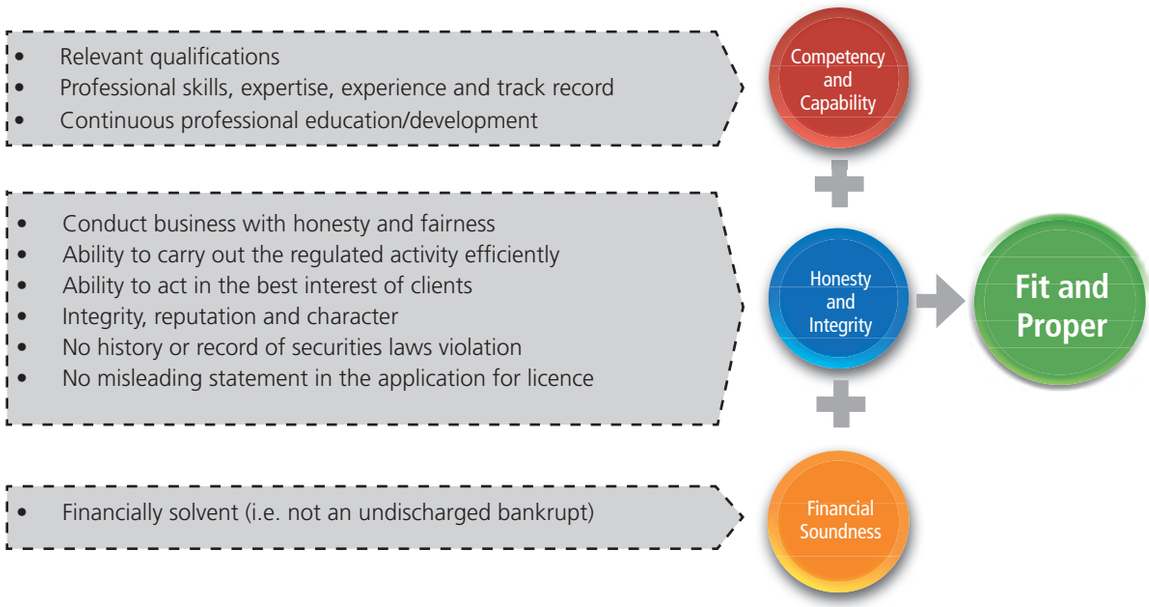
1 "Regulated activities" as defined in Schedule 2, CMSA.
2 See section 76 CMSA.

Fit and proper requirements under the CMSA can be summarised as follows:



Competency and Capability

CMSRL holders

When assessing a prospective licence holder's competency to carry out a regulated activity, the SC reviews the applicant's educational and professional background. Apart from these, the SC also considers other criteria such as relevant working experience and prior track record. The requisite level of education, working experience and track record are provided in the table below[3]:

Table 1

Minimum Qualification and Experience Requirement for CMSRL Applicants

Regulated Activity	Degree	Professional Qualification	Diploma		Sijil Pelajaran Malaysia	Without the relevant educational qualification	Relevant experience – capital market	Relevant experience in specific areas
			Relevant fields	Other than relevant fields				
Dealing in Securities (DIS)	✓							
		✓						
			✓					
				✓			✓ Min. 2 years	
					✓		✓ Min. 4 years	
						✓ Licensed in a recognised jurisdiction for DIS (at least 3 years)	✓ Min. 5 years Direct and relevant experience	

[3] Table 2 of paragraph 4.05 of the *Licensing Handbook* provides a more comprehensive view of the qualification and experience requirements.

Table 1 (Continued)

Regulated Activity	Degree	Professional Qualification	Diploma		Sijil Pelajaran Malaysia	Without the relevant educational qualification	Relevant experience – capital market	Relevant experience in specific areas
			Relevant fields	Other than relevant fields				
Dealing in Derivatives (DID)	✓							
		✓						
			✓					
				✓			✓ Min. 2 years	
					✓		✓ Min. 4 years	
						Licensed in a recognised jurisdiction for DID (at least 3 years)	Min. 5 years Direct and relevant experience	
Fund Management (Portfolio Management[4])	✓							✓ Min. 2 years – Portfolio management
		✓						✓ Min. 2 years – Portfolio management
						✓		✓ Min. 5 years – Portfolio management
Fund Management (Asset Management)	**No specific qualification requirements.**							
Advising on Corporate Finance	✓							
		✓						
						✓		✓ Min. 5 years – Advising on corporate finance
Investment Advice	✓							
		✓						
						✓		✓ Min. 5 years – Investment advice

To illustrate, a person seeking to obtain a CMRSL for dealing in securities who holds a diploma in finance (which is a relevant field of study) is not required to also prove prior relevant experience in the capital market. However, if the applicant holds a diploma in a subject other than the relevant field, the applicant will also need to prove that he has a minimum of two years' relevant experience in the capital market.

Besides having the minimum qualification and experience as stated above, applicants are also required to pass the necessary licensing examination[5] for the

[4] Including boutique portfolio management company.
[5] Table 3 of paragraph 4.05 of the *Licensing Handbook*.

relevant regulated activity. CMSRL holders and employees of FIs are required to undertake continuous professional education of at least 20 points annually to keep abreast of capital markets and regulatory developments.

CMSRL holders who hold responsible positions[6] and controllers[7]

Licensed directors are required to have a minimum of 10 years' experience in the relevant regulated activity, while heads of regulated activity are required to have eight years of relevant experience. These requirements were put in place to ensure that persons who hold responsible positions have the appropriate range of operational and management skills and expertise. Controllers are also required to fulfill the fit and proper criteria under section 64 of the CMSA.

The cases below illustrate situations where SC has:

(a) rejected applications from individuals who have applied for responsible positions; and

(b) suspended CMSRL and position of a responsible person.

- Mr X was the Head of Corporate Finance in Licensed Entity A. Licensed Entity B had applied to the SC seeking approval for Mr X to hold the position of Head of Corporate Finance in Licensed Entity B. The SC rejected Licensed Entity B's application, taking into account Mr X's involvement in previous corporate proposals which were rejected by the SC.

- Licensed Entity C applied to the SC seeking approval for Mr Y to hold the position of Head of Dealing (Derivatives). The SC rejected Licensed Entity C's application, taking into consideration Mr Y's previous involvement in insider trading activities.

- Mr K was a CMSRL holder and the Head of Dealing in Licensed Entity D. Mr J, a CMSRL holder of Licensed Entity D, was under the supervision of Mr K. The SC suspended Mr K's CMSRL when he failed to make the necessary enquiries and take appropriate action to stop and report incidents of abuse of clients' accounts by Mr J. Mr K's position as Head of Dealing in Licensed Entity D was also suspended for six months.

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6 Refers to the licensed director and head of regulated activity.

7 As defined in section 60(7) of the CMSA to mean a person who:
(a) is entitled to exercise, or control the exercise of, not less than 15 per centum of the votes attached to the voting shares in the licensed entity;
(b) has the power to appoint or cause to be appointed a majority of the directors of such licensed entity; or
(c) has the power to make or cause to be made, decisions in respect of the business or administration of such licensed entity, and to give effect to such decisions or cause them to be given effect to.

For the position of controller, the SC had rejected applications when we have reasons to believe that the controller may not be able to act in the best interest of clients, considering his reputation and character:

1. Involved in civil suits and disputes relating to companies managed by him
2. Suspected to have been previously involved in market manipulation

Honesty and Integrity

CMSRL holders are expected to act honestly and ethically, and to treat investors fairly as they occupy a position of trust. As representatives of the licensed entity, they are the conduit between investors (their clients) and the licensed entity, entrusted to ensure that monies paid by their clients are received by the licensed entity and instructions to trade are appropriately carried out in the best interest of their clients.

> "CMSRL holders are expected to act honestly and ethically, and to treat investors fairly as they occupy a position of trust."

CMSRL holders who breach clients' trust cause irreparable damage to both their reputation as well as that of their principal. Where a CMSRL holder is found to have breached securities laws, SC takes a very strict approach when considering the appropriate sanctions to be meted out.

SC views seriously breaches of securities laws relating to:

- Protection of clients' assets;
- Dissemination of accurate and timely disclosure; and
- Prevention of fraud and mis-selling.

Under section 65 of the CMSA, the consideration of whether a CMSRL holder is still fit and proper is not predicated merely upon a conviction or a civil or administrative action taken by a regulatory authority. The SC may find a CMSRL holder as not being fit and proper where the CMSRL holder–

- is subject to any disciplinary proceedings by the licensed entity;
- has engaged in deceitful, oppressive, or improper conduct or otherwise reflect discredit on his method of conducting business;
- is subject to any action for breach of any provisions under securities laws;

- is subject to any investigation by a regulatory authority, law enforcement agency or professional body[8], where the investigation relates to fraud or dishonesty; or

- is charged for a criminal offence relating to fraud or dishonesty.

Instances where applications for licences have been rejected and licences revoked

Applications rejected

1. Applicant contravened securities laws, within or outside Malaysia

2. Applicant submitted forged examination results, incorrect details of experience or failed to disclose previous actions taken by other regulators against him

Licences revoked

1. CMSRL holder engaged in market manipulation

2. CMSRL holder abused clients' accounts in the course of engaging in market manipulation

If a CMSRL holder is found to have committed a breach in respect of one regulated activity, this breach will affect his fit and properness to continue holding a CMSRL for the other regulated activity.

Financial Soundness

The requirement for an applicant to demonstrate financial soundness in his application for a licence[9] takes into account the applicant's ability to remain solvent and exercise financial prudence.

In considering financial soundness, the SC will consider whether–

(a) there are indications that the individual is unable to meet his debts as they become due;

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[8] The SC will take into consideration any investigation or action taken by–
- any law enforcement agency such as the Royal Malaysia Police;
- any local or foreign regulatory authority, for example, the Monetary Authority of Singapore;
- Bursa Malaysia for breach of its rules, e.g. where a licensed person is suspended by Bursa Malaysia for engaging in trading offences; and
- a self-regulatory organisation, locally or abroad e.g. Federation of Investment Managers Malaysia (FIMM) or Financial Industry Regulatory Authority (FINRA), for breach of its rules.

[9] This is also a continuous obligation on the licence holder.

Sales Practices: Building Trust and Confidence in the Unit Trust Industry

The unit trust industry in Malaysia has experienced steady growth since the establishment of the first unit trust company in 1959 to what it is today. As at April 2017, it has a total net asset value of RM405.1 billion constituting 22.01% of the Bursa Malaysia market capitalisation. The foundation for growth was laid after 1993 with the establishment of a robust regulatory framework to protect investors and the expansion of distribution channels of unit trust funds, in line with the approach of 'growth with governance' advocated by the SC.

Unit Trust Schemes Consultants are agents (Agents)[1] of unit trust management companies. They have played a key role in building the industry. The Agents are an important conduit in enhancing financial literacy and improving financial inclusiveness, and educating investors on the long-term benefits of unit trust schemes. As at July 2017, there are 60,432 Agents in the industry.

To ensure continuous growth, we recognise that investors' trust and confidence in the unit trust industry has to be enhanced. Towards that end, strengthening sales and business practices of institutions that market and distribute unit trust funds (Distributors) and their Agents is of paramount importance. The conduct of Agents is critical as they are the first, and sometimes, the only point of contact with investors. Unethical sales and business practices, including mis-selling of products, erode trust where an investor who has had bad experiences with Agents, will more likely than not, refrain from investing further in unit trust funds.

