

**Malaysia: Publication of Financial Sector Assessment Program Documentation—  
Detailed Assessment of Implementation of IOSCO Objectives and  
Principles of Securities Regulation**

This Detailed Assessment of Implementation of IOSCO Objectives and Principles of Securities Regulation in Malaysia was prepared by staff of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available following the FSAP discussions that ended on September 7, 2012, with the officials of Malaysia. Based on the information available at the time of these discussions, the assessment was completed in February 2013. The related ROSC was published together with the FSSA on February 28, 2013. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Malaysia or the Executive Board of the IMF.

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FINANCIAL SECTOR ASSESSMENT PROGRAM

MALAYSIA

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

DETAILED ASSESSMENT OF  
IMPLEMENTATION

FEBRUARY 2013

INTERNATIONAL MONETARY FUND  
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THE WORLD BANK  
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**GLOSSARY**

ABS	Asset-Backed Securities
AML	Anti-Money Laundering
AMLATFA	Anti-Money Laundering and Terrorist Financing Act (2001)
ANC	Adjusted Net Capital
AOB	Audit Oversight Board
ARAMIS	Automated Real time Alerts for Market Intelligent Supervision (Bursa Malaysia Market Surveillance System)
ARMADA	Automated Risk Management and Decision Making Analysis System
BAFIA	Banking and Financial Institutions Act 1989
BNM	Bank Negara Malaysia (Malaysian Central Bank)
BPA	Bond Pricing Agency
BTS	Bursa Trade Securities (Bursa Malaysia Securities Trading System)
Bursa Malaysia	Bursa Malaysia Berhad (Malaysian Exchange Holding Company)
CAR	Capital Adequacy Ratio
CBA	Central Bank of Malaysia Act 2009
CG Code	Malaysian Corporate Governance Code (for publicly listed companies)
CIS	Collective Investment Scheme
CMDF	Capital Markets Development Fund
CME	Chicago Mercantile Exchange
CMP1	Capital Market Masterplan 1 (2001–2010)
CMP2	Capital Market Masterplan 2 (2011–2020)
CMSA	Capital Markets & Services Act, 2007 (as amended)
CMSL	Capital Market Services License
CMSRL	Capital Markets Services Representative License
CP	Clearing Participant (at the derivatives clearing house)
CPO	Crude Palm Oil
CRA	Credit Rating Agency
CUTA	Corporate Unit Trust Adviser (sells unit trusts and provides financial planning)
ED	Executive Director (of the SC)
ETF	Exchange Traded Funds

ETP Bond	Electronic Trading Platform (for trading and reporting OTC bond transactions)
Exchange Group	The subsidiaries under Bursa Malaysia that operate the securities and derivatives exchanges, the securities and derivatives clearing services, depository services and bond trading and trade repository services: Bursa Malaysia Securities Berhad; Bursa Malaysia Derivatives Berhad; Bursa Malaysia Securities Clearing Sdn Bhd; Bursa Malaysia Derivatives, Clearing Sdn Bhd, Bursa Malaysia Depository Sdn Bhd; and Bursa Malaysia Bonds Sdn Bhd
FIMM	Federation of Investment Managers Malaysia
FMC	Fund Management Company (discretionary portfolio manager)
FRA	Financial Reporting Act, 1997
FRF	Financial Reporting Foundation
FRS	Financial Reporting Standards (Malaysian)
FSEC	Financial Stability Executive Committee
High Level Group	High Level Financial and Market Stability Group
JSG	Joint Surveillance Group
IAC	Independent Advice Circular
IASB	International Accounting Standards Board
IAS	International Accounting Standard
ICM	Islamic Capital Markets
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IO	Investigating Officer
IOSCO	International Organization of Securities Commissions
ISA	International Standards on Auditing
ISQC	International Standards on Quality Control (auditors)
IUTA	Institutional Unit Trust Adviser (financial institution or other regulated entity authorized to sell CIS)
KLCI	Kuala Lumpur Composite Index
MASB	Malaysian Accounting Standards Board
MGS	Malaysian Government Securities
MIA	Malaysian Institute of Accountants
Minister	Minister of Finance

Ministry	Ministry of Finance
MMOU	IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information
OTC	Over-the-counter
PAC	Persons Acting in Concert (in a take-over bid context)
PIE	Public Interest Entity (these include companies listed on the stock exchange and institutions that are subject to supervision by Bank Negara Malaysia and the Securities Commission)
PID	Public Interest Director
PIDM	Perbadanan Insurans Deposit Malaysia (the Malaysian Deposit Insurer)
PIDM Act	Perbadanan Insurans Deposit Malaysia Act, 2011
PO	Participating Organization (member firm in Bursa Malaysia Securities)
RAC	Risk Adjusted Capital
REF	Registered Electronic Facility
REIT	Real Estate Investment Trust
Regulatory Guidance	Guidance on the Regulatory Role of Bursa Malaysia Berhad
SAC	Shariah Advisory Council (part of the SC)
SC	Securities Commission Malaysia
SCA	Securities Commission Act 1993
SICDA	Securities Industry (Central Depositories) Act, 1991
SIDC	Securities Industry Development Corporation
SIDREC	Securities Industry Dispute Resolution Centre
SIFI	Systemically Important Financial Institution
SMARTS	Securities Markets Automated Research Trading and Surveillance System
SRO	Self-Regulatory Organization
SROC	Systemic Risk Oversight Committee
Take-over Code	Malaysian Code on Take-overs and Mergers, 2010
TCP	Trade Clearing Participant (at the Securities Clearing House)
TP	Trading Participant (member firm at Bursa Malaysia Derivatives)
UTC	Unit Trust Consultant (individual selling unit trusts)
UTF	Unit Trust Fund (CIS)
UTMC	Unit Trust Management Company (operator of a CIS)

## I. SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

1. **The Securities Commission Malaysia (SC), as the supervisor of the capital markets, has developed a robust supervisory framework that exhibits high levels of implementation of the International Organization of Securities Commissions Objectives and Principles of Securities Regulation (IOSCO Principles) in most areas.** The regimes governing the regulation of issuers, auditors, collective investment schemes, market intermediaries and secondary markets, and with respect to enforcement, co-operation and information sharing, are extensive.

2. **There are, however, some areas where enhancements are advisable.** The SC's independence would be buttressed by some changes to the legal provisions on removal of commission members and to protections given to the members of the Commission and to its staff. The disclosure deadlines for issuers and their substantial shareholders should be adjusted to reflect international best practices. The new frameworks for oversight of credit rating agencies (CRAs) and the Federation of Investment Managers Malaysia (FIMM) should be implemented in full by carrying out on-site inspections as presently planned.<sup>1</sup> At this stage in the jurisdiction's development, consideration should also be given to putting in place the pre-conditions that will enable the SC to ease up gradually on the intensity of its direct involvement in the day-to-day operations of the capital market and its participants.

### A. Introduction

3. **The assessment was conducted during the IMF/World Bank Financial Sector Assessment Program (FSAP) mission to Malaysia during the period April 4 to 20, 2012,** by Tanis MacLaren, an external technical expert employed for this purpose by the IMF.

4. **The assessment was carried out using the 2011 IOSCO Methodology for Assessing Implementation of the IOSCO Principles (the Assessment Methodology).** The Assessment Methodology was published in final form by IOSCO in 2011 and superseded an earlier version published in 2003. The final version of this revised Assessment Methodology is expected to be endorsed at the IOSCO annual meeting in 2012. In using the Assessment Methodology, the assessor sought to focus on the substance of the regulatory outcomes of the key requirements under each Principle.

5. **The assessment relies on information from a detailed self assessment submitted by the authorities,** as well as extensive interviews with the staff of the SC, a review of legislation, regulations, guidelines and related materials, along with interviews with the staff of Bank Negara Malaysia (BNM), Bursa Malaysia, market participants and other stakeholders.

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<sup>1</sup> On-site inspections on the two registered domestic CRAs were completed in June and September 2012.

6. **The assessor is very grateful to the staff of the SC for their extensive cooperation and assistance in the conduct of this assessment.** The staff was informed, forthright and helpful throughout. The assessor would also like to thank the regulated entities, market participants and other stakeholders who generously provided their time and honest insights. The industry participants with whom the assessor met spoke extremely highly of the quality of the staff at the SC and this assessor shares those views.

### **B. Institutional and Market Structure—Overview**

7. **The Malaysian financial system is regulated by two main authorities: the SC and BNM.** Each of these supervisors has clearly delineated areas of oversight and accountability set out in legislation. There are formal arrangements in place to govern areas of joint responsibility, such as investment banks, and to give the SC authority to approve capital markets products designed, operated and offered by institutions licensed by BNM.

8. **The SC is a regulatory authority with broad powers to regulate the capital markets in operation in Malaysia.** The SC has regulatory authority over equity securities, debt securities and derivatives<sup>2</sup>, whether traded over-the-counter (OTC) or on organized markets, as well as other capital markets activities such as discretionary portfolio management and the management of collective investment schemes (CIS—or unit trusts). The SC reports to the Minister of Finance (Minister).

9. **The regulator's responsibilities, powers and authority with respect to the capital market are established by statute.** SC draws its powers from several laws, including the Securities Commission Act 1993 (SCA), Capital Markets and Services Act 2007 (CMSA) and Securities Industry (Central Depositories) Act 1991 (SICDA). Further, under the CMSA, the SC has authority to make binding regulations, as well as issue guidelines and practice notes on products and services offered in both the conventional and Islamic segments of the capital market (s. 377 and 378). The statutes have been supplemented with detailed secondary legislation in almost every area of the SC's authority.

10. **BNM is the central bank and the supervisory authority for a broad array of financial institutions operating in Malaysia.** The statutory responsibilities and objectives of BNM are stated in the relevant statutes, such as the Central Bank of Malaysia Act 2009 (CBA) and the Banking and Financial Institutions Act 1989 (BAFIA), supported by internal governance arrangements. It is responsible for supervision of banks, insurance companies, Islamic banks, takaful operators, reinsurance companies and other participants in the financial markets. BNM also has oversight over the foreign exchange and money markets. The BNM reports to the Minister.

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<sup>2</sup> The definition of derivatives under CMSA does not include securities; any derivative to which BNM or the Government of Malaysia is a party; any exchange-rate-related derivative; or any agreement, when entered into, that is in a class of agreements prescribed not to be derivatives.

11. **The SC is led by a nine member Commission headed by an Executive Chairman.** The Commission meets monthly to deliberate on matters such as appeals and Commission policies. Other than administrative and day-to-day matters (the responsibility for which rests with the Chairman), all functions of the SC, including approvals associated with its gatekeeping authority and oversight of the capital market are vested with the Commission. Some of the Commission's functions are delegated to committees established by the Commission under the SCA<sup>3</sup> or to the Chairman.

12. **SC is organized into eight divisions to ensure the full scope of its mandate is carried out effectively.** The eight divisions are: Chairman's Office, Compliance & Examination, Corporate Finance & Investments, Corporate Resources, Enforcement, Islamic Capital Market, Market Oversight and Strategy and Development. Two affiliated agencies also have been established to complement SC's core functions, namely the Securities Industry Dispute Resolution Centre (SIDREC) and the Securities Industry Development Corporation (SIDC). SIDC was formed from the SC's training department and now is a separate corporation with its own board. Its mandate is to assist in building the skills of market intermediaries and providing investor education through its training programs.

13. **SIDREC is a specialized dispute resolution body in place to facilitate prompt settlement of claims against certain licensed market intermediaries.** It provides dispute resolution services for any dealing or transaction involving capital market products or services between clients and their stock brokers, futures brokers, fund management companies (FMCs) and unit trust management companies (UTMCs). The process involves both mediation and, where necessary, adjudication by SIDREC. It is offered as a free service to investors. The decision and award granted by SIDREC are binding on the intermediary. However, the claimant is free to pursue his claim in court if he is dissatisfied with the mediator's decision.

14. **The SC also includes the Audit Oversight Board (AOB) that was established to provide independent audit oversight of public interest entities (PIEs).** Its mandate also extends to protect the interests of investors by promoting confidence in the quality and reliability of audited financial statements of PIEs. While the AOB is part of the SC, it is governed by a separate board made up of representatives from the accounting profession, regulators including the SC, BNM and the Companies Commission Malaysia, as well as the private sector.

15. **The SC currently is prescriptive in how it executes its mandates with respect to regulating and developing the capital markets.** As a result, the SC as a regulator is very involved in most aspects of how the capital markets and their participants operate. While this level of control may have been necessary and appropriate under the Capital Market

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<sup>3</sup> These committees are chaired by a Commission member.

Masterplan 1 (CMP1) that was issued in 2000, it risks having an impact on innovation in the marketplace and leaving the Malaysia markets somewhat constrained when they face competition in the region, both for capital and market share. Nevertheless, there are clear indications that the SC is starting to take a less prescriptive approach to regulating and developing the market. The SC has issued two documents recently—the Capital Market Masterplan 2 (2011–2020) (CMP2), which sets out SC’s strategic direction in structurally reforming and developing the market, and the Corporate Governance Blueprint 2011, a plan designed to raise standards of corporate governance in Malaysia. CMP2 was launched in 2011, with the theme ‘Growth with Governance’. This 10-year plan outlines SC’s strategy to develop the capital market and support the establishment of a robust culture of governance throughout the market. Similarly, the thrust of the Corporate Governance Blueprint 2011 is to complement regulatory discipline with self- and market-discipline. Given the overall thrust of these plans, the SC appears to be giving due consideration to moving a less directive mode of regulation. For example, it has a strategy in place to give more emphasis on disclosure and less emphasis on merit reviews of new issues. These efforts should be encouraged.

**16. There is one securities exchange (Bursa Malaysia Securities) and one derivatives exchange (Bursa Malaysia Derivatives) operating in Malaysia under authorization granted by the Minister.** Both exchanges, along with the securities and derivatives clearing houses, central securities depository and the operator of an electronic trading platform for the trading and reporting of bonds are subsidiaries of the Bursa Malaysia Berhad, a holding company also authorized by the Minister under the CMSA. The holding company is listed on the securities exchange. The securities exchange has two equity markets for listings—the Main Market and the ACE Market. The Main Market is for established companies with a profit track record of three to five full financial years or companies with a sizeable business. The ACE Market is an alternative, sponsor-driven market designed for companies of all business sectors that have good growth potential but insufficient history to qualify for the Main Market. Bond trading takes place OTC but all trades must be reported to Bursa Malaysia Bonds for transparency purposes. At the time of the assessment, there were 35 securities broking firms that are participating organizations (POs) in Bursa Malaysia Securities and 20 futures broking firms that are trading participants (TPs) in Bursa Malaysia Derivatives.

**17. The number of listed companies and listed securities on Bursa Malaysia Securities has not grown over the past six years.** On both the Main Market and the ACE Market the number of listed companies has declined by 8.6 percent and 7.0 percent respectively, while the number of issues listed has declined 14.2 percent on the Main Market and increased 10.6 percent on the ACE Market. The one area of substantial growth is the number of structured warrants listed, which has increased from 33 in 2006 to 304 in 2011, an increase of over 800 percent. Under CMP1 (covering the period from 2000–2010), the emphasis was placed on growth in market capitalization, rather than on the number of

companies listed. The result was an 8.6 percent compound annual growth rate in market capitalization, but a decline in number of listed companies.<sup>4</sup>

18. **There has been substantial growth in the equity market capitalization and trading activity at Bursa Malaysia Securities over the last six years.** Total market capitalization has increased 51.4 percent (from RM 849 billion to RM 1,285 billion), with annual trading volumes up 53 percent (from 215 billion to 329 billion shares) and annual trading values up 57.6 percent (from RM 278 billion to RM 438 billion). The growth in the value of new issues listed<sup>5</sup> has been equally substantial—up over 400 percent (from RM 7.2 billion to RM 36.8 billion). RM12.6 billion was raised through new issues of shares and warrants in 2011.

<b>Bursa Malaysia Securities Trading (Including trading on the Main Market and ACE Market)</b>						
<b>Number of securities listed</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Main Market (including REITs)	831	810	758	995	992	988
Second Board	321	294	269	NA	NA	NA
ACE Market (formerly known as Mesdaq)	132	133	134	129	134	146
Structured Warrants	33	120	48	137	225	304
Bonds & Loans (introduced in 2008)	NA	NA	42	41	36	33
ETFs (introduced in 2008)	NA	NA	3	3	5	5
<b>Total</b>	<b>1317</b>	<b>1357</b>	<b>1254</b>	<b>1305</b>	<b>1392</b>	<b>1476</b>
<b>Number of companies listed</b>						
Main Market (including REITs and ETFs)	649	636	634	844	844	822
Second Board	250	227	221	NA	NA	NA
ACE Market (formerly known as Mesdaq)	128	124	122	116	113	119
<b>Total</b>	<b>1027</b>	<b>987</b>	<b>977</b>	<b>960</b>	<b>957</b>	<b>941</b>
<b>Total market capitalization (RM billion)</b>	849	1,106	664	999	1,275	1,285
Annual trading volume (on-market trades & direct business trades) (billion shares)	215	384	154	248	253	329
Annual trading value (on-market trades & direct business trades) (RM billion)	278	582	313	303	390	438
Value of new issues listed (Total market cap of new issues of IPOs, structured warrants, bonds, loans and ETFs as at end of 1st day trading in RM billion)	7.2	17.5	39.5	48.6	68.9	36.8

Note: In August 2009, the Main Board and the Second Board were merged to become the Main Market and the MESDAQ Market became the Ace Market

Source: Securities Commission

<sup>4</sup> The SC reported that over this period, 241 listed companies (out of 955) had annual growth in market capitalization of more than 10 percent per annum and 60 of these had annual growth rates above 25 percent; 78 percent of these high growth companies started out with market capitalizations of less than RM500 million.

<sup>5</sup> Value calculated as of price at the end of the first trading day for the issue.

19. **There has been substantial growth in the activity on Bursa Malaysia Derivatives over the last six years, primarily in two key futures contracts.** The trading in Kuala Lumpur Composite Index (KLCI) futures has increased 52.5 percent from 2006 to 2011. The trading in KLCI futures reached a high volume mark in 2007 before falling during the crisis and its aftermath. It resumed growing in 2011. The trading in Crude Palm Oil (CPO) futures is up 163.2 percent (by number of contracts), exhibiting growth in each year over the whole period. The overall trading on the exchange doubled over the period. The participation of foreign investors and retail investors is increasing.

<b>Bursa Malaysia Derivatives – Number of Contracts Traded</b>						
<b>Type</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
<b>KLCI Futures</b>	1,628,043	3,157,341	2,920,728	1,997,955	1,994,907	2,482,314
<b>Crude Palm Oil Futures</b>	2,230,340	2,793,560	3,003,549	4,008,882	4,064,361	5,871,132
<b>3-Month KLIBOR Futures</b>	272,502	239,314	195,193	126,690	95,477	92,775
<b>Others (i.e. Single Stock Futures, MGS<sup>1</sup> Futures, US CPO Futures, KLCI Options)</b>	30,139	12,471	572	4,300	0	16
<b>Annual trading volume (million contracts)</b>	4,161,024	6,202,686	6,120,042	6,137,827	6,154,745	8,446,237

<sup>1</sup>. MGS—Malaysian Government Securities  
Source: Securities Commission

20. **To improve accessibility, Bursa Malaysia Derivatives entered into a strategic partnership with Chicago Mercantile Exchange (CME) in 2010.** This arrangement includes the licensing of CPO futures settlement prices and global distribution of Bursa Malaysia Derivatives' products through the CME's Globex electronic trading platform. The U.S. Commodity Futures Trading Commission also exempted Malaysian brokers from the requirement to be registered as futures commission merchants in the U.S. before they could transact with U.S. customers to trade on Bursa Malaysia Derivatives.

21. **The number and aggregate market capitalization of foreign-incorporated issuers listed on Bursa Malaysia Securities are not significant.** As at 30 November 2011, out of 945 listed issuers with a total market capitalization of RM 1,228 billion on Bursa Malaysia Securities, there are only 8 foreign-incorporated listed issuers with an aggregate market capitalization of RM3 billion (representing less than 1 percent of the total market capitalization of all listed issuers).

22. **The presence of foreign investors in the markets is more significant.** For November 2011, Bursa Malaysia estimated that foreign investors trading in securities listed

on Bursa Malaysia Securities represented 27.7 percent of the total value traded and 6.1 percent of the total volume of trading on the market. Foreign shareholdings in the companies listed on Bursa Malaysia Securities accounted for 22.9 percent in value and 17.2 percent in number of shares of the total shareholdings held at the central securities depository. The proportion of foreign investors participating in the trading on the derivatives exchange is even higher at 32 percent of the total number of investors.

23. **The number of foreign companies listed in Malaysia and foreign investors participating directly in Malaysian markets is likely to rise in the future.** Bursa Malaysia currently does not have any formal links with any other securities exchanges or clearing houses. However, there are discussions on-going with the exchanges in Singapore and Bangkok to build a regional alliance, which will make it easier for Malaysians to invest in foreign securities and foreign investors to invest in Malaysian securities. Cross-listings are likely to increase.

24. **The growth in the retail collective investment scheme (unit trust) market has been steady.** The number of retail unit trusts has increased by 21 percent over the past five years, with the highest growth shown in mixed income funds (up 250 percent, from 6 to 21). Assets under management have grown much faster – up 49 percent over the same period.

<b>Retail Unit Trusts (Collective Investment Schemes) Numbers of Funds by Type</b>					
	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
<b>Equity</b>	226	236	237	251	271
<b>Fixed Income/Bond</b>	100	119	124	128	122
<b>Money Market</b>	35	31	34	32	39
<b>Balanced</b>	62	63	61	58	59
<b>Mixed Income</b>	6	9	10	18	21
<b>Feeder</b>	32	41	45	55	55
<b>Structured Products</b>	9	15	14	6	3
<b>Fund of Fund</b>	8	10	8	7	8
<b>Others</b>	6	8	8	9	9
<b>Total</b>	<b>484</b>	<b>532</b>	<b>541</b>	<b>564</b>	<b>587</b>

Source: Securities Commission

<b>Retail Unit Trusts (Collective Investment Schemes)</b>					
<b>Total Net Assets Value &amp; Number of Unit Trust Management Companies</b>					
	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
<b>Total Net Asset Value (in RM billions)</b>	<b>168.0</b>	<b>130.4</b>	<b>191.7</b>	<b>226.8</b>	<b>249.5</b>
<b>Number of Unit Trust Management Companies</b>	<b>39</b>	<b>39</b>	<b>39</b>	<b>39</b>	<b>40</b>

Source: Securities Commission

25. **The growth in the wholesale collective investment scheme (unit trust) market has been much more significant.** The number of unit trusts sold only to qualified investors (high net worth individuals, institutional investors, etc.) has increased by just under 360 percent over the past five years (from 29 to 133 funds). Assets under management have grown much faster – up over 1070 percent over the same period (from RM 2.34 billion to RM 27.4 billion).

<b>Wholesale Funds (Collective Investment Schemes)</b>					
<b>Numbers of Funds and Total Net Asset Value by Year</b>					
	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
<b>Total Number of Funds</b>	29 <sup>1</sup>	54 <sup>2</sup>	88	107	133
<b>Total NAV (in RM billions)</b>	2.34	4.9	14.0	18.7	27.4

1. 2007 - 19 Restricted Investment Schemes (RIS) and 10 Wholesale Funds (all offered to qualified investors).

2. 2008 - 29 RIS and 25 Wholesale Funds

Note: From 2006 to 2009, a fund management company that wished to pool investments of its various qualified investors who had similar investment objectives was allowed to establish a RIS under the Guidelines on Restricted Investment Schemes. From 2005 to 2009, a UTMC could establish a wholesale fund under the Guidelines on Unit Trust Funds. In light of the similarities between RIS and wholesale funds, in 2009, the SC merged the two categories of fund into one category and the Guidelines on Restricted Investment Schemes was subsumed under the new Guidelines on Wholesale Funds issued in the same year. Since then, wholesale funds can only be established by fund management companies.

Source: Securities Commission

26. **The bond market has grown steadily over the past ten years.** The total value of the Malaysian bond market stands at RM841.2 billion as at 31 December 2011, having grown at a average annual growth rate of 10.6 percent since 2001. At the end of 2011, the value of outstanding ringgit-denominated sukuk (Islamic bonds) stood at RM349.0 billion, i.e., 41.5 percent of the total bond market. Short-term debt securities were 13.8 percent of outstanding bonds, with longer-term instruments (i.e. debt securities with a term to maturity of longer than one year) making up the remaining 86.2 percent. Corporate debt securities accounted for 40.7 percent of all debt securities outstanding. 82 ringgit-denominated and 16 foreign currency-denominated corporate debt issues were approved in 2011. Net new issues of debt securities by the private sector in 2011 (gross issues less redemptions) amounted to RM24.5 billion.

27. **The number of authorized market intermediaries operating in Malaysia is stable.** Market intermediaries include stock and futures brokerage firms, investment banks, unit trust management companies, fund management companies, corporate finance advisors, investment advisors and various CIS distribution companies. Financial institutions under the

supervision of BNM (such as commercial banks, Islamic banks and insurance companies) are permitted to carry on certain capital markets activities (such as trading in government bonds, securities lending, arranging for the execution of trades in securities by customers through intermediaries licensed by the SC, advising on corporate finance, selling unit trusts and dealing in OTC derivatives or derivatives in the money market) without having to be licensed by the SC. They are, however, subject to certain market conduct rules under the CMSA and are subject to similar regulatory requirements on fit and proper standards.

<b>Number of Authorized Market Intermediaries</b>						
<b>Categories</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
<b>Investment Bank</b>	10	13	13	14	14	14
<b>Stock Broker</b>	29	20	20	19	20	20
<b>Universal Broker</b>	4	1	1	1	1	1
<b>Derivatives Broker</b>	16	13	14	13	13	13
<b>Fund Supermarket<sup>1</sup></b>	-	1	1	1	1	1
<b>Unit Trust Management Company (UTMC)<sup>2</sup> and Fund Management Company (FMC)<sup>3</sup></b>	-	-	26	27	30	31
<b>FMC and dealing in securities (restricted to Unit Trusts) licences<sup>4</sup></b>				3	3	3
<b>FMC</b>	78	78	58	55	51	48
<b>Stand alone UTMC<sup>2</sup></b>	-	-	13	12	9	9
<b>Corporate Finance Adviser</b>	-	40	40	41	43	44
<b>Investment Adviser<sup>5</sup></b>	80	21	21	21	20	19
<b>Financial Planning</b>	-	26	25	24	24	23
<b>Corporate Unit Trust Adviser (CUTA)</b>	-	-	2	4	7	7
<b>Issuing House</b>	2	2	2	2	2	2
<b>Total</b>	<b>219</b>	<b>215</b>	<b>236</b>	<b>237</b>	<b>237</b>	<b>235</b>

Notes:

<sup>1</sup> Fund Supermarket licence effective from 2007 onwards

<sup>2</sup> UTMC licence for dealing in securities (restricted to unit trusts) effectively operational from 2008 onwards

<sup>3</sup> Intermediaries licensed in both UTMC and FMC categories.

<sup>4</sup> These companies were issued a FMC and dealing in securities (restricted to unit trust) licence in anticipation of plans to undertake retail business in relation to unit trust business and becoming a UTMC.

<sup>5</sup> In 2007, licences for Corporate Finance Advisors and Financial Planning were introduced. Prior to that, they were licensed as Investment advisers

Source: Securities Commission

28. **The regulatory structure in Malaysia makes use of self-regulatory organizations (SROs) that exercise some direct oversight responsibility for certain market participants and whose rules are subject to meaningful sanctions.** There are two such SROs in the jurisdiction – Bursa Malaysia and FIMM. FIMM is a recognized and authorized SRO under the CMSA. Bursa Malaysia is recognized as an exchange holding company under the CMSA, but undertakes certain functions of an SRO and is the front line regulator of the stockbrokers and futures brokers that are members of the exchanges and the participants in the related clearing houses. FIMM is responsible for the supervision of participants in the unit trust market. This includes registration of distribution agents (individuals and institutions). If banks or stockbrokers distribute unit trusts to their clients, they are required to be registered with FIMM.

29. **There are two components to the capital markets in Malaysia: conventional and Islamic.** The Islamic capital market (ICM) is conducted based on Shariah principles and operates parallel to the conventional market. The fundamental securities regulatory scheme for each market is similar (extensive product disclosure, licensing requirements for intermediaries, etc.), but with an additional set of requirements layered on top to ensure the Islamic products and services are Shariah-compliant. In determining the Shariah-compliance status of a given security, SC is guided by the Shariah Advisory Council (SAC), which is made up of Islamic finance and Shariah experts. According to the SC, Shariah-compliant securities amounted to RM1.16 trillion at the end of 2011, accounting for 54.4 percent of the entire capital market. Of the securities listed on Bursa Malaysia Securities, 89 percent are deemed to be Shariah-compliant. Malaysia is the biggest sukuk market in the world, with RM349.0 billion in outstanding ringgit-denominated sukuk as at the end of 2011, accounting for approximately two-thirds of global sukuk outstanding. Out of this amount, RM206.2 billion was issued by private entities with the remaining RM142.8 accruing to public issuers.

