Suruhanjaya Sekuriti
Securities Commission
Malaysia

CONSULTATION PAPER

DIGITISING POST-TRADE AND SETTLEMENT FOR THE STOCKBROKING INDUSTRY: ONLINE SETTLEMENT LIMIT FOR NON-INSTITUTIONAL SECURITIES TRANSACTIONS

The Securities Commission Malaysia (SC) invites your written comments in this consultation paper. Comments are due by 22 July 2019 and should be sent to:

E-mail : bridge@seccom.com.my

Confidentiality: Your responses may be made public by the SC. If you do not wish for all or any part of your response or name to be made public, please state this clearly in the response. Any confidentiality disclaimer that may be generated by your organisation's IT system or included as a general statement in your fax cover sheet will be taken to apply only if you request that the information remain confidential.

The SC agrees to keep your personal data confidential and in full compliance with the applicable principles as laid under the *Personal Data Protection Act 2010* (PDPA).

This Consultation Paper is dated 8 July 2019

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1. Introduction

1.1 Brokerage Industry Digitisation Group (BRIDGe)[1] was setup in August 2018 to accelerate digitisation across the stockbroking value chain. The objective is to provide both investors and industry participants with enhanced digital experience and greater automation across the broking value chain. This includes customer on-boarding, settlement and execution of corporate actions.

1.2 In the area of online settlement for non-institutional investors (i.e. retail and small business investors), the use of cheques are still prevalent for large value securities transactions. Whilst brokers currently accept online settlement of securities transactions, this is limited by the daily online fund transfer limit of up to RM 30,000 or RM 50,000.

1.3 The industry has however observed sizeable number of large value securities transactions, and greater demand for higher online settlement limits. The following surveys were conducted through BRIDGe:

- A survey across 23 brokers in Dec 2018 reveals that on average, >50% of non-institutional transactions are valued above RM 30,000 and >40% are valued above RM 50,000.

- A survey across brokers' top 30 non-institutional frequent traders reveals that ~70% of the sampled 296 traders prefer limits higher than the current daily online transfer limit.

[1] BRIDGe is a multi-lateral partnership comprising of the Securities Commission Malaysia (SC), Bank Negara, Bursa Malaysia as well as industry participants across the value chain of the stockbroking industry. This includes brokers, banks, payment service providers as well as share registrars.

2. MERCHANT SPECIFIC LIMIT (MSL) FOR FINANCIAL PROCESS EXCHANGE (FPX) MERCHANTS

2.1 To cater to investors with requirement for online settlement limit that is higher than the current limits provided by the banks in Malaysia (~RM 30,000 to RM 50,000), BRIDGe is proposing that a broker can subscribe to the MSL solution as a FPX[2] merchant, through their acquiring bank (i.e. the bank which provides this service to the broker).

2.2 To qualify for MSL, the brokers will be subject to the assessment and approval of the acquiring bank and PayNet.

2.3 Figure 1 outlines how Paynet's MSL for FPX facilitates for brokers to accept high value fund transfers in order for investors to settle their large value securities transactions.

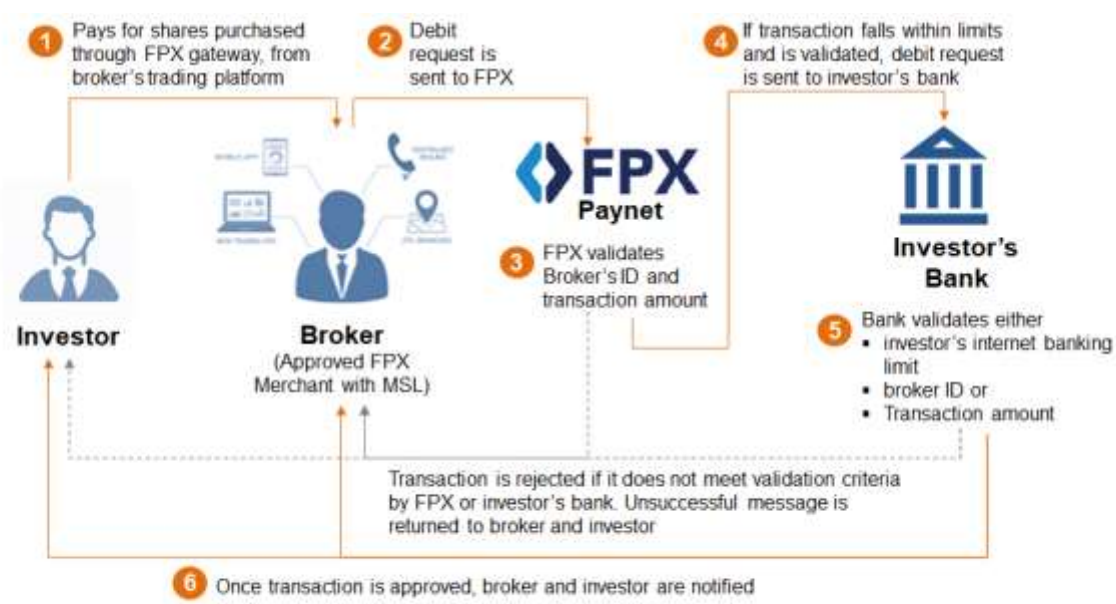

Figure 1: Overview of FPX's MSL solution which caters for higher limits for securities transactions

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[2] FPX is a payment gateway that allows real time online payments using one's current or savings account. A payer will require an Internet banking account with any of FPX participating banks.

