Part 3

STRENGTHENING ACCOUNTABILITY IN THE MARKET

INTRODUCTION

Fostering a culture of integrity in the capital market remains a priority for the SC. It continues to expect high standards of governance and accountability among all participants to protect investors and maintain market confidence.

The focus in 2019 was to implement measures to strengthen the resilience of listed companies and capital market intermediaries against the threat of corruption, in line with the goals of the National Anti-Corruption Plan (2019-2023). Among measures undertaken were the introduction of requirements for listed companies to have robust anti-corruption frameworks in place.

The SC also enhanced its supervision and surveillance approach as well as capabilities, particularly to respond to the growing prominence of digital assets and the need to facilitate the development of innovative market structures.

PROMOTING THE ADOPTION OF CORPORATE GOVERNANCE BEST PRACTICES

Monitoring and enhancing transparency on adoption of corporate governance best practices

The SC published its inaugural edition of the *Corporate Governance Monitor 2019* (CG Monitor), which was launched by the Minister of Finance, YB Tuan Lim Guan Eng (represented by YB Tuan Tony Pua, Political Secretary) on 6 May 2019. An annual publication, the CG Monitor presents data and the SC's observations in relation to the adoption of the *Malaysian Code on Corporate Governance (MCCG)*, quality of disclosures in corporate governance reports of listed companies and thematic reviews selected for the year.

The CG Monitor 2019 highlighted positive levels of adoption across a majority of the MCCG best practices and found that the best practices with the highest levels of adoption are those related to board responsibilities, audit committee, and risk management and internal control framework. Some highlights from the CG Monitor are presented in Diagram 1.

The SC also observed that there were several early adopters of the newly introduced practices such as the detailed disclosure of senior management remuneration and setting a tenure limit of nine years for independent directors without further extension. A more encouraging observation is that mid-cap and small-cap companies[1] were among the trailblazers.

DID YOU KNOW?

The CG Monitor 2019 featured thematic reviews on:

- Long-serving independent directors – policies and practices on tenure and reappointment;
- Gender diversity on boards and senior management; and
- CEO remuneration of the top 100 listed companies on the Main Market of Bursa Malaysia.

[1] Mid-cap companies are those with market capitalisation of between RM1 billion and RM2 billion. Small-cap companies are those with market capitalisation of below RM1 billion.

LAUNCH OF THE CORPORATE GOVERNANCE MONITOR 2019

6 MAY 2019

> Today's launch of the *Corporate Governance Monitor* marks a new chapter in the SC's journey in driving and promoting good corporate governance. This report, which is the outcome of thoughtful collection and analysis of data from corporate governance reports, will enable the SC to track and highlight year-on-year progress (or gaps) in the adoption of corporate governance practices in the corporate governance code and the quality of disclosures.
>
> *– Syed Zaid Albar, Chairman, SC*

A panel discussion moderated by Julian Ng, BFM where discussions focused on the findings of the *Corporate Governance Monitor 2019*. On the panel were:

- **Johan Mahmood Merican**, Director, National Budget Office, Ministry of Finance
- **Ami Moris**, Chief Executive Officer, Maybank Kim Eng
- **Jamie Allen**, Founding Secretary General, Asian Corporate Governance Association

Diagram 1

Highlights from the CG Monitor 2019

MCCG Adoption

27
MCCG best practices had an adoption level of above 70%

74%
of listed companies adopted at least one Step Up practice

12 listed companies adopted at least 3 Step Up practices → **6** Mid-cap and small-cap companies

25 listed companies disclosed detailed senior management remuneration → **22** Mid-cap and small-cap companies

163 listed companies have a 9-year tenure limit with annual shareholders approval for extension → **135** Mid-cap and small-cap companies

25 listed companies have a 9-year tenure limit without further extension → **14** Mid-cap and small-cap companies

Gender diversity on boards and senior management

634
listed issuers have at least 1 woman director on the board

23.68%
(2016: 16.6%)
of board positions on the top 100 listed issuers were held by women

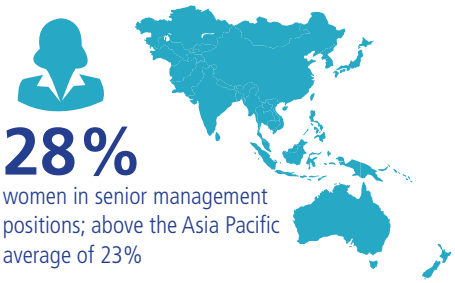
15.69%
(2016: 12%)
of board positions on all listed issuers were held by women

134 listed issuers with 30% or more women directors → **16** listed issuers have 50% or more women directors

Target achieved

No all–male boards
on the top 100 listed companies

Note: In January 2018, the SC announced the 7 top 100 listed companies with all–male boards. All 7 companies have since appointed a woman director



28%
women in senior management positions; above the Asia Pacific average of 23%

Grant Thornton, 2018

Long-serving independent directors

24.2%
of independent board positions were served by the same director for more than 9 years

242
resolutions were voted using the 2-tier voting process

116
independent directors with tenure > 12 years resigned from the board after the introduction of the 2-tier voting process

CEO remuneration

(Top 100 listed companies)

RM168 million
highest CEO remuneration

RM33.9 million
highest CEO remuneration among GLCs

RM7.98 million
highest median by sector – Telecommunications and Media

81%
of CEOs on the top 100 listed companies received RM10 million or less in remuneration

SC'S CORPORATE GOVERNANCE STRATEGIC PRIORITIES (2017-2020) *IMPLEMENTATION PROGRESS*

The SC continued to implement the initiatives identified under the SC's *Corporate Governance Strategic Priorities 2017-2020* (CG Priorities). In 2019, measures were undertaken for the implementation of 'Strategic Priority 1 – Enhancing the Corporate Governance Regulatory Framework' in particular supporting the effective discharge of directors' duties and 'Strategic Priority 2 – Strengthening the Corporate Governance Ecosystem'. A progress update on the implementation of the CG Priorities is presented in the diagram below.

STRATEGIC PRIORITY 1 – ENHANCING THE CORPORATE GOVERNANCE REGULATORY FRAMEWORK

Strategic initiatives	Status
Strategic and differentiated approach in the new MCCG to drive internalisation of corporate governance values.	**Completed** The new MCCG was released in April 2017.
Introduce corporate governance guidelines for capital market intermediaries.	**Ongoing** This strategic initiative will be implemented in 2020/2021.
Enhance surveillance and enforcement framework for serious corporate governance breaches.	**Ongoing** The SC is currently developing a framework to promote the effective discharge of directors' duties. This initiative is among the SC's measures endorsed by the Cabinet Special Committee on Anti-Corruption chaired by the Prime Minister, YAB Tun Dr Mahathir Mohamad.

STRATEGIC PRIORITY 2 – STRENGTHENING THE CORPORATE GOVERNANCE ECOSYSTEM

Establish the Corporate Governance Council (CG Council).	**On-Target** The CG Council will begin undertaking its functions in Q1 2020.
Promote shareholder activism.	**On-Target** The SC has developed an *Annual General Meeting Corporate Governance Checklist* (AGM Checklist) in collaboration with the Institutional Investors Council (IIC) and the Minority Shareholders Watch Group (MSWG). The Checklist aims to promote meaningful dialogue between shareholders and boards at AGMs, and will be released in Q1 2020.

STRATEGIC PRIORITY 3 – PROMOTING GREATER GENDER DIVERSITY ON BOARDS

Engage boards to accelerate adoption of gender diversity on boards.	**Ongoing** The SC continues to collaborate with lead advocates such as the 30% Club Malaysia Chapter.

STRATEGIC PRIORITY 4 – EMBEDDING CORPORATE GOVERNANCE CULTURE EARLY IN THE LIFE CYCLE OF COMPANIES AND AMONG YOUTH

Develop a corporate governance toolkit for SMEs.	**Ongoing** This strategic initiative will be implemented in 2020/2021.
Introduce corporate governance curriculum in tertiary education.	**Ongoing** This strategic initiative will be implemented in 2020/2021.

STRATEGIC PRIORITY 5 – LEVERAGING TECHNOLOGY TO ENHANCE MONITORING OF CORPORATE GOVERNANCE PRACTICES AND SHAREHOLDER ACTIVISM

Leverage advanced analytics capabilities to monitor and gain deeper insights into corporate governance practices.	**Completed** The SC developed an internal system leveraging advanced analytics to analyse quantitative and qualitative data on corporate governance.
Facilitate electronic voting and remote shareholders' participation.	**Ongoing** This strategic initiative will be implemented in 2020/2021.

The strategic initiative is:

- **Completed** ..... Completed
- **On-Target** ..... On target to be completed by the target date
- **Ongoing** ..... Ongoing and is targeted for completion in 2020/2021
- **Delayed** ..... Delayed from the target implementation date

Following the CG Monitor 2019, the SC continued to observe encouraging adoption of the MCCG best practices by listed companies, including an increase in the use of the two-tier voting approach[2] for the reappointment of independent directors with a tenure of more than 12 years.