30. **The ICM has not been assessed separately in this review.** The Assessment Methodology does not distinguish between conventional and Islamic markets with respect to expectations or standards. In any event, owing to the way the two markets are regulated in this jurisdiction, the ratings are equally applicable to the two markets as the base requirements for equivalent products are the same, with the Shariah-compliance component added for ICM products and services.

### **C. Preconditions for Effective Securities Regulation**

31. **The preconditions for effective supervision (a stable macroeconomic environment, sound legal and accounting framework, and effectiveness of procedures for the efficient resolution of problems in the securities market) appear to be in place in the jurisdiction.** Unlike many jurisdictions, there are specialized courts with expertise to deal with complex commercial matters, including capital markets transactions. As a result, hearings for enforcement orders can be carried out fairly expeditiously. The Companies Act 1965 (Companies Act) contains comprehensive provisions relating to the management of

the company, rights of shareholders, duties of directors and officers, preparation of company accounts and audit, issuance of shares and debentures, proceeding of general meetings and the winding up of companies. If a company is publicly listed, the CMSA and the Listing Requirements of the exchange prescribe additional requirements. Further, provisions pertaining to take-overs and mergers are contained in the CMSA and the Malaysian Code on Take-Overs and Mergers 2010 (Take-Over Code). Unlike many jurisdictions, the Take-over Code has statutory backing and is enforceable by the SC.

32. **The bankruptcy legislation is dated, but is under review and is expected to be substantially amended in the near future.** However, the CMSA provides for modifications to the laws of insolvency and miscellaneous provisions in relation to the default procedures of the clearing house (s. 41- 57). If any participant of Bursa Malaysia becomes insolvent, trades on the securities and derivatives exchanges continue to be enforceable. The CMSA states that the default proceedings of Bursa Malaysia Securities Clearing and Bursa Malaysia Derivatives Clearing take precedence over law of insolvency (s. 43).

### **Main Findings**

33. **Principles 1–8, Principles relating to the regulator:** The SC has clear statutory authority over and responsibility for the Malaysian capital markets. In practice, the SC has operational independence from the industry and the government. Its independence at law is somewhat impaired as the Minister has the right to dismiss any member of the Commission without cause at any time under the SCA. The statutory immunity of the SC, its Commission members and staff members does not extend to cover former employees and agents. Indemnities are not available to these persons if they are sued for actions taken in the course of their duties at the SC. There are clear regulatory processes in place and they are applied consistently. Persons affected by decisions of the SC are afforded a full range of protections, including the right to be heard, to written reasons and to rights of appeal. The SC's staff are very professional and subject to detailed conduct rules. Market participants uniformly praised the quality and openness of SC staff. The SC has an explicit mandate and authority for monitoring, mitigating and managing systemic risk. There are regulatory processes in place to carry out this mandate and communication and information sharing between the SC and BNM. The perimeter of regulation is assessed regularly and where developments in the market require action, the SC can exercise its public interest jurisdiction to block problematic behavior or products or change the relevant rules to permit new services and products. The SC has in place processes to address conflicts of interest and misalignment of incentives. The SC, issuers, intermediaries, CRAs the Bursa, FIMM and CIS are subject to extensive requirements regarding the management and disclosure of conflicts of interest.

34. **Principle 9, Principles relating to self-regulation:** There are two organizations in the Malaysian capital markets that exercise some direct oversight responsibility for certain markets and market participants and whose rules are subject to meaningful sanctions. Both Bursa Malaysia and FIMM are subject to the oversight of the SC and are required to observe

high standards of conduct in carrying out their tasks. The regime applicable to Bursa Malaysia is detailed, comprehensive and has been operating effectively for several years. The SC has recently established the supervisory framework for FIMM as an SRO, which includes on and off-site supervision, reporting and a rule review process. As at the date of the review, the SC had not yet conducted an on-site examination of FIMM, even though other modes of oversight were operative prior to recognition. However, since then an on-site inspection of FIMM has been carried out (May 2012).

35. **Principles 10–12, Principles relating to enforcement of securities regulation:** The SC has broad inspection, investigation and surveillance powers. It has powers to investigate and take action against anyone who breaches the laws it administers. The SC carries on active inspection and enforcement programs. Both on-site and off-site reviews of regulated entities are performed. Market surveillance is performed at the exchanges and at the SC. The fines that can be imposed by the SC and the Bursa Malaysia vary.

36. **Principles 13–15, Principles for cooperation in regulation:** The SC has the ability and capacity to share information and cooperate with regulators, both domestically and internationally. There is no requirement that there be an MOU in place. The SC has specific authority to provide assistance to a foreign supervisory authority to investigate an alleged breach of a legal or regulatory requirement that the foreign supervisory authority enforces or administers. The SC is a signatory to the IOSCO Multilateral MOU and to many bilateral MOUs with its counterparts in other countries.

37. **Principles 16–18, Principles for issuers:** Extensive requirements are in place for initial offering and continuous disclosure documents for securities. The disclosure to be provided to purchasers of futures contracts is specified in the CMSA and the rules of the Bursa Malaysia Derivatives. New issues of securities (debt, equity or CIS) to the public are required to be offered via prospectuses that must be registered by the SC. Virtually all public issues of equity securities are listed on the Bursa Malaysia Securities and are subject to the provisions in the CMSA, SC guidelines and the Listing Requirements. The SC approves listings on the Main Market of Bursa Malaysia Securities and the Bursa approves listings on the ACE Market. Continuing disclosure documents are made public through the facilities of the exchange. Investors are treated equitably with respect to voting, access to information and the ability to participate in any takeover bid. Full information must be provided for any takeover bid. As of January 2012, Malaysia implemented International Financial Reporting Standards (IFRS) for all Public Interest Entities (PIEs), which includes public companies, CIS, financial institutions and market intermediaries. The publication of annual audited financial statements and annual reports by listed companies are slow compared to the requirements that apply to CIS. The notice period for shareholder meetings may be too short for full communication with all shareholders. Substantial shareholders in listed companies are given much longer to report their initial positions and any changes than are the directors and the CEOs of these issuers. The definition of 'interests in securities' does not include

publicly offered rights. There is no timely public transparency of information on the positions of these key personnel for unlisted public companies.

**38. Principles 19–23, Principles for auditors, credit rating agencies and other information service providers:** There is a regulatory system in place in Malaysia that subjects auditors of PIEs to appropriate levels of oversight. Auditors of PIEs must be registered with the Audit Oversight Board (AOB) that is an agency of the SC. The AOB conducts examinations of auditors and has the power to sanction breaches of the standards. There are extensive requirements for auditors to be independent of the entities they audit and these requirements are enforced by the AOB. The regulatory framework in Malaysia requires that the financial statements included in public offering and listing particulars documents and publicly available annual reports be audited in accordance with the International Standards on Auditing (ISA) issued by IFAC, for all periods beginning on or after January 1, 2010. CRAs whose ratings are used for regulatory purposes are subject to registration; bonds issued in ringgit must be rated. The SC has full power to supervise these entities, including carrying out on-site and off-site examinations and sanctioning. The SC has a framework in place to conduct on-site examinations of CRAs and on-site examinations were being planned. As of the date of the review, SC had yet to conduct an on-site examination of a CRA. One inspection has since been completed. Entities that provide analytical or evaluative services include investment advisors/analysts, corporate finance advisors, bond pricing agencies and property valuers. Investment advisors/analysts, corporate finance advisors and bond pricing agencies have to be licensed or registered with the SC. Property valuers are professionals registered with the Board of Valuers at the Ministry of Finance.

**39. Principles 24–28, Principles for collective investment schemes and hedge funds:** All publicly offered CIS and their operators and distributors are subject to authorization and reporting requirements. All funds offered to the public must be approved by the SC, which process includes the review of a detailed prospectus that contains comprehensive and timely information about the CIS. Funds are established as unit trusts, with assets segregated from those of the operator and distributor and held by an independent trustee that must be approved by the SC. All CIS and their operators and distributors are subject to a comprehensive supervision framework that includes both off-site and on-site reviews. The fund's securities and its assets are subject to valuation in accordance with IFRS. Continuous disclosure of unit prices is provided through the FIMM website. A hedge fund can be set up under the wholesale framework to offer securities only to qualified (sophisticated) investors and it must be approved by the SC. The operator must be licensed as a fund management company and the offering memorandum containing extensive information about the fund must be deposited with the SC. Wholesale funds are also subject to requirements to report regularly to investors and to the SC, including delivery of audited annual reports within two months of the fund's year end.

**40. Principles 29–32, Principles for market intermediaries:** A framework is in place for licensing and to apply on-going requirements for market intermediaries. Applicants are

subject to detailed reviews before being licensed. There are initial and ongoing capital requirements for all types of intermediaries that reflect the risks that they undertake. The capital requirements for stockbroking and futures broking companies address the full range of risks to which the firms are exposed, including market, credit, liquidity and operational risk. There are requirements regarding capital calculations and immediate reporting of deficiencies by market intermediaries. Market intermediaries are required to have extensive systems of risk management and internal controls in place. There are regulations for proper protection of clients, including requirements for segregation of clients' assets and business conduct rules, such as 'know your client' and suitability. The SC has plans in place for dealing with a firm's failure. The plans are flexible to include action to restrain conduct, to ensure client's assets are properly managed and to provide relevant information to the regulators and the general public.

41. **Principles 33–37, Principles for the secondary markets:** Exchanges are subject to authorization by the Minister with the advice of the SC. An electronic facility, which falls within the meaning of "stock market" but is not intended to operate as a stock exchange or derivatives exchange, must be registered by the SC as a Registered Electronic Facility (REF). The monitoring activities conducted by Bursa Malaysia include conducting real-time surveillance of the market and supervision of its participating members and clearing members. Market surveillance for trading on the securities market is performed at the exchange and the SC in parallel. The SC has a comprehensive oversight system for exchange supervision that includes on-site examinations and off-site reviews of rules and other matters. The SC may suspend the operations of a stock exchange or REF. On the recommendation of the SC, the Minister may revoke the authorization of any exchange; the SC may revoke an REF's registration. There is both pre-trade and post-trade real-time transparency of prices on the Bursa Malaysia exchanges, other than for certain specified trades that are permitted to take place outside the automatic trading system subject to clearly defined conditions. The rules against market abusive transactions are extensive and there are mechanisms in place to detect and take action against improper conduct. Trades on both the securities and derivatives exchanges are cleared and settled through central counterparties that have detailed and transparent provisions designed to protect the markets against a default by any participant.

**Table 1. Summary Implementation of the IOSCO Principles—Detailed Assessments**

Principle	Grade	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	FI	The SC has clear statutory authority over and responsibility for the Malaysian capital markets. Where there are overlaps between the SC and BNM with respect to market participants, the securities legislation is designed to minimize regulatory differences or gaps. There are arrangements in place between the two authorities to support equivalent protections for investors and to coordinate regulatory activities.
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.	PI	The SC in practice has a high degree of independence from the government and industry and its internal processes and governance reinforce that independence. However, there are gaps in the provisions of the law that support independence of action by the Commission members and staff that need to be addressed. Persons affected by decisions of the SC are afforded a full range of protections, including the right to be heard, to written reasons and to rights of appeal.
Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	FI	The SC has sufficient powers to carry out its functions under the securities laws. The SC responsibilities, powers and authorities are set out in securities laws. It has full authority to license, inspect, enforce and regulate the participants in the capital market in Malaysia. It has the statutory power to make legally enforceable regulations and guidelines. The SC's funding is adequate to permit it to fulfill its responsibilities. The SC has policies and governance practices in place to guide the performance of its functions and exercise of its powers. The SC places a significant emphasis on investor education as a key component of its investor protection mandate.
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	FI	There are processes and procedures adopted within the SC to ensure that regulatory actions undertaken by the SC are fair and reasonable, transparent and comprehensible to the affected persons and the marketplace, and that there is consistent application of relevant principles. There is a notable level of transparency in how the SC operates and all laws, regulations, guidelines etc. are available on the website. Persons affected by decisions of the SC are afforded a full range of protections, including the right to be heard, to written reasons and to rights of appeal.
Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.	FI	SC staff observe high standards of professional conduct and are subject to detailed ethical and conduct rules. Any violation or infringement of provisions of any applicable law, the Code of Conduct, the Terms and Conditions of

Principle	Grade	Findings
		Employment and any conduct on the part of the staff member that is inconsistent with the faithful discharge of duties towards the SC would be construed as misconduct. Misconduct may result in the institution of disciplinary proceedings.
Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.	FI	The SC has an explicit mandate and authority for monitoring, mitigating and managing systemic risk. There are regulatory processes in place to carry out this mandate and communication and information sharing between the Commission and BNM. It is invited to participate in meetings of the Financial Stability Executive Committee (FSEC) only when capital markets issues have been identified as a topic of discussion.
Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.	FI	The perimeter of regulation is assessed regularly and where developments in the market require action, the SC can take action. If the developments are of concern, it may exercise its public interest jurisdiction to block problematic behaviour or products. If the existing rules are blocking positive developments, such as new services and products, the guidelines and rules may be changed. The SC has good access to the legislative agenda where changes to the law are required.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	FI	The SC has processes in place to address conflicts of interest and misalignment of incentives. The SC staff, issuers, intermediaries, the Bursa, FIMM, CRAs and CIS are subject to extensive requirements regarding the avoidance, mitigation, management and disclosure of conflicts of interest.
Principle 9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	FI	There are two organizations in the Malaysian capital markets that exercise some direct oversight responsibility for certain markets and market participants. Both Bursa Malaysia and FIMM are subject to the oversight of the SC and are required to observe high standards of conduct in carrying out their tasks. The regime applicable to Bursa Malaysia is detailed, comprehensive and has been operating effectively for many years. FIMM, for many years, has had a quasi-regulatory role with respect to supervision of unit trust marketing and distribution activities, largely with respect to individual sales personnel and has been subject to the supervision of the SC in that regard. It was recognized as an SRO in January of 2011 after a full application process and review and is subject to extensive reporting requirements under the law and its conditions of recognition. The supervisory framework for FIMM includes on- and off-site supervision, reporting and a rule review process. While the first on-site regulatory examination is scheduled to

Principle	Grade	Findings
		take place in the next quarter, there is evidence that the SC takes action where issues are identified from reports filed, complaints or from other sources. Note that the first on-site inspection of FIMM was carried out in May, 2012. The SC retains full authority to oversee Bursa Malaysia and FIMM members and registrants.
Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers.	FI	The SC has broad inspection, investigation and surveillance powers.
Principle 11. The Regulator should have comprehensive enforcement powers.	FI	The SC has broad powers to investigate and take action against anyone who breaches the laws it administers.
Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	FI	Both on-site and off-site reviews of regulated entities are performed by the SC. Bursa Malaysia performs on and off-site reviews of its participant firms. Market surveillance is performed at the exchanges and at the SC. The SC and Bursa Malaysia conduct reviews of continuing disclosure information provided by listed companies. Market intermediaries must have effective compliance systems.
Principle 13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	FI	The SC has the ability and capacity to share information and cooperate with regulators, both domestically and internationally. It can share confidential information with any other foreign regulatory authority and has a record of active cooperation.
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.	FI	The SC is a signatory to the IOSCO Multilateral MOU and to many bilateral MOUs with its counterparties in other jurisdictions.
Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	FI	The SC may provide extensive assistance to foreign regulatory authorities in carrying out their responsibilities, including by obtaining and sharing information and cooperating on inspections. The SC does not require the permission of any outside authority to share information and an independent interest or dual illegality is not required as a precondition to cooperation.
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	BI	Extensive requirements are in place for offering and continuous disclosure documents for securities. The disclosure to be provided to futures contract purchasers is specified under the law and the rules of the Bursa Malaysia Derivatives. New issues of securities (debt, equity or collective investment schemes) to the public are

Principle	Grade	Findings
		required to be offered via prospectus that must be registered by the SC. Virtually all public issues of equity securities are listed on the Bursa Malaysia and are subject to the provisions in the Listing Requirements. The SC approves listings on the Main Market of Bursa Malaysia and the Bursa approves listings on the ACE Market. Continuous disclosure documents are made public through the facilities of the exchange. The publication deadlines for annual reports and audited financial statements by public companies are long compared to international standards and very long when compared to the reporting period required for CIS in the jurisdiction.
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	BI	Investors are treated equitably with respect to voting, access to information and the ability to participate in any takeover bid. Full information must be provided for any takeover bid. The notice period for shareholder meetings is fairly short and there are limitations in the corporate law in the use of proxies that may hamper fully effective exercise of shareholders' voting rights. Substantial shareholders in listed companies are given much longer to report their initial positions and any changes than are the directors and CEOs of these issuers. Other members of the senior management have very limited disclosure obligations. The definition of 'interests in securities' does not include publicly offered rights. There is no timely public transparency of information on the positions of these key personnel for unlisted public companies.
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	FI	All Public Interest Entities (PIEs), which include public companies, collective investment schemes, financial institutions and market intermediaries are required to prepare their financial statements using International Financial Reporting Standards (IFRS).
Principle 19. Auditors should be subject to adequate levels of oversight.	FI	There is a system in place in Malaysia that subjects auditors of PIEs to appropriate levels of oversight. Auditors of PIEs must be registered with the Audit Oversight Board (AOB), which is an agency of the SC. The AOB conducts examinations of auditors and has the power to sanction breaches of the standards.
Principle 20. Auditors should be independent of the issuing entity that they audit.	FI	There are extensive requirements for auditors to be independent of the entities they audit and these requirements are enforced by the AOB.
Principle 21. Audit standards should be of a high and internationally acceptable	FI	The financial statements included in prospectuses, listing documents and publicly available annual reports must be audited in accordance with the International Standards on

Principle	Grade	Findings
quality.		Auditing issued by the International Federation of Accountants.
Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and on-going supervision.	FI	Credit rating agencies (CRAs) whose ratings are used for regulatory purposes are subject to registration; bonds issued in ringgit must be rated. The SC has full power to supervise these entities, including the power to carry out on-site and off-site examinations and sanctioning. The SC has had a supervisory framework in place for these agencies since 2006 that included off-site review and engagement with management where deficiencies were noted. At the time of the review, while the SC had yet to conduct an on-site examination of a CRA, there is evidence of active and extensive review of the activities of the CRAs and investigation into any problematic issues identified. An on-site inspection of one of the two domestic CRAs was carried out, beginning in the first week of May 2012, and has since been completed.
Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.	FI	Entities that provide analytical or evaluative services include investment advisors/analysts, corporate finance advisors, bond pricing agencies and property valuers. Investment advisors/analysts, corporate finance advisors and bond pricing agencies have to be licensed or registered with the SC. Property valuers are professionals registered with the Board of Valuers under the purview of the Ministry of Finance.
Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.	FI	All CIS offered to the public and their operators and distributors are subject to authorization and reporting requirements. The requirements for licensing by the SC require the operator and fund manager (portfolio manager) to have in place appropriate organizational and operational structures, including risk management systems and internal controls. All CIS and their operators and distributors are subject to a comprehensive supervision framework that includes both off-site and on-site reviews. Outsourcing is permitted for some activities but is subject to detailed requirements.
Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	FI	Funds are established as unit trusts, with assets segregated from those of the operator and distributor and held by an independent trustee that must be approved by the SC.
Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective	FI	All funds offered to the public must be approved by the SC, which process includes the review of a detailed prospectus that contains comprehensive and timely information about the CIS. Material changes require

Principle	Grade	Findings
investment scheme for a particular investor and the value of the investor's interest in the scheme.		prompt notice and usually the amendment of the prospectus. Prospectus amendments are subject to review by the SC prior to registration.
Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.	FI	The fund's securities and its assets are subject to valuation in accordance with IFRS. Continuous disclosure of unit prices is provided through the FIMM website. The prospectus of the fund must contain information about valuation, pricing and the applicable provisions governing purchase and redemption of funds.
Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.	FI	There is no special definition of hedge fund in the jurisdiction. CIS, including hedge funds, can be set up under a clearly defined wholesale framework to offer securities only to qualified (sophisticated) investors. These funds must be approved by the SC. The operator must be licensed by the SC as a fund management company and are subject to inspection under the risk-based supervision program that applies to all market intermediaries. The offering memorandum containing specified information about the fund must be deposited with the SC. These wholesale funds are required to provide regular reporting to their investors and to the SC, including preparing annual audited reports within two months of year end.
Principle 29. Regulation should provide for minimum entry standards for market intermediaries.	FI	A framework is in place for licensing and to apply on-going requirements for market intermediaries. Applicants are subject to detailed off-site reviews before being licensed. All firms that are applying to be Bursa Malaysia participants are subject to extensive on-site readiness assessments of their operations and systems by Bursa Malaysia before they are approved. For FMCs, the SC does an on-site check once business has commenced to ensure operations are functioning as required. Certain other licensees are subject to requirements for external audits after beginning operations to confirm systems are effective.
Principle 30. There should be initial and on-going capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	FI	There are initial and ongoing capital requirements for all types of intermediaries to ensure that they have adequate resources to meet their business commitments and address the risks of their businesses. The capital requirements for stockbroking and futures broking companies specifically address the full range of risks to which the firms are exposed, including market, credit, liquidity and operational risk. The capital formulae for other intermediaries are fairly simple, reflecting the nature of their operations that are carried on in practice. FMCs are permitted to carry on proprietary trading but a large majority of the positions held raise few risks and the

Principle	Grade	Findings
		activity is subject to extensive monitoring by the SC. There are requirements regarding capital calculations and immediate reporting of deficiencies by market intermediaries.
Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.	FI	Market intermediaries are required to have extensive systems of risk management and internal controls in place. The firm's internal audit function must review these systems annually and the results of that review must be reported to the Board of Directors of the firm. There are regulations for proper protection of clients, including requirements for segregation of clients' assets and business conduct rules, such as 'know your client' and suitability. The rules regarding conflicts of interest are extensive.
Principle 32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	FI	The SC has plans in place for dealing with a firm's failure. The plans are flexible to include action to restrain conduct, to ensure clients' assets are properly managed and to provide relevant information to the regulators and the general public. There are investor compensation funds available in the event of losses. Where a failure has cross border implications, MOUs are in place to facilitate information sharing.
Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	FI	Exchanges are subject to authorization by the Minister with the advice of the SC. An electronic facility, which falls within the meaning of "stock market" but is not intended to operate as a stock exchange or derivatives exchange, must be registered by the SC as a Registered Electronic Facility (REF). There are specified criteria that any applicant must meet, including requirements regarding systems and other infrastructure capacity, technical competence etc.
Principle 34. There should be on-going regulatory supervision of exchanges and trading systems that should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	FI	The SC has a comprehensive oversight system for exchange supervision that includes on-site examinations and off-site reviews of rules and other matters. The SC may suspend the operations of a stock exchange or REF. On the recommendation of the SC, the Minister may revoke the authorization of any exchange; the SC may revoke an REF's registration. Surveillance of the markets is carried on by the exchanges and SC.
Principle 35. Regulation should promote transparency of trading.	FI	There is both pre-trade and post-trade real-time transparency of prices on the Bursa Malaysia exchanges for most trades, Certain specified trades (Direct Business Transactions) are permitted to take place outside the automatic trading system, subject to clearly defined conditions and prompt post-trade reporting. There are no

Principle	Grade	Findings
		dark pools operating in Malaysia.
Principle 36. Regulation should be designed to detect and deter manipulation and other unfair trading practices.	FI	The rules against market abusive transactions are extensive and there are mechanisms in place to detect and take action against improper conduct. Both the SC and the Bursa collect and analyze extensive trading data to deter and detect improper transactions.
Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	FI	Trades on both the securities and derivatives exchanges are cleared and settled through central clearing houses that have detailed and transparent provisions designed to protect the markets against a default by any participant. There are regular consultations and sharing of information between Bursa Malaysia and the SC. There are also both formal and informal arrangements in place to enable SC and BNM to consult each other in order to minimize the adverse effects of market disruptions.
Principle 38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	NA	Not assessed
Fully Implemented (FI) -34, Broadly Implemented (BI) - 2, Partly Implemented (PI) - 1, Not Implemented (NI) - 0, Not Applicable/Assessed (NA) – 1.		

### D. Recommended Action Plan and Authorities' Response

**Table 2. Recommended Action Plan to Improve Implementation of the IOSCO Principles**

Principle	Recommended Action
Principle 1	The authorities should be encouraged to continue to work jointly to ensure consistency in the standards of disclosure and market conduct and in the supervision of the market participants, in order to provide Malaysian investors with an appropriate level of investor protection, regardless of which investment product or service they acquire or intermediary from which they acquire it.
Principle 2	<p>The SCA should be amended to include general qualification requirements for Commission members, state that a Commission member may only be removed from his/her office for cause and delineate those causes, such as bankruptcy, persistent failure to attend meetings, acting in conflict of interest, etc. The right of the Minister to remove members at any time should be repealed.</p> <p>Consideration should be given to extending the statutory immunity provisions in the SCA to persons who were acting on behalf of the SC at the time of the actions in question. Coverage should not depend on the person's employment status at the time of the lawsuit; former employees and agents should be included.</p> <p>Further, consideration should be given to including provisions permitting the SC to indemnify these persons for their legal costs in the event they are sued.</p>
Principle 6	As the SC has an explicit mandate and authority for monitoring, mitigating and managing systemic risk, consideration should be given to making the SC a permanent member of the Financial Stability Executive Committee.
Principle 9	<p>The first regulatory audit of FIMM by the SC should take place as soon as practicable.</p> <p>(Note that the regulatory audit of FIMM was conducted by the SC in May 2012.)</p>
Principles 11 and 12	Consideration should be given to conducting an examination of the adequacy (and the consistency) of maximum fines that may be imposed under the legislation to ensure these amounts are high enough, given the growth in the market and its profitability. In any event, the fines that can be imposed by the SC should not be less than those that may be imposed by the Bursa.
Principle 16	<p>The SC's Corporate Governance Blueprint 2011 recommends a taskforce of industry and regulators to be formed to review the current framework for periodic disclosure of financial and non-financial information, including the shortening of the submission period for quarterly and annual reports. This should be pursued. In particular, consideration should be given to requiring the audited annual financial statements to be published within 90 days of the year-end, with the annual report available promptly thereafter.</p> <p>The SC should consider recommending the CMSA be amended to provide for civil liability for misstatements in continuous disclosure documents in the same way this liability applies to misstatements in prospectuses and other offering documents. Actions on these civil liability claims can be made simpler by including a provision that anyone who purchased the security affected by the misstatement is deemed to have relied on that misstatement.</p>

Principle	Recommended Action
Principle 17	<p>The SC's Corporate Governance Blueprint contains recommendations that encourage:</p> <ul style="list-style-type: none"> <li>• Companies to voluntarily extend the notice period for shareholder meetings to ensure investors have sufficient time to make fully informed decisions about the matters to be discussed at a meeting and to return their voting instructions in time; and</li> <li>• The elimination of the restrictions in Section 149 of the Companies Act that limit who may be appointed as proxy and the actions the proxy may take.</li> </ul> <p>These changes should be pursued to ensure all shareholders have the information in time to make informed voting decisions and can execute them effectively. The proxy limitations have been addressed in the Listing Requirements, however, consideration should be given to making these mandatory requirements for all public companies.</p> <p>Consideration should be given to aligning the requirements governing reporting interests in the securities of issuers held by substantial shareholders, officers and directors. The shorter time period that currently applies to the CEO and directors of listed companies under the CMSA should be applicable to all of the substantial shareholders, directors and all senior management of the issuers. The requirements should apply to all public companies. Consideration should be given to making this information for non-listed companies available to the public on the SC's website.</p> <p>Consideration should be given to widening the definition of what must be disclosed (by both substantial shareholders, directors and officers) to include public rights offerings that are presently excluded by the CMSA and the Companies Act.</p>
Principle 22	<p>The first inspection of a CRA should take place as soon as practicable. (Note that an on-site inspection of one of the two CRAs took place shortly after the FSAP assessment visit was completed.)</p>
Principle 30	<p>In the longer term, consideration might be given to re-examining the capital requirements for FMCs and moving to a risk-based formula that is more sensitive to the risks of the specific positions held.</p>
Principle 31	<p>The Malaysian regulatory framework requires a market intermediary to be subject to a periodic evaluation of its internal controls and risk management processes. The firm's internal auditor may conduct this review. Consideration should be given to requiring external auditors do these assessments, at least for the stock brokers and futures brokers that are members of Bursa Malaysia.</p>

### *Authorities' response to the assessment*

42. **The high level of compliance accorded to the Malaysian capital market in this assessment under the more rigorous IOSCO standards and the new Financial Market Infrastructures (FMI) principles demonstrates that the strategic 'roadmap' adopted by the SC in regulating and developing the market has been appropriate.**

43. **Since its establishment, SC has been committed to benchmarking itself against international standards and best practices.** In the past, prevailing market conditions led

the SC to implement a prescribed approach to regulation which was appropriate and effective under the circumstances. The SC has instituted a comprehensive regulatory and supervisory framework, including the issuance of detailed laws and guidelines. This approach has effectively enabled the SC to heighten transparency and establish clarity on the roles and responsibilities of market participants, thus promoting stability and confidence in the Malaysian capital market.