In 2012, SC issued the *Guidelines on Sales Practices of Unlisted Capital Market Products* (SPG) with the primary aim to instil good sales ethics among the Distributors and their Agents for fair treatment of investors. The principles of the SPG are reflected in FIMM's *Code of Ethics and Rules of Professional Conduct (Unit Trust Funds)* [FIMM's Code]. These requirements are of particular importance given the availability of various types of unit trust funds where investors rely on Agents' advice to help them decide which types of funds best meet their needs.

> "The conduct of Agents is critical as they are the first, and sometimes, the only point of contact with investors."

[1] Agents are required to be registered with the Federation of Investment Managers Malaysia (FIMM).

The three key components of the SPG

Treating Investors Fairly	Agents must consider the interests of investors when marketing or selling products.
Suitability of Investment Products for Investors	Prior to recommending a product, an Agent must assess that the product suits the needs of the investor. The Agent must conduct a suitability assessment to obtain information such as the investor's financial position, investment objectives, expectations and risks tolerance level[2]. Such information provides a basis for and supports the Agent's recommendation.
Complete and Sufficient Disclosure of Information to Investors	Investors must be given: • A Product Highlights Sheet (PHS)[3] containing important information on the product, together with the application forms; and • Sufficient explanation on the nature, characteristic and risks of the product. All these are aimed at guiding the investor in making his investment decision.

Below is an illustration where a product sold is not suitable for an investor and the information given to the investor prior to investment was incomplete and insufficient.

Ms. A, a 60-year-old retiree, invested her savings of RM100,000 in a unit trust fund which is high-growth without reading the prospectus or PHS. She relied on her Agent for information.

The Agent did not conduct an assessment of her financial position, investment objectives and expectations or determine her risk-tolerance level. The Agent also did not even consider that high-growth funds are not suitable for Ms. A, a senior investor who is elderly, retired and has limited savings.

Typically, high-growth funds are for investors willing to accept high risk in return for high profits.[4] During an economic downturn, the fund performed poorly, resulting in substantial loss of Ms. A's investment.

Investor failed to understand the nature and characteristics of the product. The high-growth fund does not suit her needs and circumstances.

The Agent did not treat Ms. A fairly. He did not take time to assess Ms. A's needs and recommended a product which was unsuitable.

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2 Part 4 of the SPG.

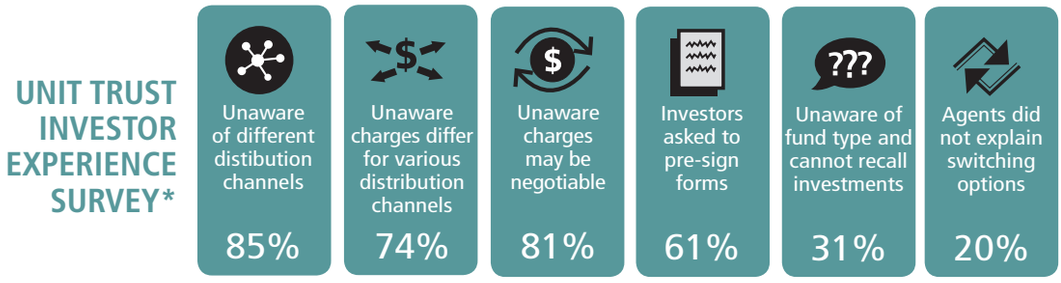
3 This is required under Para 3.03 of the SPG. A PHS contains all information relating to a unit trust fund that an investor needs to decide on investment such as the key features, risks, the fund performance and relevant fees and charges imposed.

4 Such funds attempt to achieve high capital gains and typically invests in companies that demonstrate high growth potential or shares with significant price volatility. Such funds tend to perform very well in economic upswings and very poorly in economic downturns.

SC's Observations on an Investor Experience Survey

In 2016, SC conducted a unit trust investor experience survey to assess compliance with the SPG and gauge the awareness of investors in the unit trust industry. Below are some of the concerns noted by the SC.

CONCERNS NOTED BY THE SC



Actions to Address Concerns

1. Together with FIMM, SC will study systems and controls of Distributors relating to their oversight of Agents' conduct which includes compliance with the SPG and FIMM's Code.
2. Together with FIMM, SC will conduct mystery shoppings to gauge the level of compliance by Agents.
3. SC will intensify supervision efforts to ensure effective oversight by Distributors of Agents' conduct.
4. Carry out continuous investor education efforts to build awareness in the form of unit trust seminars, InvestSmart® activities, articles and distribution of leaflets.

Notes:
* Undertaken between May to July 2016 involving 2019 respondents nationwide.

Enforcement Action Against Agents

Agents have to comply with FIMM's Code and are expected to act honestly and ethically, and to treat investors fairly as they hold a position of trust. Where an Agent is found to have breached FIMM's Code, FIMM takes a strict approach when considering the appropriate sanctions. Some of these breaches relate to Agents having:

(a) Accepted cash or requested for monies to be credited into personal bank account and subsequently, failed to invest clients' monies as instructed;

(b) Misappropriated clients' monies for investment purposes;

(c) Misrepresented fund's performance;

(d) Allowed unregistered persons to market and distribute unit trust funds using the Agent's identity;

(e) Requested clients to pre-sign transaction forms; and

(f) Submitted transaction forms without consent of clients.

"Agents have to comply with FIMM's Code and are expected to act honestly and ethically, and to treat investors fairly as they hold a position of trust."

Table 1

Statistics of actions taken by FIMM from 2015 to 2017

Type of actions	2015	2016	2017[5]
Private reprimand	5	1	5
Public reprimand	5	8	4
Revocation of registration with FIMM	8	4	2
Suspension of registration	–	–	2
Penalty	–	–	1
Requirement to attend training	–	–	4

[5] As at May 2017.

Sales Practices Matter

The conduct of Distributors in creating a culture which emphasises on good sales practices among their Agents is important. Good sales practices help build trust of investors and maintain good reputation of the Distributors.

Message to Distributors

Trust is the most valuable business commodity. Sales profits alone do not guarantee long-term success, thus it is more advisable to build long-term business relationships through ethical sales culture.

1. Re-examine in-house sales targets and reward structures to reinforce sales ethics among Agents. When setting reward and incentive structures, Distributors should take into account factors such as customer-experience scores, results of independent customer-call-back verifications and the number, and nature of complaints received.
2. Distributors should not tolerate any misconducts. If there are occurrences of unethical sales practices even with one Agent, Distributors must take swift action to identify the root cause practices and assess how lapses of institutional controls and individual action contributed to the breach.
3. Board must have oversight of mis-selling and conduct risk. As part of oversight, Board must require reporting on gaps in sales practices and overall sales culture.
4. There is a need to carry out independent assessment (e.g. customer-call-back verifications, surveys on customer's experience, mystery shopping) on Agents' sales practices to ascertain compliance and service level.
5. Distributors must be vigilant to ensure excessive switching of funds does not happen[6].
6. Distributors to carry out regular training for Agents to reinforce sales ethics and to ensure that Agents are kept abreast on the development of new products.
7. Distributors to ensure that Agents do not take a box-ticking approach when carrying out suitability assessment on their clients.

In one instance, a Distributor has taken a commendable proactive step in suspending onboarding of new clients until its anti-money laundering and counter-terrorism financing framework is fully strengthened after realising that it has breached the *Guidelines on Prevention of Money Laundering and Terrorism Financing for Capital Market Intermediaries*. The breach arose from the Distributor's failure to lodge Suspicious Transactions Reports (STRs) concerning transactions in four unitholders' accounts. Good practices including taking voluntary and immediate remedial actions are always encouraged by SC. The proactive step in suspending further onboarding of new clients was taken into account by the SC in considering the appropriate administrative action against the Distributor.

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[6] Refer to FIMM's Circular I&SP/AL/NO-KOH-jw/040-15 dated 14 July 2015.

Message to Agents

Investors place their trust in you. Take time to understand their needs and carry out a suitability assessment. This will build credibility and long-term business relationships.

1. Always act in the best interest of your clients. Exercise care, skill and diligence. Know your client, understand the products recommended and ensure investment recommendation is suitable for clients.

2. Do not omit important information. Below are some of the important information you should provide to your client:

   - Prospectus and PHS of funds;
   - Investment objective, strategies and risks of the products recommended;
   - Charges and fees imposed (including the sales charges and exit fees for switching); and
   - Free switching options.

   Note: *Different clients have different needs (e.g. a less sophisticated investor may require more explanation)*

3. Do not make statements which are exaggerated, misleading or without any basis (e.g. giving "estimated, targeted or projected" returns of funds during product recommendation)

   Note: *Past performance is not an indication of future performance. You must advise your client NOT to rely solely on past performance.*

4. Get complete documentation and instructions of transactions from clients.

5. Do not switch funds purely to earn sales commission. Switch funds only when it is in the best interest of your clients.

6. Do not get your clients to pre-sign or pre-thumbprint blank forms.

Message to Investors

You have rights and can influence sales ethics. Understand the product and be satisfied that it suits your investment needs before parting with your hard earned money, just like how you would before purchasing a house or car. You have to take effort to safeguard your own interests, even if the Agent is a friend or relative.

1. Ask for the Agent's authorisation card. You can check if the Agent is registered with FIMM at https://www.fimm.com.my/investor/is-my-consultant-authorised/.

2. Make/Issue payments directly to the Distributor. Do not pay cash to the Agent or bank monies directly into the Agent's personal or other individual or another company's account.

   Note: *Always ask for official receipt for all payments made that the Distributor is obliged to issue. If any detail or information in the receipt is inaccurate, please check with the Distributor directly.*

3. Know that various distribution channels of unit trust funds are available. Besides Agents, you may purchase unit trust funds through:

   - Banks
   - Fund management companies
   - Financial planners
   - Online platforms

Message to Investors *(Continued)*

4. Fees will eat into your returns. Enquire and shop around for funds with the best fees. Do note that sale charges or upfront fees may be negotiable. Check the prospectus on fees and charges.

5. Ensure the Agent conduct a suitability assessment prior to recommending a product. Check that the product recommended is what you want and is suitable for your needs. Make comparison between products, fees and charges.

6. Be very truthful with your risk profile during your suitability assessment.

7. Report unethical sales practices to FIMM and the Distributor whom the Agent represents.

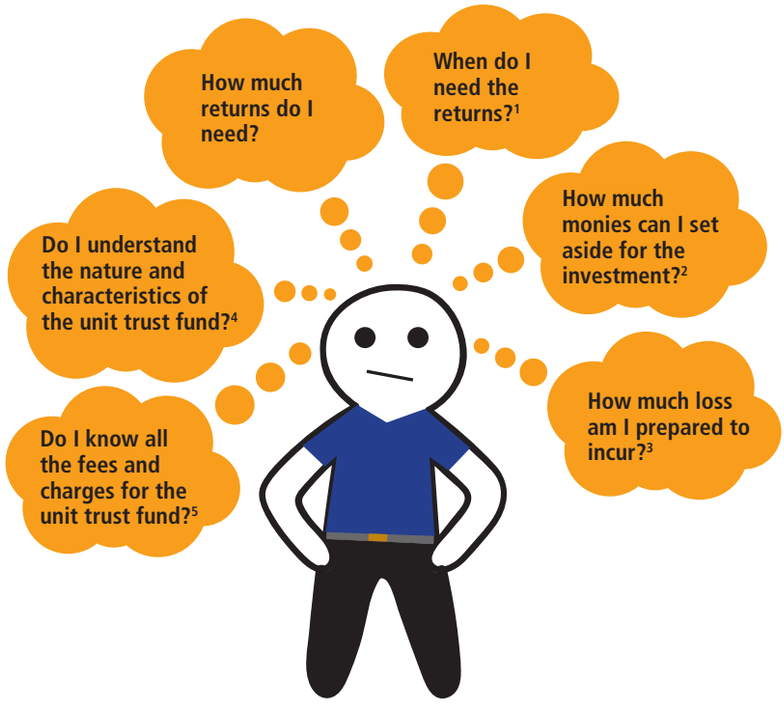
Red flags to look out for:

- Agent reluctant to provide authorisation card.
- Agent is not registered with FIMM.
- Agent requests for payments in cash or direct credit to the Agent's or another person's bank account.
- Agent failed or is reluctant to conduct a suitability assessment prior to product recommendation.
- Agent requests for pre-signing or pre-thumbprint of blank forms.
- Agent promises returns of investment or gives 'estimated, targeted or projected' returns of funds.
- Agent claims he could issue "temporary receipt".