The information presented in the CG Monitor will assist boards and senior management to reflect on their practices and put in place initiatives to close any identified gaps. It is also intended to support shareholders and other stakeholders in evaluating the corporate governance practices of companies, and the engagements with boards and management accordingly.

Introducing Annual Transparency Reporting for Audit Firms

To promote accountability among audit firms and uphold audit quality, the SC's Audit Oversight Board (AOB) on 14 August 2019 introduced requirements for the Annual Transparency Reporting for audit firms registered with the AOB.

Under the requirements, audit firms are required to disclose in their transparency reports, the audit firm's legal and governance structure, measures taken by the firm to uphold audit quality and manage risks, and information on the firm's indicators for audit quality. The report provides boards and shareholders relevant information for consideration in the evaluation and appointment of auditors.

DID YOU KNOW?

The Annual Transparency Reporting is compulsory for audit firms that meet the following criteria for two consecutive years:

- Audit firms with more than 50 public-interest entities (PIEs) audit clients; and
- Total market capitalisation of the audit firm's PIE clients is more than RM10 billion.

STRENGTHENING THE RESILIENCE OF THE CAPITAL MARKET AGAINST CORRUPT PRACTICES

One of the key priorities in 2019 was the implementation of holistic anti-corruption measures for the SC and the capital market in line with the National Anti-Corruption Plan 2019-2023 (NACP), which was launched by the Prime Minister, YAB Tun Dr Mahathir Mohamad on 29 January 2019. The NACP identified six priority areas and 115 initiatives to combat corruption. These include strengthening the effectiveness of public service delivery and inculcating good governance in corporate entities.

Establishment of the SC Anti-Corruption Committee

To ensure the national anti-corruption initiatives are efficiently and systematically implemented, the Government has established a multi-level anti-corruption governing structure through the issuance of a directive by the Prime Minister's Office in 2018.

Under the directive, all ministries and public institutions at the federal and state levels are required to establish their respective Anti-Corruption Committees, which would be chaired by the respective heads of institutions.

[2] Refer to Practice 4.2, MCCG for details on the two-tier voting approach.

OVERVIEW OF THE SC'S ANTI-CORRUPTION MEASURES IN 2019

THE SC AND ITS AFFILIATES

APR

Establishment of the **SC Anti-Corruption Committee**

NOV

Recognition of a senior SC employee as a **Certified Integrity Officer**

ONGOING

Development of the **SC's Organisational Anti-Corruption Plan**

LISTED COMPANIES AND CAPITAL MARKET INTERMEDIARIES AND AFFILIATES

MAY

Review of the anti-corruption policies of listed companies found that only **59% of listed companies** have anti-corruption policies in place.

JUL

Endorsement of the SC's action plan to support the NACP including **strengthening the anti-corruption measures** of listed companies by the Special Cabinet Committee on Anti-Corruption (JKKMAR).

SEP

The SC **conducted an engagement** session with SC affiliates on the **requirements under the NACP**.

OCT

Advocacy sessions on corporate liability provision, organised in collaboration with the MACC, involving **close to 600 senior representatives** of listed companies, capital market intermediaries and the SC's affiliates.

DEC

Listing Requirements amended to require listed companies to have **anti-corruption and whistleblowing policies in place**, and to **conduct annual assessment of corruption risk**.

The SC Anti-Corruption Committee was established on 1 April 2019 to identify improvement opportunities to strengthen governance, integrity and anti-corruption measures within the SC. The committee is chaired by the Chairman of the SC and members comprise representatives from the SC board and management. The committee is responsible for overseeing the implementation of the SC's initiatives under the NACP.

Development of the SC's Organisational Anti-Corruption Plan

A mandatory initiative under the NACP is for all public institutions to develop and implement an Organisational Anti-Corruption Plan (OACP), which is a policy document that addresses governance, integrity and anti-corruption issues within an organisation. The SC undertook a planning exercise to implement the OACP, which led to the establishment of the OACP Development Team in November. The SC's OACP is scheduled to be in place in the first half of 2020. The SC will also be conducting an internal corruption risk assessment with the assistance of the MACC in 2020.

Certified Integrity Officer Initiative

The Certified Integrity Officer (CeIO) initiative by the MACC Academy (MACA) is a measure by the Government to instil a culture of integrity in the Malaysian public and private sectors. The CeIO is a programme to train senior officers from the public and private sectors to combat corruption by implementing appropriate governance, integrity and anti-corruption measures. The programme is monitored by the *Lembaga Pengiktarafan Pegawai Integriti Bertauliah (LPPIB),* which is chaired by the MACC Chief Commissioner, and five members, including the SC Chairman, who are appointed by the Chief Secretary to the Government. The SC has two officers who have completed the programme and are qualified CeIOs.

Review of the anti-corruption policies of listed companies

In light of the corporate liability provision (Section 17A[3]) in the *Malaysian Anti-Corruption Commission Act 2009,* which comes into force on 1 June 2020, the SC undertook a review of the anti-corruption policies of listed companies. The review found that only 59% of listed companies had anti-corruption policies in place, and the majority of these policies required enhancements to bring them in line with the *Guidelines on Adequate Procedures* issued by the Prime Minister's Department.

59%
listed companies have anti-corruption measures in place

Endorsement of the SC's measures by JKKMAR, including strengthening the anti-corruption measures of listed companies

Findings of the SC's review on anti-corruption policies of listed companies and the SC's action plan to support the NACP were presented to the Cabinet Special Committee on Anti-Corruption (JKKMAR) chaired by the Prime Minister, YAB Tun Dr Mahathir Mohamad in July 2019. As part of

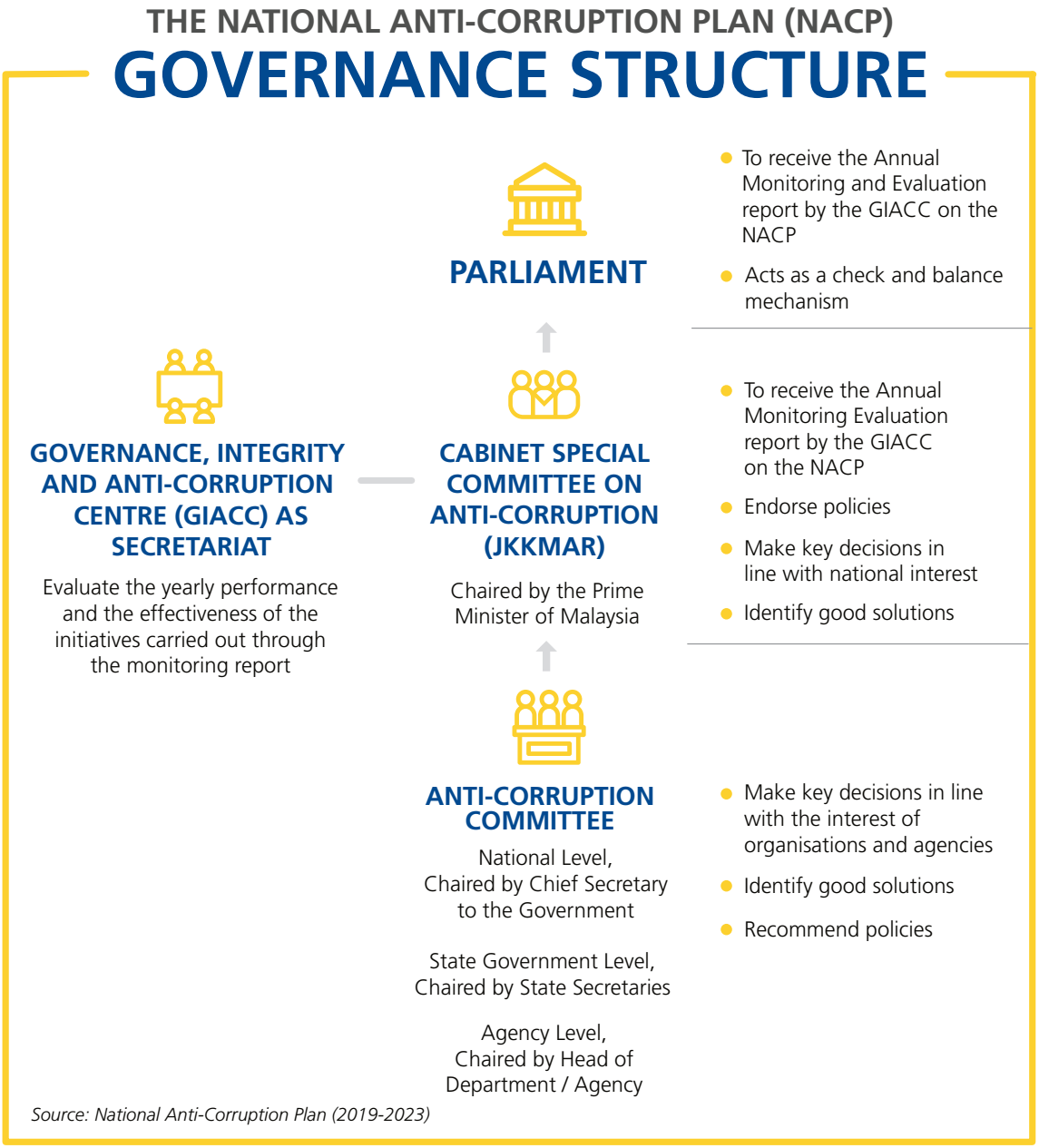
[3] Section 17A imposes liability on a commercial organisation if a person associated with that commercial organisation corruptly gives, agrees to give, promises or offers to any person gratification whether for the benefit of that or another person with the intent to obtain or retain business for the commercial organisation or to obtain or retain an advantage in the conduct of business for the commercial organisation.

the action plan, amendments were made to the Listing Requirements to strengthen the anti-corruption framework of all listed companies. The amendments require all listed companies to have policies and procedures on anti-corruption and whistleblowing, and to include corruption risk in the company's annual risk assessment framework.