44. **These strategies were documented in the first Capital Market Masterplan (CMP1), and recommendations were implemented between 2001 and 2010. These measures, including market developmental initiatives, fostered stability and resilience which helped to insulate the Malaysian capital market from the impact of the recent global financial crisis.** There is now a strong foundation for on-going efforts to develop the capital market within a robust regulatory and supervisory structure, underpinned by a mandate to ensure investor protection and reduce systemic risk. The IOSCO assessment result, as well as the Malaysian capital market's successful weathering of the recent GFC, is a validation of the regulatory philosophy that is being adopted.

45. **The capital market has expanded significantly and become an important source of financing in the Malaysian economy, particularly with the development of the bond market to meet long-term financing needs.** The capital market continues to evolve in support of Malaysia's economic transformation agenda. The resilience of the market now gives SC the flexibility to adopt a regulatory framework that can drive greater competition and innovation. Under the CMP2, the SC will adopt a regulatory approach that will further drive market growth domestically and through greater internationalisation, while focusing on strong governance arrangements, and streamlining regulatory procedures and processes.

46. **Malaysia is taking continuous steps to align its regulatory framework with the changing global regulatory landscape and is actively involved in international financial regulatory policymaking work.**<sup>6</sup> Amid the growing regional expansion of local market intermediaries and plans to further internationalize the Malaysian capital market, the SC also recognises the increasing importance of cross-border enforcement and supervisory cooperation.

47. **While SC continuously reviews its policies to ensure that regulatory and supervisory requirements remain relevant and effective,** it welcomes suggestions by multilateral institutions like the IMF and the World Bank, and pro-actively learns from international best practices for putting in place appropriate preconditions that will be essential to ensure an effective regulatory regime.

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<sup>6</sup> The SC Chairman is a member of the IOSCO Board and Vice-Chairman of the Emerging Markets Committee. The SC is also involved in several regulatory policy committees of IOSCO.

48. **The SC notes that a number of recommendations in the IOSCO DAR reflect strategies identified in CMP2 as well as the CG Blueprint.** Consequently, the SC is already in the process of implementing the recommendations in this Report.

49. **This Report noted that, as a self-funding statutory body with comprehensive rules of internal governance, SC is operationally independent.** The Report also noted that, in practice, any discretionary power of the Minister provided by the securities law has always been exercised upon advice and recommendation by the SC. The ability of the SC to promote a sound and transparent capital market that supports economic growth has resulted in building market confidence. The SC works closely with other regulators to ensure financial stability while encouraging the development of new market segments and entry of new players to promote competition. The overall stability of the capital market, amidst rapid but orderly growth, has also meant that SC is trusted by the market and the government to perform its functions effectively within its current governance structure.

50. **Issues raised in this Report on further enhancing information disclosure practices by issuers and treatment of securities holders have already been identified in the CG Blueprint, published prior to this assessment.** Resolving these issues is a priority for the SC and is part of its on-going efforts to heighten the quality of corporate governance in Malaysia. These include the formation of a taskforce to review the current framework for periodic disclosure by issuers (including the need to shorten the submission period for quarterly and annual reports); a proposed extension of the notice period for shareholder meetings to ensure effective and informed investor participation; and the removal of restrictions on proxy voting. As of 3 January 2012, the Bursa Malaysia Listing Requirements no longer have qualification restrictions for proxies and allow shareholders of listed companies to appoint multiple proxies.

51. **The SC would like to thank the IOSCO assessors for their time and effort in engaging with the SC staff, other authorities, market institutions and intermediaries, and other stakeholders.** While the assessment required significant resources and time, it has been valuable in enabling the SC to identify its strengths as well as areas for further improvement. The IOSCO assessment methodology is a useful tool for reviewing of the effectiveness of regulatory and supervisory frameworks. The analysis and recommendations contained in this Report will feed into SC's on-going improvement efforts, with the aim of effectively supporting the projected growth and greater internationalization in the capital market during the CMP2 period.

## II. DETAILED ASSESSMENT

52. **The purpose of the assessment is primarily to ascertain whether the legal and regulatory securities markets requirements of the country and the operations of the securities regulatory authorities in implementing and enforcing these requirements in practice meet the standards set out in the IOSCO Principles.** The assessment is to be a means of identifying potential gaps, inconsistencies, weaknesses and areas where further powers and/or better implementation of the existing framework may be necessary and used as a basis for establishing priorities for improvements to the current regulatory scheme.

53. **The assessment of the country's observance of each individual Principle is made by assigning to it one of the following assessment categories:** fully implemented, broadly implemented, partly implemented, not implemented and not applicable. The IOSCO assessment methodology provides a set of assessment criteria to be met in respect of each Principle to achieve the designated benchmarks. The methodology recognizes that the means of implementation may vary depending on the domestic context, structure, and stage of development of the country's capital market and acknowledges that regulatory authorities may implement the Principles in many different ways.

- A Principle is considered **fully implemented** when all assessment criteria specified for that Principle are generally met without any significant deficiencies.
- A Principle is considered **broadly implemented** when the exceptions to meeting the assessment criteria specified for that Principle are limited to those specified under the broadly implemented benchmark for that Principle and do not substantially affect the overall adequacy of the regulation that the Principle is intended to address.
- A Principle is considered **partly implemented** when the assessment criteria specified under the partly implemented benchmark for that Principle are generally met without any significant deficiencies.
- A Principle is considered **not implemented** when major shortcomings (as specified in the not implemented benchmark for that Principle) are found in adhering to the assessment criteria specified for that Principle.
- A Principle is considered **not applicable** when it does not apply because of the nature of the country's securities market and relevant structural, legal and institutional considerations.

**Table 3. Detailed Assessment of Implementation of the IOSCO Principles**

<b>Principles Relating to the Regulator</b>	
<b>Principle 1.</b>	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>The Securities Commission's (SC) responsibilities, powers and authorities are set out in the relevant statutes, including the Securities Commission Act 1993 (SCA), Capital Markets &amp; Services Act 2007 (CMSA) and Securities Industry (Central Depositories) Act 1991 (SICDA).</p> <p>The SCA establishes the SC and gives legal mandate to the SC to act as the regulator for the Malaysian capital market. The objectives and functions of the SC are set out in the SCA and these provisions give SC wide power, <i>inter alia</i>, to promote and maintain market integrity, supervise and monitor market activities and market participants, take enforcement action against illegal, improper practices and market misconduct and promote market development.</p> <p>The CMSA and SICDA detail the manner in which the SC is to carry out its responsibilities. The CMSA is the primary legislation that regulates the securities and derivatives markets, market participants and their conduct, while the SICDA establishes the central depository and securities accounts and regulates the activities of the central depository and users of its services.</p> <p>The SC's authority to regulate the capital market generally and the SC's power to issue guidelines under s. 377 of CMSA have not been challenged but the SC's regulatory decisions have been challenged and upheld by the courts.</p> <p>As a statutory body, the SC's ability to interpret and apply its authority is limited to the statutory scope of securities laws and regulations. If challenged in court, any inconsistent interpretation or application may be struck down as <i>ultra vires</i>. Further, the general legislation governing interpretation of statutes provides that subsidiary legislation (such as a regulation) is void if it is inconsistent with the relevant principal legislation (Interpretation Acts 1948 and 1967, s. 23).</p> <p>The scope of application of relevant provisions of the securities laws is well defined. The need and room for the SC to interpret its authority is correspondingly narrow. However, when necessary, the SC can and has provided the marketplace with interpretations regarding the application of its authority via the issue of guidelines. The SC's aims in this regard are to:</p> <ul style="list-style-type: none"> <li>• Clarify and delineate the application of existing regulation to new products and services;</li> <li>• Clarify the operational aspects of existing requirements; and</li> <li>• Clarify the scope of waivers and exemptions.</li> </ul> <p>See, for example, the Guidelines on the Offering of Structured Products that were issued in 2007 to clarify and set out minimum criteria before a market participant is allowed to offer unlisted structured products to investors.</p> <p>While the SC is the primary regulator of capital markets activities in the jurisdiction, Bank Negara Malaysia (BNM), the banking and insurance supervisor, also has a role where institutions under its supervision are carrying on capital markets activities or where investment banks are concerned.</p> <p>Investment banks are required to hold licenses from both BNM (as merchant banks) and the SC (as stockbroking companies) to run their operations and the responsibility of regulating these institutions is shared between BNM and the SC. BNM is responsible for prudential regulation (capital, risk management while the SC is responsible for business and market conduct. The division of responsibilities in relation to banking activities and</p>

capital market activities is set out in the respective laws and there is an MOU in place between the authorities to coordinate their respective responsibilities.

Certain institutions licensed and supervised by BNM under the banking and insurance laws are categorized as Registered Persons under the CMSA and are permitted to carry on specified regulated activities without separate registration with the SC. These activities are listed in Part 1 of Schedule 4 to the CMSA and include activities such as trading in government bonds, securities lending, arranging for the execution of trades in securities by customers through intermediaries licensed by the SC, advising on corporate finance, selling unit trusts and dealing in OTC derivatives or derivatives in the money market. These institutions include Islamic banks, commercial banks and insurance companies. However, the securities legislation and arrangements between the two authorities have been designed to minimize regulatory differences or gaps.

Registered Persons are required to comply with a number of the obligations imposed on Capital Market Services License (CMSL) holders, including the duties related to disclosure of certain interests in securities, making recommendations, giving priority to client's order and dealings as principal (CMSA, s. 91 - 93 and 97). In addition, the SC and BNM jointly issued Guidelines on Investor Protection which contain details on competency and entry requirements of employees of Registered Persons in order to ensure parity between CMSL holders and employees of Registered Persons who carry out regulated activities. Their activities are also subject to business conduct expectations that are similar to those that apply to CMSL holders. BNM is responsible for supervising these registered persons to ensure they comply with the applicable parts of the CMSA as well as the relevant requirements imposed by BNM.

There are also products offered by insurance companies (investment linked insurance products) and distributed through life agents that are similar to capital markets products (such as collective investment schemes). These products are subject to disclosure, suitability and other market conduct provisions imposed and supervised by BNM and/or the Life Insurance Association of Malaysia.

Capital market products generally are subject to consistent regulatory requirements. In addition, the general requirements apply equally to both conventional and Shariah-compliant products. Shariah-compliant products are also required to fulfil the additional Shariah requirements.

The SC and BNM co-operate and communicate in the areas of shared responsibility. To facilitate that cooperation, the SC and BNM have entered into several MOUs. The MOUs include:

- A general MOU that establishes a framework for co-operation between BNM and SC, sets out their respective responsibilities and mechanisms to facilitate co-operation and information exchange;
- An MOU on Investment Banks that outlines the roles and responsibilities of BNM and SC and sets out the arrangements for co-operation and co-ordination on the dual regulatory and supervisory framework;
- An MOU on Mutual Recognition of Financial Advisers and Financial Planners that establishes a framework for mutual recognition of financial advisers licensed by BNM and financial planners licensed by SC and sets out the functional roles and responsibilities of BNM and SC to ensure functional equivalency of requirements.

There are arrangements in place for cooperation and communication between the SC and BNM, including joint committees that act as forums to coordinate matters affecting joint functions and responsibilities. There are also regular meetings and discussions between the regulators to address operational supervisory matters and stability issues. The Chairman of the SC and the Governor of the BNM also meet annually. In addition, there are regular discussions at the staff level on areas of shared responsibility and consultations on policy matters.

	<p>The SC's responsibilities include a specific mandate to promote market development. In fulfilling this mandate to develop and regulate the Malaysian capital market, SC has issued two blueprints, the Capital Market Masterplan (2001-2010)(CMP1) and Capital Market Masterplan 2 (2011-2020) (CMP2), which map out SC's strategic direction in structurally reforming and developing the market. CMP2 was launched in 2011, with the theme 'Growth with Governance'. The new 10-year plan outlines SC's strategy to develop the capital market while recognizing that a robust culture of governance must be in place to prevent a build-up of vulnerabilities that could lead to economy-wide instability. The potential for conflict between regulatory and market development objectives is recognized by the SC and there are extensive structures and processes in place to mitigate the conflicts to ensure investor protection remains the foremost consideration.</p> <p>For example, where a new issue arises or a change to existing requirements is proposed, the SC has a formalized 'challenge' process in place whereby the concept is circulated to all affected or interested areas of the SC for review and comment. The proposal is tested against the SC's investor protection and other mandates, its operational processes etc. to make sure all views and issues are canvassed and full consideration is given to the implications.</p>
Assessment	Fully implemented.
Comments	Both BNM and the SC have responsibility for supervision of certain capital markets activities undertaken in the Malaysian markets. There are guidelines and other requirements in place that are intended to impose consistent regulatory requirements on substantially similar conduct and products. The authorities are encouraged to continue to work jointly to ensure consistency in the standards of disclosure and market conduct and in the supervision of the market participants, in order to provide Malaysian investors with an appropriate level of investor protection, regardless of which investment product or service they acquire or the institution from which they purchase that product or service.
<b>Principle 2.</b>	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	<p>The SC generally operates without interference from the government or commercial interests. The day-to-day operation of the regulator is the responsibility of its Executive Chairman under the SCA (Section 4).</p> <p>The SC is also financially independent. It is self-funded and is not reliant on the government for funding. Its funding comes from levies, fees and charges imposed on market activities and licensed persons (SCA, s. 23 and 24). The SC sets its budget and expenses and has full authority over its use of its funds. The SCA provides the funds are to be administered and controlled by the SC exclusively (s. 23). The income has been sufficient to meet all of the SC's regulatory and operational needs. The SC has never sought financial support from the government. The SC also has built up a significant reserve fund (RM 700 million, enough to fund its operations for five years with no additional income) to provide funding if there is any shortfall in fees in any year.</p> <p>There are clear internal processes and procedures that govern the raising and use of budgets and operational expenditures, including an institutionalized annual budgeting process, a policy and guidelines on procurement, authority matrices and approval limits, integrity pacts signed with third party providers and a transparent tender process with periodic reporting to the whole organisation of successful tender details. Excess funds and cash reserves are invested and managed throughout the year in a prudent manner to ensure preservation of surplus funds. The Treasury Management Committee of the SC ensures that the funds are managed in accordance with the Treasury Management Guidelines.</p> <p>The SC regularly consults the Minister of Finance (Minister) and others on matters of</p>

regulatory policy and matters that involve a change in the regulatory framework. Consultation takes place on various regulatory and policy initiatives such as legislative amendments and the issue of subsidiary legislation.

The circumstances that require consultation with or approval of the Minister are set out in the relevant statutes. For example, the approval of the Minister is required for approving a new stock exchange (CMSA, s. 8(1)) or making regulations (SCA, s. 159, CMSA, s. 378(1) and SICDA, s. 63). The concurrence of Minister is required to approve a clearing house (CMSA, s. 38(4)).

The Minister also has powers to issue exemptions, such as:

- Exemption from disclosure of interest in securities (CMSA, s. 91(11)).
- Prescription to allow short selling of securities. (CMSA, s. 98(4)(e))
- Exemption from false trading and stock market manipulation provisions (CMSA, s. 180)
- Exemption from insider trading provisions (CMSA, s. 188).

These powers are exercised on the recommendation of the SC and are issued on a general policy basis, that is, for a class of transactions or circumstances, not for individual parties or transactions. For example, the Minister issued an exemption from the market manipulation rules to permit the issue and exercise of underwriter's greenshoe options. The exemptions are issued as regulations and published in the official government gazette.

Matters which require the Minister's approval and concurrence undergo a process established by the Ministry of Finance where such matters are reviewed by the policy department in the Ministry of Finance (known as Loans Department, Financial Market and Actuary Division) and the Treasury Solicitor's Office.

If the matter relates to the exercise of the Minister's powers to issue subsidiary legislation, (e.g. Regulations, Orders, Prescriptions and Declarations), the Attorney General's Chambers is involved in reviewing and ensuring that the processes to obtain the Minister's approval or concurrence are met. Once the Minister's approval or concurrence is given, the draft subsidiary legislation is then signed by SC's Chairman and published.

Overall, SC has in place a governance framework that promotes clear accountability, transparency and other checks and balances. Legal provisions are supported by internal protocols and processes. The work of the SC is facilitated by various board committees, established under SCA s. 18 and consisting of Commission members. These committees provide independent challenges to management's recommendations pertaining to matters requiring the SC's approval. The committees include the Licensing Committee, Issues Committee, Trust and Investment Management Committee and Take-overs and Mergers Committee. Meetings of the Commission as well as those of the committees provide a forum for balanced deliberation of issues and transparent decision-making. Due notice is given on issues to be discussed during such meetings, with the agenda and papers distributed for consideration by participants ahead of each meeting. All Commission members also have access to the Commission Secretary who ensures that they have sufficient information, support and resources to make informed decisions.

The Commission, any member of the Commission or Shariah Advisory Council or Audit Oversight Board (AOB), any member of any committee established by the Commission or Shariah Advisory Council or AOB, the Chairman and any staff member of the Commission is covered by a statutory immunity clause for any action taken in good faith in pursuance of their duties (SCA, s. 160). The statute does not include provisions to indemnify these persons for their legal costs in the event they are sued. An agent of the SC is not covered by the statutory provisions but often would be provided with an indemnity as part of the contract with the SC.

All nine members of the Commission are appointed by the Minister. Four of the nine

	<p>specifically 'represent the Government' and presently include representatives of the Ministry of Finance, BNM and Ministry of Primary Commodities.<sup>7</sup> The SC makes recommendations to the Minister on appointments and the objective is to ensure a broad range of professional expertise is present. While the SCA does not explicitly state qualification requirements for Commission members, appointees are required to be of significant calibre and experience given the role of the Commission. The majority of Commission members are independent, non-salaried non-executives who serve a function substantially similar to public interest directors and receive an allowance for their time and effort. While the SCA provides the Minister with the power to determine the quantum of the allowance, this is undertaken based on recommendations by the SC. The SCA requires the revocation of an appointment in specified circumstances, such as conviction of an offence under the law, bankruptcy, being of unsound mind or is otherwise incapable of discharging his duties, or absence from three consecutive Commission meetings without leave (s. 8). The SCA also says the appointment of any member may, at any time, be revoked by the Minister (s. 7(1)). The statute does not limit the Minister's power to revoke to circumstances where there is just cause for dismissal.</p> <p>There are some mechanisms in place to protect the independence of the Executive Chairman, the Deputy Chief Executive and Commission members of the SC.</p> <ul style="list-style-type: none"> <li>• Each Commissioner is appointed for a fixed term not to exceed three years (renewable)</li> <li>• To maintain objectivity and isolate any commercial influence, a Commission member or a potential member cannot also be an executive/ salary-director of a public listed company or someone who has an employment contract with a public listed company (SCA, s. 5)</li> <li>• A Commission member must disclose all direct and indirect interests he may have on any matters under discussion by the Commission or committee (SCA, s. 13).</li> </ul> <p>The SC advised that no Commission member had been subject to arbitrary removal and in their view such action would be unlikely. The financial regulators are generally respected and any such action would be subject to a great deal of negative public comment both at the industry level and in the press.</p> <p>The SC is accountable to Parliament on an ongoing basis as it is a statutory body established pursuant to a federal law. Members of Parliament are at liberty to question the SC with regard to the exercise of its regulatory powers. It is required to provide to Parliament, through the Minister, its annual report, including audited statements of account and reports of the activities undertaken by the SC for the year (SCA, s. 28 and 29). The SC's financial statements are prepared in accordance with Financial Reporting Standards (FRS) and accounting principles generally accepted in Malaysia and external auditors audit its financial statements. The SC also posts its annual report on its website.</p> <p>There is no legal requirement for the SC to make public its actions and decisions. However, in cases where actions and decisions of the SC impact market participants and regulated entities, the SC will publish its actions and decisions on its website, issue press releases and through speeches by Chairman and senior management at relevant public forums. The SC's website contains extensive information on the SC, its actions, all relevant laws, regulations and guidelines, speeches etc.</p> <p>The SC is not legally mandated to provide written reasons for its decisions. However, in</p>
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<sup>7</sup> Although the law specifies that four out of nine Commission members must represent the Government, the law does not specify the Ministry or agency from which these members must be appointed. Members representing the government have included representatives from Ministry of Finance, Ministry of Primary Commodity, BNM and Companies Commission of Malaysia.

	<p>practice it provides written reasons in all cases that would materially affect someone's rights, such as when it rejects a person's application for a licence. It also issues reasons when it imposes administrative sanctions against licensed persons and when it suspends and revokes licences.</p> <p>The SC's decision-making process includes extensive procedural protections. As noted above, various board committees have been established under section 18 of the SCA to assist the SC in making decisions on matters that require its approval. The processes followed by each of these committees support the goal of ensuring full procedural fairness is afforded to the affected parties. Before any sanction is imposed, the SC gives affected persons an opportunity to put across their defenses by issuing a show cause letter detailing SC's findings. The affected persons are also allowed to put across facts within their own knowledge and to submit documents to support their case in reply to the show cause letter. Prior to the issue of the show cause letter, the SC staff will have engaged in extensive discussions with the affected party. For administrative sanctions, the responses of affected persons are assessed against the evidence gathered by the SC and deliberated by a working-level committee known as the Sanctions Committee. This committee is chaired by the Chairman, Executive Director (ED) of Enforcement, ED of Market Oversight, ED of Compliance &amp; Examination, ED of Corporate Finance &amp; Investment and the General Counsel. The SC's decision will then be communicated to the affected person in writing together with reasons.</p> <p>The circumstances where the right to be heard and to appeal apply are set out expressly in the CMSA.</p> <p>The consent of the Public Prosecutor is required before the SC can commence any criminal prosecution of securities offences.</p> <p>All actions and decisions of the SC are subject to judicial review. The administrative laws in Malaysia require all government agencies including the SC to adhere to principles of natural justice and procedural fairness, failing which the court may quash their action and/or decision. As in many common law countries, the courts grant a great deal of deference to the decisions of an expert administrative tribunal such as the SC. In the period 1993 to 2011 there have been 10 cases filed against the SC for judicial review. However, none of these cases succeeded; few made it past the initial threshold necessary to obtain judicial leave for appeal.</p> <p>See also the discussion under Principle 4.</p>
Assessment	Partly implemented
Comments	<p>The SC operates free of influence from the government and the industry on a day-to-day basis and the assessor was given no reason to doubt the independence of the SC and its staff in practice. However, unlike under the CBA, the legal provisions that support the SC's ability to operate free of political interference are missing certain terms that are expected under the Assessment Methodology. The structure of the Commission and terms of appointment for Commission members, including the Chairman, as set out in the SCA give the Minister unfettered ability to remove any Commission member at any time, without cause or notice, which is contrary to Key Question 5. Further, unlike the equivalent provision in the Central Bank Act that applies to BNM, there are no qualifications specified for appointment as a Commission member. The SCA should be amended to include general qualification requirements for Commission members and set out that a Commission member may <u>only</u> be removed for cause (such as bankruptcy, persistent failure to attend meetings, acting in conflict of interest, etc. as listed in s. 8 of the SCA). The right of the Minister to remove members without cause should be repealed.</p> <p>The Commission, any member of the Commission or Shariah Advisory Council or Audit Oversight Board (AOB), any member of any committee established by the Commission or Shariah Advisory Council or AOB, the Chairman and any staff member of the</p>

	<p>Commission is covered by a statutory immunity clause for any action taken in good faith in pursuance of their duties (SCA, s. 160), An agent of the SC is not covered by the statutory provisions but often would be provided with an indemnity as part of the contract with the SC. To cover the full ambit of the expectations in Key Question 5 of the Assessment Methodology for this Principle, consideration should be given to extending the language in the immunity provision to protect persons who were acting on behalf of the Commission at the time of the actions in question. Coverage should not depend on the person's employment status at the time of the lawsuit; former employees and agents should be included. Further, legal immunity does not completely eliminate the possibility of being sued, and the costs incurred by a person, even when vindicated in the end, can be ruinous. While not strictly required by the Assessment Methodology, consideration should be given to including provisions permitting the SC to indemnify these persons for their legal costs in the event they are sued.</p>																																	
<p><b>Principle 3.</b></p>	<p>The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.</p>																																	
<p>Description</p>	<p>The SC has sufficient powers to carry out its functions under the securities laws. The SC responsibilities, powers and authorities are set out in securities laws (the SCA, CMSA and SICDA). It has full authority to licence, inspect, enforce and regulate the participants in the capital market in Malaysia. Section 15 of the SCA sets out the objectives and functions of the SC and gives SC the power to promote and maintain market integrity, supervise and monitor market activities and market participants, and power to take enforcement action against illegal, improper practices and market misconduct. It has the power under the CMSA to make legally enforceable regulations and guidelines (s. 377 &amp; 378).</p> <p>The SC's funding is adequate to permit it to fulfil its responsibilities. The SC's funds are derived from levies as well as fees and charges. A levy is imposed on the purchaser and seller on every transaction in securities on the securities exchange (Bursa Malaysia Securities), while fees and charges are imposed on all corporate proposals submitted to and approved by the SC. The SC has full authority to affect the operational allocation of its financial resources.</p> <p>The SC ensures that it has sufficient qualified staff and appropriate technological infrastructure, systems and databases to fulfil its responsibilities. The level of resources in the SC recognizes the difficulty of attracting and retaining experienced and skilled staff. The SC's workforce consists of graduates with various professional qualifications as well as subject matter experts, in addition to non-executive support staff. The SC has in place an extensive framework to attract, retain, develop and motivate staff. In addition, the organisation tracks "people risk" as one of the key operational risks in the SC's risk management framework.</p> <table border="1" data-bbox="418 1438 1398 1896"> <thead> <tr> <th colspan="3"><b>Total Number of Staff by Business Group/Department–2011</b></th> </tr> <tr> <th></th> <th><b># of Staff</b></th> <th><b>% of Total Staff</b></th> </tr> </thead> <tbody> <tr> <td>Chairman's Office</td> <td><b>88</b></td> <td><b>13</b></td> </tr> <tr> <td>Corporate Resources</td> <td><b>176</b></td> <td><b>26</b></td> </tr> <tr> <td>Enforcement</td> <td><b>86</b></td> <td><b>13</b></td> </tr> <tr> <td>Issues &amp; Investment /Corporate Finance &amp; Investments</td> <td><b>100</b></td> <td><b>15</b></td> </tr> <tr> <td>Market Supervision</td> <td><b>140</b></td> <td><b>20</b></td> </tr> <tr> <td>Strategy &amp; Development</td> <td><b>55</b></td> <td><b>8</b></td> </tr> <tr> <td>Islamic Capital Market</td> <td><b>24</b></td> <td><b>3</b></td> </tr> <tr> <td>Audit Oversight Board</td> <td><b>15</b></td> <td><b>2</b></td> </tr> <tr> <td><b>Total</b></td> <td><b>684</b></td> <td><b>100%</b></td> </tr> </tbody> </table>	<b>Total Number of Staff by Business Group/Department–2011</b>				<b># of Staff</b>	<b>% of Total Staff</b>	Chairman's Office	<b>88</b>	<b>13</b>	Corporate Resources	<b>176</b>	<b>26</b>	Enforcement	<b>86</b>	<b>13</b>	Issues & Investment /Corporate Finance & Investments	<b>100</b>	<b>15</b>	Market Supervision	<b>140</b>	<b>20</b>	Strategy & Development	<b>55</b>	<b>8</b>	Islamic Capital Market	<b>24</b>	<b>3</b>	Audit Oversight Board	<b>15</b>	<b>2</b>	<b>Total</b>	<b>684</b>	<b>100%</b>
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	<p>To support the SC's regulatory functions, staff has a wide range of technical support, including extensive IT infrastructure and tools, various systems and many databases. Information on the markets and other data are used throughout the SC's activities. The SC has an extensive annual budget for technology, covering both capital expenditure and development spending.</p> <p>The SC ensures staff receives adequate and on-going training. The SC has a structured development programme for staff including the development of identified technical and leadership competencies and exposure of staff to new developments in the industry and sharing of experiences through workshops. The SC has consistently allocated an average of 4% of staff salary yearly for learning and development initiatives.</p> <p>The SC has policies and governance practices in place to guide the performance of its functions and exercise of its powers. As a capital market regulator, the SC advocates high standards of corporate governance and endeavours to uphold sound governance principles and best practices in its own operations. For example, it has a detailed system of internal controls in place.</p> <p>The SC's governance practices and control environment include:</p> <ul style="list-style-type: none"> <li>• An organisation structure with defined responsibilities and delegation of responsibilities to specified committees to carry out key regulatory functions;</li> <li>• Job profiles incorporating detailed job descriptions and accountabilities;</li> <li>• A systematic job evaluation process; and</li> <li>• A Policy-Making Framework that is designed to ensure greater accountability, more robust challenges and validation to improve consistency of policies and actions.</li> </ul> <p>In addition to this, the SC has in place an internal audit process the goal of which is to ensure that the SC complies with all established processes and procedures. The Internal Auditor reports to the Audit Committee, which is made up of independent, non-executive members of the Commission.</p> <p>The SC places a significant emphasis on investor education as a key component of its investor protection mandate. The SC's efforts are aimed at widening the coverage of investor education programmes to promote nationwide financial literacy and financial inclusion. These programs target a cross-section of the public to build the knowledge and skills of current and potential investors.</p> <p>The Securities Industry Development Corporation (SIDC) participates in the SC's education efforts. SIDC was formed from the SC's training department and now is a separate corporation with its own board. Its mandate is to assist in building the skills of market intermediaries and providing investor education through its training programs. Between 2008 and 2011, SIDC conducted 847 programmes for over 60,000 market intermediaries and more than 650 financial literacy and investor education programs for more than 150,000 individuals. Substantial resources from the SC's own funds and from the Capital Market Development Fund (CMDf) are devoted to these efforts. In addition the CMDf has allocated significant funds towards efforts to promote shareholder activism.</p>
Assessment	Fully implemented.
Comments	
<b>Principle 4.</b>	The regulator should adopt clear and consistent regulatory processes.
Description	There are processes and procedures adopted within the SC to ensure that regulatory actions undertaken by the SC are fair and reasonable, transparent and comprehensible to the affected persons and the marketplace, and that there is consistent application of