If any of these red flags appear, contact SC, FIMM or the Distributor whom your Agent is attached to immediately.

Questions to ask before investing

Whether you are a first-time investor or have been investing for many years, there are some basic questions you should always ask before you commit your hard-earned money to an investment.

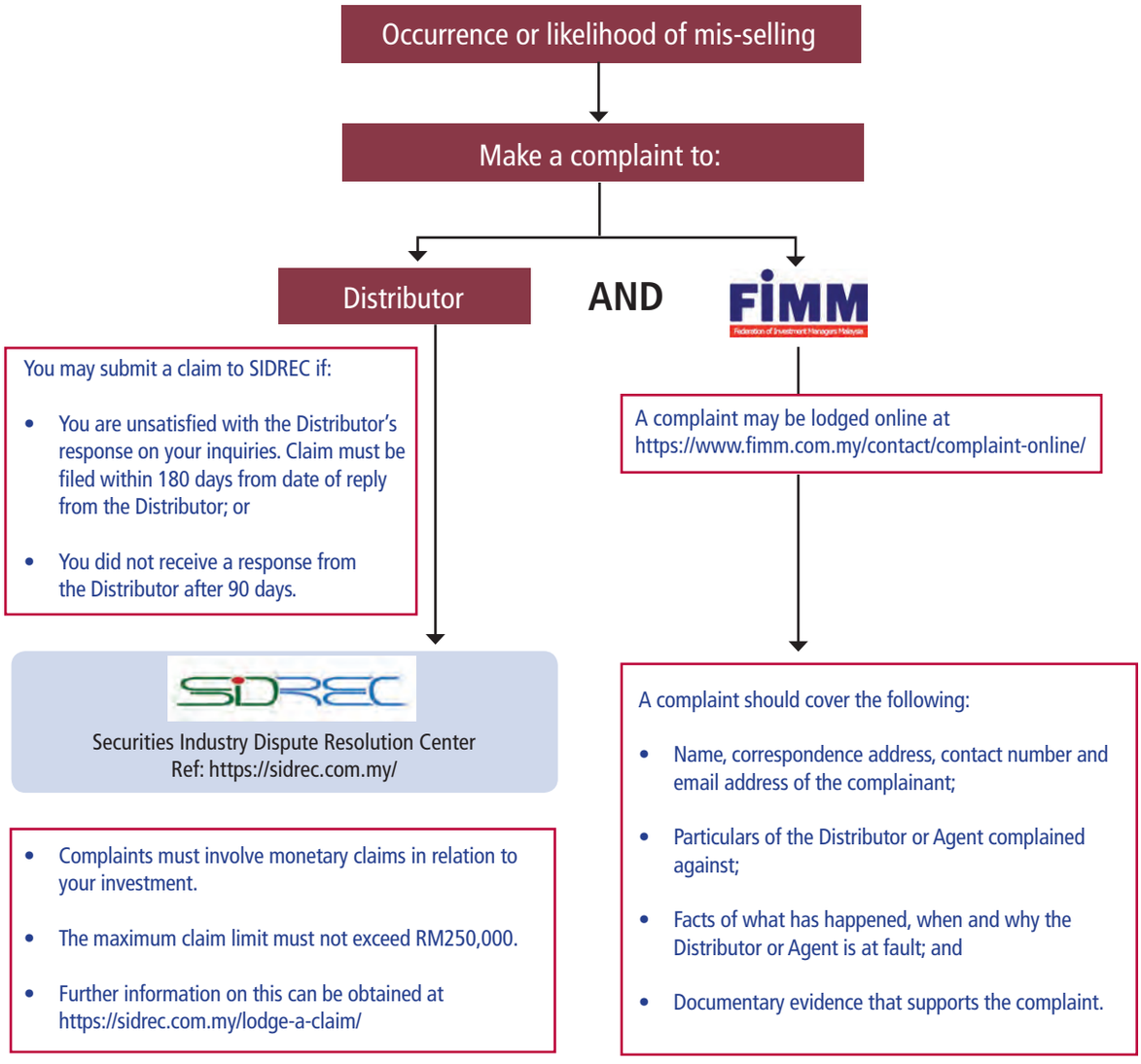


Important to Note:

- Greater returns come with greater risk.
- If you do not understand the information given by your Agent, do seek help from another Agent. If you are still confused, you should think twice about investing in the particular unit trust fund.

1 This will help you decide if you need a short, medium or long-term unit trust fund.
2 You must make sure you have funds for daily needs and savings for emergencies.
3 You must be comfortable with the level of risks that comes with the investment product.
4 You can get all the information from the Agent and the fund's prospectus or PHS.
5 Different funds may have different charges imposed and may be negotiable.

What to do if you suspect a mis-selling has occurred?



Important to Note:

- Mis-selling can occur if you have not been given complete and sufficient information prior to making an investment or you have been sold a fund that does not suit your needs.
- Mis-selling is not just about whether you have lost money. You may still lodge a complaint if you think that the fund sold is not suitable for you (e.g. where your risk tolerance is low and you have been sold a high-risk fund or you were not told about the risk).
- On the other hand, complaints cannot be lodged just because a fund has performed badly. By its very nature, investments have an element of risk where its value can fall as well as rise. (e.g. if the fund has halved in value, this in itself is not a ground for a complaint.)

Peer-to-Peer (P2P) Financing – Greater Access to Market-Based Financing Through Electronic Platforms

P2P Financing is a relatively new technology-enabled, market-based financing solution in the capital market. It offers alternative access to funding particularly for businesses and provides retail investors another investment option.

P2P Financing is a type of crowdfunding, which generally means a form of fundraising where multiple individuals pool together money, usually on an online platform, to fund a business venture, project or a cause. Crowdfunding can generally be categorised as investment-based (e.g. Equity Crowdfunding (ECF) and P2P Financing) or non-investment-based (e.g. charity or reward-based crowdfunding).

As at end 2015[1], the global market for online alternative finance has seen an overall 159% growth with P2P Business Financing recording a market size of US$44.7 billion. ECF on the other hand recorded a market size of US$2.19 billion.

> “SC announced six registered P2P Financing platforms at the SCxSC 2016.”

Important to Note:

- SC does NOT regulate charity or reward-based crowdfunding activities.
- If any platform claims itself as having been registered, approved, licensed, authorised or otherwise regulated by SC, you should **always confirm** with SC at https://www.sc.com.my/digital/list_rmo/ or call us at 603-6204 8000.

Building on the success of our ECF framework and in line with our effort to democratise finance in the Malaysian capital market, SC introduced a regulatory framework for P2P Financing in April 2016[2].

Subsequently, SC announced six registered P2P Financing platforms at the Synergy and Crowdfunding Forum (SCxSC) in November 2016. They are **B2B FinPAL**, **Ethis Kapital**, **FundedByMe Malaysia**, **ManagePay Services**, **Modalku Ventures (Funding Societies)** and **Peoplender (Fundaztic)**. To date, **B2B FinPal**, **Funding Societies**, and **Fundaztic** are fully operational, with the rest expected to be fully operationalised by end 2017.

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1 Cambridge Judge Business School Center for Alternative Finance, 2016.

2 The regulatory framework for P2P Financing can be found in the *Guidelines on Recognized Markets* at http://www.sc.com.my/legislation-guidelines/recognisedmarkets/

What is P2P Financing?

P2P Financing is essentially a lending and borrowing activity between businesses and investors, facilitated through an online marketplace i.e. a P2P Financing platform operator. It operates very similarly to the issuance and subscription of corporate bonds or even a bank lending activity, **except** that the funding needs are met by a group of investors putting in small amounts of money, and the business' risk scoring[3] (or rating) is carried out by a P2P Financing platform operator instead of a traditional credit rating agency.

What is the role of a platform operator?

A P2P Financing platform operator must be registered with SC. The platform typically undertakes the role of a marketplace provider, and both businesses and investors utilising the platform will be subjected to its rules.

As P2P Financing has debt-like features, and the fund-seeking business' ability to repay is very important. A platform operator will conduct a background check on a fund-seeking business and assign a risk-score accordingly. Overall, the fund-seeking business will be imposed a higher financing rate if the platform operator's assessment shows the business has a higher risk of default. However, the financing rate should not exceed 18% per annum without prior consultation with SC.

The platform operator is subjected to other regulatory requirements such as maintaining trust accounts for funds raised on its platform and repayments to investors. Further, the platform operator needs to ensure adequate disclosure to investors and establish processes to manage payment default, debt collection and complaints, among others.

What does it mean for businesses?

P2P Financing offers great funding opportunity to business owners with more stable cash-flow that do not wish to surrender control over their business operations.

In Malaysia, the regulatory framework for P2P financing is only allowed for businesses. It gives businesses access to alternative funding sources at a relatively lower cost compared to traditional sources such as banks, to spur the growth of commerce.

There is no funding cap imposed on businesses utilising P2P Financing platforms. However, a business will need to raise at least 80% of its target financing amount before the funds are released, but it will not be able to keep any amount exceeding the target financing amount. The platform operator will return the monies in excess of the target amount or reject the additional offers, as the case may be, in accordance with its rules.

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[3] Refers to the likelihood of default by a business.

What does it mean for investors?

P2P Financing offers a new investment opportunity for investors looking to diversify their investments to suit their goals and risk profiles. Unlike ECF which is a long-term investment, investors in P2P Financing receive fixed amount of periodic repayments according to the predetermined payment schedule. Some repayments may be done on a monthly basis, others on a quarterly basis.

As mentioned, P2P Financing investment need not be assessed and assigned an investment grade by traditional credit rating agency. Each platform operator has its own risk assessment criteria. Investors therefore must understand how the risk scoring works, what the criteria are and what level of risk the investor is comfortable taking. A higher rate of return typically means higher default rate; hence such investment may be riskier.

Further, investors should understand the ways in which a platform operator manages a repayment delay or a default. There is no investment limit imposed on the investors, but it is highly encouraged for retail investors to limit their P2P investment exposure at RM50,000 at any given time.

Table 1

Comparison between P2P Financing and ECF

Details	P2P Financing	ECF
Investment instruments	Investment notes.	Shares.
Nature of investment	Debt-like features; fixed amount of periodic repayments of capital and interest (or profit).	Equity; dividends will be declared when profits are made.
Rights of investors in case of insolvency	Creditor.	Shareholder.
Who can invest	Everyone.	Everyone.
Limits on investment	**Sophisticated investor**[4] No limit. **Angel investors**[5] No limit. **Retail investors**[6] Encouraged to limit investments on any P2P platform to maximum RM50,000 at any period of time.	**Sophisticated investor** No limit. **Angel investors** Maximum of RM500,000 within 12 months. **Retail investors** Maximum RM5,000 per company with total amount of not more than RM50,000 within 12 months.