Advocacy sessions on corporate liability provision

The SC collaborated with MACC to organise three awareness sessions for directors of listed companies, capital market intermediaries and the SC's affiliates. These sessions, attended by close to 600 participants, were aimed at raising awareness and understanding on the impact of the corporate liability provision, and the importance of having anti-corruption measures in place.

Diagram 2



Source: National Anti-Corruption Plan (2019-2023)

ENSURING MARKET RESILIENCE

The year started with concerns on synchronised slowdown in global growth due to the re-emergence of trade tensions and uncertainties surrounding geopolitical tensions. Markets, however, have been supported by easing through central banks' rate cuts to support growth. Similarly, the Malaysian capital market saw movements that reflected such sentiments, with the main equity index experiencing continued downward pressure as growth on earnings remained muted along with declining yields for bonds.

Notwithstanding the challenging global environment and domestic market activities, Malaysia's capital market remained resilient and continued to finance the crucial segments of the domestic economy.

The SC has continuously strengthened its monitoring and surveillance of any emerging risk from the heightened uncertainties. This is to detect and assess any trends and vulnerabilities that could contribute to the build-up of systemic risks.

Concurrently, the SC adopts robust and up-to-date approaches for identification, monitoring, mitigation and management of systemic risk. In this regard, while the SC has in place an integrated approach through formalised processes and arrangements, it constantly reviews and enhances the framework to ensure relevance and adequacy. Business continuity also plays an integral role in the management of systemic risk within the SC, the capital market and the broader financial system. In 2019, the SC took steps to further accelerate the SC's as well as the capital market's capacity and capability in managing vulnerabilities to ensure continuity of critical functions and operational resiliency.

Surveillance and assessment of vulnerabilities and risks to the stability of the capital market

The SC undertakes a methodological and integrated approach to its systemic risk surveillance and assessment function (Diagram 3). The established governance structure in the form of Market Risk Working Group (MRWG) and the Systemic Risk Oversight Committee (SROC) ensures a streamlined and structured escalation of the systemic risk surveillance and assessment.

The focus in 2019 centred on both domestic and external developments such as geopolitical and trade tensions, monetary policy easing, and Malaysia's position in global equity and fixed income indices, which could serve as potential headwinds to the stability of the domestic capital market.

Given the interconnectedness of the financial and capital markets, the SC is an active participant of various joint regulatory discussions with other authorities via a combined working group – the Macro Risk Focus Group with BNM, as well as being a member of the Financial Stability Committee of the Labuan IBFC. These regulatory discussions were organised collaboratively throughout the year to identify areas of risks within the financial and capital markets in Malaysia.

Recognising the importance of understanding and assessing interplay between various markets and participants in the broader financial system, an internal macro stress test model was developed to provide a more holistic form of surveillance and to complement other assessments undertaken by other relevant regulators or market participants. The SC also engaged market participants and subject matter experts to gain better insights of current or emerging market trends and risks, and to validate its risk assessment work.

Diagram 3

Assessment on various components in the capital market

CAPITAL MARKET SEGMENTS	ASSESSMENT
Equity market and Infrastructure	• Sufficient domestic liquidity to facilitate efficient investment activities. • Market wide circuit breaker and price limit on equity are part of the risk management mechanism to address excessive market volatility. In 2019, no circuit breaker was triggered. • Securities and Derivatives Clearing Guarantee Funds are in place to manage sudden surge of stress.
Bond market	• Yields declined in tandem with other regional markets amidst monetary policy easing environment. • Corporate bond default risk remained low with 0.39% of the outstanding amount falling within the vulnerable category.
Public-listed companies	• Corporate earnings continued to be affected by the challenging operating environment whereas corporate leverage increased due to the implementation of MFRS 16.
Investment flow	• Foreign investors as a percentage of shareholding in the equity market dropped slightly below the 3-year average amidst net outflows. • For bond market, foreign holdings remained stable amidst net inflows but capped due to issuances that have matured.
Investment management	• Fund managers have taken measures to manage liquidity risk i.e. liquidity management framework to safeguard against any adverse market conditions. • Cash and liquid assets held are sufficient to meet investors' redemption.
Stockbroking intermediaries	• Stockbrokers are well-capitalised, supported by sufficient liquidity buffers to address any potential defaults that may arise during times of stress. • Current risk-based capital position remained above the prescribed minimum financial requirement.

Various components of the Malaysian capital market continue to function normally despite domestic and external headwinds. The SC's assessments in 2019 indicated that there were no immediate major systemic risk concerns given the prevailing market, liquidity and infrastructure conditions.

Crisis Preparedness Programme

A two-day Crisis Preparedness Programme was jointly organised with the Toronto Centre (TC) to further strengthen and enhance both internal and external crisis communication and co-ordination to ensure preparedness for any untoward events that may affect the capital market.

The main objective of the programme was to ensure relevant departments within the SC will be able to apply organisational contingency arrangements to address risks during times of crisis. The intended outcome of the simulation was to increase awareness on the importance of timely and effective communication, identify improvements to the existing incident management framework and regulatory parameters as well as to consider ways to address gaps identified from the simulation.

Macro Stress Test

The SC has a clear mandate to monitor, mitigate and manage systemic risks arising from activities in the securities and derivatives markets as provided under the *Securities Commission Malaysia Act 1993* (SCMA) and *Capital Markets and Services Act 2007* (CMSA). This is also in line with Principle 6 of the IOSCO Objectives of Securities Regulation where a securities regulator has the obligation to undertake functions of monitoring, mitigating and managing systemic risk.

In this regard, as liquidity risks of CIS would have an impact across various market segments given the allocation to various asset classes, investment funds have been selected as the first segment for the macro stress test exercise. For purposes of this exercise, the SC conducted a macro stress test focusing on liquidity risk *vis-à-vis* redemption pressures on unit trust funds and wholesale funds (herein collectively referred to as 'investment funds'). This exercise was not meant to replace existing stress tests undertaken at the portfolio level by market participants. Rather, it was intended to complement them with a broader system-wide understanding of potential transmission channel and amplification of shocks that could undermine the stability of the capital market and their interactions with the overall financial ecosystem.

There were various considerations made in the scenario design, namely the number and type of shock factors that would be applied to the investment portfolios and the hypothetical liquidation method that would be applied by fund managers on their respective funds. The macro stress test employed sensitivity analysis where only a single shock factor of large redemption pressure was applied to the liability side of the funds i.e. redemption pressure. Three broad scenarios of redemption pressure were applied in the macro stress test exercise based on historical redemption patterns.

In order to satisfy the redemption pressures, two common liquidation approaches were considered: by selling the most liquid to the least liquid investments (waterfall liquidation method[4] or horizontal slicing[5]), or by selling the investments on a pro-rata basis (pro-rata liquidation method or vertical). After weighing the pros and cons between these two liquidation approaches, it was determined that the horizontal slicing approach would best fit the overall objectives of the macro stress test at this juncture as it allows for a more pronounced observation of potential transmission channel with other segments of the financial markets i.e. cross-contagion effect arising from the deposits and money market placements in the banking sector, and the fixed income and equities investments in the capital market.

Since each investment fund is unique, an internal model was developed to ensure that all underlying assumptions and methodologies can be applied to the hundreds of investment funds before the results were aggregated at the macro level. Results of the macro stress test showed that the investment funds were resilient to the range of redemption pressures applied in this exercise and the liquidity within each fund was sufficient to meet the redemption request. Overall, there was minimal contagion impact to the other segments of the capital market.

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4 *Liquidity Stress Tests for Investment Funds: A Practical Guide, IMF Working Paper*, October 2017.

5 Arora, Rohan, *et al. Bond Funds and Fixed-Income Market Liquidity: A Stress Testing Approach, Technical Reports No. 115, Bank of Canada*, August 2019.