	<p>relevant principles.</p> <ul style="list-style-type: none"> <li>• The SC is subject to rules of procedural fairness set out in the securities laws (see Principle 2);</li> <li>• There is a statutory right to appeal in the event affected persons are dissatisfied with SC's decisions (see Principle 2);</li> <li>• The SC may be questioned by Parliament at all times with respect to its actions; and</li> <li>• The courts act as the final arbiter in the event the SC's regulatory actions are challenged.</li> </ul> <p>The SC has established extensive internal criteria and processes to ensure consistent processes are applied and to enhance the quality of its decision-making process. For example, the enforcement process is guided by three documents:</p> <ul style="list-style-type: none"> <li>• The Enforcement Handbook that relates to undertaking administrative actions;</li> <li>• The Guidelines for the Prosecution of Securities Offences (for commencing criminal prosecution); and</li> <li>• The Guidelines on Compounds that relate to offering compounds<sup>8</sup> to affected persons.</li> </ul> <p>The SC has created several committees to provide structured, independent challenges of management's recommendations on matters that require SC's approval. These committees are the Licensing Committee, Issues Committee, Trust and Investment Management Committee and Take-overs and Mergers Committee (SCA, s. 18). For example, if staff were proposing that an application for licensing be refused, the matter and all related facts would be reviewed by the Licensing Committee to make sure all factors were considered and that the decision was fully justified. Many of the day to day decisions of the regulator – such as the approval of licensing applications – have been delegated to these specialized committees.</p> <p>The SC has also set up various working-level committees to consider applications that require its approval on other matters. These working-level committees are the Intermediary Review Committee (IRC), the Surveillance Review Committee (SRC) and the Systemic Risk Oversight Committee (SROC). For example, the IRC considers the findings of the SC's examiners on stockbrokers and fund managers before making any recommendation to the Sanction Committee.</p> <p>The SC has put in place processes for consultation for policy-making and has adhered to these processes in carrying out its duties. These processes are engaged when the SC is:</p> <ul style="list-style-type: none"> <li>• Developing new or amending regulatory policy;</li> <li>• Conducting Post-Implementation Review;</li> <li>• Performing cost-benefit analysis; and</li> <li>• Developing exposure drafts.</li> </ul> <p>The consultation process may involve one or more of the following approaches depending on the significance and impact of the subject matter:</p> <ul style="list-style-type: none"> <li>• Inviting public comments through exposure/consultation paper;</li> <li>• Seeking market/sector feedback through dialogues, syndications and focus group discussions; and</li> <li>• Establishing committees/seeking experts' advice through formation of</li> </ul>
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<sup>8</sup> The SC may, with the written consent of the Attorney General's Chambers, reach an agreement with a person who has committed a criminal offence. The person pays the amount offered in the compound and no criminal prosecution takes place.

	<p>committees comprising industry experts and/or engagement of subject matter experts (including international experts).</p> <p>The SC has in place a Policy-Making Framework that establishes a set of clear protocols applicable to any line department that wishes to propose new policies to senior management of the SC for decision. These protocols include an assessment of policy implications, discussions internally, risk assessments and the development of a Concept Note to test new ideas with senior management before embarking on any detailed work. The Concept Note must include information on the:</p> <ul style="list-style-type: none"> <li>• Purpose of the initiative;</li> <li>• Analysis involved;</li> <li>• Stakeholders that will be affected; and</li> <li>• Project plan, which includes the consultation process, communication strategy and measurements of the effectiveness of the policy i.e. desired outcomes of any regulation implemented.</li> </ul> <p>The SC may also establish expert-committees in undertaking new policy-making. These expert committees were used in the development of the regulatory framework for the Audit Oversight Board (AOB) and in the process leading to the new CMSA in 2007. There are extensive examples of where the SC invited public comments through the release of consultation papers.</p> <p>The SC publicly discloses and explains its policies (including changes and the reasons for such changes) especially those areas having significant and important impact on the market through a variety of channels, such as public consultations, market dialogues, sector and industry association briefings, press briefings, press releases and through speeches delivered by the SC's Chairman and its two Managing Directors at major public forums.</p> <p>The cost of compliance with regulation is routinely assessed to identify and determine cost-benefit impact and implication on stakeholders, in order to minimize the unjustified burden on markets that may inhibit growth and development of the capital market. Cost is an integral issue that the SC takes up in its consultations with the industry. The SC identifies who will bear the cost of regulation, compares and assesses benefits and costs for each available option, and balances the cost for compliance and the need for regulations in order to meet the SC's regulatory objectives.</p> <p>The securities laws and regulations, including Guidelines, Codes and Practice Notes are made available to the public on the SC's website for free. In addition, printed copies of securities laws and regulations are available for purchase at the SIDC Bookshop, the government printer and retail book stores.</p> <p>The SC's broad rule-making process is made available to the public via the SC's website while detailed step-by-step, processes and internal timelines for carrying out the action items are made available to staff via the SC's intranet.</p> <p>There are rules in place that are intended to ensure procedural fairness. Various provisions in the securities laws mandate the SC to provide an affected person an opportunity to be heard, such as on a variation of terms or suspension of a licence (CMSA, s. 69(5) and 72(4)). See the discussion under Principle 2.</p> <p>In dealing with affected persons, the SC has in place the safeguards including:</p> <ul style="list-style-type: none"> <li>• Requiring an inquiry and evidence-gathering process: Before the SC invokes any sanction, line departments are required to inquire into the complaint and all aspects of the inquiry are recorded in writing and filed;</li> <li>• Show cause process where details of contravention are given: If the SC is satisfied that a case is made out, a show cause letter is issued which acts as an opportunity for the person to state his case why action should not be taken by the SC. The SC will state in the show cause letter the breach, nature and a</li> </ul>
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	<p>description of the breach and the person's right to respond;</p> <ul style="list-style-type: none"> <li>• Reasonable time to prepare response: The SC gives the person a reasonable time in which to prepare his explanation. As a matter of practice, the SC gives 14 days, which may be extended at the SC's discretion;</li> <li>• Right to counsel: An affected person has the right to seek legal representation in preparing his response to the SC;</li> <li>• Sanction Committee has clear procedures and protocols;</li> <li>• Reasons are given for decisions;</li> <li>• Right to appeal: There are various provisions in the securities laws that provide aggrieved persons the right to appeal against SC's decisions. All material actions and decisions of the SC are subject to reviews: <ul style="list-style-type: none"> <li>• Its own decisions pursuant to section 146 of the SCA and sections 364 and 365 of the CMSA; and</li> <li>• Judicial review by the courts; and</li> </ul> </li> <li>• Independent panel for appeal: When a matter is appealed, the panel that sits and deliberates the appeal consists of the entire board of Commission members who are independent from SC's management and who were not part of the decision being appealed.</li> </ul> <p>As noted under Principle 2, the securities laws do not expressly mandate the SC to give reasons in writing for its decisions. However, to promote transparency in its decision-making process, the SC gives reasons in all cases that materially affect the rights of persons.</p> <p>The general criteria for granting, refusing to grant, revoking or suspending a licence are clearly set out in the CMSA, the Licensing Handbook and various applicable guidelines:</p> <ul style="list-style-type: none"> <li>• Sections 64 and 65 set out the grounds where the SC may refuse to grant a license: and</li> <li>• Section 72 sets out the grounds when the SC can revoke or suspend a licence.</li> </ul> <p>Those affected by the SC's licensing decisions to revoke, suspend or impose conditions on an existing license are given a right to be heard before the action is taken. First time applicants are not given a right to be heard but will be given full reasons for the refusal and they have the right to appeal in the event they are not satisfied with the SC's decision.</p> <p>The SC exercises its powers and discharges its functions consistently. There are extensive measures and procedures put in place to ensure consistent application. These include:</p> <ul style="list-style-type: none"> <li>• Requiring all guidelines and regulations proposed by line departments to be vetted by General Counsel's Office before they are released to the market to ensure consistency in drafting and application.;</li> <li>• Requiring referrals of all administrative actions to the Sanctions Committee for review and decision to ensure similar misconduct attracts similar sanctions.</li> <li>• Making the SC's regulatory processes available to all staff of the SC via the intranet; and</li> <li>• Using specialized committees with clear terms of reference (the Licensing, Issues, Takeovers and Mergers, Trust and Investment Management Committees) to ensure similar treatment is given to cases that come before the committees for decision. Many of the day to day decisions of the regulator – such as the approval of licensing applications – have been delegated to these specialized committees.</li> </ul>
Assessment	Fully implemented

Comments	<p>As noted under Principle 2, the securities laws do not expressly mandate the SC to give reasons in writing for its decisions. However, to promote transparency in its decision-making process, the SC gives reasons in all cases that materially affect the rights of persons.</p> <p>Those affected by the SC's decisions generally have a right to be heard before the decision is rendered and a right to appeal that decision. Those affected by licensing decisions to revoke, suspend or impose conditions on an existing license are given a right to be heard before the action is taken. First time applicants for licensing are not given a right to be heard but are given full reasons for the refusal and have the right to appeal in the event they are not satisfied with the SC's decision.</p> <p>The courts in Malaysia consistently have upheld the SC's application of procedural fairness in reaching its decisions. See for example, the Court of Appeal decision in <i>NasionCom v Securities Commission Malaysia</i> rendered on April 9, 2012.</p>
<b>Principle 5.</b>	The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality.
Description	<p>All staff members of the SC are required to strictly comply with the SC's Code of Ethics and Code of Conduct. The Codes form part of the overall terms and conditions of employment of the SC, which the SC has the power to establish under the SCA (s. 20). The Codes include:</p> <ul style="list-style-type: none"> <li>• A mandatory obligation on staff to avoid any situation that can prejudice their independent judgment.</li> <li>• A requirement to make prompt disclosure of any conflict of interest to the SC. All disclosures must be made immediately, in writing, to the Executive Director of Corporate Resources.</li> <li>• A prohibition on investing in any securities, except for: <ul style="list-style-type: none"> <li>• Securities in a private limited company;</li> <li>• Securities managed for the staff member under a fund management arrangement where the staff member has no discretion in the management of such securities;</li> <li>•</li> <li>• Malaysian Government securities;</li> <li>• any unit trust approved by the SC; and</li> <li>• foreign securities traded in a foreign securities exchange.</li> </ul> </li> </ul> <p>Staff members are informed prior to joining the SC of this restriction and are permitted to maintain any securities already owned when they join the SC. Where a staff member wishes to dispose of an existing shareholding, the written permission of the Chairman must be obtained.</p> <p>All staff members are required to complete an asset declaration on becoming an employee of the SC. In addition, the SC runs an annual asset declaration process for all executive staff and management, including the Chairman. A full declaration is required every 5 years supported by annual updates listing acquired assets or an affirmative declaration of no changes.</p> <ul style="list-style-type: none"> <li>• A requirement that the staff strictly comply with the secrecy obligation imposed by the SCA (s. 148). Further, staff members must ensure that the confidentiality of all information from computer sources (including passwords, application systems, files, databases, reports, media storage, software etc.) is maintained.</li> <li>• An express prohibition on using any information acquired by virtue of their position in the SC for their own personal gain.</li> </ul>

	<p>The SC expects staff members to comply with all procedural requirements in the performance of their functions. The SC has documented processes and procedures that include time charters, key performance indicators, standard operating procedures and service level agreements that staff must observe properly and fairly. Staff must ensure procedural fairness in their functions, particularly with respect to applications, appeals and reviews.</p> <p>Any violation or infringement of provisions of any applicable law, the Code of Conduct, the Terms and Conditions of Employment and any conduct on the part of the staff member that is inconsistent with the faithful discharge of duties towards the SC would be construed as misconduct. Examples of possible misconduct that may result in the institution of disciplinary proceedings against the relevant staff members are set out in the Code of Conduct.</p> <p>The SC has internal guidelines that set out the procedures that apply when disciplinary action is taken against a staff member for failing to comply with agreed standards. The procedures provide a systematic approach in handling disciplinary matters, including inquiry, investigation and resolution of the allegations.</p> <p>Where staff members are dissatisfied with the outcome, they may appeal to the Chairman of the SC, and should they continue to be dissatisfied with the decision on appeal, they may bring their grievance to the Malaysian Labour Department. The Labour Department has the power to review the matter and determine if the case should be brought before the Industrial Tribunal.</p> <p>A breach of conduct may result in disciplinary action, including a warning letter, a reprimand, prohibition of the use of the SC's facilities, a requirement to bear the cost of replacement of the SC's assets and goods, forfeiture of salary, suspension without salary, stoppage of salary increment, deferment of salary increment, ineligibility for bonus, reduction of salary, demotion, or dismissal. The SC may also issue a public notice of the dismissal of the staff member following disciplinary action.</p>
Assessment	Fully implemented
Comments	
<b>Principle 6.</b>	The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.
Description	<p>The SC has an explicit mandate and authority for monitoring, mitigating and managing systemic risk.</p> <ul style="list-style-type: none"> <li>• Section 15(1)(p) of the SCA gives the SC the power to take all reasonable measures to monitor, mitigate and manage systemic risks arising from activities in the securities and derivatives markets</li> <li>• Part IXA of the CMSA (ss. 346A to 346D) sets out measures available to the SC to carry out these systemic risk responsibilities that supplement the other powers that the SC has under the relevant legislation.</li> </ul> <p>This mandate is consistent with the scope of the SC regulatory responsibilities. While Part IXA was only added to the CMSA in 2011, a system to monitor, mitigate and manage systemic risk has been in place and operational at the SC for many years. Systemic risk assessments have been a formal part of the SC's functional arrangements for nearly 10 years and part of its regulatory approach and philosophy for even longer. In 1997, the SC recognised the significance of systemic risk surveillance and assessment for securities regulators, having seen first-hand the effects of the Asian crisis on systemic stability of markets. It began a process of strengthening and developing a framework for systemic risk supervision in the immediate period after that crisis. The SC consulted with central bankers who were putting in place financial stability frameworks.</p>

The SC also held discussions with other stability regulators' experience with managing volatility spill-over between the currency and stock markets during the Asian crisis.

In 2003, a fully-fledged Division of Strategy and Risk Management was created and staffed with teams of economists and finance specialists. The division's responsibilities covered the macro aspects of policy making—which also involved assessing what is now referred to as “the perimeter of regulation”—as well as putting in place a process of looking at macro risk indicators, thus allowing the SC to assess systemic risks in the capital market.

The SC continues to enhance its efforts in this area, including combining systemic risk assessments with those of the Commission's enterprise risk framework to give the SC board and management a comprehensive picture of overall risks to the organisation and the capital market.

#### *Risk Identification*

The SC has regulatory processes that examine and assess sources of systemic risk; seek to reduce the likelihood of a systemic event; and seek to minimise the systemic impact of an adverse event in the capital market. The processes operate at the level of the firm (including market intermediaries, market operators, collective investment schemes, trustees and custodians, credit rating agencies and auditors); the industry level; and the level of markets and products. The processes incorporate the SC's assessment of its own enterprise risks, which include those arising from developments in the capital market, as well as regular consultations and co-ordination of work with other regulators, especially BNM.

Explicit responsibilities for identification of systemic risks are assigned to the Risk Management, Economics and Strategy and Research departments in the SC's Strategy and Development Business Group. These departments have dedicated resources to deliver on this objective. The arrangements allow for the identification of systemic risk from a variety of sources as described below.

*Key firms.* Systemic risks from key firms and their activities are identified through a number of tools, including :

- Systemic risk matrix for capital market entities – This assesses the systemic significance of capital market entities on the basis of a number of factors, including their interconnectedness, size, market presence/substitutability;
- Monitoring of firms' capital positions (e.g., shareholders' funds, paid-up capital) and capital-adequacy positions (e.g., capital-adequacy ratios, risk-weighted capital requirements); and
- Stress tests of the financial and prudential positions of stockbroking companies, including capital-adequacy ratios and shareholders' funds against specific shocks and scenarios.

*The macro environment, including the wider economy and financial markets.* Systemic risks from the macro environment are identified through regular monitoring of a number of macro indicators, including:

- Capital market stress indices (modified financial conditions indices which focus on capital market specific factors);
- Market valuation metrics (e.g., price-earnings, etc);
- Risk aversion indicators (e.g., futures term-structure, CDS premiums, credit spreads etc); and
- Portfolio investment exposure to relevant risk factors (e.g., geographical markets, currencies, industry sectors, asset classes).

Also, the SC regularly monitors for risks to orderly markets from international contagion, changes in liquidity, valuation changes as a result of ratings changes and shifts in investors' risk appetite, among other factors.

*Capital market products.* Systemic risks from capital market products are identified through a number of tools, including

- Credit risk assessments (e.g., Bond-Under-Stress matrices); and
- Product-complexity reviews (e.g., fixed-income, structured products, managed-investments schemes, etc).

*Assessment of Entities, Products and Activities Across the System*

The output of the analyses of product/firm/macro risks are reviewed by the relevant heads for Investments (products), Risk Management (macro) and Supervisory risk (firms), who then escalate their analyses to the Systemic Risk Oversight Committee (SROC) for a more holistic review.

SROC is an internal high-level cross-departmental committee. Its role is to consider the implications of such product/firm/macro risks on the stability of the capital market as a whole, with a view to taking pre-emptive regulatory action where necessary, as well as to identify where enhancements can be made to prevailing arrangements for monitoring, mitigating and managing systemic risks. In particular, SROC assesses risk issues along several lines, including:

- Inter-relationships between risks across product/firm/macro levels;
- Major stress points in various product/firm/macro segments;
- Common factors across various product/firm/macro segments (e.g., entities operating in multiple markets and products);
- Regulatory coverage/regulatory perimeter; and
- Methodological reviews (e.g., criteria for identification of systemically important financial institutions (SIFIs), intermediary-at-risk intervention framework, crisis management procedures).

SROC engages in discussions on relevant issues with external parties (e.g., the BNM, Bursa Malaysia and the Ministry).

Also, these systemic risks are regularly captured and assessed each quarter at the enterprise level and reported to the Risk Management Committee (RMC) of the SC.

*Periodic Re-assessment*

Systemic risks are periodically re-assessed to identify priority issues and to take pre-emptive regulatory action where necessary. The review cycle is as follows:

- Monthly – Credit risk analysis, firm prudential risk analysis, stress-testing of stockbroking companies, macro risk analysis;
- Quarterly – SROC discussion and holistic assessments, Risk Management Committee enterprise risk assessment;
- Annual – Regulatory perimeter, firm systemic risk assessment.

The SC also reviews its processes and arrangements periodically to enhance the monitoring, mitigating and managing of systemic risks. The current focus of the SC's review includes:

- The stress-testing methodology for market intermediaries – Engaging experts to benchmark against best-of-class;
- The identification of SIFIs – Refinement of risk impact parameters, e.g. differentiating of impact on retail/wholesale segments, etc.;
- Measuring capital market stress – Refinement of current capital market stress indicators/indices; and
- Crisis management procedures – Improvements to co-ordination of internal responses to multiple crisis scenarios.

*Regulatory Expertise*

The SC has developed significant in-house expertise and tools related to systemic risk issues. It has established dedicated functions in the Strategy and Development Group to

provide an organisational overview of risks, economic and strategic issues in the Risk Management, Economics and Strategy and Research departments, respectively. It also has put in place research programs, staff training programs, and cross-departmental collaboration.

Resources have been dedicated to deepening its expertise in the areas of risk measurement and analysis to support its systemic risk oversight activities, particularly in the areas identified as being under review above.

#### *Regulatory Actions*

These systemic risk oversight arrangements have led to early detection of systemic risks and the SC took pre-emptive regulatory action to mitigate and manage such risks.

For example, in late 2010 the SC's monitoring and analysis of credit risk conditions in the corporate bond market flagged a potential issue at certain Malaysian utility companies that had begun to face cash-flow problems amid a prolonged dispute on government-related concessions. These companies had issued bonds with total principal outstanding of approximately RM6 billion (US\$1.9 billion or 1.8% of the total corporate bond market's capitalisation). The concession dispute represented a common risk factor which, if crystallised, could have led to a default event involving all the bonds issued by these utilities, as well as a sharp loss of investor confidence in similar government-related bonds. This was viewed as a systemic threat because the similar government-related bonds were estimated to account for at least half the value of the corporate bond market at the time (i.e., RM160 billion (US\$51 billion) out of a total capitalisation of RM320 billion (US\$101 billion)). The situation was all the more pressing as the government, under its Economic Transformation Program, was embarking on major infrastructure projects where the bond market was to be one of the key sources of financing. The SC engaged with key stakeholders including the Ministry, BNM, investors and bond trustees to develop a full view of risks and to consider appropriate measures to be taken. Based on the SC's advice, the government agreed to expedite a scheme to buy back the bonds from investors at agreed prices, which was effective in restoring confidence on this segment of the bond market, as well as limiting systemic consequences on the overall bond market.

#### *Communication, Information Sharing and Coordination*

There is communication and information sharing between the Commission and BNM, both through the existing MOU and less formally. Staff members of the Commission communicate and share information with their counterparts in BNM on routine operational matters. The Commission communicates and shares relevant information with BNM and the Ministry at times of high market risk. The last time this happened was on March 10th 2008, when the Kuala Lumpur Composite index fell 10% during the day and triggered an automatic market-wide trading halt for one hour.

The Commission also raises relevant matters with BNM (such as regulatory issues on investment banks, exchange of information and impact of domestic and external developments concerning risks to institutions and markets in the banking and capital market, the financial system, and the economy) through several forums, such as the Joint Surveillance Group (JSG) which brings together managerial staff in dealing with operational supervisory matters and the High Level Financial and Market Stability Group (High Level Group) that looks at issues that are more complex or strategic in nature. The High Level Group is chaired by a Managing Director of the SC and Deputy Governor of BNM. Issues discussed at JSG are escalated to the High Level Group for their consideration as appropriate.

The Commission engages with other relevant domestic authorities on systemic risk-related matters whenever necessary. For example, the Commission engages with the Malaysia Deposit Insurance Corporation on implementation details concerning the establishment of a trade repository for over-the-counter derivatives.

The SC also participates in the Financial Stability Executive Committee (FSEC), the

	<p>members of which are the Governor of the BNM (chair), one Deputy Governor and three to five external members (CBA, s. 37). The FSEC is empowered to make decisions when there are threats to financial stability that involve (a) financial institutions that are outside BNM's direct regulatory perimeter or (b) where it involves public funds or (c) where it impinges on personal property rights. The SC is not a permanent member of the committee. A representative of the SC attends by invitation if the FSEC is considering a matter that it has identified as raising capital markets issues.</p> <p><i>On-going Work</i></p> <p>The SC is developing a formal operational framework to guide its exercise of the powers granted by Part IXA of the CMSA to obtain information or documents and direct any person to take measures to address systemic risk in the capital market (CMSA, s. 346B and 346C).</p> <p>It is also working with the BNM and others to enhance existing arrangements (such as the MOU with BNM) to communicate and co-ordinate supervisory responses to systemic risks, including obtaining information or documents from each other, as well as from any other supervisory authority or government agency responsible for providing financial stability, whether domestic or foreign (s. 346D(1)(b)).</p>
Assessment	Fully implemented
Comments	<p>The SC participates in the FSEC by invitation, only if the committee is considering a matter that has been identified as involving a capital markets issue. Consideration should be given to making the SC a permanent member of this committee. Both BNM and the SC have express responsibilities with respect to financial stability in their respective spheres. The recent global financial crisis has shown that stability issues may arise from many capital markets activities. It would seem prudent for this committee to have the benefit of the SC's capital markets expertise and perspective at the table on a routine basis so issues relating to the capital markets affecting financial stability (and vice versa) can be identified as early as possible.</p>
<b>Principle 7.</b>	The Regulator should have or contribute to a process to review the perimeter of regulation regularly.
Description	<p>The SC has extensive systematic processes in place to identify, assess and respond to issues relating to the delivery of its regulatory objectives, including those concerning the perimeter of regulation. These issues may arise from the:</p> <ul style="list-style-type: none"> <li>• Business environment in which the SC and capital market operates (including the financial system and economy, legal environment and global conditions);</li> <li>• Capital market products, markets, participants and activities; and</li> <li>• The SC's own internal circumstances (including internal processes, resources, organisational structure, governance and culture).</li> </ul> <p>The approach combines a consideration of long-term structural issues faced by the capital market and more immediate regulatory concerns. Where appropriate, the process results in recommendations to formulate or clarify policy or to change securities laws and regulations. In addition, the SC may also seek such reform to align the laws and regulations with global standards and international best practices. For example, as a result of these processes, the SCA was amended in 2010 to establish the AOB. The SC has good access to the legislative agenda and has been successful at getting necessary legislative reforms enacted promptly. Its existing consultation and advisory processes and resulting good relationship with the Ministry and Attorney General's Chambers facilitate prompt action.</p> <p>The longer-term issues are addressed through the CMP2, which is reviewed every five years. The shorter-term issues are addressed in an annual cycle that begins with a</p>

	<p>review of the business and operating environment, assessment of key risks to regulatory objectives and prioritisation of issues. Risks are documented and an overall enterprise risk profile is developed. Senior management then reviews this risk profile, proposed work plans and mitigation strategies, as well as resource requests. The result is incorporated into the SC's formal work programme for the year. The SC also assesses the adequacy of its regime throughout the year as issues arise (such as proposals for new capital market products and activities) and through periodic engagements with stakeholders.</p> <p>The SC has a formal process in place to review its regulatory policy decisions to evaluate whether the objectives of a project or regulatory initiative have been met (Guide To Conducting A Post-Implementation Review). In practice, the SC reviews its regulatory guidelines whenever a significant event takes place in other markets and takes the steps necessary to address any weaknesses identified in order to be able to respond effectively or prevent the occurrence of similar events in the domestic market.</p> <p>The processes described above include reviews of unregulated products, markets, market participants and activities, including the potential for regulatory arbitrage. In addition, the SC also raises relevant matters with BNM (including areas where both authorities share supervisory and regulatory responsibilities). Where developments in the market pose risks, the SC can exercise its public interest jurisdiction to block problematic behaviour or products or change the relevant rules to permit new services and products.</p>
Assessment	Fully implemented
Comments	
<b>Principle 8.</b>	The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.
Description	<p>The SC has in place processes to identify and evaluate potential and actual conflicts of interest and misalignment of incentives. The assessment of the potential and actual conflicts of interest are part of many processes at the SC, including the:</p> <ul style="list-style-type: none"> <li>• Licensing process (such as whether an applicant has policies and processes to monitor and manage conflicts of interest);</li> <li>• The review of proposed issues of securities (the SC may reject applications if there are conflict of interest situations which are not satisfactorily addressed by the issuer and promoters);</li> <li>• The examination process for licensed persons; and</li> <li>• The disclosure requirements (both for public companies and market intermediaries).</li> </ul> <p>There are provisions in the CMSA and guidelines issued by the SC that are designed to avoid and deter conflicts of interest and misalignment of incentives. The requirements require disclosures of conflicts of interest and the violation of these requirements will attract administrative, civil or criminal sanctions. (See the discussion under Principle 31.)</p> <p>Where any conflicts of interest or misalignment of incentives have been identified, the SC has processes in place to address these problems. These steps are instituted not only at the pre-approval stage but also undertaken on a continuous basis. For example, the mitigation of conflicts of interest and misaligned incentives is considered to be a key component of corporate governance, which is an important consideration when the SC is undertaking surveillance and enforcement activities.</p> <p>Malaysian securities laws contain express provisions prohibiting certain types of conduct that may arise out of conflicts of interest and misaligned incentives. For example, section 93 of CMSA prohibits a licensed dealer or fund manager from trading for its own account before filing orders for clients to prevent front-running. Legal provisions also exist to</p>

	<p>mitigate conflicts of interest that could arise due to Bursa's status as a listed company as well as its statutory duties as a frontline regulator. To address this potential conflict of interest, the SC has the power to issue directions to Bursa when a conflict exists or may come into existence due to Bursa's dual roles (CMSA, s. 26). (See the discussion under Principles 9 and 33.)</p> <p>In addition to clearly prohibiting certain types of conduct, the SC also addresses the issues of conflicts of interest and misalignment of incentives by:</p> <ul style="list-style-type: none"> <li>• Imposing requirement for independent opinions on transactions, such as those with related parties;</li> <li>• Requiring market professionals, such as stockbrokers, principal corporate finance advisers, and CRAs, to have internal controls and processes in place while carrying out regulated activities;</li> <li>• Imposing regulatory requirements on product design and distribution (e.g. Guidelines on Offering of Asset-Backed Securities (ABS) that require special valuation reports and impose cash flow requirements on the underlying assets);</li> <li>• Mandating regulated entities to disclose conflicts of interest (applies to issuers, credit rating agencies, securities firms etc.);</li> <li>• Mandating disclosure in relation to the offering and issuance of ABS; and</li> <li>• Taking corrective and enforcement action for non-compliance.</li> </ul> <p>The disclosure of conflicts of interest is mandated to ensure it comes to the attention of the affected parties – the clients of the securities firm with the conflict (via account statements, specific disclosure, research report disclosure etc.), the potential purchasers of a new issue of securities (in the prospectus), and the current investors in an issuer (in continuous disclosure documents). If there is a concern, the SC has the authority to require additional disclosure or take other appropriate actions to address the issues.</p> <p>The Federation of Investment Managers Malaysia (FIMM), a self-regulatory organization (SRO) for operators and distributors of collective investment scheme (CIS) products (unit trusts), has market conduct rules in place that require its members to disclose compensation arrangements to address conflicts of interest concerns.</p>
Assessment	Fully implemented
Comments	
<b>Principles for Self-Regulation</b>	
<b>Principle 9.</b>	Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	<p>There are two organizations in the Malaysian capital markets that exercise some direct oversight responsibility for their areas of competence and their rules and whose rules are subject to meaningful sanctions – Bursa Malaysia Berhad (Bursa Malaysia) and the Federation of Investment Managers Malaysia (FIMM). FIMM is a recognized and authorized self-regulatory organization (SRO) pursuant to Part VIII of the CMSA. Bursa Malaysia is recognized as an exchange holding company under Part II of the CMSA, but undertakes certain functions of an SRO.</p> <p><b>Bursa Malaysia</b></p> <p>Bursa Malaysia is an exchange holding company, whose duties are set out in the CMSA (s. 21). It operates a fully integrated exchange, offering the complete range of exchange-</p>

related services including trading, clearing, settlement and depository services for both securities and derivatives.