4 Persons referred to in Part I of Schedules 6 and 7 of the CMSA, and venture capital management/corporation and private equity management/corporation registered with SC.

5 For the purpose of SC's P2P Financing framework, 'angel investor' is defined in the *Guidelines on Recognized Markets* as 'an investor that is accredited by the Malaysian Business Angels Network as an 'angel investor'.'

6 Persons who are not sophisticated investors.

Table 1 (continued)

Comparison between P2P Financing and ECF

Details	P2P Financing	ECF
Who can raise funds	**Locally registered** – sole proprietorships; and – partnerships. **Locally incorporated** – limited liability; partnerships; – private companies; and – unlisted public companies.	**Locally incorporated private companies**[7]
Limits on fundraising	No limit on fundraising.	RM3 million within a 12-month period. On top of that, a company can only utilise the ECF platform to raise a maximum of RM5 million in capital, after which it can no longer seek further funding on any ECF platform.
Minimum amount to be raised to constitute successful campaigns	At least **80%** of the target amount must be raised. Any amount exceeding target amount shall not be kept.	Target amount must be **fully met** in order for fund raised to be released to companies seeking funding.
Who can operate platforms	Only SC-registered operators can operate P2P Financing platforms.	Only SC-registered operators can operate ECF platforms.
What are some of the inherent risks	– Default. – Lack of liquidity. – Fraud.	– Business failure. – Lack of liquidity. – Fraud.

[7] Companies incorporated under the *Companies Act 1965* (and subsequently *Companies Act 2016*).

Message to Investors

1. **Check if a P2P Financing operator is registered with SC**

- Only SC registered persons can operate a P2P Financing platform. You should always confirm their registration status with SC at https://www.sc.com.my/digital/list_rmo/ and only deal with a SC-registered P2P Financing operator.

2. **Know the risks of your investments**

- Bear in mind that P2P Financing is subject to default risk i.e. risks of businesses defaulting on their repayments. As such, you may see occasional delays in repayment, or worse, lose part or all of the monies you have invested.
- Given that the return of your invested capital and profit are fixed over a period of time, you may not be able to recoup your investment within a short period.
- There is also the risk of fraud. The law cannot completely eliminate the risk of fraud. You must always stay vigilant.

3. **Know your rights**

- The money you have invested will be placed in a trust account and should be returned to you in the following circumstances:
  - At the end of the fundraising period when the company fails to raise 80% of the targeted amount. This means that if the company seeks to raise an amount of RM10,000 within 30 days but only managed to raise RM5,000, the fundraising exercise would be considered to have failed. In this situation, the entire RM5,000 must be returned to investors; and
  - During the fundraising period where there is a material adverse change[8] affecting the company or the project for which funding is sought.
- You are entitled to obtain all relevant information pertaining to the company or the project such as key characteristics of the company, purpose of fundraising, business plan of the company and its financial information.
- The platform operator is required to disclose to you all fees, charges and other expenses relating to your investment. In particular, check if there will be extra expenses incurred for debt collection services. Understand all the changes imposed for your investment before you invest.
- If you have any complaints regarding your investment, you may refer the matter to the platform operator or SC.

[8] For example, discovery of a false or misleading statement submitted by the company, or material change in the circumstances relating to the company.

SIDREC – Providing Impartial, Efficient and Effective Dispute Resolution in the Malaysian Capital Market

Background

The Securities Industry Dispute Resolution Center (SIDREC) was established by the SC in 2010 for efficient and effective settlement of disputes between investors and SIDREC members. Access to mediation and adjudication feeds into SC's larger investor protection framework and builds confidence in the market. All capital market intermediaries licensed by the SC such as stockbrokers, derivatives brokers, unit trust management companies, fund managers and providers and distributors of private retirement schemes are required to be members of SIDREC.

Six years later, in 2016, SIDREC became a one stop centre for the settlement of claims in relation to capital market products and services when its membership expanded to include 43 commercial and Islamic banks, which are entities under the purview of Bank Negara Malaysia. Previously, investors who encountered disputes while dealing with such entities were referred to the Financial Mediation Bureau.

Filling a Gap in the Dispute Resolution Landscape in Malaysia

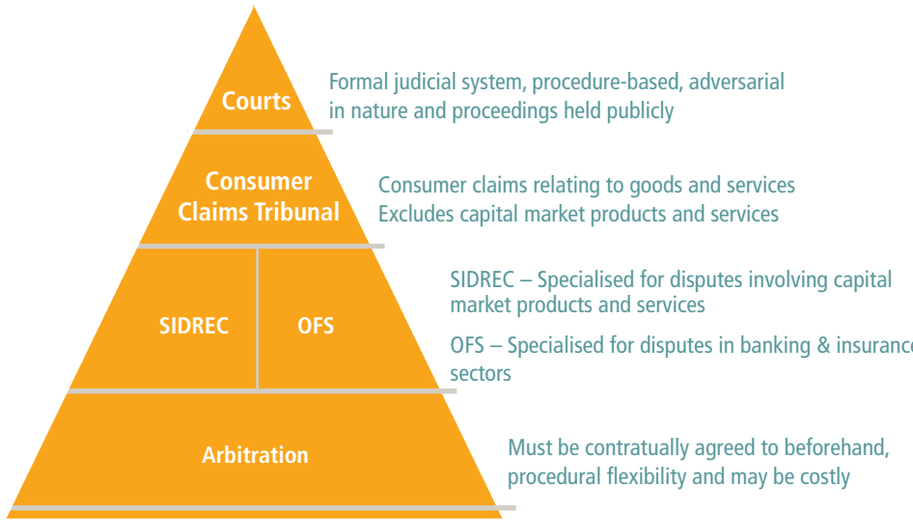
Without SIDREC, the dispute resolution landscape in Malaysia which is largely provided by court system, is procedurally more formal and adversarial in nature. The other alternative is arbitration, which must be contractually agreed upon by the parties beforehand and is usually costly.

Compared to the courts and arbitration, SIDREC's processes are more flexible. For example, SIDREC's mediation and adjudication process accepts a variety of supporting documents including WhatsApp messages between the investor and the intermediary to establish communications made between them as it is not bound by the *Evidence Act 1950*. SIDREC's approach is to give a fair and reasonable outcome by focusing on the interest of the parties and not the rights of the parties per se.

“Compared to the courts and arbitration, SIDREC's processes are more flexible.”

There were other specialised tribunals and alternative dispute resolution bodies that existed before the establishment of SIDREC but they did not cover capital market products and services. These include the Ombudsman for Financial Services (OFS) which covers the banking and insurance sectors and the Tribunal for Consumer Claims Malaysia under the auspices of the Ministry of Domestic Trade, Co-operatives and Consumerism.

DISPUTE RESOLUTION LANDSCAPE IN MALAYSIA



Mandatory Scheme for Dispute Resolution in the Capital Market

SIDREC operates three types of dispute resolution schemes:

- Mandatory Scheme;
- Voluntary Scheme; and
- Court-referred Mediation Scheme.

When an investor has a dispute with his bank, broker, unit trust management company, PRS distributor or provider, or fund manager, he needs to file a complaint with SIDREC members.

If the investor is unable to settle the dispute with the SIDREC member, the investor can file a claim with SIDREC under the mandatory scheme. SIDREC's dispute resolution services are provided free to the investors for claims up to RM250,000 (or in foreign currency which is equivalent to RM250,000). Investors whose claims are above RM250,000 can opt to limit their claims to RM250,000 if they wish to be eligible under the mandatory scheme. While SIDREC may allow other persons to attend the dispute resolution process subject to signing the

confidentiality agreement, legal representation is not allowed in the mandatory scheme. The summary of the dispute resolution process is as follows:

- When a claim is filed, a case officer will be appointed to manage the case to first ascertain whether the claim falls within 'eligible dispute'. Otherwise, it will be dismissed.

- If the case has merit, the parties would go through a process of mediation to see if a settlement can be reached.

- If the matter cannot be resolved through mediation, it would then be sent for adjudication where the adjudicator will make a decision/award after hearing evidence from both parties.

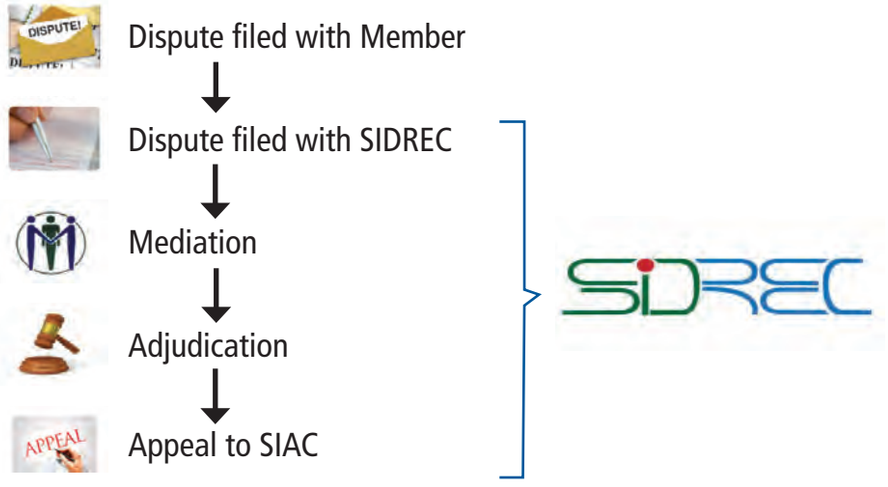
- During adjudication, both parties can present any evidence, call any witnesses in support of their position, and seek clarifications from the other party.

- The adjudicator's decision/award will be binding on SIDREC members. As for the investor, he has the option to accept the decision/award or pursue the claims elsewhere.

- Both parties may appeal against the decision/award to SIDREC's Appeal Committee (SIAC) only in the circumstances below if it materially affects the decision/award–

  (a) Serious error of law or fact in the award; or
  (b) Production of new evidence.

DISPUTE RESOLUTION PROCESS UNDER VOLUNTARY SCHEME IN THE CAPITAL MARKET



SIDREC Provides an Efficient and Effective Avenue for Dispute Resolution

In 2016, SIDREC managed to resolve 90% of the cases within the timeframe of 90 working days from the receipt of complete documentation and information of the dispute. SIDREC effectiveness is largely due to its combined capital market knowledge and dispute resolution expertise and skills.

SIDREC takes a mediative approach, aimed at obtaining a fair and reasonable outcome in each case. The process is confidential. The mediative process is proven to be effective as 92% of all disputes are resolved through mediation.

Besides the investor, SIDREC members too benefited through the quick and amicable settlement of disputes through SIDREC. The quick settlement enables them to focus on core business activities and not be burdened and disrupted by the disputes with clients.

In addition, SIDREC members also gain as a dispute is an opportunity for members to discover more about valid issues of concern or challenges faced by their clients. Sometimes the issues involve practical processes, products or system issues that may not have been apparent to SIDREC members until the arising of the dispute which SIDREC members can then use to address issues for their internal risk management purposes. Furthermore, resolving investors' concern speedily and on reasonable and acceptable terms also contributes to investor loyalty and enable SIDREC members to retain clients in the long run.

> "Mediator not only made a difference but was instrumental in the process, without whom, we undoubtedly would not have reached a resolution."
>
> – Investor A

Voluntary Dispute Resolution Scheme for Claims above RM250,000

In 2015, SIDREC's Terms of Reference were expanded to allow disputing parties who have claims above RM250,000 to have access to SIDREC's dispute resolution services.