Guiding Principles on Business Continuity

As part of the SC's ongoing efforts to enhance the systemic resiliency of the capital market, the *Guiding Principles on Business Continuity* (Guiding Principles) was issued in May 2019.

The principles set out the SC's expectations on the business continuity management approach of capital market entities to ensure timely continuity of critical services and the fulfilment of business obligations in the event of disruptions.

A comprehensive business continuity management approach will also help mitigate any possibility of wider systemic risk implications to the capital market, taking into consideration the rapidly changing landscape of the market.

The principles, developed in close consultation with the industry, highlighted six focus areas:

- Board and senior management's responsibility in ensuring sound and effective business continuity protocol;
- The importance of risk identification, in particular interdependency and concentration risks;
- Risk-based recovery strategy;
- Annual testing of business continuity protocols;
- Comprehensive escalation procedures and communication plans in the event of major disruptions; and
- Ongoing review of business continuity arrangements.

The Guiding Principles are applicable to all licensed intermediaries which include entities regulated by the SC either via licensing, authorisation, approval or registration as required under the CMSA. Currently, entities that are excluded are Cagamas, PLCs and financial institutions under the purview of BNM as well as financial institutions that are categorised as registered persons under *Part 1, Schedule 4* of the CMSA. Any financial institutions that are licensed by the SC are also subject to the requirements of these principles.

Proactive surveillance of corporate activities

The SC continues to conduct surveillance through active monitoring of risk areas, corporate transactions, disclosures and financial reporting of listed companies to ensure high quality, reliable and accurate information is disseminated for investors to make informed investment decisions.

To achieve these objectives, aside from conducting comprehensive intelligence gathering, the SC engages listed companies, statutory auditors and relevant stakeholders through meetings and query letters. These proactive surveillance measures enable the SC to detect corporate transgressions and instances of non-compliance with accounting standards.

To ensure the surveillance of listed companies remains robust and dynamic, the SC continues to strengthen the effectiveness of its surveillance function through collaboration with other authorities, both local and international.

On the regional front, the SC is part of the Financial Statements Surveillance Group (FSSG), which comprises peer regulators in Asia. The FSSG organises annual workshops to share and exchange regulatory knowledge and experiences in the area of corporate financial reporting. This includes discussions on the adoption and implementation of accounting standards as well as emerging regulatory challenges faced by respective jurisdictions. In 2019, the SC participated in a workshop hosted by the Securities and Exchange Commission of Thailand.

Ensuring quality financial reporting

Compliance with the *Malaysian Financial Reporting Standards* (MFRS) is crucial for listed companies to produce high quality financial information that faithfully represents the financial position and performance of their businesses. In 2019, the SC continued to review financial statements of listed companies to detect any potential non-compliance with MFRS. The

regulatory actions taken in 2019 for corporate transgressions and non-compliance with approved accounting standards are presented in Diagram 4.

To create awareness and manage potential impact of recent changes made in the *Agenda Decision on Overtime Transfer of Constructed Good (IAS 23 Borrowing costs)*, the SC facilitated four dialogues which were attended by 124 participants, including representatives from the Malaysian Accounting Standards Board, listed companies, statutory auditors, research analysts and bankers.

Diagram 4

REGULATORY ACTIONS FOR CORPORATE TRANSGRESSION AND NON-COMPLIANCE WITH APPROVED ACCOUNTING STANDARDS IN 2019

FORMS OF CORPORATE TRANSGRESSIONS

- Used proceeds raised from private placement for questionable purchases
- Made payments to suppliers without receiving goods
- Recorded false or misleading cash and bank balances
- Subsidiaries acting as guarantor for a director's personal loans
- Furnished false documents to the regulatory authority
- Falsely recorded loss of inventories

ACTIONS TAKEN

Detected issues involving breaches of securities laws amounting to **RM11.4 million** for further investigation

Administrative actions taken against three listed companies and 13 directors, former directors and CFOs

Four warning letters issued to directors and former directors

AREAS OF NON-COMPLIANCE WITH APPROVED ACCOUNTING STANDARDS

- **IMPAIRMENT ASSESSMENT**
  Impairment assessment on plant and equipment was not performed
- **VALUATION OF INVENTORIES**
  Carrying value of the inventories was not properly assessed
- **OPERATING SEGMENT DISCLOSURE**
  Wrongly disclosed figures in relation to geographical revenue
- **RECOGNITION ON WAIVER OF DEBT**
  Incorrect recognition

ACTIONS TAKEN

Issued supervisory letters to two listed companies and their directors, and five former director

Surveillance through risk-focused approach

Given the fast-changing landscape of the capital market, the SC's surveillance function goes beyond monitoring broad-based development of listed companies. It includes a risk-focused approach through thematic reviews of specific sectors, capital market products, financial reporting and earnings, and impact of global risks. These thematic reviews enable the SC to identify trends and developments as well as emerging risks in the capital market.

The SC regularly conducts earnings analysis across all listed companies, which forms the basis of in-depth assessments into a specific sector to identify internal and/or external factors that may affect the listed companies within that sector.

In 2019, a downward trend was observed in the earnings of listed companies in the real estate sector over the period of 2015-2018. An in-depth assessment of the real estate sector revealed the following:

- Impairment of receivables and inventories, and write-off of development expenditure in a number of listed companies; and
- Interest coverage ratio deteriorated despite consistent corporate gearing level.

The resilience of the listed companies was therefore tested under several stress scenarios. Findings from the stress testing however showed that the overall risk of the listed companies within the sector is manageable. An overview of the entire exercise is presented in Diagram 5.

Diagram 5

THEMATIC REVIEW ON LISTED COMPANIES IN THE REAL ESTATE SECTOR

SCOPE OF REVIEW

The focus was on listed companies in the real estate sector. Areas of review included analysing the earnings and assessing the gearing and interest coverage ratio of the listed companies.

OBSERVATIONS

- Downward trend in the earnings of listed companies in the real estate sector. The identified key factors that affected the earnings of the listed companies were:
  - Impairment of receivables and inventories; and
  - Write-off of development expenditure.
- The interest coverage ratio deteriorated despite consistent corporate gearing, which triggered a stress test exercise.

STRESS TESTING

Using projected financials over four years in terms of revenue, gross profit and earnings against the growth of nominal gross domestic product and property sales.

STRESS SCENARIO I

Nominal GDP is assumed to initially decline by 8%, followed by a strong rebound of 12% in 2020, before normalising towards baseline by 2022.

STRESS SCENARIO II

Nominal GDP is assumed to initially decline by 8%, followed by prolonged period of flattish growth (0%) in the 2020 and 2021, before recovering only slightly by 2% in 2022.

OBSERVATIONS

Findings from the stress testing revealed that the overall risks of the listed companies in the sector were manageable.

Enhancing cyber resilience

The SC is cognisant of the importance of cyber resiliency for the capital market given the evolving cyber threats in financial markets worldwide. Enhancing cyber risk management is critical given the diversity of market players in the capital market.

The SC conducted thematic reviews and a cyber-simulation in 2019 to assess the capabilities of selected market players. (Diagram 6)

Capital Market Cyber Simulation

For the 2019 capital market simulation exercise, multiple scenarios were simulated to ensure the participants' internal incident response protocols are capable to remediate cyber incidents and maintain orderly market. Results from the cyber simulation exercise showed a 12% improvement compared to 2018's exercise despite the increased difficulties in the assessment scenarios. Some participants demonstrated maturity in their level of cyber resilience and were better prepared in the event of cyber-attack.

Diagram 6

THEMATIC ASSESSMENT ON INTERMEDIARIES AND REVIEW ON TECHNOLOGY SERVICE PROVIDERS RISK MANAGEMENT

BACKGROUND

The SC conducted a series of assessments of selected capital market participants with high technology and cyber risk profile to assess their compliance with the *SC's Cyber Risk Guidelines.*

An assessment was conducted by the SC on the effectiveness of outsourcing risk management to technology service providers given that the use of third-party service providers in core market operations is becoming a common practice due to cost and efficiency benefits.

OBSERVATIONS

There are several areas for improvement to enhance cyber resilience including the need for greater accountability by the board and senior management on technology systems management as well as to ensure consistency of practice with the policies and procedures that are in place.

On outsourcing technology to service providers, while the SC observed that there was improvement in governance structure and third–party's technology processes, the oversight on the performance measurement can be increased to align with the service level agreements.

OUTCOME

Firms should undertake continuous improvement process to ensure the effectiveness of their cyber resilience. For example, firms can leverage findings of an effective third line of defence i.e. internal audit to manage any gaps for improvement.

Identified gaps will require participants to exercise due attention and diligence to strengthen their cyber security. The simulation also promoted close interaction between capital market entities with the SC and the National Cyber Security Agency (NACSA) to co-ordinate responses and share information on cyber incident handling.