The following are subsidiaries of Bursa Malaysia that operate the securities and derivatives exchanges, the securities and derivatives clearing and settlement services, depository services and the operator of the electronic trading platform for the trading and reporting of bonds -

1. Bursa Malaysia Securities Berhad;
2. Bursa Malaysia Derivatives Berhad;
3. Bursa Malaysia Securities Clearing Sdn Bhd;
4. Bursa Malaysia Derivatives Clearing Sdn Bhd
5. Bursa Malaysia Depository Sdn Bhd; and
6. Bursa Malaysia Bonds Sdn Bhd. (collectively, the Exchange Group)

Bursa Malaysia, as the exchange holding company, is responsible for establishing the rules for its subsidiaries, including rules of eligibility that must be satisfied by individuals or firms in order to participate in the securities, derivatives and bonds markets. Each of these entities has rules in place to govern eligibility to participate in the respective market or access the services. These rules are subject to the SC's approval pursuant to Section 9 of the CMSA and section 7 of the SICDA. Such rules are made public via Bursa Malaysia's website.

Bursa Malaysia has established and enforces various binding business rules that govern the trading or business conduct and qualifications for registered persons and/or market participants engaging in securities and derivatives activities. These rules are binding on the individuals and firms on a contractual basis. The Listing Requirements also impose binding requirements on listed companies and their key officers and directors.

Section 8(2)(d) of the CMSA requires Bursa Malaysia to take appropriate action against its participating organizations (POs) or affiliates for any breach of its rules. Bursa Malaysia has extensive disciplinary procedures and can take action against listed companies and their key officers and directors under the Listing Requirements and against registered persons and/or market participants under the Business Rules for any breaches.

Bursa Malaysia by virtue of its Business Rules can take the following enforcement actions against a market participant and/or registered person -

1. Issue a private or public reprimand;
2. Impose fines;
3. Suspend the right to trade;
4. Strike off or terminate a person from the register; and
5. Impose restrictions on any activities of the person.

Bursa Malaysia by virtue of its Listing Requirements can take the following enforcement actions against a listed company and its key officers and directors –

1. Issue a private or public reprimand;
2. Impose fines of up to RM 1 million;
3. Suspend the trading of listed securities; and
4. De-list listed the securities or the listed company.

There is evidence that the Bursa Malaysia has imposed sanctions for breaches.

<b>Sanctions</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Fines	65	107	60
Caution	27	56	66
Any of Reprimand, Fine, Suspension &/or Striking off	4	11	19
Reprimand or Fine and Deferred Suspension	4	0	0
Any of Private Reprimand, Directive to Rectify and Fine for Failing to Rectify	33	38	17
<b>Total</b>	<b>133</b>	<b>212</b>	<b>162</b>

**Bursa Malaysia Sanctions for  
Breach of Listing Requirements**

<b>Sanctions</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Public Reprimands and Fines	191	107	57
Public Reprimands	102	121	35
Private Reprimands	15	52	16
<b>Total</b>	<b>308</b>	<b>280</b>	<b>108</b>

A stock exchange or derivatives exchange requires the approval of the Minister to operate (CMSA, s. 8). The Minister will only grant approval on the recommendation by the SC, if he is satisfied that the body corporate has the capacity to operate, with sufficient financial, human and other resources to ensure that trading of securities or derivatives through its facilities are done in an orderly and fair manner. The process of formulating the SC's recommendation includes an express assessment of these capacities.

Section 11(7) of the CMSA also imposes a duty on the exchange to have sufficient financial, human and other resources at all times. Other capacity requirements would include having the following:

- Adequate and properly equipped premises to conduct the trading of securities and derivatives contracts;
- Competent personnel for the conduct of its business; and
- Automated systems with adequate capacity, security arrangements and facilities to meet emergencies

Further, section 8(2)(d) of the CMSA provides that the body corporate must also satisfy the Minister that it is able to take appropriate action against its POs or affiliates if they breach any of its rules.

The SC's Guidance on the Regulatory Role of Bursa Malaysia (Regulatory Guidance) imposes an obligation on Bursa Malaysia to ensure that it treats all its market participants and any person applying to be a market participant in a fair and consistent manner

(paragraph 1.1.1(e), Part II). Further, the process for approving a rule change by the exchange under section 9 of the CMSA expressly includes an assessment by the SC to ensure that the proposed rule change results in fair treatment of its members and applicants for membership.

By law, the exchange is required to act in the public's interest, particularly protecting investors and where exchange's interest conflicts with the interests of the public or investors, the latter's interest shall prevail (CMSA s. 11(3)(a)). The Minister's approval of an exchange is conditioned on him being satisfied that the exchange or exchange holding company will not act contrary to the interest of the public and in particular, the interest of investors (CMSA, s. 8(2)(c)). Further, the Minister can revoke, amend or impose new terms and conditions on the approval given if it is appropriate to do so for the protection of investors. The SC will not approve submissions for rule changes if it is of the opinion that the proposed rule change is not in the public's interest.

Additionally, Bursa Malaysia is a member of the World Federation of Exchanges (WFE), and has to meet the membership criteria set by WFE, including having measures and procedures in place for the protection of investors as well as standards for participants.

To ensure that the rules of the exchange are consistent with the public policy, the SC has established a detailed rules review and approval process. For any proposed rule or rule amendment, the exchange is required to submit the proposed rules or amendments and a concept paper relating to the proposed change that details the rationale for the proposal, includes an impact analysis of the proposal to investors/markets as well as any conflict of interest situations that could arise, benchmarks the rules to other relevant jurisdictions and outlines the industry feedback received by the Bursa on the proposal. In its review, the SC takes into consideration whether the proposed rule change creates any anti-competitive situation.

The CMSA imposes various duties on the members of the Exchange Group to cooperate with the SC:

- To provide assistance to the SC, which includes the furnishing of returns, and the provision of information relating to their operations or dealing in securities or trading in derivatives contracts, for the proper administration of the securities laws. (CMSA, s. 29)
- To notify the SC immediately if it becomes aware of any irregularity, breach of any provision of the securities laws, the rules of a stock exchange or approved clearing house or any other matter which indicates that the financial standing or financial integrity of any PO or any of its affiliates or of the chief executive or directors is in question or may reasonably be affected (CMSA s. 11(5)(b)).

Further, under the Regulatory Guidance, Bursa Malaysia must provide co-operation and assistance as may be requested by the SC to assist it in performing its functions under the applicable laws (part II, paragraph 1.1.1(l)).

Bursa Malaysia, together with its subsidiaries, acts as a front-line regulator of the markets that they operate. Bursa Malaysia is vested with regulatory powers under the law and has a statutory responsibility to ensure a fair and orderly market and prudent risk management (Sections 8, 11 and 15 of the CMSA). These responsibilities relate to the regulation and surveillance of securities and derivatives markets.

The CMSA requires public interest directors (PID) to make up one third of the number of directors on the board of any exchange holding company, stock exchange or futures exchange. However, if the stock exchange or futures exchange is a subsidiary of an exchange holding company, the PIDs are only required at the holding company board level (CMSA, s. 10(1) and 10(2)). PIDs are appointed by the Minister, in consultation with the SC. One person among the PIDs is appointed as the non-executive Chairman of the board of Bursa Malaysia. Further, Bursa Malaysia is required to obtain the prior approval of the SC in relation to the appointment of the chief executive officer (CMSA, s. 10). In addition, Bursa Malaysia as a public listed company is required to comply with the

corporate governance requirements under the Malaysian Corporate Governance Code (CG Code). The CG Code requires a balanced board representation for all public listed companies (Principle A(2) of Part 1).

The current board of directors (Board) of Bursa Malaysia consists of six independent members, two members representing the participating organisations (POs) and four members representing public interest. The independent directors are nominated by the Nomination and Remuneration Committee of the board, with the concurrence of the SC and elected by the public shareholders. The various committees of the board (Audit, Risk Management, Listing etc.) all contain at least a majority of directors who are independent of the POs. The Audit Committee is entirely independent of the POs. In some cases, such as the Listing or Appeals Committees, the committees include independent experts.

The SC has a comprehensive on-going oversight framework on the Exchange group, which combines extensive reporting requirements with on-site examinations, rule review and approval, the power to modify or suspend the application of rules, the ability of the Minister to withdraw approval of the exchange (on recommendation of the SC), involvement in the appointment of directors, the power to appoint an independent auditor and the power to issue directions to the Bursa Malaysia. As a publicly listed company, Bursa Malaysia is also subject to the public disclosure and oversight processes that apply to these entities.

During annual regulatory audits, the SC assesses the efficiency, timeliness and effectiveness of Bursa in discharging its statutory or administrative responsibilities including effectiveness in taking enforcement actions for breach of listing requirements and exchange rules, market surveillance of trading activities, handling of corporate disclosure matters, inspection of market intermediaries, review of financial reports submitted by listed issuers, risk management operations, market operations and other related issues. Thereafter the SC may make recommendations for remedial measures for adoption by Bursa.

Staff at the Bursa Malaysia are subject to confidentiality requirements that are similar and no less stringent to that of the SC. Employees of Bursa Malaysia are subject to confidentiality requirements and undertakings in the Bursa's Code of Ethics and are prohibited from disclosing or using confidential information other than as required in the course of their duties.

Bursa Malaysia is bound by the principles of natural justice and must ensure that due process is observed when exercising its powers of enforcement. The due process steps include:

1. Upon determination that evidence supports a prima facie case against a defaulting participant, a notice to show cause is issued under the rules. The notice specifies the alleged breach(es), the relevant provisions of the rules alleged to have been breached/triggered and in the case of a hearing on a charge, the time, place and date of the meeting when such charge is to be heard;
2. The defaulting participant may respond in writing to Bursa Malaysia within 14 days from the date of the notice;
3. Where a hearing will be conducted, the defaulting participant may attend and be heard at such hearing;
4. If the defaulting participant fails, within the time stipulated to respond to, or appear before, Bursa Malaysia, Bursa Malaysia may proceed to deal with the charge against the defaulting participant;
5. Where Bursa Malaysia issues a reprimand to, imposes a fine on or suspends the defaulting participant, the defaulting participant shall be notified in writing of the sanction;
6. Any participant against whom a decision has been made by Bursa Malaysia may appeal by notifying Bursa Malaysia of his intention to appeal within

	<p>fourteen (14) days from receipt of the notice of the sanction. Appeals go first to the Appeals Committee of the Bursa and then to the SC or the courts.</p> <p>There is a statutory duty imposed on Bursa Malaysia to always act in the public's interest, particularly in protecting investors and where this duty conflicts with any other duty, the duty to act in the public interest shall prevail. (Section 11(2) and (3) of the CMSA). As noted above, the SC can direct the exchange to address any case of conflict of interest. Other measures taken to prevent conflict of interest include:</p> <ul style="list-style-type: none"> <li>• The Regulatory Guidance provides that Bursa Malaysia must have processes in place to deal with conflicts of interest and use its best endeavours to ensure that its employees and those of its subsidiaries are alert to and can identify any potential conflict of interest in the course of performing their respective functions.</li> <li>• Bursa Malaysia has issued Conflicts of Interest Guidelines as a guide to handle any conflicts of interest or potential conflicts of interest that may arise. Bursa Malaysia submits monthly reports on conflicts of interest to the SC.</li> <li>• The requirement that at least 1/3 of the board of the exchange and exchange holding company must be public-interest directors and that one of the public-interest director is the non-executive chairman of the board.</li> </ul> <p>The SC has, in its annual regulatory audit of Bursa Malaysia, included a review of its conflict of interest policy and procedures to ensure that potential conflict of interest issues are addressed appropriately. The SC has made recommendations to address any concerns identified.</p> <p><b>FIMM</b></p> <p>FIMM (formerly known as the Federation of Malaysian Unit Trust Managers) was established in 1993 as a trade association by unit trust management companies (UTMCs). When the SC was established, UTMCs were exempted from licensing requirements of the law, an exemption that no longer exists. However, they were required to be registered with a body approved by the SC. FIMM was recognized as the "body approved" to register UTMCs and persons who deal in securities on behalf of the UTMCs – largely individual unit trust consultants (UTCs). FIMM does the fit and proper assessments for these UTCs, administers the exam requirements and enforces marketing and distribution guidelines.</p> <p>The SC worked with FIMM to raise governance and other standards at the organization over a period of time before FIMM applied to be recognized as an SRO under the CMSA, which status was granted in January of 2011. UTMCs (licensed by the SC) are required to be members and IUTAs (Institutional Unit Trust Advisers licensed by the SC or BNM) and CUTAs (Corporate Unit Trust Advisers licensed by the SC) and UTCs have to be registered with FIMM. UTCs, IUTAs and CUTAs are known collectively as "registered persons".</p> <p>FIMM has issued and enforces a series of rules for its members and unit trust distribution agents that set out detailed rules for business conduct at the firm level, individual sales representative conduct as well as minimum qualifications of individuals applying for registration to distribute unit trust products. UTCs act as agents of their sponsoring UTMC, CUTA or IUTA and the company is responsible for their supervision.</p> <p>FIMM is required by law (CMSA, s. 324(1)) to ensure that any exercise of any power or function will be undertaken in the public interest having particular regard to the need for investor protection. Under FIMM's Memorandum of Association, FIMM has the power to ensure that its members and registered persons comply with its regulations and relevant securities laws and to expel, suspend, discipline or sanction any of its members and registered persons (paragraph 3(1A)(c)). Further, under its disciplinary by-laws, FIMM may impose one or more of the following penalties against its members and its registered persons for non-compliance with its by-laws</p>
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- Issue a private or public reprimand;
- Impose a fine;
- Suspend the membership or registration of the registered person; and/or
- Terminate the membership or revoke the registration of the registered person

In 2011, FIMM received 36 complaints against its members and/or persons registered by it. Out of the 36 complaints, the Disciplinary Committee reviewed and resolved 11 complaints. FIMM reprimanded four UTMCS and eight IUTAs. It also deregistered one UTC. The rest are pending. There is an arrangement between the SC and FIMM in relation to complaints received by FIMM. Under the arrangement, FIMM refers complaints to the SC that are related to the CMSA and other securities laws under the purview of the SC.

As a person seeking to be recognised as an SRO, FIMM needed to satisfy the SC that it met the requirements set out in the CMSA which include that it -

- Has sufficient financial, human and other resources to carry out its functions;
- Is fit and proper;
- Is managed by officers who are fit and proper; and
- Has competent personnel to carry out its functions.

Further, the CMSA provides that a person seeking to be recognised as an SRO must satisfy the SC that it is able to take appropriate action against its members and any person to whom its rules apply. (CMSA, s. 323(1)).

As an SRO, FIMM had to satisfy the SC that its rules make appropriate provisions to:

- Promote investor protection,
- Promote fair treatment of its members and any person who applies for membership;
- Promote proper regulation and supervision of its members;
- Promote appropriate standards of conduct of its members;
- Ensure there is fair representation of members in its governing body;
- Ensure that its members and officers duly comply with the securities laws, regulations and guidelines issued by the SC and where relevant, the rules of the stock exchange or futures exchange; and
- Allow an aggrieved member to appeal against any decision of FIMM. (CMSA, s. 323(1)(g))

Further, FIMM's Code of Ethics and Standards of Professional Conduct for the Unit Trust Industry sets out the general principles and minimum standards of good practices to be observed by its members.

Under the CMSA:

- No amendment to the rules of a recognised SRO have effect unless it has been approved by the SC;
- Where the SRO proposes to make any amendment to its rules, it must submit the text of the proposed amendment and an explanation of the purpose of the proposed amendment to the SC; and
- The SC may, after consultation with the SRO, require the SRO to amend its rules. (s. 325)

When approving a rule change by FIMM, the SC must be satisfied that the proposed rule change is consistent with the conditions of approval of the SRO.

The CMSA places an obligation on FIMM, as a recognised SRO to provide assistance to the SC, or person acting on behalf of the SC, including provision of such information relating to its operations or any other information as the SC may require for the proper

administration of the securities laws (s. 331). The statute also imposes a duty on FIMM to notify the SC immediately if it becomes aware of any matter that adversely affects or is likely to adversely affect the interests of investors and any contravention by its members of any securities law (CMSA, s. 324(2)).

Any appointment, election or nomination of a Board member of an SRO requires SC's prior approval and to ensure public interest is upheld and protected at all times, at least 1/3 of the Board comprise PIDs (s. 326). In recognising FIMM as an SRO, the SC imposed a more stringent condition that requires at least 45% of its Board to comprise PIDs and that the Chairman of the Board is also a PID. The current Board of FIMM is made up of nine members and nine PIDs, with one board member board position unfilled.

A constituency concept has been adopted for appointment of members to the board to ensure fair representation of members. Under this concept, the members are divided into 5 constituencies based on their annual management fees. Each constituency is allocated two seats on the Board of FIMM. During the AGM, the members of FIMM vote for the two members who will represent each constituency on the Board of FIMM.

FIMM has established a number of governance committees (e.g. Disciplinary Committee, Appeals Committee, Rules Committee, Audit Committee and Industry Development Committee). The Disciplinary Committee is made up exclusively of PIDs. The Rules and Audit Committees have a majority of PIDs, while the industry development committee has a majority of industry members.

Under a new by-law that is being introduced (By-Laws Relating to the Appointment and Functions of the Councils and Committees of the Federation of Investment Managers Malaysia) all committees of FIMM will be required to include at least two PID members. In addition, the Committees may include:

- Board directors;
- Authorized representatives of members of FIMM;
- Senior executive officers of members, Institutional Unit Trust Advisers (IUTA) and/or Corporate Unit Trust Advisers (CUTA);
- Individuals deemed fit and who demonstrate sound knowledge of the investment management industry.

The oversight of FIMM by the SC combines periodic regulatory reporting (including an annual report on how it complied with all terms and conditions of its recognition and other specialised reports, such as on enforcement actions), prior review of new rules and amendments, approval of directors, the power to withdraw recognition and the power to issue directions to the SRO.

The SC has recently established the supervisory framework for FIMM which includes the following:

- On-site audit;
- Review of corporate governance standards and practices;
- Rules review and approval process;
- Off-site supervision; and
- Regular communication/engagement protocol between FIMM and the SC on supervisory concerns.

The supervisory objectives of the framework are to ensure that:

- FIMM is in compliance with the:
  - statutory obligations set out in the CMSA;
  - conditions of approval upon recognition as a SRO;
  - submission, reporting and notification protocol set by the SC;

	<ul style="list-style-type: none"> <li>- IOSCO's standards for an SRO;</li> <li>• FIMM's operating environment and regulatory processes are sound, efficient, effective, fair and consistent; and</li> <li>• FIMM has adequate staffing, resources and training to perform its regulatory functions as an SRO effectively and efficiently.</li> </ul> <p>While the SC has not yet conducted a regulatory inspection of FIMM, it did engage in a detailed review process of all its rules, processes and governance prior to recommending its recognition. Further, it required FIMM to obtain a 'readiness audit' from an external auditor prior to receiving recognition as an SRO. The SC participated in setting the scope of that audit and received the report.</p> <p>FIMM is subject to detailed periodic and ad hoc reporting requirements, such as quarterly reports of complaints received with respect to its members and immediate reports of any enforcement actions that have begun. These are reviewed by the SC on an on-going basis and followed up, where necessary, with FIMM. Where the SC requires actions be taken by FIMM, the staff follow up to ensure compliance.</p> <p>The SC expects to undertake the first regular regulatory audit on FIMM later this year. The first audit is expected to examine</p> <ul style="list-style-type: none"> <li>• The organization's compliance with its conditions of recognition;</li> <li>• Its governance;</li> <li>• Its regulatory and supervisory framework; and</li> <li>• Its complaints handling.</li> </ul> <p>The SC is considering establishing a guideline equivalent to the Bursa Malaysia Regulatory Guidance that will put additional structure around the oversight relationship.</p> <p>The confidentiality requirements that apply to FIMM, its directors and employees are set out in FIMM's Framework on Conflicts of Interest and Risk Management Framework. A director, officer and employee may not, without the consent or ratification of the Board use any information acquired by virtue of his/her position as a director, officer or employee to gain (directly or indirectly) a benefit for himself/herself or any other person, or cause detriment to FIMM, unit trust investors or investment management industry.</p> <p>FIMM is required to have policies where employees sign off on the "Letter of Confidentiality" that they will not disclose FIMM's and members' information to unauthorized persons and that disciplinary action can be taken against them including lodging of police reports. The FIMM Code of Ethics and Articles of Association further require members shall respect and preserve the confidentiality of information relating to their clients and investors and shall not misuse such information in their possession in any manner that may result in them making an unfair gain.</p> <p>By statute, FIMM may not make a decision under its rules that adversely affects the rights of a person unless it has given the affected person an opportunity to make representations to FIMM about the matter (CMSA, s. 324(4)). Further, FIMM must provide a registered person with notice containing the particulars of the complaint together with copies of the relevant supporting documents, if any. The registered person has fourteen business days from the date of receipt of the notice to submit a written reply to the complaint made against him.</p> <p>The CMSA provides that in order for the SC to recognise a person as an SRO, that person must be able to satisfy the SC that its rules make satisfactory provision to manage any conflict of interest that may arise between its interest and the public's interest, particularly, in protecting investors. The SC can issue directions to a recognised SRO, where the SC is satisfied that a conflict exists or may come into existence between the interest of a recognised SRO or its members and the interest of the proper performance of the functions or duties conferred by the legislation, its rules or any guidelines issued by the SC. Further, the requirement that at least 1/3 of the board</p>
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	<p>members of the SRO be public-interest directors reduces the likelihood for conflicts of interest in the operation of the SRO. The consensus view is that the PIDs on the board take their public interest role very seriously and are very active in ensuring FIMM operates with investor protection as its foremost objective. The new annual regulatory audit framework for FIMM includes a component that reviews FIMM's conflict of interest policies and procedures to ensure that potential conflict of interest issues are avoided and appropriately managed.</p> <p><b>General</b></p> <p>In Malaysia, the Competition Act 2010, which came into force on 1 January 2012, established a framework to promote competition for the economic development of the country. Under the Competition Act, anti-competitive conduct comprising (i) entering into anti-competitive agreements; and (ii) abuse of dominant position is prohibited and the Competition Commission is empowered to take action against entities, including the stock exchange, which engages in any anti-competitive activities.</p> <p>In addition to the roles of Bursa Malaysia and FIMM, the SC retains full authority to inquire into matters affecting the investors or the market. The SC is empowered by securities laws to take a full range of enforcement actions which include civil, criminal or administrative action against persons who breach securities laws, including the exchange, the exchange holding company, participating organisations, affiliates and recognised SROs (CMSA, s. 354 and 355). The SC can take administrative action for contravening the provisions of the CMSA or for failing to comply with, enforce or give effect to –</p> <ul style="list-style-type: none"> <li>• the rules of a stock exchange, approved clearing house or central depository;</li> <li>• any written notice, guidelines issued or condition imposed, by the SC; or</li> <li>• any rule of a recognised self-regulatory organisation.</li> </ul> <p>The SC can also take enforcement action against any person who submits false reports to the SC, Bursa Malaysia or Bursa Malaysia Clearing (CMSA, s. 369) and against any person who breaches the provisions relation to serious market misconduct, such as false trading and market manipulation (CSMA, s. 175-179 and 181)</p> <p>Both Bursa Malaysia and FIMM have adequate powers for inquiring into or addressing particular misconduct or allegations of misconduct. If either fails to use its powers, the SC can require it to do so (CMSA s. 354 and 355). The SC has taken action against people for breach of the stock exchange requirements where the market impact and significant public interest justified that intervention.</p> <p>Both Bursa Malaysia and FIMM and their respective officers are subject to the prohibition on insider trading in the CMSA. In addition, each has requirements in place to prevent insider trading by its officers and employees.</p>
Assessment	Fully implemented
Comments	<p>Both organizations that exercise direct oversight responsibilities for their members – Bursa Malaysia and FIMM – are subject to the oversight of the SC and are required to observe high standards of conduct in carrying out those tasks. The regime applicable to Bursa Malaysia is detailed, comprehensive and has been operating effectively for several years.</p> <p>The status of FIMM as a recognized SRO is of comparatively short standing but the SC's engagement with the organization is long-standing. It only was recognized in January 2011. The SC has full powers to supervise its activities, review its rules and conduct on-site and off-site examinations. The SC has recently established the supervisory framework for FIMM which is comprehensive.</p> <p>FIMM is subject to a rules review process and to detailed periodic and ad hoc reporting</p>

	<p>requirements, such as quarterly reports of complaints received with respect to its members and immediate reports of any enforcement actions that have begun. These are reviewed by the SC on an on-going basis and followed up, where necessary, with FIMM. Where the SC requires actions be taken by FIMM, the staff follow up to ensure compliance. While the SC has not yet conducted a regulatory inspection of FIMM, it did require FIMM to obtain a 'readiness audit' from an external auditor prior to receiving recognition as an SRO. The SC participated in setting the scope of that audit and received the report. At the time of the review, the SC expected to undertake the first regular regulatory audit on FIMM later in 2012. Given the experience of the SC staff with oversight of Bursa Malaysia and with FIMM, there is ample reason to believe that the on-site supervision of FIMM will be equally effective. Nevertheless, the first regulatory audit of FIMM should take place as soon as practicable. The assessor notes that the first on-site regulatory audit on FIMM was conducted in May 2012, soon after the completion of the FSAP assessment visit.</p>
<b>Principles for the Enforcement of Securities Regulation</b>	
<b>Principle 10.</b>	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	<p>Entities regulated by the SC include:</p> <ul style="list-style-type: none"> <li>• Licensed intermediaries and representatives;</li> <li>• Approved stock exchanges, derivatives exchanges, clearing houses and depositories (Bursa Malaysia);</li> <li>• Recognised self-regulatory organisations (FIMM); and</li> <li>• Registered persons (financial institutions authorized to carry on certain capital markets activities without having to obtain a licence from SC, as set out in Schedule 4 to the CMSA).</li> </ul> <p>The SC has wide powers to inspect its regulated entities, including access to books, via on-site or off-site inspections. There is no obligation on the SC to give prior notice before conducting an inspection (SCA, s. 126). The directors and officers of a regulated entity are obliged to give the examiners of the SC access to all of its books or other documents and accounts, including documents of title to its assets and all securities held by it in respect of securities transactions in relation to the examination conducted by the SC (SCA, s. 127). The CMSA provides that the SC has full and free access to the trading facilities of the Exchange (s. 29(2)) and the Regulatory Guidance reinforces this with a provision that allows the SC's examiners, where necessary to make copies or take possession of any books, documents, records and information. Bursa and its subsidiaries must cooperate fully with the examiners. This power of inspection also extends to recognized SROs (CMSA, s. 330(4)).</p> <p>For investment banks, which are licensed under both the Banking and Financial Institutions Act 1989 (BAFIA) (for banking activities) and CMSA (for capital market activities), a joint regulatory framework has been adopted by BNM and the SC. BNM (responsible for prudential regulation of investment banks) and the SC (responsible for the investment banks' business and market conduct) may conduct independent examinations of investment banks as desired in line with their regulatory objectives. The reviews are coordinated, the other agency has an opportunity to have input into what is looked at and the findings are discussed with the other agency. BNM and the SC retain their respective powers under banking and securities laws to take action against investment banks and/or their personnel.</p> <p>The SC has the power to obtain books and records, and request data or information from regulated entities without judicial action, even in the absence of suspected misconduct, whether in response to a particular (ad-hoc) inquiry or on a routine basis as part of the on-site examination. See for example, CMSA s. 348 that gives the SC power to direct a</p>

holder of a Capital Market Services License (CMSL) to produce the books relating to its business or affairs, any dealing in securities or trading in derivatives, any advice or publication of report/analysis concerning securities or derivatives, character or financial position of the relevant persons or report of an auditor concerning dealing in securities. In fact, the SC has very wide powers to require information or data, including a power under the SCA (s. 152) to require **any person** (regulated or otherwise) to disclose any information it deems expedient for the due administration of the securities laws. Further, for the purposes of monitoring, mitigating and managing systemic risks in the capital market, section 346B of the CMSA empowers SC to obtain any information from any person that the SC considers necessary. This is over and above the existing provisions in the securities laws that allow SC to have access to information from all institutions and intermediaries under its supervision.