Under the voluntary scheme, both parties will enter into a Dispute Resolution Agreement where they agree to accept SIDREC's decision/award and to pay its fees. While legal representation is allowed in this instance, even in voluntary schemes SIDREC's approach to dispute resolution focuses on 'resolution' rather than 'adversarial'. Therefore, any legal representatives who participate in the process will need to abide by this approach and will be subject to SIDREC's Rules. The idea is to give parties in dispute the opportunity to work through disputes with the help of a neutral and impartial third party like SIDREC. The fact that SIDREC has capital market and dispute resolution expertise and skills will certainly help in the matter.

> "With the presence of a neutral person, parties involved are assured that the outcome is fair for both parties."
>
> – SIDREC member

Court-Referred Mediation

Following a Practice Direction issued by the Chief Justice in 2016 which requires judges to direct the parties of court cases to consider settlement of matters through mediation before proceeding through the court process, SIDREC introduced the Court-Referred Mediation Scheme in April 2017.

Given the specialised dispute resolution services SIDREC provides, parties who have commenced litigation in courts on disputes involving capital market products and services can now refer to SIDREC for mediation and in accordance with any condition which the court may impose. This enables the parties to pursue their claims in an amicable and more flexible manner with a view of coming to a resolution of the dispute, without the costs and anxiety of litigation.

Like the voluntary scheme, lawyers are allowed in the process but will be subject to SIDREC's Rules and fees would be charged on both parties.

MODES OF ACCESS TO SIDREC

Mandatory scheme	Voluntary scheme	Court-referred mediation
• Disputes <RM250,000 • Involves mediation or adjudication by SIDREC • Lawyers not allowed • SIDREC's decision binding on member but not on the investor • Fees charged on member • Free for investor • Both parties may appeal against SIDREC's decision	• Disputes > RM250,000 • Involves mediation or adjudication by SIDREC • Parties agree to submit to SIDREC's jurisdiction • Lawyers may be allowed • SIDREC's decision binding on both parties • Fees charged on both parties	• Any dispute before the courts regardless of amount • Parties agree with court to refer matter for mediation • Involves mediation by SIDREC • Lawyers may be allowed • SIDREC's decision binding on both parties • Fees charged on both parties

SIDREC's Role in Improving Standards in the Market

Apart from providing an independent and fair dispute resolution mechanism, SIDREC has an important role to play in improving the overall standards in the capital market. By virtue of handling disputes, SIDREC is able to use its unique position to identify issues and make recommendations to the SC relating to any trends or recurring misconduct while maintaining case confidentiality.

Eligible Disputes

Claims by individual investors or sole proprietors relating to a capital market transaction or services which involve a SIDREC member.

Ineligible Disputes

1. Disputes which involve a Member who is unable to meet its financial obligations because it has been wound up or declared to be financially insolvent by the courts, or been declared to have triggered an event of default under the Capital Market Compensation Fund Corporation Rules

2. Disputes arising from commercial decisions, e.g. with regard to product pricing, fees and charges, or rejection of credit/margin applications, made by the Member

3. Disputes concerning the performance of a product or investment (except in respect of any alleged nondisclosure/misrepresentation by the Member in relation to such product or investment)

4. Disputes which have been referred by the Claimant or the Member to a court or arbitration and the case–

   (a) has been decided in the court or arbitration; or

   (b) is pending in the court or arbitration unless the matter is stayed for the purposes of referral of the dispute to SIDREC;

5. Disputes involving matters under investigation by the SC or any other Government enforcement authority where the SC has issued a direction under the Regulations to SIDREC not to proceed with the Dispute Resolution Process; and

6. Any claim, which is time barred under the law at the time it is submitted to SIDREC for resolution.

Message to SIDREC Members

1. Practice and maintain good client relations.
2. Be attentive to the client's complaints and try to resolve disputes early.
3. Be facilitative and committed to resolving disputes. Refer the client to SIDREC if you are unable to resolve the matter with your client.
4. Be open and constructive during mediation/adjudication process.
5. Obtain and understand all the facts of the case - do your homework before going to the mediation process or adjudication hearing.
6. Understand how the issues have affected your client.
7. Client should be given a reasonable opportunity to present their case.
8. Listen to client's side of the story with an open mind.
9. Mediation should not be approached with a combative mindset.
10. Come with a mandate to resolve the dispute and make sure that your representative has the authority to negotiate and enter into a settlement agreement.
11. Pay up when an award is made against you by SIDREC.
12. Use complaints and disputes as a feedback loop to continuously improve your internal systems, controls and processes.
13. You should improve conduct supervision of representatives and agents to avoid claims which may be filed against them for losses and against you as principal for failure to supervise.
14. Remember this: When you resolve disputes amicably with your client, it goes a long way in enhancing your reputation and building a long standing business relationship with clients.

Message to Investors

1. Make sure you invest in legal and licensed schemes as SIDREC's dispute resolution services would not be available if you invest in illegal schemes or unlicensed activities.

2. Know your rights – You have the right to complain and seek redress if you have a monetary dispute as a result of an action or inaction of a SIDREC member or their agents/representatives. Resolve it with the member, if this fails then bring the dispute to SIDREC.

3. Don't wait. Complain to your Broker/Unit Trust Management Company etc. as soon as you have a concern and seek redress.

4. Be prepared to substantiate your claim/dispute by keeping a record of all communications and transactions. Put important instructions or mutual agreements in writing e.g. details of dates, instructions, communications, documents that support your case.

5. Understand the product and exercise informed judgment – i.e. do your homework before you invest.

6. Come to SIDREC with clean hands. The information provided to SIDREC must be true and accurate. SIDREC is here to help but it will not hesitate to terminate a process if information provided is false.

7. Be fair and reasonable in making and pursuing your claims.

8. If you are not satisfied with SIDREC's decision/award, you may appeal to SIDREC's Appellate Committee if you fulfil the criteria in SIDREC's Terms of Reference.

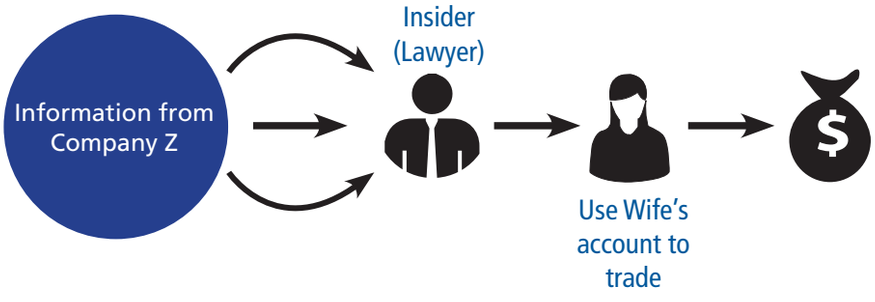
9. You may also pursue other alternatives such as taking the matter to court if SIDREC's decision /award is not in your favour.

Prohibition Against Insider Trading

Are you aware that insider trading is an offence?

Insider trading often occurs even without most people realising it. It can happen at golf courses, coffee shops or other social settings where people casually pass on material non-public information concerning securities to friends, relatives and associates, without realising they are committing insider trading. People who do know about the prohibition of insider trading but still proceed to take the risk often think that the possibility of them getting caught is remote.

Imagine a scenario where you are a lawyer acting for company Z who is involved in a negotiation to acquire a competitor. In your mind you know that once the deal is concluded the share price of Company Z would likely go up. Thinking that you might not be caught for buying a small amount of company Z's shares with this information, you proceed to buy 10 lots of company Z's shares under your wife's name before the official announcement of the news. Company Z's share price surges by RM0.50 per share immediately after the announcement resulting in you making a profit.



After some time, you would probably have forgotten about the purchase but don't be surprised that one day the SC might appear at your doorstep and charge you for committing insider trading. The SC might also add on a civil enforcement action against you for disgorgement of three times the amount of profit that you have made.

The above scenario is a classic illustration on how insider trading is committed i.e. when someone who is in possession of material non-public information buys or sells shares based on that information. It is also an example how certain people could easily fall into the temptation of profiting from material non-public information.

Who is an insider?

The definition of an insider under *Capital Markets and Services Act 2007* (CMSA) is very wide to include any person who comes into possession of material non-public information relating to securities.

As far as the law is concerned, so long as a person is in possession of "information" and that person knows that the said information is not generally available, which upon becoming generally available would have a material effect on the price or the value of securities, that person becomes an insider.

How do you determine whether the information is material or not?

The test in determining whether or not the information is material is a rather straightforward test i.e. would the information influence a reasonable investor in deciding whether or not to buy or sell securities based on the information he possesses.

What constitutes 'information' for the purpose of insider trading?

It is important to know what constitute as 'information' under the context of insider trading. The definition of 'information' according to the law is wide and covers various instances. The CMSA has defined and included the following as "information":

(i) matters of supposition and other matters that are insufficiently definite to warrant being made known to the public;

(ii) matters relating to intentions or likely intentions of a person;

(iii) matters relating to negotiations or proposals with respect to commercial dealings or dealing in securities;

(iv) information relating to financial performance of a corporation;

(v) information that a person proposes to enter into, or has previously entered into one or more transactions or agreements in relation to securities or has prepared or proposes to issue a statement relating to such securities; and

(vi) matters relating to the future.

In addition to the wide scope of definition of 'information' as illustrated above, the court has also in several cases included the following instances as 'information' within the context of insider trading:

- information in the form of management accounts of subsidiaries and associates to a listed company which indicated that the financial performance of the company was in decline has been held by a Malaysian court to be 'specific confidential information'. *Public Prosecutor v Chua Seng Huat [1999]*;

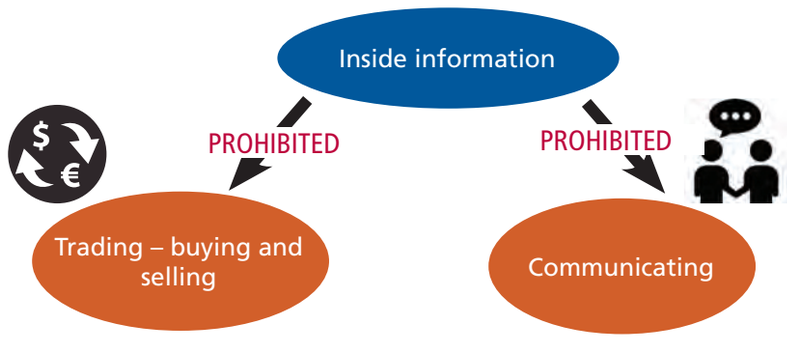
- information concerning a loss forecast and a possible impairment charge over a loss-making subsidiary discussed in a management meeting was held by a Singapore court to be material information. *Lew Chee Fai Kevin v Monetary Authority of Singapore (MAS)[2012]*; and

- information relating to possible findings of copper and zinc deposits by a mining company on a piece of land it acquired was held by a US Court to be inside information. *SEC v Texas Gulf Sulphur Co [1968].*

What are prohibited conducts for an insider?

Essentially a person who is an insider is prohibited from committing the following two acts:

(i) Buy or sell securities; and
(ii) Communicating the inside information.



It is important to note that apart from the prohibition against the act of buying and selling shares using inside information, another equally important element of insider trading law in Malaysia is the prohibition against the act of communicating inside information to another person if he knows or ought reasonably to know that the other person would trade based on the information.