Cyber Risk Working Group

The Cyber Risk Working Group (CRWG) met on a quarterly basis since March 2018 to gain insights on the macro landscape of cyber risks and to raise cyber awareness for protection and preventive measures. Key outcomes from the CRWG is presented in Diagram 7. As the capital market grows, the nature and scale of underlying cyber risks evolves rapidly. The major contributing factors include the changing nature of technologies, higher deployment of financial technology, aggressive lead times for launching electronic financial services as well as the expanding roles of fintech and technology service providers, with some operating outside the SC's regulatory ambit.

As the capital market advances with new players embracing technology in their core business operations, there is growing importance for both the incumbent and fintech firms to establish a robust cyber risk management framework for cyber security resilience as well as better data protection protocols to prevent data breaches. The SC has also emphasised on effective information-sharing and timely incident reporting by intermediaries to reinforce their ability to oversee cyber risk management and provide critical information to monitor the responsiveness of the industry.

REINFORCING ORDERLY TRADING CONDUCT AND GOVERNANCE AMONG MARKET PARTICIPANTS

Preserving market integrity and facilitating a vibrant marketplace

The SC seeks to strike a balance between facilitating a vibrant marketplace and the need to preserve market integrity. Therefore, the SC takes into consideration diversity in trading practices and strategies when analysing trading conduct.
As part of its proactive oversight, the SC conducted regular engagements with the frontline regulator to ensure regulatory responses commensurate with the risks and gravity of trading anomalies detected.

The SC continued to remain vigilant in addressing trading irregularities that may pose risks to the integrity of the capital market. Measures were undertaken in collaboration with Bursa Malaysia to heighten the level of accountability among intermediaries by communicating the standards of conduct and governance expected of them.

Diagram 7

OUTCOMES OF THE CYBER RISK WORKING GROUP

These measures included engagements and communication to raise awareness of emerging risks and market trends, as well as to guide and facilitate the intermediaries in ensuring orderly trading conduct and discharge of their self-regulation responsibilities.

Detecting market abuses and other questionable trading conduct

In 2019, the SC detected several cases of serious market misconduct involving possible stock market manipulation, insider trading, securities fraud and front running. These cases have been escalated for further investigation to be carried out.

The SC also observed questionable trading conduct that fell short of control levels and monitoring standards expected from intermediaries. Certain transactions executed by intermediaries, although harmless on their own, were subsequently found to be related to possible illegal investment schemes. Surveillance observations were often shared with internal stakeholders to facilitate the SC's supervisory efforts in strengthening intermediaries' governance standards and accountability. The cross functional collaboration within the SC has led to convergence of common areas of regulatory interest, which in turn, allowed the SC to address issues of concern in a holistic manner.

Addressing emerging risks from internet and automated trading

In 2019, the SC continued to undertake proactive surveillance measures to curb trading anomalies caused by automated trading. This ensures undesirable trading practices were addressed at an early stage.

To complement the SC's proactive measures, a thematic review was carried out by the frontline regulator on intermediaries' trade surveillance of automated trading. The review covered areas such as intermediaries' risk controls, governance and compliance framework as well as front office monitoring in relation to electronic trading. The findings revealed different degrees of intermediaries' understanding and management of risks associated with automated trading. The review findings were shared with the intermediaries to facilitate improvements in their respective controls and ongoing monitoring in relation to automated trading by their clients.

Surveillance oversight of Digital Asset Exchanges

Following the registration of three exchanges as Recognised Market Operators (RMOs) to operate Digital Asset Exchanges (DAX) in Malaysia, the SC enhanced its processes to ensure effective oversight of DAX and the trading activities conducted on their platforms.

The DAX are responsible to ensure that their platforms operate in a fair, orderly and transparent manner. As RMOs, they are also expected to conduct real-time market surveillance and put in place adequate measures to deter and detect manipulative trading activities on their platforms.

As part of the SC's oversight of DAX, it conducts regular engagements and discussions with them to ensure that real-time surveillance functions are discharged effectively. The SC will also focus on post-trade analysis of trading misconduct that may be in breach of securities laws such as false trading and market manipulation.

In 2019, the SC embarked on initiatives to further leverage the use of technology in carrying out its market surveillance functions. Investments were made on system upgrades. The SC is also looking into potential acquisitions or development of new analytical tools to facilitate its oversight of DAX and analysis of trading of regulated digital assets.

Market Study on Misconduct by Licensed and Registered Persons

The SC conducted a market study on misconduct by Licensed and Registered Persons in November 2019. Rigorous quantitative analysis was conducted on 30,000 data points spanning over nine years. The market study has uncovered insights to the trends of market misconduct in Malaysia. The findings from this were used to support the SC's regulatory policymaking and behavioural economics work. This was undertaken in the spirit of the SC's Evidence-Based Regulatory Policy Framework.

Based on the available data from administrative and supervisory actions (excluding civil and criminal cases) between 2010 to 2018, there were 498 individuals who were suspected to have engaged in misconduct (Alleged Persons) in 561 instances. The majority of them were found to be male (56%), less-experienced (40% had less than five years of industry experience) and aged between 30 – 49 years old (55% of Alleged Persons).

Analysis further showed that larger Principals, with their bigger market share and wider base of Licensed and Registered Persons, generally had more Alleged Persons. However, once scaled for their base of Licensed and Registered Persons, smaller Principals were found to have a higher proportion of their population suspected to have engaged in market misconduct. This suggests that there remains scope to strengthen self-discipline, particularly among smaller Principals.

Overall, these 498 individuals represent less than 1% of the population of Licensed and Registered Persons, indicating that the incidence of market misconduct in Malaysia remains sporadic and that the overall compliance level in the industry remains robust.

There were 19 types of misconduct identified and grouped into the following five key categories:

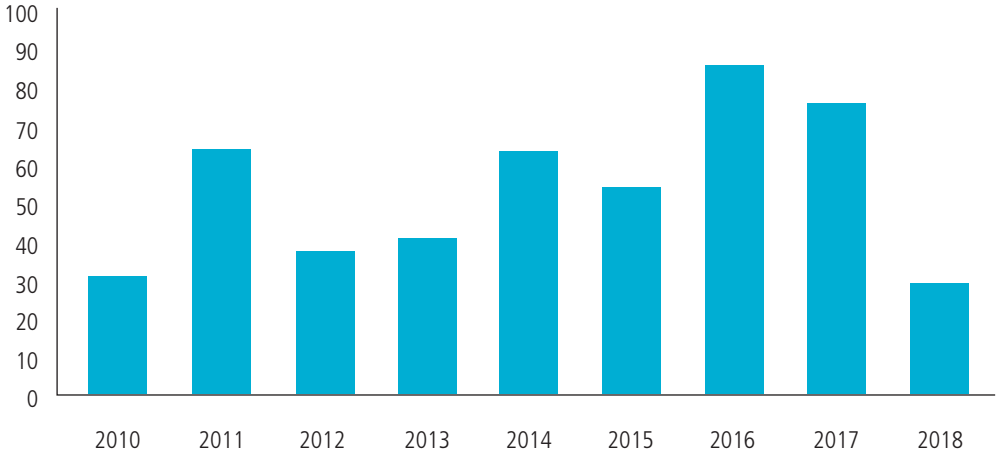
- Unauthorised trading and investment;
- Misuse of client information and/or money;
- Misrepresentation to client or improper sales practices;
- False trading/market manipulation/insider trading; and
- Others (including conflict of interest, failure to conduct customer due diligence / KYC, failure to declare as a bankrupt, etc.).

Trends indicated that the incidence of market misconduct has decreased in recent years after trending upwards between 2012 and 2016. There were mixed trends among the various types of misconduct, suggesting that there was no evidence of systematic regulatory risk from a particular type of misconduct.

Market misconduct had affected 502 investors, resulting in an estimated total loss of RM54 million or about RM108,000 per affected investor. This is about 1.7 times the Malaysian median annual income of RM62,736 (based on 2016 data from the Department of Statistics Malaysia). Hence, while data showed that market misconduct cases may be sporadic, the harm to an affected investor can be very large.

Chart 1

Number of Alleged Persons by year 2010-2018



In response to these market misconduct cases, relevant authorities including the SC, Bursa Malaysia, FIMM and SIDREC have imposed monetary fines and penalties totaling RM22 million. In addition to monetary fines and penalties, the authorities also took other types of regulatory actions on Licensed and Registered Persons who were found guilty of market misconduct. Non-monetary penalties, among others, include issuing directives/warning letters, suspension/revocation of licenses and reprimands. Some cases remain under investigation and action will be taken where appropriate.

Evidence showed that regulatory disciplinary actions have been important to strengthen market integrity. Only 4% of Alleged Persons were repeat offenders, suggesting that sanctions by authorities have been effective in preventing future misconduct.

Preserving market integrity is a shared responsibility by all stakeholders in the capital market ecosystem. In addition to regulatory actions by authorities, the market study indicated that Principals played an important frontline role in elevating firm-level discipline. Principals and senior management should remain vigilant of potential misconduct and step up their supervisory efforts on Licensed and Registered Persons by setting the tone of strong compliance culture and self-discipline.