The SC has powers to conduct and supervise surveillance of trading activity on its authorised exchanges and regulated trading platforms (SCA, s. 15 & 16). These powers include supervising and monitoring the activities of an exchange holding company, exchange, clearing house and central depository.

The SC conducts surveillance of trading activities on Bursa Malaysia Securities and Bursa Malaysia Derivatives. Bursa Malaysia Securities represents the bulk of trading activities and exposure of retail investors and so parallel surveillance of trading is undertaken by both the SC and Bursa.

The SC conducts its day-to-day trade surveillance of the securities market through an automated system called Securities Markets Automated Research Trading and Surveillance (SMARTS). This surveillance system incorporates alerts to highlight suspicious transactions for further enquiry. When alerts are triggered, analysis is carried out by SC for further action or where necessary, referred to Bursa for their onward analysis and action. Surveillance activities are also carried out on a thematic basis in response to market intelligence.

The SC monitors the activities in the derivatives market (through an on-line, real-time information feed from the Bursa) to detect any unusual movements in the derivatives market. Further, the SC also reviews the periodic (daily, weekly and monthly) reports submitted by Bursa on the trading activities in the derivatives market.

Bursa Malaysia undertakes day-to-day real time monitoring of trading activities for both the securities and derivatives markets, as well as its participants through a fully automated surveillance system called ARAMIS. The ARAMIS incorporates alerts that are based on a number of parameters including ones related to price and volume. Alerts that reveal possible breaches of Bursa's rules are analysed for appropriate regulatory or enforcement actions. As necessary, Bursa will refer such cases to the SC for appropriate enforcement. The Bursa is in the process of replacing ARAMIS with a new surveillance system that will incorporate more features to facilitate analysis of trading data.

Bursa is also responsible for cross-market surveillance by monitoring for unusual movements of price and volume and identities of market participants. The cross-market surveillance function is conducted by performing online monitoring of trading activities in the underlying and its respective derivatives products. Information on any unusual trading activities and price movements are shared between both markets and analysed to determine if there are any manipulative activities.

Bursa also conducts an extensive corporate surveillance program focusing on compliance by listed companies with their obligations as listed companies.

The regulatory system sets out record-keeping and record retention requirements for regulated entities. For example, the CMSA (s. 108) requires a regulated entity to maintain accounting records and other books to sufficiently explain the transactions and financial position of its business and requires these accounting records and other books be retained for a period of at least seven years. Anti-Money Laundering (AML) legislation generally requires extensive recordkeeping and retention of such records for at least six

	<p>years after the last transaction on the account.</p> <p>Regulated entities are required to maintain records concerning client identity. The required transaction records include details such as client's name, particulars of the beneficial owner, address, type and particulars of the transactions (amount, price, commission charged, date, time etc.) and account number. Further, SICDA provides that every securities account opened must be in the name of the beneficial owner of the deposited securities or in the name of an authorised nominee (s. 25(4)). It further requires an authorised nominee to furnish the central depository with the name and other particulars of the beneficial owner of the securities deposited in the securities account, opened in the name of the authorised nominee (s. 25A). The rules of the Bursa (for both securities and derivatives markets) require market intermediaries to take all reasonable steps to ensure all essential particulars and information about their clients are obtained (Bursa Malaysia, Securities Rule 404.4 and Derivatives Rules 603.1 &amp; 601.3A). The Guidelines on Compliance Functions for Fund Management Companies (FMC) require FMCs to maintain proper records of clients' details (para. 9.07).</p> <p>AML legislation requires regulated entities to maintain accounts in the name of the account holder and take reasonable measures to obtain and record information about the true identity of the person on whose behalf an account is opened or a transaction is conducted.</p> <p>There are sufficient records that are required to be kept to permit tracing of funds and securities in and out of brokerage and bank accounts related to securities transactions.</p> <p>The central depository is required to keep records and accounts, in sufficient detail, to show (inter alia):</p> <ul style="list-style-type: none"> <li>• All money received or paid by the central depository;</li> <li>• All deposited securities and particulars showing for whom they are held; and</li> <li>• All purchases and sales of deposited securities and particulars of other dealings with respect to those securities, the identity of the buyer and seller of each of those deposited securities or, in the case of other dealings, the identity of the persons executing such dealings and the persons in whose favour such dealings are executed. (SICDA, s. 27)</li> </ul> <p>The rules of the Bursa (for both securities and derivatives) require market intermediaries to keep detailed records for each account including details of each transaction carried out. For example, Rule 601.3(b) of Bursa Malaysia Derivatives Rules provides that a Trading Participant (TP) must maintain records that include the source of funds used for the trading in derivatives on the holder's own account.</p> <p>Further, AML legislation requires regulated entities to maintain records to enable the reconstruction of all financial transactions, for a period of not less than six (6) years from the date an account has been closed or the transaction has been completed or terminated (AMLATFA, s. 17(2)).</p> <p>The SC has the power to access any record and document maintained by its regulated entities for the purpose of obtaining information on the identity of all clients of regulated entities. The SC also has the authority to require a regulated entity or any person to disclose information pertaining to client identity for any trading in, acquisition or disposal of securities. Further, intermediaries are required to furnish information relating to the beneficial ownership of trading accounts as and when required by Bursa Malaysia (Bursa Malaysia Securities Rules, para. 404.3(7)). As noted above, the SICDA requires the intermediary to know the ultimate client and open the account at the central depository accordingly.</p> <p>The SC does not, per se, outsource inspection to third parties. However, there are two entities that exercise some direct oversight responsibility for their areas of competence and their rules are subject to meaningful sanctions – Bursa Malaysia and FIMM. The recognition accorded these organizations is described under Principle 9.</p>
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	<p>Bursa Malaysia is the front-line regulator of its member/participant firms in the markets it operates and performs inspections and takes enforcement actions as required. Sections 11 and 21 of the CMSA require exchanges to perform certain regulatory functions:</p> <ul style="list-style-type: none"> <li>• Participant supervision;</li> <li>• Secondary market surveillance; and</li> <li>• Supervision of public-listed companies.</li> </ul> <p>FIMM is responsible for regulating its members, particularly in the areas of distribution and marketing of unit trust products. This includes registration of distribution agents.</p> <p>The SC engages in detailed oversight of these organizations' inspections and enforcement activities. See the description under Principle 9. As noted above, the SC has full access to all information maintained by the exchanges and FIMM.</p> <p>The SC has the power to cause changes/improvements to be made to the processes of the exchanges and FIMM as an SRO. These may be made as part of the rule review process or as a result of an inspection/audit of the organization. This has been done in practice with Bursa Malaysia.</p>
Assessment	Fully implemented
Comments	Note that the SC's compliance with AML oversight requirements under international standards is not part of the IOSCO Assessment Methodology and will be assessed separately at another time.
<p><b>Principle 11.</b> The regulator should have comprehensive enforcement powers.</p>	
Description	<p>The SC has a broad range of powers to investigate securities offences in order to enforce compliance with the laws and regulations relating to securities activities.</p> <p>With respect to investigative and enforcement powers, the SC may:</p> <ul style="list-style-type: none"> <li>• Appoint an Investigating Officer (IO) to carry out investigations for any securities offences where there is a reasonable belief that there has been a breach of the law;</li> <li>• Initiate administrative sanctions and civil actions; and</li> <li>• With the consent of the Public Prosecutor, conduct criminal prosecutions.</li> </ul> <p>An IO of the SC has wide powers provided under the SCA (in ss. 128, 132, 134 &amp; 141) to carry out investigations, including the power to:</p> <ul style="list-style-type: none"> <li>• Enter any place for the purpose of searching, taking possession and seizing any document, record, minute book or register that is relevant to securities offences and may be used as evidence;</li> <li>• Require the production of any relevant document/books/registers etc.;</li> <li>• Require the surrender of any travel documents of persons subject to investigation;</li> <li>• Require the presence of any person for the purpose of gathering oral evidence through the recording of their statement; and</li> <li>• Arrest without warrant any person suspected to have committed securities offence.</li> </ul> <p>It is a criminal offence to fail to cooperate with or obstruct an IO conducting an investigation of a securities offence (SCA, s. 128(7) and 134(5)).</p> <p>Under the CMSA, the SC has the power to seek court orders by way of civil proceedings in the High Court. A wide range of court orders are available to the SC including to -</p> <ul style="list-style-type: none"> <li>• Recover an amount not exceeding three (3) times the gross amount of pecuniary gain or loss avoided and impose a civil penalty up to RM1.0 million (s. 200(2))</li> </ul>

and 201(5);

- Remove or bar a director or officer from being a director or chief executive of any public company for a period of time (s. 318, 360);
- Compel an offender to give effect to the provisions of the Malaysian Code on Takeovers and Mergers or the SC rulings (s. 220(3)); and
- Recover the amount of loss or damage on behalf of aggrieved persons (s. 358(1)).

There are specialized commercial courts with significant expertise in Malaysia. In the experience of the SC, these court orders could be obtained fairly expeditiously and injunctive relief (such as to freeze assets) where there was urgency could be obtained on an ex parte basis very quickly.

To prevent or remedy a contravention of any CMSA provision or to mitigate the effect of such a contravention, the SC may:

- Restrain contravention or require the cessation of the contravention;
- Restrain dealing in securities or trading in derivatives;
- Declare a derivative void/voidable;
- Restrain acquisition or disposal of or other dealing with assets;
- Direct the disposal of any securities;
- Restrain the exercise of any voting rights or rights attached to any securities;
- Restrain a person from making available, offering for subscription or purchase, or issuing an invitation to subscribe for or purchase any securities;
- Appoint a receiver of the property of the CMSL holder or of a property that is held by such holder for or on behalf of another person whether in trust or otherwise;
- Vest securities in SC or a trustee;
- Require a person to do an act required to be done which he or she fails/refuse to do;
- Give direction for the compliance with the rules of a stock exchange, a derivatives exchange or an approved clearing house;
- Require a person to remedy the contravention or mitigate its effect including making restitution;
- Direct a person to do or refrain from doing an act;
- Direct a person to comply with any directions issued by the SC under sections 354, 355 and 356 of the CMSA; and
- Make any other ancillary orders (s. 360).

The SC can and has entered into binding settlements with parties in breach of the laws. All fines and settlement amounts are generally payable to the Consolidated Revenue Fund of the government and are not retained by the SC.

Between 2008 and 2011, the SC initiated 11 civil actions against a total of 40 persons for various breaches of securities laws. In addition to civil actions, since 2008 the SC has entered into out of court settlements with 13 individuals who have breached insider trading laws where the defendants agreed to disgorge up to three (3) times the gains made from their trading activities.

The SC has the power to impose administrative sanctions for breaches of securities laws and rules against various parties including the exchange holding company, the exchanges, central depository, clearing house, participating organisations, their directors and officers and any licensed person.

The CMSA provides a wide range of administrative sanctions which include:

- Directing the person in default to comply with the rules or listing requirements;

- Imposing a penalty in proportion to the severity or gravity of the offences up to RM500,000;
- Reprimanding the person in default;
- Requiring the person in default to take steps to remedy/mitigate the effect of the breach including making restitution to persons aggrieved by the breach;
- Refusing to accept/consider corporate proposals;
- As against promoters/directors of a corporation:
  - Imposing a moratorium or prohibition against trading and dealing in securities; or
  - Issuing a public statement to the effect that the retention of office by the director is prejudicial to the public interest.
- As against the exchange holding company or derivatives exchange, directing it to:
  - Suspend trading, limit transactions on derivatives;
  - Defer completion of closing date of derivatives;
  - Immediately close out derivatives positions;
  - Discharge derivatives; and
  - Require affiliates to act in a particular manner desired by SC (s. 354 and 355).

In addition to the above, the SC has the powers to impose particular administrative sanctions on specific securities breaches. For example, for take-overs and mergers breaches, section 220 of the CMSA provides the SC with the power to issue compliance directives; impose fines of up to RM1.0 million; reprimand; give a direction to mitigate the breach, including making restitution to aggrieved persons; prohibit the person from using the facilities of the stock exchange; directing the stock exchange to suspend trading in securities of the corporation in breach, suspend the listing of the corporation, or remove the corporation/class of securities of the corporation from the official list; and where the person in breach is an unlisted corporation, to direct any stock exchange to prohibit the listing of any of the corporation's securities.

The CMSA also gives the SC a wide range of powers to protect the assets of clients of licensed persons by issuing directions or prohibitions to a licensed person, trustee, custodian, private retirement scheme administrator, registered person and person who maintains a trust account for clients' assets (s. 125):

For persons licensed by the SC under the CMSA, the SC has the power to:

- Not renew their licence (s. 64 and 65);
- Revoke or suspend the license (s. 72);
- Issue a compliance directive (s. 356);
- Impose a penalty not exceeding RM500,000 (s. 356); and
- Require the persons to take steps to mitigate the breach, including making restitution to persons (s. 356).

In determining the type of administrative sanction, the SC has in place a process to ensure consistency of the sanctions imposed. The assessment criteria expressly take into consideration the nature and seriousness of the contravention, the conduct of the person after the contravention as well as any previous regulatory record.

Between 2008 and 2011, SC imposed 123 administrative sanctions:

<b>Nature of breaches</b>	<b>Reprimand</b>	<b>Revocation/ Suspension of license</b>	<b>Directives</b>	<b>Imposition of fine/penalty</b>	<b>Refusal to receive submission</b>	<b>Total</b>
Misconduct of intermediaries & licensing breaches	13	21	17	11	-	<b>62</b>
Take-over breaches	27	-	17	6	-	<b>50</b>
Misleading information (financial statements, prospectuses)	1	-	1	-	-	<b>2</b>
Non-compliance with asset valuation guidelines	2	-	1	-	1	<b>4</b>
Non-compliance with AML guidelines	1	-	1	1	-	<b>3</b>
Inaccurate submission by corporate advisor	1	-	-	-	-	<b>1</b>
Late submission of financial information	1	-	-	-	-	<b>1</b>
<b>Total</b>	<b>46</b>	<b>21</b>	<b>37</b>	<b>18</b>	<b>1</b>	<b>123</b>

The SC has the power to initiate criminal prosecution for offences under the CMSA, SCA and SICDA with the written consent of the Public Prosecutor (CMSA, s. 375, SCA, s. 136 and SICDA, s. 61). The SC's prosecuting officers conduct the prosecution of these securities cases. In addition, the Public Prosecutor has empowered five of SC's prosecuting officers as Deputy Public Prosecutors to prosecute securities cases that also involve breaches of the Penal Code (such as criminal breach of trust) and to conduct the appeals of these cases at High Court and Court of Appeal.

Between 2008 and 2011, the SC initiated criminal prosecution against 29 persons for various breaches of securities laws as follow:

Offences	No. of Persons*	Outcome
Financial statement fraud	15	Pleaded guilty – 8 Compounded – 1 Acquitted – 3 On-going – 3
Securities fraud	6	Convicted – 2 On-going – 4
Issuance of securities without having prospectus registered with the SC	2	On-going - 2
Carrying out regulated activities without license	3	Convicted – 1 Pleaded guilty – 1 On-going – 1
Failing to provide statement to the SC in connection with an investigation	3	Pleaded guilty – 3
Audit partner abetting a director of a public listed company in connection with financial statement fraud	1	On-going -1
Total	30*	

\*Note: One (1) individual was charged for two (2) offences, i.e. financial statement fraud and failure to provide statements to the SC.

The SC has power to order the suspension of trading in securities or derivatives, both trading in particular issuers/instruments or trading in the market more generally (CMSA, s. 28, 220, 355 and SICDA, s. 61B).

The SC has investigative and enforcement power to require and to obtain from any person involved in relevant conduct or who may have information relevant to a regulatory or enforcement inquiry/investigation contemporaneous records sufficient to reconstruct all securities and derivatives transactions.

An IO of the Commission may enter any place or building to inspect and make copies of or take extracts from any book, minute book, account, register or document. The IO may also, where there is reason to believe there has been a breach of securities laws, take possession of and detain any object, article, material, thing, property, book, minute book, account, register or other document including, travel or other personal document which may be used as evidence (SCA, s. 128(1)). The IO may also by notice in writing require any person to produce the documents mentioned above which are in the custody or under the control of that person (SCA, s. 128(5)), and section 128(6) provides the IO the power to seize, take possession of, and detain the documents for such a duration which the IO feels necessary for the investigation (SCA, s. 128(5)).

The SC is able to obtain banking documents and information relating to possible breaches of securities laws directly from banking institutions with the written authorisation of BNM. BNM has given a written undertaking to facilitate the disclosure of this information and there is a protocol in place. In practice, BNM has provided authorisation to the SC within three (3) to five (5) working days. No requests have been denied. In addition, the SC is also able to obtain banking information, where available, directly from the regulated entities.

Under the proposed Financial Services Bill 2012 (expected to be introduced later this year), a financial institution may, in compliance with an order or request made by an enforcement agency in Malaysia under any written laws, disclose any document or

	<p>information relating to the affairs or account of its customers to an IO for the purposes of an investigation. (Proposed section 131 of the Financial Services Bill on Permitted Disclosure read together with Schedule 11) This will enable IOs of the SC to obtain banking documents and information directly from a financial institution without prior written authorisation from BNM.</p> <p>Regulated entities are required to keep records for securities and derivatives transactions which would include all the records listed in Key Question 3(b) (See discussion under Principle 10).</p> <p>A Malaysian company is required to keep a register of its members that contain, inter alia, a statement of the shares held by each member (Companies Act, s. 158(1)(a)). Companies law also gives a listed company powers to require any member of the company to inform the company if the member holds any voting share as beneficial owner or as trustee. If the person holds the shares as trustee, the person must tell the company (as far as he can) the persons for whom he holds them by name and other relevant particulars sufficient to enable those persons and the nature of their interest to be identified (s. 69O). Further, both the SC and the Companies Commission may order the disclosure of shareholders' identities and interests.</p> <p>Private persons are empowered to seek their own remedies for misconduct relating to the securities laws under the CMSA. Sections 199, 201, 210, 224, 282, 357 and 360 of the CMSA provide that private persons who have suffered loss or damage by reason of a misconduct of securities laws may seek their own remedies by civil proceedings. Private remedies are available whether or not the Public Prosecutor has initiated a criminal prosecution. Many types of misconduct or situations are covered, including:</p> <ul style="list-style-type: none"> <li>• Prohibited conduct relating to securities such as false trading, market rigging, market manipulation, use of manipulative devices and insider trading (s. 175 to 179, 181 and 201);</li> <li>• Any dissenting shareholders in a compulsory acquisition may apply to Court for an order that the offeror will not be entitled or not bound to acquire those shares or specify terms of acquisition which are different from the terms of the offer (s. 222); and</li> <li>• Breaches under Part VI of the CMSA, including: <ul style="list-style-type: none"> <li>- Misleading statement or information in a prospectus;</li> <li>- Misleading or deceptive acts in respect of a prospectus or the allotment or offer and invitation for subscription and purchase of securities; and</li> <li>- Breaches on take-overs and mergers or any regulation made under the CMSA</li> </ul> </li> </ul> <p>In addition, the SC may, if it considers that it is in the public interest, recover damages on behalf of a person who suffers loss arising from the conduct of another person who contravened securities law provisions relating to issuance of securities, take-overs and mergers or any regulations pursuant to CMSA (s. 358).</p> <p>Both the securities exchange and the derivatives exchange have established funds to compensate investors for losses.</p> <ul style="list-style-type: none"> <li>• The Compensation Fund<sup>9</sup> is to compensate a person who suffers monetary loss as a result of misappropriation or misuse of funds or property by a stockbroking company or its employees, or of a stockbroking company becoming insolvent (CMSA, s. 152); and</li> </ul>
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<sup>9</sup> The Capital Market Compensation Fund Bill has been passed by the Parliament in May 2012 and is currently awaiting royal assent for the Bill to come into force. The Bill, together with the new CMSA provisions, will provide an integrated compensation structure for retail investors. See also the discussion in Principle 32.

	<ul style="list-style-type: none"> <li>The Fidelity Fund compensates a person who suffers monetary loss as a result of defalcation or fraudulent misuse of monies or other property by a futures broking company or its employees (CMSA, s. 167).</li> </ul> <p>Finally, with the establishment of the Securities Industry Dispute Resolution Center (SIDREC), the SC has provided a further avenue for private recourse to the smaller investor who has a monetary dispute not exceeding RM100,000 against a licensed intermediary. SIDREC will provide dispute resolution in any dealing or transaction involving capital market products or services between clients and their securities brokers, futures brokers, fund managers and unit trust management companies. The process involves both mediation and where necessary adjudication by SIDREC and is offered as a free service to investors. The decision and award granted by SIDREC is binding on the CMSL holder. However, the claimant is free to pursue his claim in court if he is dissatisfied with the mediator's decision.</p> <p>The SC has the authority to share information with other authorities on matters of investigation and enforcement (SCA, s. 149). The SC may on its own initiative or upon request provide assistance to a police or a public officer. Information which the SC may share includes:</p> <ul style="list-style-type: none"> <li>A copy of documents seized or obtained;</li> <li>Statements recorded during investigation; and</li> <li>Any book/document produced in any examination.</li> </ul> <p>The SC may, without restriction, disclose such information to domestic authorities. The SCA permits the SC to publish information in relation to enforcement actions it has instituted (s. 152A) and it does so by publishing the information on its website. Criminal prosecutions are disclosed when charges are laid. That information would be considered public information that the SC is able to share with other authorities. For non-public information, the SC is required to protect the confidentiality of any information obtained in the course of its duties (SCA, s. 148). Disclosure of non-public information can occur with the SC's authorization. (See the Cooperation Principles below).</p>
Assessment	Fully implemented
Comments	<p>The Principles and Assessment Methodology relating to the Enforcement Principles require that the available sanctions be sufficient to be dissuasive. The maximum fine that may be imposed by the SC under the legislation varies from RM 500 thousand to RM 1 million. The Bursa Malaysia may impose fines of up to RM 1 million for breach of the Listing Requirements. There is no cap for breach of the Business Rules. While there is no evidence to suggest that the current maximum fine levels are not sufficient, consideration should be given to conducting an examination of the adequacy (and the consistency) of maximum fines that may be imposed under the legislation to ensure these amounts are high enough, given the growth in the market and its profitability, to operate as a real deterrent. In any event, the fines that can be imposed by the SC should not be less than those that may be imposed by the exchange. While the maximums available vary from jurisdiction to jurisdiction, the trend is to set the number at a fairly high level. For example, in Canada, the maximum fine for fraudulent behavior under the Ontario Securities Act was recently increased to Cdn \$ 5 million (or more than RM15 million). The assessor understands that the SC recently began a review of the fine structure at the SC and Bursa.</p>
<b>Principle 12.</b>	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	The SC conducts examination on regulated entities on a regular and ad-hoc basis. There are three types of examination:

1. Risk-focus (limited/full scope), which focus on high-risk areas of the regulated entities. Risk-focused audits are also conducted to assess compliance with regulatory requirements;
2. Thematic (Industry wide). These are inspections relating to practices, products or areas of concern that cut across the industry, such as business conduct; and
3. Investigative (Business Conduct Audit): These are more focused examinations of one or more issues and are usually conducted in response to complaints from the public or a referral from other departments within the SC or other agencies.

Examinations on regulated entities may be conducted at any time the SC deems necessary; no prior notice is required.

The SC's Risk Profiling Framework within the Risk-Based Supervision Framework considers risk from both qualitative and quantitative perspectives. From the quantitative aspect, the SC places emphasis on the risk-based capital adequacy requirements as well as other prudential and capital limits that are imposed on market intermediaries. On the qualitative side, the SC factors in the quality of the management, number and types of complaints received, etc. This assessment takes into account the risk mitigation programmes/controls implemented by the intermediary as well as the systemic impact of an intermediary.

The SC then generates a Total Net Risk Rating for each firm and the firms are then divided into high risk, medium high risk, medium low risk and low risk categories. Intermediaries with high overall net risk rating attract higher priority, greater coverage, time and resource allocation from the SC.

Typically, intermediaries categorized under high risk are subject to yearly audit, while intermediaries categorized under medium high and medium low risk would be subject to an audit once every two (2) and three (3) years, respectively. Low risk intermediaries are subject to four (4) year audit cycle. In addition, regardless of which risk category an intermediary may fall under, if it is identified as a SIFI, the intermediary is subject to a two (2) year audit cycle. The Bursa Malaysia also uses a risk-based approach to prioritizing its activities and the oversight programs of the two entities are coordinated. As a result, 52% to 76% of stockbroking firms are examined annually.

The SC's primary focus is on the company's controls and procedures and the effectiveness of such controls. Where controls are found to be weak and ineffective, or non-existent, the entity is considered high-risk, and will be subject to more frequent and in-depth examinations.

Between 2008 and 2011, of a total of 48 stockbroking and futures broking companies (including investment banks and universal brokers) in the industry, the SC has conducted 35 on-site inspections: 19 risk-focused examinations; 10 thematic inspections and 6 surprise inspections.