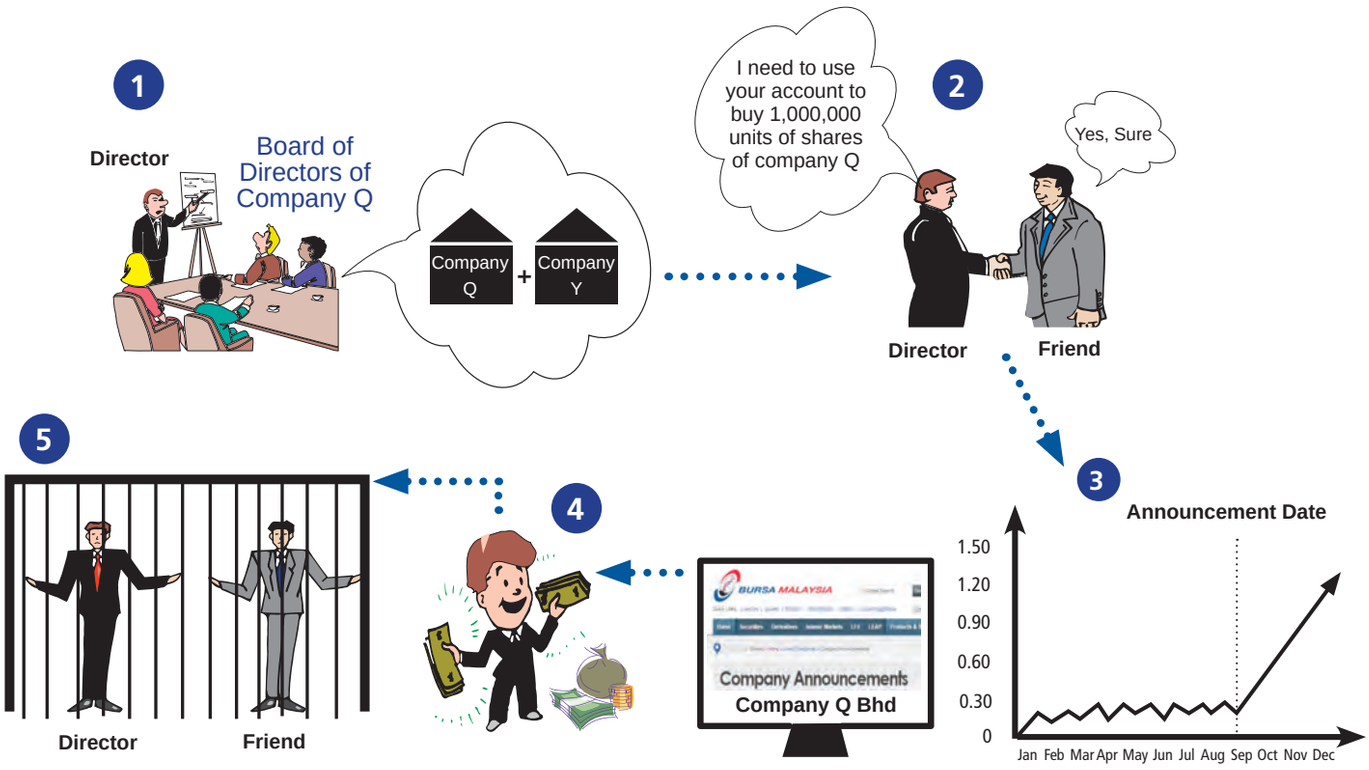
The penalties for committing insider trading in Malaysia are severe: a person could face a jail term of up to 10 years and pay a fine of not less than one million ringgit. It is also important to note that a person who communicates inside information is equally liable for insider trading under the law regardless whether he derives any direct economic benefit.

Here are some examples of insider trading:

(i) A public-listed company Q was in a discussion for a merger with company Y. A director of company Q was actively involved in the merger exercise. Before public announcement of the merger, the director bought 1,000,000 company Q shares through a friend's trading account and made a profit in the process.

Offences committed:

- Director – Insider trading of company Q shares.
- Friend – Abetting with the director.



(ii) A professional who acted for a public-listed company X was advising on the proposed acquisition of its shares by company Y. The professional then bought 1,000,000 company X shares before the announcement of the proposed acquisition and benefitted from the mandatory general offer made to company X.

Offence committed:

- Professional – Insider trading of company X shares.

(iii) A corporate finance (CF) adviser was advising company P on a take-over of the company by company S. The CF adviser communicated the information on the take-over to his friend J who acquired 1,000,000 company P shares through an account belonging to K.

Offences committed:

- CF adviser – Communicating inside information.
- J – Insider trading of company P shares.
- K – Abetting with J.

Why insider trading is regarded as a serious offence?

Insider trading is considered a serious offence because:

- It involves misappropriation and the taking advantage of inside information which should rightly belong to the company;
- The insider unjustly enriches himself to the detriment of others based on the inside information;
- It is unfair to the other market participants who are not in the position to gain access to similar inside information; and
- Lastly, insider trading injures the overall market confidence of our stock market.

Conclusion

To date insider trading enforcement continues to be the focus of SC's enforcement action given our commitment in ensuring a transparent and fair stock market in Malaysia. In the last 4 years from 2014 to 2017, the SC has filed as many as 370 criminal charges against 38 individuals for insider trading and 6 civil cases against 19 individuals by way of civil enforcement actions.

The SC has also successfully disgorged a sum of RM7,926,039.29 through regulatory settlements process against 23 individuals where a sum of RM1,981,209.10 has been restituted to 525 investors.

If you come into possession of inside information...

- Do not trade securities based on inside information.
- Do not communicate such information to anyone including your spouse, relatives, friends and business associates.
- A person can only use inside information when the information has been made public through a proper channel and sufficient time have elapsed to allow investors to digest and understand the implication of the information – typically 24 hours for simple information and 48 hours for more complex information.
- Advisers (lawyers, accountants, valuers, consultants etc.) who come into possession of inside information in the course of carrying out their work should not share the inside information with anyone, including their colleagues who are not involved in the work at hand. When you are caught, not only will your professional career would be affected, you could also face a criminal charge.

How a company should safeguard inside information

- A company must make sure that it steps up its governance system and controls to safeguard material non-public information concerning the company.
- A company must manage flows of inside information by putting in place "Chinese Wall" to prevent leakages.
- A company must continuously create awareness among its employees on the importance of managing flows of inside information.

Opportunities and Challenges: Financial innovation and the Fintech landscape in Malaysian Capital Market

Background

Fintech – technology in financial services, until recently, has been focusing mainly in the areas of payments, deposits and remittances, i.e. in the retail banking segment of the financial services industry. However, over the last few years, there has been an expansion of Fintech activities into other segments of the financial services industry e.g. insurance and the capital markets. For example, the auto insurance companies have started using new technology, where they take into account current driving habits of customers instead of depending solely on customers' past driving records, when pricing and quoting insurance premiums. Investment banks have begun using Fintech applications as part of a solution to create new product offerings and enhance service delivery. Fund managers and asset-management companies are embracing innovations such as robo-advisors, to gain an edge to generate alpha over their competitors. Meanwhile, securities brokers have introduced integrated and innovative online brokerages, to increase revenue and gain customer loyalty.

This article explores growth opportunities that the Malaysian capital market and market participants can get out from Fintech. It also discusses how market participants can utilise Regtech to meet and reduce the costs of meeting regulatory requirements.

Lastly, the article highlights concerns of the SC and SC's assessment on the impact of the emergence of Fintech in the capital markets to the investors, market participants and market institutions.

"Investment banks have begun using Fintech applications as part of a solution to create new product offerings and enhance service delivery."

Driving factors of Fintech in recent years

Various factors have come together, at first gradually and then suddenly, to result in what we now witness as a surge of technological innovations occurring in the financial sector shortly after the global financial crisis (GFC) of 2007-2008, more notably, in the last few years. Practitioners, intellectuals and financial literature writers commonly group these factors into the following dynamics:

- First, there has been a sharp increase in technological capabilities coupled with an attendant decrease in costs. This is evident in the increase in computing capacity of computers as well as other online and communication

devices (such as smart phones and tablets) to process and store large volume of data, which combined nicely with sharp falls in the costs of hardware, software and storage of data;

- Second, the effect of 'innovation spiral' has played out most prominently in the tech-industry. This spiral effect is major as an invention of one technology that may or may not be successful commercially, can become an important driver to condition further product market innovation that becomes more useful or more successful. The 'innovation spiral' effect spawned by the tech-industry has extended to and is a significant driver that fuels better market innovation and product evolution in the financial services sector. Such development only goes to prove the adage that innovation is not a linear process but a continuous cycle where inputs from difference places and parties can be leveraged by various other parties, including regulators and businesses to meet own needs. For example, distributed ledger technology (DLT) has created much interest in the financial services industry as it projects a huge potential to change the way we carry out and record transactions in a decentralised and secured manner, without having to go through a central authority. Potential areas identified for DLT application in the capital markets are, for now, in the areas of securities trading, clearing and settlement. Regulators have also started mulling over whether they could use the same technology to plug into the network of financial institutions (FIs) to conduct risks surveillance and track transactions to detect anti-money laundering and counter-terrorist financing (AML-CTF).

- Third, the withdrawal of traditional FIs from some segments of the financial markets after GFC has opened a door of opportunity to new entrants. For example, the retreat of many traditional banks from certain risky lending activities (owing to more stringent capital requirements and rigorous risk management post GFC) is the window allowing online platform-lenders to occupy that space. Often these entrants arrive with novel idea of providing a service the incumbents may have overlooked or did not contemplate possible. New entrants like Fintech firms have an advantage as they often come unburdened by regulatory incumbency, compliance costs and capital requirements, or having to deal with legacy systems, processes and infrastructure. As a result, Fintech firms are more able to move faster, focus their resources on developing solutions and compete directly with traditional financial service providers. A number of these new entrants were able to scale up quickly using new technology before traditional service providers have time to defend their turf, much less consider any counter-attack or strike-back strategy;

- Fourth, consumer trust in traditional FIs e.g. the banks has been on a decline since the GFC erupted in 2007-2008. This is significant, as it is the trust that has hitherto acted as a barrier to entry for new entrants to financial services industry. Consumers blame the financiers and their insatiable greed to maximise profits as the main cause of GFC that had caused havoc to the financial system and in doing so brought about a global economic downturn and hardship to many. As a result, consumers are more willing to engage services of new entrants. More crucially, they are more willing to use new specialist-providers on specific services on an

> "The innovation spiral effect spawned by the tech-industry has extended to and is a significant driver that fuels better market innovation and product evolution in the financial services sector."

'a la carte' basis, (e.g. on payments, saving and investment products) that were previously offered by a single bank. The negative consumer sentiments towards traditional FIs is most notable in developed markets like the US and Europe where the financial crisis began and accelerated, and where there had been huge taxpayer-financed bailouts; and

- Fifth, the increasingly wider access to internet connections and spread of high-speed mobile devices world-wide allowing real-time transactions to take place on the go at any time, have provided consumers a totally new and enhanced customer experience. More crucially, the distribution efficiency of the web, the proliferation of websites and the exponential growth of social media from a passing trend to global obsession, have empowered consumers by the ease of sharing of digestible financial education/information to a much wider audience on the net and the quick access to choices of financial products and services. Consumers now feel they have the power to make a Buy decision, rather than being Sold financial products.

This experience has given rise to higher customer expectations with regard to convenience, speed, costs and user-friendliness of online financial services, which has in turn become one of the most important factors in transforming consumer purchasing-decisions on products and services. Furthermore, as consumers become increasingly accustomed to using online devices to undertake financial transactions, they are more willing to log on and use other services and new product offerings of these new entrants.