STRENGTHENING CONDUCT AND GOVERNANCE OF INTERMEDIARIES

Supervisory strategy

The SC adopts a forward-looking and risk-focused approach to supervision with emphasis on culture and conduct. The strategy is geared towards ensuring that an intermediary has the right compliance culture and governance framework in place for the promotion of responsible corporate conduct and governance.

In this regard, the SC expanded the scope of its intermediary supervision mandate beyond ensuring micro-prudential soundness and compliance to include assessing the strength of governance, oversight and risk functions of intermediaries. This approach helps to ensure that an intermediary has adequate and effective oversight of critical risk elements and to ensure that an intermediary's risk fundamentals are recognised as strategically important to its operations.

Leveraging integrated data analytics framework to strengthen supervisory oversight

The SC has further strengthened its data collection and assessment methodology through the utilisation of an integrated data analytics framework. This information allows the SC to update intermediaries' risk profiles, determine appropriate examination programmes and establish its supervisory priorities.

The framework has resulted in an enhancement to the quality of risk identification and risk assessments in monitoring historical trends and detecting regulatory non-compliance by intermediaries.

Compliance with anti-money laundering/counter terrorism financing/counter proliferation financing (AML/CFT/CPF) requirements

In view of the updated recommendations[6] issued by the Financial Action Task Force (FATF) on virtual asset (VA), virtual assets service provider (VASP) and the upcoming Follow Up Assessment (FUA) with respect to Malaysia's adherence with the recommendations of the FATF, the SC is committed to enhance its oversight on new players and activities, and raise the compliance standards of reporting institution. The SC will provide further guidance and organise continuous awareness programmes focused on the areas of improvement under assessment, including supervision and compliance with counter proliferation financing (CPF) requirements.

DID YOU KNOW?

The SC's thematic review in 2019 focused on the proliferation financing requirements for capital market intermediaries, standards of fiduciary duties and responsibilities of bond trustees, controls by fund management companies (FMC) to prevent misuse of material non-public information (MNPI), and a follow up from 2018's review on liquidity risk management.

Continuous guidance and awareness of AML/CFT/CPF requirements

Following the SC's thematic review on market intermediaries' compliance with the *Guidelines on Implementation of Targeted Financial Sanctions Relating to Proliferation Financing for Capital Market Intermediaries* (TFS-PF Guidelines), the SC issued a *Quick Guide to TFS-PF Guidelines* (Quick Guide) on 29 October 2019 to facilitate understanding and compliance with proliferation financing requirements among market intermediaries.

[6] *International Standards on Combatting Money Laundering and the Financing of Terrorism and Proliferation.*

The Quick Guide provides a snapshot of the obligations under the TFS-PF Guidelines and a case study. Details of the thematic review is provided in Diagram 9.

The SC also held various engagements with market intermediaries including ECF and P2P operators to strengthen their understanding of the AML/CFT/CPF requirements.

In addition, the SC continues to strengthen its supervisory capabilities in respect of proliferation financing by engaging representatives from the Ministry of International Trade and Industry and Ministry of Foreign Affairs for training on matters under the *Strategic Trade Act 2010* and United Nations sanctions in relation to proliferation financing.

Inclusion of new reporting institutions under the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001

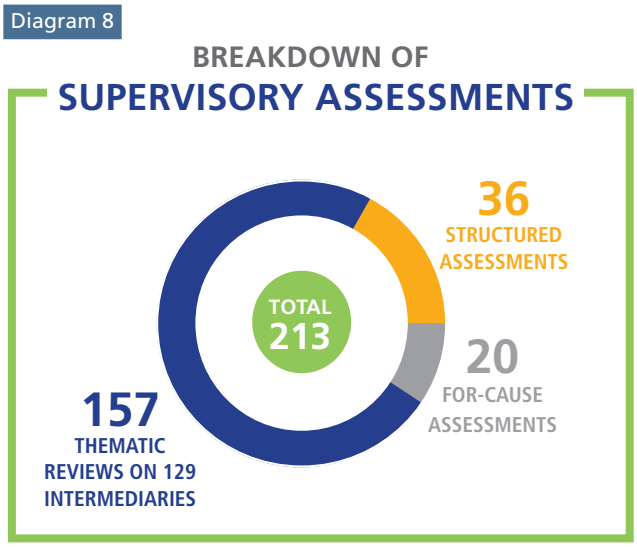
The rise of fintech and digitisation has led to the emergence of new players and activities in the capital market including ECF, P2P Financing, PCF and DAX. Given the potential money laundering and terrorism financing risks posed by these activities and players, the SC continues to strengthen its anti-money laundering, counter terrorism financing and counter proliferation financing (AML/CFT/CPF) regulatory framework to detect and prevent potential money laundering, terrorism financing and proliferation financing activities in Malaysia.

Cognisant of the revised Recommendation 15[7] of FATF Recommendations 2012 relating to new technologies, VA and VASP, the SC together with BNM are reviewing the First Schedule of the *Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001* (AMLATFAPUAA) to expand the list of reporting institutions in the capital market by adding these new players and activities. These new capital markets institutions are expected to become full reporting institutions under AMLATFAPUAA and will be required to comply with the SC's *Guidelines on the Prevention of Money Laundering and Terrorism Financing for Capital Market Intermediaries* once the review exercise is completed in early 2020.

Supervisory assessments and thematic reviews

In 2019, a total of 213 assessments were carried out as illustrated in Diagram 8. This comprised 36 structured assessments and 157 thematic reviews involving 129 intermediaries on identified areas of risk. Thematic reviews are typically employed upon the identification of cross-sector trends, risks and compliance lapses that require prompt regulatory responses. Additionally, the SC carried out 20 for cause assessment arising from complaints and referrals received with regards to misconduct. The purpose of such examinations are to enable swift intervention to be taken in identifying the root-cause or control failures of intermediaries.

Diagram 8



[7] Recommendation 15 – Countries and financial institutions should identify and assess the money laundering/terrorism financing risks that may arise in relation to the development of new products and new business practices, including new delivery mechanisms, and the use of new or developing technologies for both new and pre-existing products. Countries should take appropriate measures to manage and mitigate the risks including by ensuring that virtual asset service providers are regulated for AML/CFT purposes, and licensed or registered and subject to effective systems for monitoring and ensuring compliance with the relevant measures called for in the FATF Recommendations.

Thematic Reviews

Proliferation Financing

The SC conducted a comprehensive review on selected market intermediaries with a view to assess intermediaries' compliance to the TFS-PF Guidelines. A range of supervisory tools which included on-site assessments and analysis of Reporting Institution (RI)[8] questionnaire responses were utilised for the review.

Diagram 9

THEMATIC REVIEW ON PROLIFERATION FINANCING REQUIREMENTS FOR CAPITAL MARKET INTERMEDIARIES

BACKGROUND

The SC issued the TFS-PF Guidelines on 6 April 2018.

On 9 July 2019, a TFS-PF Questionnaire was issued to 118 RIs to assess their understanding and compliance of TFS-PF requirements. A series of group engagements was held with the RIs to further enhance their understanding on TFS-PF requirements.

The SC also conducted on-site assessments on selected RIs, to review the intermediaries' implementation on the TFS-PF requirements.

In carrying out the review, the SC placed particular emphasis on assessment of the following areas:

- The risk awareness of market intermediaries in relation to the sanctions list, risk detection and mitigation of proliferation financing risks;
- The effectiveness of framework and controls for countering proliferation financing; and
- Intermediaries' approach in identifying and monitoring higher risk customers and transactions.

OBSERVATIONS

- Most RIs have adequate understanding of their obligations under the sanctions regime.
- RIs have put in place a governance process for their respective boards and senior management to be adequately apprised of PF risks relating to their business;
- RIs have established policies and procedures for the implementation of the TFS-PF requirements, including:
  - Processes to update the sanctions list database and perform ongoing screening;
  - Staff training on regulatory changes; and
  - Conduct regular audits and compliance testing of key sanctions-related controls.
- Larger RIs use some level of automation to undertake sanctions screening while the process remains mostly manual for smaller RIs.

SUPERVISORY OUTCOME

RIs to strengthen the implementation of the TFS-PF requirements, including ensuring effective documentation of the justifications for disposing of potential name matches, if any.

[8] Reporting Institution means a person carrying on regulated activities under the CMSA as specified under the First Schedule of the AMLATFAPUAA.

Diagram 10

OVERVIEW OF THE TFS-PF OBLIGATIONS OF REPORTING INSTITUTIONS

MAINTAIN UPDATED SANCTIONS LIST

RIs must maintain a list of designated persons on TFS-PF as specified in the United Nations Security Council Consolidated List.

List must be continually updated, and adopted without delay.

Database may be maintained by the RI (whether internally generated or sourced from an external vendor).

SCREENING AGAINST SANCTIONS LIST

Sanctions list must be used to screen potential/new and existing clients.