SC and BNM jointly supervise the activities of investment banks with a risk-focused supervisory approach that integrates on-site supervisory practices, extensive regulatory reporting, and off-site monitoring. The SC is responsible for the supervision of the business and market conduct of investment banks with the objectives to promote market integrity and investor protection in the capital market. As the co-functional regulator, BNM is responsible for prudential regulation to ensure safety and soundness in the interest of depositors. BNM's Supervisory Risk-based Framework provides a strong structure for supervisors to carry out consistent and effective supervision across BNM's portfolio of regulated firms, both through individual firm supervision and through horizontal or thematic reviews. Ratings and supervisory recommendations and remediation requirements are conveyed effectively to banking institutions in writing, and through extensive interaction with the Board and senior management; necessary remediation is followed through in a highly disciplined way. (See the discussion of the BNM supervision program in the Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision.)

For fund management companies, a total of 23 examinations comprising 16 risk-focused examinations (full scope) and 7 thematic inspections were conducted between 2008 and 2011. These examinations are primarily conducted on fund managers that fall into the higher risk categories. The SC also conducts diagnostic engagements to assess the compliance status of fund management companies and unit trust management companies. These engagements mainly focus on the firms that pose medium high to medium low risk. Between 2008 and 2011, the SC conducted 36 diagnostic engagements. Diagnostic assessments are narrower in scope and focus on specific areas of concern that have been identified during the risk profiling stage.

There is a process in place to ensure that examiners follow-up on the actions undertaken by the regulated entities to fix any non-compliance or weaknesses detected during the course of an examination.

The intermediaries addressed some instances of non-compliance with regulatory requirements satisfactorily without the need for formal disciplinary action. In more serious cases, the SC has instituted formal disciplinary action such as issuing compliance directives, reprimanding the Boards of Directors for failure to supervise and imposing financial penalties for serious cases.

Where deficiencies were found, the SC has taken action, including :

- Revocation of license;
- Refusal to renew license;
- Issuance of warning letters;
- Issuance of directives, inclusive of requiring restitution; and
- Imposition of fines.

In 2009, the SC obtained a High Court order for the appointment of a receiver in relation to the affairs, assets and properties of a fund management company to protect the funds from being fraudulently dissipated.

To complement the on-site examinations, the SC also conducts off-site monitoring to enable early detection of areas of concern. Off-site supervision is responsible for monitoring and providing analysis as part of the preliminary desk review to the examiners before the SC initiates an on-site examination.

SC reviews financial returns submitted by the regulated entities, carries out stress testing on regulated entities' financial positions, and implements Key Supervisory Indicators (bank line utilization, adjusted net capital, margin level, etc.) to trigger supervisory attention. Periodic assessments are also conducted on the capital adequacy position of investment banks and stockbroking companies vis-à-vis their exposures.

#### **Inspections conducted by Bursa Malaysia**

To complement SC's supervision efforts, inspections are also conducted by Bursa. Bursa adopts a risk-based approach (RBA) in profiling and selecting intermediaries for on-site inspection. Under the RBA, the participants are profiled based on internally established financial and non-financial factors. The RBA is carried out annually to prioritise Bursa's resources for on-site inspection. All high-risk intermediaries are inspected every year, medium-risk intermediaries over a period of three (3) years, and low risk intermediaries once in three (3) years. The Bursa's inspection program is discussed annually with the SC and reassessed and adjusted throughout the year if circumstances change.

Apart from routine inspections, Bursa also conducts non-periodic inspections prompted by issues, themes or trends detected during the routine inspections or by external triggering factors such as alerts from other divisions in Bursa, the SC, as well as from external complaints and whistle blowers.

(See also the description of the Bursa Malaysia's oversight of member firms set out in Principle 34.)

Between 2008 and 2011, Bursa conducted the following inspections:

	Participating Organizations <sup>1</sup>	Trading Participants <sup>1</sup>	Total
Periodic	51	26	77
Non-periodic	18	7	25
Total	69	33	102

1. At the present time, there are 35 POs and 20 TPs.

Source: Securities Commission and Bursa Malaysia

(See the discussion under Principle 9 with respect to the SC's inspection program and oversight of Bursa Malaysia and FIMM.)

The SC utilises an automated surveillance system called Securities Markets Automated Research Trading and Surveillance (SMARTS) to identify unusual transactions on authorised exchanges and regulated trading systems. The SMARTS system is premised on a set of predetermined parameters and is reviewed according to changes in market condition or in every 2 years. The parameter is based on the volatility or velocity of trading activities, and if triggered, the SC will be alerted on possible market irregularities and potential breaches of securities laws. SC also conducts surveillance based on market intelligence.

Once an alert is triggered, the SC will undertake further analysis of the trading pattern and trading participation with the objective of ascertaining cogent evidence of any possible breach of securities laws. (See also the discussion under Principle 11 on the automated system used by the Bursa Malaysia.)

There are extensive mechanisms at both SC and Bursa for the detection of market and/or price manipulation. The SC has a process for oversight of Bursa surveillance and there is close cooperation between SC and Bursa through an established process that includes gap assessments and a communication protocol. In addition, the SC conducts parallel surveillance on trading activities and conducts discussions on issues or irregularities detected with Bursa on a regular basis, in order to close gaps and enhance the Bursa's surveillance capabilities.

Bursa uses several means to detect market and/or price manipulation. In addition to its automated surveillance system, Bursa also relies on market intelligence and feedback from the public.

Bursa conducts trade analysis to detect price manipulations through price ramping/depression, bidding up/down activities and marking the close. Bursa also conducts volume analysis to detect high levels of crossed trades, churning, stacking, order withdrawals, no change in beneficial ownership and avoiding priority in the order books.

If necessary, Bursa will submit a surveillance report to SC for further assessment. Following the assessment, the matter may be referred to relevant departments of the SC for further actions or returned to Bursa for enforcement action under their rules.

Between 2008 and 2011, the SC received 11 referrals from Bursa relating to possible market and/or price manipulation. Of this, six cases were forwarded to relevant departments of the SC for further action and five were returned to Bursa for enforcement action under their rules. At the SC over the same time period, 18 cases of possible market manipulation were reviewed by the Enforcement Business Group. As a result investigations were initiated for six cases and administrative actions were recommended for three cases. Sanctions (administrative, civil and criminal) have been imposed including suspensions of licenses, fines ranging from RM1.0 million to RM3.0 million each and jail terms of 1 day to 2 years.

The mechanisms and procedures involved for the detection and investigation of insider

<p>trading violations by the SC and the Bursa are similar to those in place for market manipulation.</p> <p>Between 2008 and 2011, the SC received 71 referrals from Bursa relating to possible contravention of insider trading provisions. Of these, 47 cases were forwarded to relevant departments of the SC for further action, meanwhile two cases were returned to Bursa for enforcement action under their rules.</p> <p>The SC's Enforcement Business Group reviewed 61 cases of possible insider trading between 2008 and 2011 following which investigations were initiated for 42 cases. During this period, the SC pursued civil action against 15 individuals for contravention of insider trading laws. 13 of the individuals have entered into out of court settlements with the SC, by agreeing to disgorge up to three times the gains made from trades. The cases on the two remaining individuals are still ongoing.</p> <p>The SC conducts proactive surveillance activities to detect and investigate any misrepresentation of material information by listed corporations. This includes reviewing the unaudited quarterly financial statements, monitoring company announcements, circulars, prospectuses, reviewing complaint letters and other publicly available information. Triggering factors include a qualified audit report, a significant change in board composition without a corresponding change in shareholdings, a change of external auditor and late submission of financial statements.</p> <p>Apart from the SC conducting its own surveillance, auditors of listed corporations have a statutory obligation to submit a report to the SC if they detect a possible breach of securities laws or stock exchange rules, or any matter that may adversely affect the financial position of the listed corporation in the course of their audit (CMSA, s. 320). This would include misrepresentations of material financial information.</p> <p>Bursa has the following mechanisms and procedures in place to detect misrepresentation of information by listed companies:</p> <ul style="list-style-type: none"> <li>• Tracking promotional announcements that may affect the price or volume of securities;</li> <li>• Monitoring and detection of profit deviation between audited and unaudited quarterly results;</li> <li>• Complaints and whistle-blowing mechanisms to expose such misrepresentations;</li> <li>• Review of the corporate announcements made by public listed companies; and</li> <li>• On-site inspection of stockbroking companies.</li> </ul> <p>See the data in Principle 9 on the enforcement activities of Bursa Malaysia.</p> <p>Between 2008 and 2011, SC preferred criminal charges against 17 individuals for the disclosure of false/misleading information in financial statements to Bursa. Of this, nine individuals were charged as a result of investigations that commenced following the receipt of reports submitted by auditors of listed corporations pursuant to section 320 of the CMSA. Of the 17 individuals charged, eight pleaded guilty, one paid a compound of RM100,000, three were acquitted after full trial while the cases against the five remaining individuals are still ongoing. The eight individuals who pleaded guilty were convicted and sentenced to fines ranging from RM300 to 400 thousand. In addition, four of these individuals were sentenced to jail terms ranging from one day to six months.</p> <p>The SC has extensive powers to ensure compliance with regulatory requirements by regulated entities by conducting examinations and investigations.</p> <p>The SC drives and encourages dialogues with intermediaries' board of directors, senior management and compliance personnel to strengthen their appreciation of SC's policy and regulatory approaches and to intensify supervision.</p> <p>During inspections, SC examiners review the books and records and ascertain the adequacy of policies, procedures and risk management systems in place to identify,</p>
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monitor and control risks including those relating to market abuse. Examiners also perform transactional testing on sampling basis to ascertain whether controls are effective.

Bursa has a centralised supervision framework to carry out routine on-site and off-site monitoring of its participants, the purpose of which is to monitor the business conduct and compliance of the participants with the provisions of the relevant rules and directives of Bursa, as well as internal policies and procedures of the participants in relation to their activities in trading, clearing, settlement and depository. The scope of activities includes front office, middle office and back office functions which covers, amongst others, conduct of business, capital adequacy, disclosure or segregation of client assets.

Bursa's monitoring activities include inspections at the premises of participants and off-site monitoring of financial standing and review of other financial and non-financial measures through periodic returns submitted by participants. The supervision approach uses detection and prevention methods, supplemented by voluntary self-reporting. Findings from the monitoring and supervisory activities are referred to Bursa's Enforcement Division. Relevant reports and analysis (including a copy of the inspection report) will also be sent to the SC.

FIMM has not yet begun regular on-site examinations of its members and registered firms, but all of these firms (UTMCs, IUTAs and CUTAs) are subject to examination by the SC, or in the case of some IUTAs that are financial institutions, by BNM. FIMM does require annual self-reporting of compliance by UTMCs and UTCs and where deficiencies are found, FIMM follows up to address the issues. FIMM investigates complaints lodged against members and registered persons. See the discussion under Principle 9 of the results of such actions.

For financial institutions that distribute capital market products (such as retail sales of CIS), the SC monitors their compliance on sales practices/marketing matters via review of periodic filings of complaints received. Issues detected from these filings are addressed by way of engaging the affected financial institution. If these financial institutions market and distribute unit trust funds, they also must be registered with the Federation of Investment Managers Malaysia (FIMM), which provides an additional level of supervision as FIMM also monitors and resolves marketing and distribution issues. In addition, BNM has on-site and off-site processes in place to supervise the activities of its institutions with respect to market conduct. These supervisory processes have increased in intensity and scope in recent years. This program includes review of disclosure and sales documents, 'secret shopper' visits and formal on-site reviews of financial institutions.

The SC has a detailed system in place to receive and respond to the intelligence that it receives. The SC receives intelligence/information through various channels such as web-based complaint submissions, emails to a dedicated address, phone hotline, letters, faxes, walk-in and referrals from other agencies.

The SC has a dedicated department, the Investor Affairs and Complaints Department (IAC), to handle intelligence/information management in order to ensure that the integrity and independence of the review process is maintained. In addition to receiving intelligence/information from various channels mentioned above, IAC has also put in place sharing of information arrangement with SIDREC, an approved alternative dispute resolution body established by the SC to resolve monetary disputes between investors and capital market intermediaries registered as its members, such as stockbrokers, futures brokers, unit trust management companies and fund managers. Apart from quarterly report from SIDREC on its cases and findings, SIDREC also escalates, on a case-by-case basis, matters that may fall under the SC's purview.

The SC also has a system in place to identify and analyse trends from intelligence/information that highlight areas of regulatory, policy or process concerns, concerns relating to regulated entities, public listed companies as well as gaps in investor knowledge and engaging with various market players in this regard. All this

information is maintained in a database and it feeds into SC's strategic thinking and ongoing regulatory efforts.

Between 2008 and 2011, SC received 3,985 items of intelligence/information, including complaints and enquiries. A total of 1,166 files were opened of which 631 files were resolved and 278 files were referred to other regulatory agencies including foreign agencies.

See the discussion under Principle 9 regarding FIMM's sanctioning powers and enforcement activities.

#### *Compliance Systems*

The SC requires all regulated entities to have in place supervisory and compliance procedures reasonably designed to prevent securities laws violations. For example,

- The Licensing Handbook requires all regulated entities to supervise and monitor the business to ensure compliance with securities laws, regulations, guidelines and relevant code of conduct (Para 7.02(7)). This is intended to prevent and identify breaches of securities laws, regulations, guidelines and relevant code of conduct; and
- All participants of Bursa Malaysia Securities and Bursa Malaysia Derivatives are required to comply with the Rules of Bursa Malaysia Securities Berhad, Rules of Bursa Malaysia Securities Clearing, Rules of Bursa Malaysia Derivatives, Rules of Bursa Malaysia Derivatives Clearing and Rules of Bursa Malaysia Depository as relevant.

The SC monitors how compliance procedures are executed and communicated to employees of regulated entities through its inspection programs (both of firms, the Bursa and FIMM). For example, the SC monitors how compliance procedures are executed and communicated to employees of POs and TPs of Bursa, via the monthly compliance reports submitted by the intermediary and during the periodic examinations of the intermediary. The compliance officers are required to submit monthly reports that must include the assessment of sufficiency and comprehensiveness of the training system and programme conducted by the intermediary. During the periodic examination, assessment will also be performed on whether employees have been notified of compliance procedures including the regular updates of their internal compliance procedures.

The SC and the exchanges are able to undertake administrative actions against a licensed intermediary or its Board of Directors if its employees or licensed representatives violate any securities laws or the exchanges' rules.

- Rule 404.1(7)(b) of the Bursa Malaysia Securities Rules specifies that each stockbroking company needs to ensure that at all times it exercises strict supervision over the overall operation of its business activities and the activities of its registered person(s) and employees. It also needs to maintain a proper and adequate supervisory and compliance system with a view to prevent any contravention of the securities laws and rules of the exchange and the stockbroking company's own internal policies and procedures.
- Rule 610.1(a) of the Bursa Malaysia Derivatives Rules prescribes that each futures broking company shall establish and maintain a proper system to supervise the activities of each Registered Representative, agents and other personnel and that is reasonably designed to achieve compliance with the Rules of Bursa Derivatives and the CMSA.

Both rules further state that the final responsibility for proper supervision shall rest on the broking company and its board of directors. Therefore, the exchanges may take action against the licensed intermediary or its board of directors for failure to supervise.

- Paragraph 7.02 of the Licensing Handbook imposes a condition on a licensed intermediary that it must monitor and supervise the activities of its

representatives.

If an employee or a representative of a CMSL holder commits a breach of securities laws, the CMSL holder or the employer is deemed to have committed the breach (CMSA, s. 367(2) and 367(3)). The SC can impose administrative sanctions against regulated entities for contravening the rules of the exchange and any securities laws and guidelines that would include those relating to employee supervision (CMSA, s. 354(3) and 356).

The SC has taken action to enforce these obligations. For example, the SC has imposed fines ranging from RM100,000 to RM275,000 on five regulated entities for failing to supervise their business activities to ensure that the business were conducted in a manner which contributes to the maintenance of a fair and orderly market. In addition, the SC reprimanded the Boards of Directors of regulated entities, issued warning letters to two unlicensed persons for carrying out regulated activity and issued a directive to cease carrying out regulated activities on a regulated entity for a period of 15 months.

Bursa is required to keep extensive books and records of all transactions that take place on the exchanges. The market surveillance mechanisms at the Bursa and the SC permit an audit of the execution and trading of all transactions.

#### *Effectiveness*

The SC has an extensive program in place to enforce securities laws. Under the CMSA, the SC has wide powers to take action against breaches of the securities regime, including administrative sanctions, civil actions and criminal prosecutions. The responsibility of undertaking the enforcement function of the SC is borne by both the Enforcement Business Group and the various supervisory departments of the SC. Information of the various enforcement actions taken by the SC are available to the general public via its website.

**Administrative sanctions** are imposed for breaches that require immediate action and redress. This includes directives for restatement of accounts by public listed companies, the revocation and suspension of license, the barring of submissions/proposals to the SC for advisors, reprimands and imposition of fines.

In determining the type of administrative sanction, the SC has in place criteria that take into consideration the nature and seriousness of the contravention, the conduct of the person after the contravention as well as any previous regulatory record.

Between 2008 and 2011, SC imposed 122 administrative sanctions comprising the following:

- 48 cases of issuance of reprimands;
- 21 suspension/revocation of license;
- 34 cases of issuance of directives;
- 18 cases of imposition of penalties totalling RM2.7 million; and
- 1 case of refusal to receive submission.

A table setting out the breakdown of these actions is set out in Principle 11.

Examples of administrative sanctions imposed by the SC:

- imposition of penalties ranging from RM100,000 to RM275,000 on five regulated entities for failing to supervise their business activities to ensure that their businesses were conducted in a manner which contributes to the maintenance of a fair and orderly market.
- reprimand and imposition of penalty of RM100,000 on a public listed company for failure to undertake a mandatory offer to shareholders in accordance with the provision of the Malaysian Code of Take Over and Mergers when it acquired more than 2% of the voting shares in a public listed company.

The SC has also issued a total of 400 supervisory letters against corporate advisers,

	<p>regulated entities, public listed companies, boards of directors, research houses as well as individuals for various breaches that were minor in nature and had low impact.</p> <p><b>Civil actions</b> are pursued seeking restitution and damages to deprive transgressors from enjoying illegally earned gains or when there is a need to compensate investors, as well as to seek orders to preserve assets or to require compliance with SC's directives. In some instances, the SC has also obtained injunctions to preserve monies pending the outcome of the civil actions.</p> <p>Between 2008 and 2011, the SC initiated civil actions against 40 persons including:</p> <ul style="list-style-type: none"> <li>• Obtained a civil injunction refraining an individual from dealing in RM10.2 million worth of proceeds arising from disposal of shares in contravention of insider trading provisions;</li> <li>• Obtained civil orders against 10 defendants seeking restitution to aggrieved investors in the amounts exceeding RM34.4 million;</li> <li>• Actions against 14 individuals for insider trading contravention. Out of court settlements were entered with 13 defendants who agreed to disgorge up to three (3) times the gains made from their trading activities and recovered RM2.187 million. The case against 1 other defendant is still ongoing.</li> </ul> <p><b>Criminal actions.</b> Consistent with the SC's effort to protect market integrity and improve the standards of corporate governance in public listed companies, the SC pursues criminal action when the breaches of securities laws have significant impact on the market and where there has been a high degree of deliberateness and pre-meditation or gross abuse of position of trust. For less serious infractions, a compound may be offered to the offender.</p> <p>Currently there are four dedicated Sessions courts in Malaysia to hear securities and commercial crime cases. These dedicated courts are intended to build the expertise among the judiciary in dealing with cases of this nature as well as to improve the speed at which these trials completed.</p> <p>(See the Table set out in Principle 11 regarding criminal prosecutions.)</p> <p>The SC seeks custodial sentences for serious offences to serve as a deterrent to others. Between 2008 and 2011, the SC filed a total of 26 appeals regarding sentences that were viewed as inadequate deterrents. To date, three appeals were allowed, four appeals dismissed and the remaining 19 appeals are still ongoing.</p> <p>Between 2008 and 2011, the SC had also imposed compounds totalling to RM4.825 million on nine persons for securities law offences.</p>
Assessment	Fully implemented
Comments	<p>The SC has extensive powers to carry out inspection, surveillance and enforcement activities and exercises these powers in an effective and credible manner. These powers and activities are complemented by similar activities at Bursa Malaysia. The inspection program is risk-based and all market intermediaries are subject to review on a regular basis. Market intermediaries are required to have compliance systems in place and these are evaluated annually by the intermediary and by the regulator during the inspection process. Given the size of the market and the number of participants, the enforcement program established by the SC operates to identify and take action against breaches of the law in a timely and effective manner.</p> <p>See the comments under Principle 11 on the maximum fines that the SC may impose.</p>
<b>Principles for Cooperation in Regulation</b>	
<b>Principle 13.</b>	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.

Description	<p>The SC has full authority to share public information with anyone. A great deal of public information on the SC and its functions, laws and regulations, data and statistics relating to market intermediaries, issuers and collective investment schemes (CIS) is posted on the SC's website or on the website of Bursa Malaysia (for listed companies). The SCA allows the SC to publish information on enforcement actions that have been instituted (s. 152A), which it does through its website and the Annual Report. This information can therefore be shared with other domestic regulators and authorities.</p> <p>For non-public information, the SC is required to protect the confidentiality of any information obtained in the course of its duties. However, the SCA permits the disclosure of information:</p> <ul style="list-style-type: none"> <li>• For the purposes of civil or criminal proceedings under any written law;</li> <li>• Where it has been authorised by the SC; or</li> <li>• Subject to section 124<sup>10</sup> of the Evidence Act 1950 (s. 148).</li> </ul> <p>No external approval is required.</p> <p>A Special Committee has been charged with the responsibility for deciding on disclosure requests to be authorized under s. 148. Each request is assessed individually to ensure proper reasons exist for the disclosure. The information to be disclosed must be specific in nature and clearly identified. In all cases appropriate controls are imposed, such as the information may not be disclosed to any other party than the requesting authority, without a specific additional consent from the SC.</p> <p><i>Sharing with domestic authorities</i></p> <p>Section 149 of the SCA provides that the SC may, on its own initiative or upon request, provide assistance to the police or a public officer. In this regard, the SC may supply a copy of:</p> <ul style="list-style-type: none"> <li>• any document seized or obtained; and</li> <li>• any statement recorded during an investigation.</li> </ul> <p>In addition, the SC may allow a police officer or a public officer to have access to and inspect documents obtained in the course of an investigation.</p> <p>The SC has authority to share with other <i>domestic</i> regulators and authorities information on:</p> <ol style="list-style-type: none"> <li>1. Matters of investigation and enforcement;</li> <li>2. Determinations in connection with authorization, licensing or approvals;</li> <li>3. Surveillance;</li> <li>4. Market conditions and events;</li> <li>5. Client identification including persons who beneficially own or control non-natural persons organized in the regulator's jurisdiction;</li> <li>6. Regulated entities; and</li> <li>7. Listed companies and companies that seek a listing of their securities.</li> </ol> <p>There is ample evidence that non-public information of these types has been shared with</p>
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<sup>10</sup> Section 124 of the Evidence Act provides that a public officer shall not be compelled to disclose certain non-public information if he considers that such disclosure may be prejudicial to public interest unless the head of department of the public officers certifies that such disclosure would not be prejudicial to the public interest.

other regulators. For example, between 2008–September 2011, the SC has shared information with domestic authorities in 274 instances in relation to possible breaches of laws under the respective authorities’ jurisdiction. The SC has also shared documents and information that have been obtained in the course of its investigations in relation to five cases to the Royal Malaysia Police, BNM and the Companies Commission Malaysia.

#### *Sharing with Foreign Authorities*

In addition to the general authority given under s. 148 of the SCA to the SC to share information where authorized by the SC, Section 150 of the SCA provides the SC with specific authority to provide assistance to a foreign supervisory authority<sup>11</sup> to investigate an alleged breach of a legal or regulatory requirement that the foreign supervisory authority enforces or administers. The SC may, when carrying out an investigation into the alleged breach, provide such other assistance as the SC thinks fit.

The SC’s ability to provide assistance to a foreign supervisory authority is not dependent upon the alleged conduct constituting a breach of Malaysian securities laws.

The SC has authority to share with *foreign* regulators and authorities information on:

1. Matters of investigation and enforcement;
2. Determinations in connection with authorization, licensing or approvals;
3. Surveillance;
4. Market conditions and events;
5. Client identification including persons who beneficially own or control non-natural persons organized in the regulator’s jurisdiction;
6. Regulated entities; and
7. Listed companies and companies that seek a listing of their securities.

The SC has met all requests for information from foreign counterparts. For example, between 2008–September 2011, the SC has responded to many requests for information, including:

- 26 requests for investigation assistance from foreign regulators involving eight jurisdictions pursuant to the IOSCO Multilateral Memorandum of Understanding (MMOU); and
- 2 requests for investigation assistance involving two jurisdictions pursuant to bilateral MOUs between the SC and foreign regulators
- 181 requests for information on licensing from foreign regulators.

See the tables in the discussion on Principle 15.

To facilitate discussions at official meetings, the SC has shared information on general market conditions or events bilaterally and through closed-door official forums and regulators’ meetings, such as roundtable discussions at Asian Development Bank regional forums, annual Article IV consultations with the IMF and IOSCO Working Group/Standing Committee meetings.

The SC can provide information to domestic and foreign authorities on an unsolicited basis. The SC provides unsolicited information to other domestic authorities where there are possible breaches of other laws disclosed in the matters reviewed or investigated by the SC. Similarly, information received by the SC which discloses possible offences under the purview of other authorities are also shared with the relevant domestic regulators and authorities. Between 2008 – September 2011, the SC referred almost

<sup>11</sup> “foreign supervisory authority” means a foreign authority which exercises functions corresponding to the functions of the Commission under a securities law or any person outside Malaysia exercising regulatory functions and in respect of which the Commission considers desirable and necessary to render assistance in the interest of the public.

	<p>270 cases of this type to domestic regulators and agencies.</p> <p>The SC is a signatory to the IOSCO MMOU, which provides for the sharing of information with foreign regulators on an unsolicited basis. The SC has 32 bilateral MOUs in place that also facilitate the sharing of information with regulatory counterparts on a voluntary basis. Between 2008–September 2011, the SC referred 10 cases to foreign regulators on an unsolicited basis.</p> <p>In addition, the SC regularly shares technical expertise with foreign regulators.</p> <p><b>Banking Information.</b> The SC is able to obtain banking information for foreign regulators where it relates to alleged breaches of securities laws or to ensure compliance with those laws from relevant banks. The information may be obtained from the banks with the written authorisation from Bank Negara Malaysia. (See the discussion of the arrangement with BNM to obtain this information as discussed under Principle 11.)</p> <p><b>Brokerage accounts.</b> Regulated entities are required to maintain records that permit tracing of funds and securities in and out of brokerage and bank accounts related to securities transactions. The SC is able to share information and records identifying beneficial owners of brokerage accounts with domestic and foreign authorities, pursuant to sections 148 and 150 of the SCA.</p> <p><i>Confidentiality</i></p> <p>All information gathered when shared with another competent authority, either domestically or internationally, is subject to rules and statutory provisions of confidentiality.</p> <p>Domestic authorities are bound by secrecy provisions of their respective governing laws. For example, BNM officials who obtain confidential information from the SC are subject to relevant provisions under the CBA to preserve the secrecy of the information received. In addition, section 8 of the Official Secrets Act 1972 makes it an offence for any public officer to wrongfully communicate official secrets obtained in the course of duty.</p> <p>In respect of foreign regulators, the confidentiality clause in the MOUs requires them to keep confidential all information provided to them and not to disclose the assistance or information to third parties without the SC's prior consent.</p> <p>The SC's letter transmitting the information to domestic or foreign regulator will state that the information is provided on a strictly confidential basis and the information is not to be disclosed to any third parties without the SC's prior written consent.</p> <p>For information received by the SC from foreign regulators, all officers of the SC are obliged to protect the confidentiality of the information obtained in the course of their duties (SCA, s. 148).</p>
Assessment	Fully implemented.
Comments	
<b>Principle 14.</b>	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	<p>Sections 15 and 16 of the SCA, read with sections 148-150, provide the SC with the powers necessary for the performance of its functions with respect to information sharing with other domestic and foreign authorities. Note that no MOU needs to be in place as a precondition to the SC sharing information with another domestic or foreign regulator.</p> <p>In 2005, the SC entered into a tripartite MOU with the Royal Malaysian Police and Companies Commission Malaysia to facilitate sharing of information and inter-agency cooperation. The SC is also an active member of other inter-agency collaborative arrangements such as the Joint Committee on White Collar Crimes coordinated by the Ministry of Domestic Trade which is made up of the Malaysian Anti-Corruption</p>

Commission, Royal Malaysian Police, Inland Revenue Board, BNM, Companies Commission, Malaysian Customs and the SC.