Thus, much like a symphony with multiple and distinct movements and instruments, all of the above dynamics have worked together to result in what seems like a sudden surge of Fintech activities in various aspects of financial services sector in recent years, which evolution has in actual fact begun decades ago when one looks closer.

Fintech outlook for the Malaysian capital market

If we view Fintech as a movement that has brought about transformative changes to the financial services industry globally in a way that has not happened before, we must then ask ourselves, "What is Malaysia's Fintech journey, where we are, what is next?"

Fintech has become one of the biggest growth industries in the world. According to the latest analysis by Accenture on the data published by CB Insights (a global finance data and analytics firm), investment in Fintech ventures reached an all-time high in 2017, buoyed by a surge in funding for start-ups in the US, UK and India.[1]

"...investment in Fintech ventures reached an all-time high in 2017, buoyed by a surge in funding for start-ups in the US, UK and India."

[1] https://newsroom.accenture.com/news/global-venture-capital-investment-in-Fintech-industry-set-record-in-2017-driven-by-surge-in-india-us-and-uk-accenture-analysis-finds.htm

Another report dated 2017 indicates that[2]:

- In May 2016, London was ranked as the largest Fintech hub in the world, employing 61,000 people and generating £6.6 billion (US$8.5 billion) in revenue. The report states further that the UK government's support for Fintech sector remained strong even in the post-Brexit era; and
- In 2016, 35 New York Fintech companies have raised financing US$59 million. It was reported that in New York the average early-stage funding per start-up was US$568,000, more than double of global average amounting US$252,000 per start-up.

The data tells us one thing: while nobody can predict precisely how Fintech will change the future of the financial services sector, investors' interest are high in the Fintech sector as shown by the amount of venture capital pumped into the sector. In view of the venture investors' interest in the Fintech sector, we can only expect more innovations and cutting-edge technologies coming out of Fintech labs and hubs, and flowing into and disrupting the financial services sector further. The only question is how fast.

In the Asia-Pacific region alone, we see a flourishing of activities taking place where large sums of venture money have flowed into investing in the future of Fintech. Though these ventures are driven by the private sector, they are eagerly supported by the public sector:

- In 2014, Hong Kong launched a new Asia-Pacific Fintech Innovation Lab, where eight start-ups offering a wide range of solutions from security to analysis and risks were selected to participate in the Lab. The Lab is a 12-week annual programme that helps early-and growth-stage Fintech entrepreneurs to gain exposure to top financial institution executives' thoughts, ideas and mentorship. The Lab marks its fifth year of operation into 2018 with alumni participants having raised up to US$288 million as at 2017;

- In 2015, Sydney launched a Financial Services Knowledge Hub to provide start-ups with office space, mentoring, networking, export support and opportunities to access capital. In terms of growth figures, the number of Fintech start-ups in Australia has increased from less than 100 in 2014 to 579 companies as at July 2017. In addition, the latest numbers indicate that Fintech investment in Australia has remained steady with US$675 million invested across 25 deals in 2016;

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[2] https://assets.kpmg.com/content/dam/kpmg/au/pdf/2017/scaling-Fintech-opportunity-sydney-australia.pdf

- In Singapore, the Monetary Authority of Singapore (MAS) has established a new Fintech & Innovation Group (FTIG) within its own organisation structure in August 2015. The FTIG is tasked to develop regulatory policies and strategies to facilitate the use of technology and innovation in managing risks and strengthening competitiveness in the financial sector. MAS also announced its commitment of SGD225 million (US$160 million) worth of fund to be disbursed over a period of five years from 2015 to 2020, to support the private sector in creating a vibrant innovation ecosystem in Singapore. The fund targets three core areas:

1. Attract FIs to set up their R&D and innovation labs in Singapore.
2. Catalyse the development of innovative solutions that can potentially promote FI's growth, efficiency and competitiveness.
3. Support the building of industry-wide technology infrastructure required for the delivery of new and integrated services in Singapore financial services industry.

The SC's initiatives in Fintech

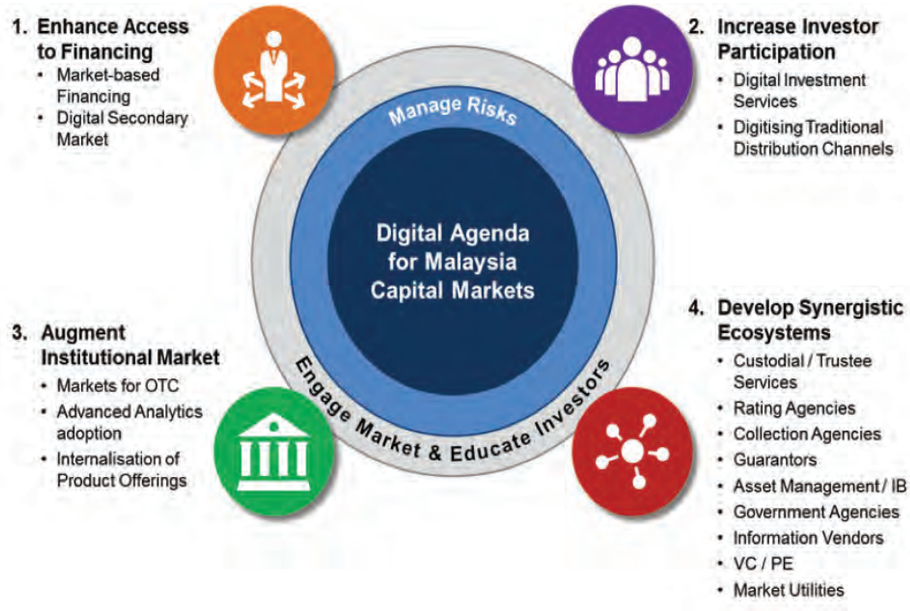
- In 2014, the SC hosted a public conference called **SCxSC** to generate interest and create awareness among local tech firms and enthusiasts, the investing public including business world at large, on the potential of using technologies and innovations to tap the Malaysian capital markets for funding. This annual public conference marks the SC's first attempt to reach out and bring together all stakeholders of digital finance i.e. the issuers, Fintech firms, angel investors, venture companies and retail investors, to one forum. This annual event has created much hypes among all stakeholders and more importantly, it serves to raise profiles of the local niche growth sectors and attract Fintech talents and vital capital to our ecosystems;

- In 2016, the SC published an agenda on Fintech by sharing with market participants a comprehensive plan called **Digital Agenda for Malaysia's Capital Market**[3]. The plan is a roadmap that sets out the SC's vision for a holistic development of Fintech for the Malaysian capital markets. It identified four strategic objectives that the SC seeks to achieve, in facilitating full adoption of digital technology and innovation across the entire capital markets, and underpinned by a three-pronged regulatory principles of managing risks, engaging markets, and educating investors. Diagram below presents a snapshot of the SC's Digital Agenda:

"The plan is a roadmap that sets out the SC's vision for a holistic development of Fintech for the Malaysian capital markets."

[3] For more information on the digital agenda, please refer to the SC's *2016 Annual Report*.

Diagram 1:



- Prior to rolling out the Digital Agenda, Malaysia became the first ASEAN country to introduce a legal framework on Equity Crowdfunding (ECF) when the SC released its ECF regulatory framework in February 2015. The framework was well received with keen interest in the new framework from among start-ups and incumbent market participants. In June 2015, the SC announced the approval of seven ECF operators in the country as 'recognised market operators'. They were selected from a list of 27 applicants and the selection process assessed, among others, the ability of the approved operators to bring unique strength, expertise and different flavour to our capital markets;

- In August 2016, the SC followed up with a legal framework on peer-to-peer debt financing (P2P). Both the ECF and P2P regulatory frameworks were introduced to encourage and enhance access to capital market financing by smaller enterprises, particularly micro, small and medium enterprises (MSMEs).[4]

> "The ECF and P2P frameworks have gained traction especially among start-ups and MSMEs."

The ECF and P2P frameworks have gained traction especially among start-ups and MSMEs. They have proven to be viable alternative routes to fundraising for smaller enterprises from our capital markets. These new avenues also provide retail as well as sophisticated investors with an alternative channel for investment. More significantly, both the online fundraising platforms have attracted a strong following of young investors of less than 35 years old. Both these alternative online platforms have seen 38% youth participation compared to the traditional stock market where youth participation on Bursa Malaysia is just over 20%.

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[4] For more information on ECF and P2P, please refer to the April 2016 and January 2017 issues of *The Reporter* respectively

Key statistics on the performance of ECF and P2P are summarised below:

Alternative Market-based Financing Avenues

1,200 Successful deals across ECF and P2P Financing
ECF: 40 campaigns
P2P: 1,160 campaigns

309 MSMEs successfully raised funds
ECF: 40 issuers
P2P: 296 unique issuers

118M Total funds raised thus far across ECF and P2P
ECF: RM38 million
P2P: RM80 million

75% Issuers have women or youth founders

5,000 Investors participating in ECP and P2P

38% of participating investors are less than 35 years old

- Recognising the early success of this segment, the Malaysia Government has announced in Budget 2019 the establishment of a RM50 million Co-Investment Fund (CIF) to be co-invested in MSMEs alongside private investors through ECF and P2P platforms. The CIF will leverage the collective wisdom of the crowd and will only co-invest in MSMEs that have gained significant traction with private investors. Doing so will allow for greater transparency on how the funds are utilised, where the CIF is targeted to be eventually self-sustaining on the returns generated from its investors.

- In 2015, the SC initiated the setting up of an industry-wide networking group called **aFINity** (Alliance of Fintech Community) to spur further financial innovations and depth to our capital markets. aFINity is a developmental cum advocate group led by the industry. The SC supports aFINity by providing policy and regulatory clarity, and facilitating Fintech discussions with other relevant authorities and government agencies, with the objective to help Fintech entrepreneurs move up the value-chain from solutions-designing, setting up businesses to commercialising innovations. Since the launch, aFINity now counts for more than 200 registered industry participants drawing from existing market participants, techno-preneurs and start-ups as well as from the surrounding ecosystem players.

  The SC has facilitated more than 100 engagement sessions with aFINity since its inception on a wide range of topics, which included larger community-wide information sharing, targeted focus group discussion, to even one-on-one engagement. The SC continues to encourage financial services community, innovation community, researchers and academia, and Fintech start-ups including industry

> “The SC has facilitated more than 100 engagement sessions with aFINity.”

experts and emerging disruptors, to use this network to link up and explore insights and opportunities for more mutually beneficial collaborative actions;

- In May 2017, the SC launched the Digital Investment Management (DIM) framework to give retail investors access to specialist services of investment management industry i.e. the portfolio management services. Traditionally, only high net worth (HNW) investors get to access and enjoy professional services of portfolio managers. The DIM regulatory framework democratises it by allowing the offering of automated portfolio management services to all Malaysian, regardless of their net-worth or income level. The idea is to liberalise the retail investment framework at low costs and in an affordable manner without compromising safeguards for investor protection. So far, the SC has registered one DIM operator.

Where are we at now?

The Fintech movement and disruptive innovations it brings about has indeed reshaped the way financial services are structured, provisioned and consumed globally. It has forced open the capital markets to serve a wider cross-section of issuers and investors than ever before imagined. In Malaysia, new business models using innovative technology platforms such as ECF, P2P and DIM are just some of the financial services and channels that the SC has facilitated, as part of the overall initiatives to continuously grow and develop our Malaysian capital markets. We anticipate more innovative Fintech entrepreneurs coming to Malaysian shores to tap on hitherto untapped segments of the Malaysian capital market, e.g. the segments on financial planning, investment advice, social investing and automated trading space.