Screening against current terrorist and sanction designations must be carried out:-

(a) upon the establishment of the business relationship; and

(b) thereafter against any new or updated designations (without delay).

Screening function can be performed manually or via an automated financing sanction checking facility.

FREEZE/BLOCK/REJECT

Existing customers
Should the identity be matched with the designated person, the intermediary must freeze the funds, properties or accounts of the customer.

Potential or new customer
Should the identity be matched with designated person, the intermediary must reject the customer if the transaction has not yet commenced.

REQUIREMENTS TO REPORT

To report to the SC immediately on any freezing, blocking or rejection actions taken, and any changes to the frozen assets by 31 January in the next calendar year.

To submit suspicous transaction report to the Financial Intelligence and Enforcement Department of BNM

- Positive name matches arising from ongoing screening of customer database; and
- Any attempted transaction by any of the designated person or its related party.

Thematic review on bond trustees

Bond trustees form an integral part of the bond market ecosystem and play a critical role in safeguarding and upholding bondholders' interests and rights. A thematic review was carried out on identified bond trustees, with a view to assess their standards of fiduciary duties and responsibilities.

The review focused on the following areas:

- **Fiduciary duties** – an assessment of the ongoing conduct obligations of bond trustees in carrying out their duties;
- **Governance** – adequacy of current structures to ensure the required governance processes are in place;

- **Operational areas** – evaluation of critical areas of bond trustee operations; and
- **Conflict of interest** – adequacy of policies and procedures to address the identification, elimination, avoidance and management of conflict of interest.

The observations and outcome are summarised in Diagram 11.

Diagram 11

THEMATIC REVIEW ON BOND TRUSTEES

BACKGROUND

The thematic review was conducted to assess the standards of fiduciary duties and responsibilities of bond trustees as well as to understand and evaluate crucial areas of operations. The review was carried out through on-site engagements and issuance of questionnaires to the identified bond trustees.

OBSERVATIONS

- While our findings on the 4 focused areas showed no major concerns in the industry, the SC observed that generally, the overall standards of bond trustees' operations can be improved to further safeguard the interest of bondholders, particularly the need for active monitoring in addressing their fiduciary duties.
- Currently, bond trustees do not have direct access to the list of bondholders except through the respective Authorised Depository Institutions, which remain a concern to the operations of a bond trustee.
- There is a need for bond trustees to identify aspects of their operations, which can be enhanced for greater efficiency namely through the use of digital solutions.
- Bond trustees need to ensure that their officers have the required competencies and undergo continuous professional development.

SUPERVISORY OUTCOME

The SC will develop its supervisory framework on bond trustees based on insights gained from the thematic review to ensure that the bond trustees play their roles effectively. This is imperative in complementing and supporting the SC's ongoing supervision and continued regulatory oversight on bond trustees.

Preventing misuse of MNPI by FMC

Due to the nature of the fund management business, an FMC may inadvertently come into possession of MNPI. When such information is not effectively managed by intermediaries via the implementation of adequate controls, this may lead to the risk of market abuse. A thematic review of intermediaries' controls was carried out to assess the quality of FMC's controls to prevent and manage misuse of MNPI.

The review focused on the following areas:

1. **Governance** – adequacy of current structures to ensure the required governance processes are in place;
2. **Policies and procedures** – adequacy of policies and procedures on managing conflict of interest;
3. **Controls** – assessing the effectiveness of controls implemented by the intermediaries to prevent misuse of MNPI; and

Diagram 12

THEMATIC REVIEW ON PREVENTING MISUSE OF MNPI BY FMC

BACKGROUND

Through the interactions between the FMCs and existing or potential investee companies, fund managers and their research analysts may inadvertently come into possession of MNPI. Thus, FMCs must have adequate controls and processes in place to mitigate the risk of misuse of such information. A thematic review was carried out to assess the controls adopted by FMCs to prevent the misuse of MNPI.

OBSERVATIONS

- The range, level and quality of controls adopted by FMCs in managing MNPI vary according to the size of the FMCs.
- The policies and procedures of some small-and medium-sized FMCs could be improved in terms of comprehensiveness.
- Although a majority of FMCs have expressed that employees in possession of MNPI are expected to inform the compliance function and are restricted from trading on such information, some have yet to formalise the procedures.
- Only a limited number of large FMCs use surveillance systems for purposes of managing the dissemination of MNPI. This may potentially lead to the risk of market abuse.

SUPERVISORY OUTCOME

The SC will issue a circular on best practices for managing and preventing misuse of MNPI.

4. **Training** – measures undertaken by the intermediaries on awareness and training for their employees and representatives on preventing the misuse of MNPI and the risk of market abuse.

The observations and outcomes are summarised in Diagram 12.

Guidance for intermediaries

As part of its efforts to ensure business resilience of intermediaries, the SC issued *Guidance Notes on Liquidity Risk Management* (LRM) for *Fund Management and Unit Trust Management Companies* on 16 December 2019. Salient features of the guidance notes are presented in Diagram 13.

Diagram 13

SALIENT FEATURES

OF THE GUIDANCE NOTES ON LRM

LRM IN DIFFERENT STAGES THROUGHOUT THE LIFECYCLE OF OPEN-ENDED FUNDS

GOVERNANCE	Establish effective governance structure to oversee the LRM function
INITIAL PRODUCT DESIGN	Evaluate liquidity risks when considering the key product features at the product design stage
ONGOING LRM	Day to day monitoring and managing liquidity risks of a product throughout its lifecycle to anticipate or identify emerging liquidity shortage before it occurs, and take appropriate steps to minimise disruption or detriment
STRESS TESTING	Conduct ongoing fund stress testing based on multiple scenarios to assess the impact of market disruptions on the liquidity and redemption levels of the funds
LRM TOOLS AND CONTINGENCY PLANS	Proactively consider LRM tools that enable the company to readily assess and decide on actions required in a liquidity disruption, or stress and periodically test contingency plans to meet short-term bridging requirement

PROMOTING MARKET INTEGRITY

Reinforcing Bursa Malaysia's risk governance and regulatory independence

The SC continues to undertake a comprehensive supervisory approach to ensure Bursa Malaysia discharges its regulatory and market functions effectively and acts as a prudent central counterparty. Such actions include:

- Regular regulatory assessments;
- Review of Bursa Malaysia's reporting submissions;
- Oversight supervision of intermediaries participating in Bursa Malaysia;
- Oversight of Bursa Malaysia's surveillance of trading activities conducted on its exchanges;
- Review and approval of Bursa Malaysia's rules and rule amendments; and
- Close and regular engagements with the board and senior management of Bursa Malaysia.

Given the importance of Bursa Malaysia as a single integrated exchange in the country, the SC continued to strengthen the governance arrangements and practices of Bursa Malaysia. The independence of Bursa Malaysia's regulation is a key focus area to mitigate the risk of conflict of interest arising from an exchange group with both commercial and regulatory objectives. In 2019, the SC intensified engagements with Bursa Malaysia to address potential conflict of interest between its commercial and regulatory role.

In relation to the oversight of Bursa Malaysia's cyber risk management, the SC focused on reducing risk, achieving greater transparency and improving efficiency to establish a safer market environment. Bursa Malaysia participated in the capital market cyber simulation to assess cyber preparedness as well as response and recovery from cyber incidents – the results of which were satisfactory.

The SC also facilitated the implementation of the shortening of Bursa Malaysia equity market settlement cycle from T+3 to T+2 in April 2019, which is on par with practices of global and developed exchanges for global settlement harmonisation.

The shortening of the settlement cycle is expected to yield important benefits including reduced settlement risk as well as lower margin requirements and clearing risk from a central counterparty perspective.

To strengthen accountability in the market, the SC approved the increase in the derivatives clearing default fund to augment the default risk management of Bursa Derivatives Clearing. The current clearing fund size will be increased from RM23 million to RM41.5 million, which is expected to be sufficient to cover potential losses of its clearing participants' trading exposures.

DID YOU KNOW?

The SC has approved the increase in the derivatives clearing default fund size from RM23 million to RM41.5 million.

This will be implemented in stages over a period of five years beginning 2020 by way of additional contributions from Bursa Malaysia and its clearing participants.

Strengthening FIMM's discharge of self-regulatory duties

The oversight of the Federation of Investment Managers Malaysia (FIMM) as an industry self-regulatory organisation (SRO) remains a key supervisory emphasis for the SC. In 2019, the supervision of FIMM centred on further strengthening the governance framework and practices within FIMM to effectively regulate the

marketing and distribution of unit trust and private retirement schemes (PRS) products given the increased focus on digital marketing efforts.

The goal for FIMM is to promote ethical industry practices and improve the conduct of consultants and distributors in the marketing and distribution of these products. Education programmes using e-learning technology have been embraced in this respect. The SC focused on enhancing the effectiveness of FIMM's enforcement actions through the bilateral Referral Working Group process between the SC and FIMM, which facilitates co-ordination on complaints or breaches reported to FIMM.