2.4 While MSL feature is supported by majority of FPX participating banks, individual investors may still be constrained by the online banking transaction limits imposed by their banks.

2.5 To enable higher online banking transaction limits whilst mitigating the fraud risk associated with higher limits, the banks have requested for the brokers with MSL facilities to instil better controls for inward and outward transfers.

3. PROPOSED STANDARDISED CONTROLS AS A PREREQUISITE FOR ONLINE SETTLEMENT

3.1 To cater to the request from banks, BRIDGe is proposing a set of standardised control procedures to ensure that payments and transfers to and from trading accounts are conducted by the intended or designated parties.

3.2 As such, the following controls are proposed to manage inward online payments to the trading account (cash-in leg) and outward online transfers of proceeds from the trading account (cash-out leg).

3.3 BRIDGe also proposes that these controls be made mandatory for all clients opting for online settlement. In line with overall intent for better Anti-Money Laundering (AML) practices, making these controls mandatory would be an effective tool to mitigate the risk of suspicious transactions made by unknown third parties.

Inward payments to investor's trading account (Cash-in leg)

- Brokers will need to undertake steps to ensure that a customer or investor of a broker is only allowed to fund his or her trading account using funds from his or her own bank account.

- Brokers will need to pre-register one or more bank account numbers to an investor's trading account. Clients or investors will need to be notified of pre-registration of bank account numbers.

- For each inward FPX transaction, PayNet will provide the brokers with two unique identifiers of the payer:

  - Name (existing practice)

  - Bank account number (new)

- Brokers will need to verify that both identifiers of the payer provided by PayNet matches the identity of the trading account owner (bank account number must be pre-registered to the trading account).

- If a broker detects that an FPX payment is not made from the pre-registered bank account(s), the broker should initiate a refund to the originating bank account via the FPX system.

Outward transfer of proceeds from investor's trading account (Cash-out leg)

- Brokers will also need to strengthen the controls for outward transfers to ensure that a customer or investor of a broker is only allowed to withdraw the funds from his or her trading account, into a bank account that belongs to the customer.

- As such, brokers will need to ensure the following controls are in place for outward transfers

  - Transfers can only be effected to bank account(s) pre-registered with owners of trading account.

  - Should investors insist on using cheques as means to receive sales proceeds, cheques must be made to the name of the trading account owner.

- This serves to mitigate the risk of such funds being paid into a fraudulent account.

3.4 The SC encourages brokers to automate the proposed inward payment and outward transfer controls for efficiency. In the case that this is not automated, the broker will need to outline procedures of how the proposed controls are implemented.

3.5 In accordance to Bank Negara's Interoperable Credit Transfer Framework, PayNet will establish rules that shift the liability for fraud losses to PayNet's participants (banks and selected non-bank service providers) with the weaker security or AML/CFT controls.

3.6 PayNet's liability shift rules that bind the participants will be replicated in back-to-back agreements between the participants (in this case the acquiring banks) and the merchants (in this case, the brokers). This will require the acquiring banks to enter into an agreement with the brokers to outline:

(i) The requirement for brokers to conduct the necessary Customer Due Diligence (CDD) and implement the proposed controls;

(ii) The provision to shift the liability of the said fraud losses from the acquiring banks to brokers in instances of fraud losses and brokers' non-compliance to 3.6 (i);

(iii) The requirement for necessary supporting evidence of compliance to 3.6 (i) in the event of a fraud; and

(iv) The dispute resolution mechanism between acquiring banks and brokers.

Consultation question 1:

Would it be feasible to adopt the proposed inward payments and outward transfer controls, and if yes, how long would it take to implement such controls in your organisation? [If this will take longer than 6 months, please indicate rationale]

Consultation question 2:

BRIDGe proposes to have 1 – 5 pre-registered bank accounts per trading account. Do you agree / disagree? If you disagree, please indicate the proposed number.

4. REQUEST FOR INDUSTRY WIDE ONLINE SETTLEMENT LIMIT

4.1 Higher maximum limit for online settlement or transfers for broking sector

Consultation question 3:

What is your proposed industry-wide limit for broking sector? Please provide a rationale for your proposed limit.

Consultation question 4:

What percentage of volume and value of your clients' 2018 transactions would the proposed industry-wide limit cover? (e.g. with a RM 100,000 limit, this would cover 80% of transactions from non-institutional investors in 2018).