For completeness, other innovations that have come before the SC for approval and/or consultation are summarised below:

- In April 2017, the SC approved Rakuten Trade, the first digital only equities broker for the Malaysian market. Rakuten Trade has received positive response from investors since its launch with more than 10,000 accounts opened by end 2017. More encouragingly, a big portion of these are new-to-market investors.
- Stockbit, an Indonesian start-up has arrived at our shore in early 2018 with an investment-focused social media platform that aims at facilitating public-listed companies (PLCs), equities analysts, investors' engagement and exchange of information on its social media page.
- In July 2018, the Financial Planning Association of Malaysia (FPAM) has launched Smartfinance.my, a digital portal with attached tools that allow consumers to gain a snapshot of their current financial position and connect users with licensed financial planners.

The emergence of other innovations such as cryptocurrencies and initial coin offerings (ICOs) has unleashed a renewed wave of interest, notably among retail interest on investment activities. Cryptocurrencies and ICOs are digital assets and a new method of financing for start-ups and new businesses where digital tokens or coins are issued to raise funding, instead of these enterprises having to turn to traditional funding avenues such as public stock markets, private equities (PEs) or venture capitals. We note from the engagements the SC had with the industry and the volume of queries received on cryptocurrencies and ICOs from various parties that there are keen interest in the investment and trading of digital assets.

What's Next: An Expanded Horizon for Incumbents

While the recent financial innovation brings in new entrants, which means increased competition for incumbents, it also brings about an opportunity for incumbents to rethink their business models and strategy. Yes, incumbents may have misgivings on this development, however as more technologies become available in the market, these technologies could become new tools to be leveraged by incumbents to evolve their own product offerings and improve service delivery to protect their core business from further erosion. The development also serves as a good reminder for incumbents to review how they conduct business compared with new entrants in order to stay nimble, efficient and on top of the game.

Some incumbents are already taking advantage of the proliferation of digital devices as an opportunity to capture and engage with clients in building stronger relationships and enhance 'stickiness' i.e. creating longer-term customer loyalty. Others responded to the shift in customer behaviour by improving product offerings towards more customisation and personalisation. As social media become more common and pervasive in consumers' everyday life, we also see market participants responded by using social media more extensively as a marketing tool and a feedback loop when engaging clients while some firms have started experimenting with chatbots for customer servicing. These initiatives are already happening in Malaysia. Globally, some markets have evolved where market participants have moved towards pure digital, self-directed offerings while others are equipping their sales-force with digital tools to enhance marketing capabilities. We are seeing the emergence of this trend in Malaysia as well, and expect further adoption in years to come.

"Some incumbents are already taking advantage of the proliferation of digital devices as an opportunity to capture and engage with clients in building stronger relationships and enhance 'stickiness' i.e. creating longer-term customer loyalty."

The potential for Fintech to drastically improve the middle-and-back office are often not stressed enough. While cost reduction and regulatory compliance remain a priority for market participants, the two objectives can be met with the help of technology. There can indeed be lessons learned from start-ups in running lean and efficient operations, enabled by technology. It could be as simple as getting systems to become more integrated to enable straight-through processing, deploying bots to automate repetitive tasks, using biometric information for identity verification, or even leveraging artificial intelligence (AI) and analytics for better risk management.

As technologies allow operations to scale efficiently, we also see the emergence of market utility firms whether in know-your client (KYC) best practices, post-trade reporting or other areas, to service incumbents. A *September 2018 Report* published by the Financial Industry Regulatory Authority (FINRA)[5] showed that a growing number of Fintech start-ups have leveraged a variety of innovative technologies to assist incumbent providers in cutting costs and reducing compliance burden. Some incumbents are seen developing a variety of Regtech tools in-house, in meeting their compliance obligations particularly in the compliance of KYC and AMLA-CTC.[6] Regtech solutions are getting popular among financial service providers as they offer higher level of information accuracy, granularity and availability, which help to improve incumbents' responsiveness to regulatory changes and in monitoring systemic risk, which in turn brings uniformity to risk management and regulatory reporting. For example, in the same report several market participants have noted significant reductions in false alerts generated by their surveillance systems after utilising Regtech tools.

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Besides market participants, Fintech innovations have also made inroads into market infrastructure institutions i.e. the exchanges and other trading avenues, central counterparty clearing-houses (CCPs), securities depositories and index providers that have provided essential infrastructure for the efficient operation of a modern capital market. A 2018 joint report by World Federation of Exchanges (WFE) and McKinsey & Company indicates that Fintech-led innovations are already found across the entire capital market infrastructure value chain. Market institutions are advised to adopt a focused and proactive approach when considering how best to engage and work with Fintech companies, to drive further capital market efficiency.[7]

While incumbents will struggle with legacy processes, systems and infrastructure, it is important that incumbents recognise that their entrenched position also means it comes with a trove of data stretching back decades. How they use and mine these untapped data for strong actionable business insights could potentially be a key differentiator for incumbents. The idea is to take advantage of Fintech by modernising existing business operations and generate new sources of revenue by exploring and capturing new business opportunities through Fintech.

Given the sweeping scope of change and the nascent demand in the Malaysian capital market, we believe collaboration between industry participants, both incumbents and new entrants, is key. The SC continues to encourage the industry to explore mutually beneficial partnerships, collaborations and arrangements to deliver the greatest value and experience to our investors and issuers.

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5 FINRA is a self-regulatory body that provides first line of oversight over broker-dealers firms and professionals who deal in securities in the US markets

6 http://www.finra.org/sites/default/files/2018_RegTech_Report.pdf

7 https://focus.world-exchanges.org/articles/wfe-mckinsey-joint-report-fintech-capital-markets-infrastructure-industry-reveals-likely-future-innovations-opportunities

Regulatory concerns

While we look forward to the promises in which Fintech can potentially deliver to improve ways in which the financial system operates to make our capital markets a more inclusive and vibrant marketplace, at the same time, we are aware that such promises are not without risks. These potential risks include:

Cyber security and privacy protection – As Fintech's growth largely involves growth using online platforms, it makes this industry uniquely vulnerable to security breaches. Incidents of security breaches at large companies like Yahoo, Uber, Equifax and Google resulting in privacy of customers' personal data being compromised, only add to the worries. Until Fintech firms upgrade their security architecture on data protection and compliance, cyber security will remain a concern to regulators;

AML and cross-border transactions – Convenience and fast transactions is much more complex in cross-border transactions as recipient identification relies on processes in another country. Thus, the standard of regulations on AML-CTF of a country, and capacity of Fintech firms to comply with AML-CTF regulations will continue to be a regulatory concern. The FATF, the international body responsible for combating money laundering, has been spearheading efforts to prevent the misuse of virtual assets (such as virtual currencies, wallet providers and ICOs) for financing illicit activities. This includes enhancing its existing standards to ensure virtual asset service providers are subject to AML-CFT regulations which involves monitoring, record-keeping and reporting of suspicious transactions;

Corporate governance (CG) – Compliance culture of tech firms that are now operating in the space of financial sector will be a concern to regulators as tech firm have been operating in less regulated environment, and may not have cultivated the stringent compliance culture required to operate in a highly regulated environment like the financial sector. The recent failure of the founder cum chief executive of the largest online P2P lender, Lending Club, to disclose personal interest in a sale of loans to a big investor, is a highly publicised governance breach that serves to intensify the point; and

Investor education – Investors need better education and constant reminders on the fundamental correlation between investment risk and returns so that they are not blindsided by the appeal and shine of new technologies. The dotcom bubble of the late '90s is a good reminder of hypes over information technology resulting in exuberant and excessive speculation by investors on dotcom stocks. Recent reports on thousands of retail investors across China suffering losses as fraudulent Chinese P2P platform lenders collapsed in the midst of tighter regulatory environment, only goes to expose the vulnerability of retail investors and the need for regulators to continuously enhance investor education programmes.

> "Fintech can potentially deliver to improve ways in which the financial system operates to make our capital markets a more inclusive and vibrant marketplace."

Final Thoughts

As regulator of the Malaysian capital market, the SC is responsible for designing and supervising rules of conduct by which market participants operate. These rules are aimed at minimising harm to investors, market participants and systems. In return for gaining access to the markets, market participants are obligated to observe regulatory standards when dealing with clients, or suffer penalties and other more stringent sanctions including suspension and revocation of licence or registration.

We are aware that as regulator our level of understanding and how we respond to market innovations will be of interest to market participants. While we continue to be flexible and adaptive to market developments, the safety and investor protection will remain as imperatives. For the orderly development of the Malaysian capital market, the SC will continue to facilitate innovative financing activities only if they meet the needs of the market with appropriate safeguards in place for investor protection and market stability. We continue to work to understand the kind of risks that new entrants may introduce and remain cautious in allowing innovations where the operators cannot demonstrate minimum fit and proper attributes, or articulate a viable business plan. Of equal importance is to see existing market participants and new entrants make it a part of their business strategy to give consumers better service, experience and outcome in undertaking capital market activities.

Message to Intermediaries

1. Be mindful of addressing the risks of your services or products being exploited by unscrupulous parties. This include having robust AML-CFT process in place to address the risk of misuse of virtual financial products and services for illicit activities. Cyber security and governance should also be focused upon to combat risks of being a victim of cyber security breaches and data theft.

2. Ensure good corporate governance and compliance practices are in place from the very outset. As the Fintech arena is coming under increasing scrutiny by regulators and it is best to cultivate a high culture of compliance in order to succeed in the longer term.

3. While pursuing the next wave or breakthrough, technology firms should focus on how it can best serve the needs of the investors, especially where retail investors are involved, as well as focus on providing a seamless investing experience. For new products and services, this also includes running investor education programmes, as well as using innovative channels to deliver education messages, in order to help investors understand the opportunities and risks of using Fintech products and services.

Message to Investors and Issuers

1. Through the digital agenda, new innovative avenues for fundraising and investments such as ECF, P2P, DIM and digital stockbroking are being introduced to the Malaysian capital market. We encourage you to explore these new avenues to see if any of these meet your fundraising and investment needs.

2. At the same time, before investing or fundraising, do check that the digital platform or operator of your choice is registered with the SC. An up to date list is published on the SC's website at https://www.sc.com.my/digital/list_rmo/

3. For issuers, understand that fundraising from the public through ECF or P2P is a regulated activity and a serious exercise. Be prepared by:

   a. Understanding your obligations to new shareholders or debtors;
   b. Having your company's financial information in good order;
   c. Crafting a holistic business plan outlining the company's goals;
   d. Planning for how the newly raised funds will be utilised; and
   e. Getting ready to pitch your business and value proposition to potential investors.

4. For investors, as these are new products and services being introduced to the market:

   a. Be sure to ascertain your own risk profile. Only choose products and services which commensurate with the investment risk you are willing to take;
   b. If you are investing in a company through ECF or P2P, understand your rights as a shareholder or debtor; and
   c. If you are using the services of a digital stockbroker or DIM, read the relevant disclosures to understand the nature of the service provided and fees involved before signing up.

Message to Investors and Issuers *(continued)*

5. There could be government incentives offered related to these digital businesses, for example the Malaysian Business Angels Network (MBAN) Tax Incentive which covers angel investors participating in ECF. Issuers and investors should take the opportunity to benefit from these incentives.

6. All licensed or registered digital platform operators are members of the Securities Industry Dispute Resolution Center (SIDREC). If there are any disputes arising between investors or issuers with the operators which cannot be resolved bilaterally, the case can be brought up to SIDREC.

FOR MORE INFORMATION

www.sc.com.my

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