Introduced in 2018, this process has helped to ensure more timely and efficient case management as well as improve the effectiveness of enforcement actions. The SC has also sought to broaden the range of expertise of the board of directors by ensuring diversity through the appointment of directors with backgrounds in financial services and the law.

Ensuring the PPA performs its public interest role efficiently

The Private Pension Administrator (PPA) plays a critical role as the central administrator for the PRS industry, providing online PRS services and consolidating records of PRS investments of its members. In addition to its existing online PRS services such as member enrolment, unit top-up of members' contribution, withdrawal and beneficiary nomination, the SC facilitated the implementation of an online bulk enrolment service for employers and corporates in 2019. This has eased membership enrolment for corporates and facilitated collaboration between PRS providers and corporates.

The SC's oversight of PPA centres on ensuring its continuous delivery of efficient and effective central administrative services as well as long-term operational sustainability. Given PPA's increased use of technology in its operations, in 2019, the SC focused on ensuring operational compliance and adequate cyber risk management.

Facilitating development of innovative market structures through proactive supervisory approach

The universe of market operators under the SC's *Guidelines on Recognized Markets* (RMO Guidelines) has expanded in 2019 with the introduction of new market structures, i.e. DAX and PCF, as well as the registration of additional ECF and P2P platform operators.

With the *Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019* coming into force, the SC revised the RMO Guidelines in January 2019 to include the regulatory framework, governing the trading of digital assets. The same Guidelines was further revised in May 2019 to introduce an alternative financing venue for first time home buyers through a PCF platform, utilising technology to benefit investors by democratising access to investment while broadening home financing options available for Malaysians.

The supervisory approach adopted for all RMOs is aimed at facilitating the development of innovative market structures while providing adequate customer protection and robust risk management. The SC has undertaken close and regular engagements with the RMOs to set minimum standards emphasising:

(i) Adequate and enhanced client onboarding processes in compliance with anti-money laundering, fraud and proliferation financing prevention requirements;

(ii) Stronger cyber and operational risk management that fulfil the obligations set out in the SC's *Guidelines on Management of Cyber Risk* and SC's *Guiding Principles on Business Continuity*. The ECF and P2P operators are required to participate in the annual cyber drill exercises organised by the SC to strengthen their cyber threat preparedness;

(iii) Stronger clients' asset protection and custody arrangements based on the SC's engagement with the Association of Trust Companies Malaysia (ATCM) to clarify obligations and duties in ensuring clients' monies / assets are managed appropriately; and

(iv) Increased transparency for P2P operators. Based on the SC's review of the default rate methodology, it has provided standardisation of the default calculation for transparent disclosure on their platforms.

Moving forward, the SC will continue to closely supervise the RMOs through regular engagements and reporting activities. Oversight efforts will also consist perusing business plans of RMOs, which include business strategy as well as compliance reports on all areas of the business.

ENFORCEMENT HIGHLIGHTS 2019

ACHIEVING EFFECTIVE DETERRENCE

The SC believes that effective deterrence is best achieved when the enforcement action is swift and its outcomes are certain. Thus, the SC has recalibrated its strategy to ensure robust application of its enforcement powers to ensure that the intended outcomes from the enforcement actions are achieved.

ADMINISTRATIVE ACTION

99

ADMINISTRATIVE SANCTIONS IMPOSED

Various types of administrative sanctions were imposed against capital market intermediaries, professional advisors, listed companies and their directors to ensure accountability for their misconduct:

24 PENALTIES IMPOSED AMOUNTING TO

RM5,384,500

64 REPRIMANDS | **2** LICENCES REVOKED | **4** PUBLIC STATEMENTS | **5** DIRECTIVES ISSUED

SANCTIONS WERE IMPOSED FOR:

- Failure to comply with the *Guidelines on Prevention of Money Laundering and Terrorism Financing for Capital Market Intermediaries*.
- Failure to report to the SC on irregularities which would materially affect the ability of a sukuk issuer to perform its financial obligation.

The SC imposed reprimands and penalties totalling RM2.2 million on Deloitte PLT for failure to immediately report to the SC on irregularities, which may have a material effect on the ability of Bandar Malaysia Sdn Bhd to fulfil its obligations in repaying its sukukholders under the Sukuk Murabahah Programme.

- Knowingly authorising false and/or misleading statements to the SC.

The SC reprimanded China based PLC, listed on Bursa Malaysia namely China Stationery Ltd (CSL), Maxwell International Holdings/Bhd (Maxwell) and Xingquan International Sports Holdings Ltd (Xingquan) together with some of its directors for knowingly causing the lodgement of false or misleading financial statements to Bursa Malaysia. The SC also issued a public statement that the retention of office by Chan Fung of CSL, Li Kwai Chun of Maxwell and Dato' Wu Qinguan of Xingquan as directors of those companies as being prejudiced to the public interest.

- Committing an act with the intention of causing wrongful loss to a related corporation of a listed entity.

CIVIL ENFORCEMENT

SUCCESSFUL DISGORGEMENT AMOUNTING TO
RM33.8 MILLION
in relation to civil enforcement action on insider trading and false disclosure

16 INDIVIDUALS

Regulatory settlements were entered between the SC and 16 individuals in 5 cases in relation to insider trading breaches where the sum disgorged amounted to
RM16,037,061.19

9 INDIVIDUALS

Consent judgements were obtained by the SC against 9 individuals for insider trading and submission of false information where the sum disgorged amounted to
RM17,775,986.93

CIVIL PENALTY
obtained amounting to
RM8.8 MILLION

RESTITUTION TO INVESTORS:

RM1,264,882.00
have been restituted to investors

RM1,170,187.53
have been earmarked for further restitution

619
investors have been restituted

214
investors have been earmarked for further restitution

Civil enforcement actions were initiated against
8 INDIVIDUALS
7 Individuals for insider trading; and 1 individual for submission of misleading statement to Bursa Malaysia

Judgment amounting to
RM12.4 MILLION
obtained from the High Court against a deputy managing director of a PLC for causing wrongful loss

RESTRAINING AND BARRING ORDER:

- **Barring order against 3 directors** of PLCs from becoming a director in any PLCs for a period of **5 years**; and
- **Restraining order against a CMSRL holder** and **2 PLC directors** from dealing in any securities in the Malaysian stock market for a period of **5 years**.

CRIMINAL PROSECUTION

CONVICTION SECURED

against **14 individuals** for offences of insider trading, false financial reporting, failure to register prospectus and failing to assist in investigation

Court meted out **jail sentences** of up to **5 years**

CONVICTIONS INCLUDE OFFENCES SUCH AS:

- Committing insider trading with the disposal of **10,200,800 shares** while in possession of MNPI;
- Furnishing false statements to Bursa Malaysia in relation to revenue figures ranging from **RM7 million** to **RM40 million**, which contain fictitious sales; and
- Furnishing false statements to Bursa Malaysia in relation to false announcement of acceptance of **RM1.6 billion** project.

ENFORCEMENT - DIGITAL ASSET

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CEASE AND DESIST ORDERS

Issued to persons carrying out unauthorised activities

The SC noted that there was an increase in regulatory issues pertaining to digital assets, unauthorised DAX and ICO, which affected members of the public. This required the SC to take swift enforcement actions through issuance of cease and desist orders.

Enforcement collaborations and co-operations

Establishment of the National Anti-Financial Crime Centre

The *National Anti-Financial Crime Centre Act 2019* (NFCC), which was gazetted on 31 December 2019 provides for the establishment of a centre to carry out activities relating to the prevention of financial crime. Essentially, NFCC is a vehicle to optimise collaboration among Law Enforcement Agencies (LEAs) through co-ordination and collaboration in integrated operation between the LEAs in matters relating to financial crime. The NFCC will have three main functions:

- To co-ordinate and collaborate in integrated operation with enforcement agencies on matters relating to financial crimes and to advise the agencies on related matters;
- To establish, administer and maintain a centralised data system relating to financial crimes, in order to provide support for the integrated operation and to transmit information in the centralised data system to other government agencies; and
- To carry out activities relating to the prevention of financial crimes.

The SC together with several other LEAs such as the Royal Malaysian Police, the MACC, BNM and the Royal Malaysian Customs are among the pioneer LEAs in the establishment of the new centre.

Launch of Public-Private Partnership to combat money laundering

The SC is one of the agencies in the collaboration and co-operation initiative between BNM, LEAs and financial institutions, which was launched by the Prime Minister, YAB Tun Dr Mahathir Mohamad on 5 November 2019 to enable closer collaboration between LEAs and selected financial institutions. Essentially, the Public-Private Partnership (PPP) facilitates rapid and effective exchange of financial information and intelligence in combating money laundering and other financial crimes through improved quality of Suspicious Transactions Reporting (STR) from financial institutions in the PPP. This objective is achieved through effective, timely and seamless sharing of financial intelligence from financial institutions for the purpose of crime prevention and law enforcement.