The SC also has an MOU with BNM to facilitate cooperation and information exchange relating to investment banks, payment and settlement systems and mutual recognition of financial advisers and financial planners. The SC and BNM are in the process of finalizing amendments to the MOU to extend its scope to include investigation and enforcement matters, regulation of derivatives, supervision of auditors and management of systemic risk. As a matter of practice, senior management of the SC and BNM meet on a quarterly basis to discuss matters of mutual interest.

The SC is a signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (IOSCO MMOU). In addition to the IOSCO MMOU, the SC has entered into written bilateral MOUs with its foreign regulatory counterparts to facilitate the discharge of licensing, surveillance and enforcement responsibilities. To date, the SC has entered into 32 bilateral MOUs with foreign regulators in areas primarily related to enforcement, supervision and to ensure compliance by issuers and fitness and properness of licensed persons. To facilitate the cross-border offering of CIS, the SC's MOUs with the Central Bank of Ireland and the Commission de Surveillance du Secteur Financier of Luxembourg provide for the exchange of information and cooperation on the regulation and supervision of entities and persons that are authorized or licensed by both the SC and the relevant foreign regulator.

The confidentiality clause in the MOUs requires foreign regulators to keep confidential all information provided to them and not to disclose the assistance/information to third parties without the SC's prior consent. The letter transmitting the information to the foreign regulator will also state that the information is provided on a strictly confidential basis and the information is not to be disclosed to any third parties without the SC's prior written consent.

For information received by the SC from foreign regulators, as noted all officers of the SC are legally obliged to protect the confidentiality of the information obtained in the course of their duties.

If there is any action to compel the SC to release information related to a foreign request, the SC will notify the foreign regulator prior to making the disclosure and, where applicable, will apply any available legal exceptions and privileges to resist disclosure.

A person who contravenes the secrecy obligation contained in the SCA, if convicted, may be subject to a fine of up to RM1 million or to imprisonment of up to five years or both.

The SC has responded to numerous requests for information from both domestic and foreign authorities.

The SC has responded to all requests for information from its foreign counterparts. For instance:

- In 2008, the SC responded to four requests for assistance from foreign regulators involving three jurisdictions pursuant to the IOSCO MMOU and two requests pursuant to bilateral MOUs.
- In 2009, the SC responded to four requests for assistance from foreign regulators involving three jurisdictions pursuant to the IOSCO MMOU.
- In 2010, the SC responded to 12 requests for assistance from foreign regulators involving five jurisdictions pursuant to the IOSCO MMOU.
- In the first nine months of 2011, the SC responded to six requests for assistance from foreign regulators involving three jurisdictions pursuant to the IOSCO MMOU.

In respect of domestic authorities, the SC responds to all relevant requests for information. The SC has also acceded to requests by domestic authorities for access to

	<p>documents seized in the course of the SC's investigations. Between 2008–September 2011, copies of relevant documents were provided to the enforcement agencies to facilitate their investigations of five cases under their respective jurisdictions. Further, pursuant to requests from foreign regulators, the SC has recorded statements from witnesses. Between 2008–September 2011, the SC recorded three statements on behalf of foreign regulators.</p> <p>The response times varied from a few days to several months and depended on the nature of the information requested and the complexity of the process required to collect all the information.</p>
Assessment	Fully implemented
Comments	
<b>Principle 15.</b>	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>The SC is able to offer effective and timely assistance to foreign regulators under the SCA.</p> <p>Under s. 148 of the SCA, the SC and its officers are required to protect the confidentiality of any information obtained in the course of its duties. However, there are several exceptions to this requirement. Disclosure of non-public information is permitted for the purpose of civil or criminal proceedings or subject to section 124 of the Evidence Act<sup>12</sup> or where such disclosure is authorized by the SC.</p> <p>As such, pursuant to authorisation under s. 148 of the SCA, the SC has the authority to share information with a foreign supervisory authority, including for general supervisory purposes. This authority is not dependent upon an alleged breach of law or regulatory requirement.</p> <p>For example, in 2010 and 2011, the SC shared information relating on fund management companies with two foreign regulators where no breach was suspected. Information shared by the SC with one of the foreign regulators included the amount of shareholders' funds held by the fund management company and the SC's findings from desktop reviews and reports submitted by the fund management company. Further, between January, 2008 and September, 2011, the SC has responded to over 180 requests for information on licensing from foreign regulators (Please the discussion under Principle 13).</p> <p>Further, section 150 of the SCA may be used to obtain contemporaneous records sufficient to reconstruct all securities and derivatives transactions, including records of all funds and assets transferred into and out of bank and brokerage accounts. The SC's ability to provide assistance to a foreign supervisory authority is not dependent upon the conduct in question constituting a breach of Malaysian securities laws.</p> <p>Under section 152 of the SCA, the SC can obtain information from any person it deems expedient for the due administration of securities laws.</p> <p>Section 128 of the SCA allows the SC's Investigating Officers (IOs) to obtain information and enter into any place or building to inspect and make copies of or take extracts from any book, minute book, account, register or document. The IO may also, where there is reason to believe there has been a breach of securities laws, take possession of and</p>

<sup>12</sup> Section 124 of the Evidence Act provides that a public officer shall not be compelled to disclose certain non-public information if he considers that such disclosure may be prejudicial to public interest unless the head of department of the public officers certifies that such disclosure would not be prejudicial to the public interest.

detain any object, article, material, thing, property, book, minute book, account register or other document, including travel or other personal document, which may be used as evidence.

The IO, by notice in writing, may require any person to produce the documents mentioned above which are in the custody or under the control of that person, and the IO has the power under the statute to seize, take possession of, and detain the documents for such a duration which the IO feels necessary for the investigation.

See the discussion above under Principles 10 and 11 on the SC’s authority and process for obtaining banking records.

The SC is able to offer assistance to foreign regulators under the SCA in obtaining -

1. Records for securities and derivatives transactions that identify:
  - a. The client:
    - i. Name of the account holder;
    - ii. Person authorized to transact business;
  - b. The amount purchased or sold;
  - c. The time of the transaction;
  - d. The price of the transaction;
  - e. The individual and the bank or broker and brokerage house that handled the transaction; and
2. Information located in its jurisdiction identifying persons who beneficially own or control non-natural persons organized in its jurisdiction (s. 150).

For example, in:

2009, the SC provided brokerage account opening forms, statement of account and relevant supporting documents for an investigation involving illegal investment scheme;

2010, the SC provided information on the investment banks through which securities trades were carried out, brokerage account opening forms, details of end beneficial owner, information on the amount of securities purchased and sold and confirmation of trades for an investigation involving insider trading;

2011, the SC provided brokerage account opening forms, monthly trading statements and information;

in response to requests from foreign regulators.

<b>Information Requests (Other than fit and proper)</b>				
<b>Year</b>	<b>Domestic Requests</b>		<b>Foreign Requests</b>	
	<b>Number of Requests</b>	<b>Nature of Information</b>	<b>Number of Requests</b>	<b>Nature of Information</b>
2007	0		4	Documents from broking firms, and Companies Commission Malaysia
2008	3	Documents seized during investigation	6	Request for affidavits, documents from Companies Commission Malaysia, telephone companies and assistance in statement recording.

2009	1	Documents seized during investigation	4	Documents from broking firms, banks, and assistance in statement recording
2010	1	Documents seized during investigation	12	Documents from broking firms, banks, leasing documents, assistance in statement recording, and information from Ministry of Health.
2011	0		8	Documents from Royal Malaysian Customs, broking firms and banks, information from telephone companies, and assistance in locating witnesses.
Source: SC				

<b>Information Requests Fit and Proper</b>				
<b>Year</b>	<b>Domestic Requests</b>		<b>Foreign Requests</b>	
	<b>Number of Requests</b>	<b>Nature of Information</b>	<b>Number of Requests</b>	<b>Nature of Information</b>
2007	284	Fit and proper	0	Fit and proper
2008	237	Fit and proper	64	Fit and proper
2009	172	Fit and proper	36	Fit and proper
2010	158	Fit and proper and adverse records	53	Fit and proper and adverse records
2011	385	Fit and proper and adverse records	31	Fit and proper and adverse records
Source: Securities Commission				

The SC is able to offer effective and timely assistance to foreign regulators upon receiving a written request from a foreign supervisory authority for assistance to investigate an alleged breach of a legal or regulatory requirement which the foreign supervisory authority enforces or administers and to provide such assistance other than just investigation to the foreign supervisory authority as the SC authorizes (SCA, s. 148 and 150).

The SC is empowered to provide such assistance as if the breach of the legal or regulatory requirement were an offence under Malaysian securities law and is able to exercise its wide range of powers under Part V (Enforcement and Investigation) of the SCA in offering its assistance (SCA, s. 150(3)).

These include matters related to:

	<ul style="list-style-type: none"> <li>• Insider dealing, market manipulation, misrepresentation of material information and other fraudulent or manipulative practices relating to securities and derivatives, including solicitation practices, handling of investor funds and customer orders;</li> <li>• The registration, issue, offer or sale of securities and derivatives, and related reporting requirements;</li> <li>• Market intermediaries of all types, collective investment schemes and transfer agents; and</li> <li>• Markets, exchanges and clearing and settlement entities.</li> </ul> <p>The SC is able to offer effective and timely assistance to foreign regulators in obtaining information on the regulatory processes in Malaysia. Aside from assistance in investigation, the SCA in s. 150 also allows the SC to provide any other assistance to the foreign supervisory authority as it thinks fit.</p> <p>See the discussion under Principle 13 regarding the SC's ability to assist a foreign regulator regarding the production of documents and taking a person's statement or testimony under oath.</p> <p>The SC is able to provide assistance to foreign regulators in obtaining necessary and relevant documents to support the foreign regulators' application for court orders.</p> <p>Further, where the offence in the foreign jurisdiction also discloses a possible offense in Malaysia, the SC may assist the foreign regulator in freezing bank accounts to prevent dissipation of illegal proceeds.</p> <p>In addition, the SC may also obtain an order from the Public Prosecutor under the Anti-Money Laundering and Terrorist Financing Act (2001) (AMLATFA) to freeze relevant bank accounts where a foreign serious offence is disclosed by the issuance of a Certificate of Serious Offence from the requesting country.</p> <p>The SC may assist foreign regulators regarding information about financial conglomerates subject to its supervision and assistance in relation to:</p> <ul style="list-style-type: none"> <li>• The structure of financial conglomerates;</li> <li>• The capital requirements in conglomerate groups;</li> <li>• Investments in companies within the same group;</li> <li>• Intra-group exposures and group-wide exposures; and</li> <li>• Management responsibility and the control of regulated entities.</li> </ul> <p>This information on financial conglomerates related to entities licensed by the SC and subject to the SC's supervision is obtained in the course of its routine supervision activities and is submitted to the SC on a monthly basis. Information about other financial conglomerates and their shareholders could be obtained under section 152 of the SCA. There is evidence that this information has been provided as described.</p>
Assessment	Fully implemented
Comments	
<b>Principles for Issuers</b>	
<b>Principle 16.</b>	There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.
Description	<p>The regulatory framework in Malaysia has comprehensive and very specific disclosure requirements that apply to:</p> <ul style="list-style-type: none"> <li>• Public offerings, including the conditions applicable to an offering of securities for public sale, the content and distribution of prospectuses and other offering</li> </ul>

	<p>documents;</p> <ul style="list-style-type: none"> <li>• Annual reports;</li> <li>• Other periodic reports;</li> <li>• The information provided to shareholders prior to making voting decisions; and</li> <li>• Advertising of public offerings outside of the prospectus.</li> </ul> <p>The CMSA, coupled with a variety of specific guidelines, such as the Prospectus Guidelines (authorized under CMSA, s. 235(1)(f)), sets out an extensive framework for disclosure by and about issuers. These are supplemented by the Listing Requirements imposed by the Bursa Malaysia on listed companies.</p> <p><i>Availability of Disclosure Information on Listed Issuers</i></p> <p>Any public disclosure of material information by a listed issuer must be made by an announcement first or simultaneously to Bursa Malaysia, the press and newswire services. A listed issuer must not release any material information to the media even on an embargoed basis until it has given the information to Bursa Malaysia (Listing Requirements, Para. 9.08(5)).</p> <p>Since 1999, the Bursa has required that all information and documents provided by applicants or listed companies to the Bursa be filed electronically via Bursa Listing Information Network (Bursa LINK). With the launch of Bursa LINK, all announcements submitted by listed companies are available on Bursa Malaysia website immediately. The Listing Requirements also oblige a listed corporation to have a website and publish on that website all announcements made to Bursa Malaysia pursuant to the Listing Requirements (Para. 9.21). The listed corporation must ensure that such announcements are placed on its website as soon as practicable after the same are released on the Bursa Malaysia's website.</p> <p>Further, Paragraphs 9.22 and 9.23 of the Listing Requirements impose obligations on a listed corporation to announce and issue its quarterly report, annual audited accounts and annual report.</p> <p><i>Exemptions</i></p> <p>Certain offerings, issues and invitations of securities are exempt from the requirement to register a prospectus under the CMSA. These are set out in Schedule 6 and Schedule 7 (excluded offers or excluded invitations or excluded issues, respectively). These schedules include many of the exemptions available in other markets, such as an exemption for government debt, issues by private companies to existing shareholders, rights offerings by non-listed issuers, offerings to employees under a share purchase plan or offers to sophisticated investors, such as licensed financial institutions or certain holders of CMSLs.</p> <p><b>General disclosure standard</b></p> <p>There are general requirements in the CMSA and the Listing Requirements on public issuers to disclose all material information and all information necessary to keep the disclosures made from being misleading.</p> <p>Under the CMSA, the SC may specify the nature and extent of information to be given to a person who invests in any capital market product and specification may include the following information:</p> <ul style="list-style-type: none"> <li>• That explains the key characteristics of the capital market product;</li> <li>• That explains the nature of the obligations assumed by the parties dealing in the capital market product;</li> <li>• That sets out the risk associated with the capital market product; and</li> <li>• Details of the essential terms of the capital market product (s. 92A).</li> </ul> <p><b>Detailed disclosure requirements</b></p> <p><i>Public offerings</i></p> <p>Public offerings, invitations to the public to purchase, issues or applications to list</p>
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securities may not be made unless a prospectus relating to the securities has been registered by the SC under the CMSA. The SC is responsible for the approval of listing of securities on the Main Market of the Bursa Malaysia and for the review and registration of all prospectuses regarding offering securities to the public. The Bursa Malaysia approves listing of companies on the ACE Market.

The SC may refuse registration if the prospectus does not comply with any provision of the CMSA, or contains a statement that is false or misleading or from which there is a material omission. The SC may also refuse to register a prospectus if it is not accompanied by copies of all consents required for the issue of the document, and every material contract or document referred to in the prospectus (s. 232, 233).

The CMSA requires the prospectus to contain all the information that investors and their professional advisers would reasonably require and expect to find in a prospectus for the purpose of making an informed assessment of–

- Assets and liabilities;
- Financial position;
- Profits and losses;
- Prospects;
- Rights attaching to the securities; and
- Merits of investing in the securities and the extent of the risks involved in doing so (s. 236).

It also says that a prospectus must not contain any statement or information that is false or misleading or from which there is a material omission (CMSA, s. 246).

The issuer must submit a supplementary/replacement prospectus for registration upon becoming aware that there has been a material change with respect to the issuer or securities, the prospectus contains a statement that is false or misleading or there has been a material omission (CMSA, 238).

The statute sets out general requirements for the contents of a prospectus. The Prospectus Guidelines specify the minimum information required in public offering prospectuses, abridged prospectuses and supplementary/replacement prospectuses. The minimum information includes disclosures on details of offering, risk factors, company's operation and financial performances, shareholders/ promoters/ directors/ key management, related party transactions and conflicts of interest. The disclosure requirements set out in the Prospectus Guidelines are very detailed and are substantively similar to the International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers and International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers published by IOSCO.

The prospectus is subject to a detailed review process at the SC prior to registration, including the publication of the draft on the SC's website for public comment for 15 business days. Proposals that raise novel policy issues are reviewed extensively within the SC and must be approved by the Operational Policy and Regulations Committee and Management Committee prior to the final prospectus being registered. This review addresses matters including how the SC will supervise the issuer on an on-going basis; what additional disclosure might be required initially and on continuing basis; etc.

Upon registration of a prospectus, hard copies of the prospectus are available from the issuer and the participating organisations such as investment banks, banks, issuing houses and stockbroking companies. An electronic copy of the prospectus (with subscription form attached) is available on the Bursa Malaysia's website. Participating organisations may also distribute electronic copies of the prospectus and the application/subscription form via their websites (which is governed under Electronic Prospectuses and Application Guidelines).

In addition, a person or his agent may issue an information memorandum describing the

business and affairs of the person in connection with any excluded offer, excluded invitation or excluded issue (specified in Schedules 6 and 7). An information memorandum is deemed to be a prospectus insofar for the purposes of imposing liability on the person or his agent for any statement or information that is false or misleading or from which there is a material omission. A person issuing the information memorandum must deposit a copy of the information memorandum with the SC within seven days after it is first issued (CMSA, s. 229, 230).

*Annual reports*

The disclosure of information in annual reports, which include annual audited accounts, is governed under the Listing Requirements for the Main Market and ACE Market. These requirements set out detailed requirements for the contents of an annual report, which include:

- Particulars of each director and his/her remuneration package within certain bands;
- A discussion and analysis of the listed issuer's performance during the year and material factors underlying its results and financial position, with emphasis on trends and identifying significant events or transactions during the year under review,
- Particulars of related-party transactions; and
- Sanctions imposed by regulatory bodies.

Annual reports must be filed with the Bursa and the SC and made available to shareholders within six months of the issuer's year-end. The annual audited accounts must be filed and made available within four months of the issuer's year-end.

*Other periodic reports*

The Listing Requirements impose an obligation on listed issuers to provide quarterly reports to Bursa Malaysia for public release, within two months of the interim period end, including the fourth quarter of the year. The required contents are stipulated and include:

- A review of the performance of the listed issuer and its principal subsidiaries, setting out material factors affecting the earnings and/or revenue of the listed issuer and the group for the current quarter and financial year-to-date;
- A commentary on the prospects, including the factors that are likely to influence the listed issuer's prospects for the remaining period to the end of the financial year,
- Status of corporate proposals announced but not completed; and
- Status of on-going and pending material litigation.

The periodic reports are posted on the Bursa Malaysia's website for public information.

*Shareholder voting decisions*

Under the Listing Requirements, listed issuers must ensure that circulars issued (including those relating to matters relating to shareholders' voting decisions) meet certain standards of disclosure, including being factual and clear, not false or misleading, avoiding representation of future performance without adequate justification, and avoiding use of promotional jargon and technical language. Bursa Malaysia reviews the circulars before they are issued to shareholders. Circulars must be sent to all shareholders entitled to vote at the meeting, including those located abroad (Listing Requirements, para. 9.33).

Shareholder votes are required in a number of circumstances, including:

- Issues of securities
- Approval of material related party transactions;
- Disposals of major assets or undertakings.

The appendices to the Listing Requirements set out detailed requirements for disclosure

and, in some cases such as for a sale of substantial assets, for the appointment of an independent advisor to opine on the transaction.

*Continuous disclosure requirements for companies that are not listed.*

It is possible for an issuer to offer securities to the public without being listed on the Bursa Malaysia, but it is extremely rare. If the company is not listed, its continuous disclosure requirements are governed by the Companies Act, which requires interim and annual financial statements, proxy circulars for shareholder meetings and annual reports be provided to shareholders.

*Advertising of public offerings outside of the prospectus*

The requirements on advertising are set out in section 241 of the CMSA and the SC's Advertising Guidelines. Advertising before and after the SC has registered the prospectus is addressed. The Advertising Guidelines cover oral representations, speeches and press interviews, including forward-looking statements by a listing applicant and its directors. The rules govern what information may be included in an advertisement and generally prohibit misstatements or material omissions.

*Material change disclosure*

Under the Listing Requirements, listed issuers must make immediate public disclosure of material information or events that could affect the price, value or market activity of the listed securities or the decision of a holder of securities of the listed issuer or an investor in determining his choice of action. The provision includes an extensive, but not exhaustive, list of examples of events that require disclosure, including a change in management, material acquisition or sale of assets, entry into a joint venture agreement or merger, and the occurrence of an event of default on interest and/or principal payments on its loans (para. 9.19). Guidance provided by Bursa Malaysia indicates in practice, "immediate generally means a period within the same day as the event.

The Listing Requirements say that any announcement made by a listed company must:

- Be factual, clear, unambiguous, accurate and succinct;
- Contain sufficient information to enable investors to make investment decisions;
- Not be false, misleading or deceptive;
- Be balanced and fair;
- Avoid over-technical language;
- Explain, if the consequences or effects of the information on the listed issuer's future prospects cannot be assessed, why this is so; and
- Explain in relation to an announcements on internal targets, that the information disclosed is merely internal management targets or aspirations set to be achieved by the listed issuer and not an estimate, forecast or projection (Chapter 9).

*Risk disclosure*

The CMSA requires a prospectus to contain information for the purpose of making informed assessment (inter alia), of the merits of investing in the securities and the extent of the risk involved in doing so (s. 236(1)(c)). The guidelines that govern prospectus offerings (generally, or with respect to specific types of offering such as asset-backed securities (ABS) or structured warrants) impose the requirement to disclose risk factors that are specific to the corporation, its industry and to the securities being offered. In addition, issuers are encouraged to list risk factors in order of material impact on the investment.

The Prospectus Guidelines – Equity and Debt provide detailed disclosure requirements about:

- The corporation, including, its history and a description of and information on principal activities, types of products manufactured or services provided, principal markets for products and marketing activities, etc.

- The shareholders, promoters, directors and key management including their direct and indirect shareholdings in the corporation before and after the offering; profile including business activities and management experience and directors' remuneration and material benefits in-kind (on individual basis);
- Salient details of any existing or proposed service agreements between the corporation and its directors and key managements; and
- Details on board practices.

There are also additional specific requirements that apply to offerings of particular types of securities such as ABS or structured warrants.

*Financial disclosure requirements* (See also the discussion under Principle 18.)

Prospectuses must contain information on the issuer's last three to five years financial results (depending on the type of issuer). For a full prospectus, the audited financial statements in the prospectus must not be more than six months from the date of the prospectus (Prospectus Guidelines – Equity and Debt, para. 12.10 and 13.13). The issuer may provide interim unaudited financial statements, but these financial statements must have been reviewed by the issuer's external auditor. If the audited financial statements of the last financial year are more than six months old, the prospectus must include the interim audited financial statements. (The comparative financial information is not required to be audited.) For an abridged prospectus (that can be used by a listed company making a rights offering where the securities are transferable to persons other than the existing investors and the securities are to be quoted on the stock exchange) or one for structured warrants, the latest audited financial statements included in the prospectus must not be more than 15 months from the date of issue of the prospectus. Listed corporations/issuers are also required to disclose the latest quarterly and cumulative quarterly financial statements available, including the explanatory notes in the prospectus.

Further, the directors must confirm that there has been no material change in the condition of the listed company from the date of the last financial statements to a date not earlier than 14 days before the date of issue of the prospectus. Disclosure must be made of any circumstances that have arisen which have adversely affected the value of the assets of the corporation, any default or known event that could give rise to a default situation on payments of either interest and/or principal sums for any borrowings and whether there have been any material change in reserves or unusual factors affecting the profits of the listed corporation/issuer.

In addition, the Listing Requirements require the following reports to be made available for public release within the specified time period:

- Annual reports within six months from the close of the financial year of the listed issuer;
- Annual audited accounts together with the auditors' and directors' reports within four months from the close of the financial year of the listed issuer; and
- Quarterly reports within two months from the end of each quarter of a financial year.

The SC's Corporate Governance Blueprint 2011 recommended a taskforce of industry and regulators to be formed to review the current framework for periodic disclosure of financial and non-financial information, including the shortening of the submission period for quarterly and annual reports.

*Accountability for disclosure.* There is an array of measures available to the SC to address concerns with the sufficiency, accuracy and timeliness of the required disclosures. These measures include an extensive review process before securities are issued or listed, certification requirements and sanctions that may be imposed for breach of the obligations under the disclosure regime.

The SC may refuse registration if the prospectus does not comply with any provision of

the CMSA, or contains a statement that is false or misleading or from which there is a material omission. The SC may also refuse to register a prospectus if it is not accompanied by copies of all consents required for the issue of the document, and every material contract or document referred to in the prospectus (CMSA, s. 233). The SC may also refuse to permit an issuer to list on the Bursa where the issuer or securities are unsuitable for listing. In addition, Bursa Malaysia reserves the right to reject or not accept any application, circular or any other document submitted by an adviser on behalf of an applicant or a listed issuer where such adviser has not lodged an undertaking letter with Bursa Malaysia.

The directors and/or promoters of the company/offeror/issuer/guarantor are required to provide responsibility statements that they collectively and individually accept full responsibility for the accuracy of the information submitted in the prospectus (Prospectus Guidelines, para. 3.01).

Failure to ensure that the prospectus contains all information necessary to make an informed assessment or there is no material omission, may also attract criminal liability under section 246 of the CMSA and make the defaulting person subject to civil liability under section 248 of the CMSA. Additionally, failure to comply with the requirements of the Prospectus Guidelines may attract administrative sanctions under section 354 of the CMSA.

*Civil liability.* Persons who subscribe for or purchase securities or suffer loss or damage as a result of any false/misleading statement/information in the prospectus or from which there is a material omission, may recover the amount of loss/damage from any or all of the:

- Issuer and each director;
- Promoter;
- Principal adviser;
- Person named in the prospectus with his consent as having made a statement that is included in the prospectus or on which a statement made in the prospectus is based;
- Person named in the prospectus with his consent as a stockbroker, underwriter, auditor, banker or advocate of the issuer; and
- Person who authorises the issue of the prospectus (CMSA, s. 248).

A defence of due diligence is available under the CMSA to these persons (s. 248). Civil liability does not extend to misstatements in other disclosure documents, such as annual financial statements or reports, nor are investors deemed to have relied on the misstatements in the prospectus.

*Administrative sanctions.* Under section 354 of the CMSA, a person has committed a breach if the person fails to comply with, observe, enforce or give effect to the Listing Requirements, any written notice, guidelines issued or condition imposed by the SC or any rule of a recognised self-regulatory organisation. Persons liable under this provision include:

- A corporation that has submitted a proposal under Part VI of the CMSA (Issues of Securities and Take-overs and Mergers) or which is listed on Bursa Malaysia;
- The directors or officers of the corporation;
- The advisers of the corporation in relation to any corporate proposal or transaction;
- The issuer and each director of the issuer at the time of the issue of the prospectus;
- A promoter in respect of the preparation of the prospectus;
- A person named in the prospectus with his consent, as having made statement

	<p>that is included in the prospectus;</p> <ul style="list-style-type: none"> <li>• A person named in the prospectus with his consent, as a stockbroker, share broker or underwriter; or</li> <li>• Any other person on whom an obligation under any guidelines issued by the SC has been imposed.</li> </ul> <p>SC may issue a stop order where in the opinion of the SC –</p> <ul style="list-style-type: none"> <li>• A prospectus does not comply with or is not prepared in accordance with any provision of the CMSA;</li> <li>• A prospectus contains a statement or information that is false or misleading;</li> <li>• A prospectus contains a statement or information from which there is a material omission or</li> <li>• An issuer has contravened any provision of the securities laws or the Companies Act. (CMSA, s. 245)</li> </ul> <p>Bursa Malaysia may take the actions set out in Chapter 16 of the Listing Requirements against the listed issuer, directors or officers of the listed issuer for any breach of the Listing Requirements. The sanctions include imposition of a fine, suspension of trading of securities and delisting of listed securities.</p> <p>For failure to comply with the accounting standards regulations (Securities Industry (Compliance with Approved Accounting Standards) Regulations 1999), the SC may impose sanctions or penalties against the listed corporation, its directors or officers, including rectification of the relevant accounts and imposition of a fine.</p> <p><i>Omitted or delayed disclosures</i></p> <p>For prospectuses, the SC may exempt disclosures of information if the SC is satisfied that:</p> <ul style="list-style-type: none"> <li>• Compliance is unnecessary for the protection of persons who may normally be expected to deal in the securities; or</li> <li>• Compliance with the requirements of the CMSA would impose an unreasonable burden on the issuer (CMSA, s. 235(5)).</li> </ul> <p>In practice, relief is generally limited to trade secrets, proprietary information and other valid business purposes.</p> <p>The Listing Requirements provide certain circumstances for temporary withholding of disclosure:</p> <ul style="list-style-type: none"> <li>• When disclosure would prejudice the ability of the listed issuer to pursue its corporate objectives;</li> <li>• When the facts are in a state of flux and a more appropriate moment for disclosure is imminent, such as various stages of negotiations; or</li> <li>• Where company or securities laws may restrict the extent of permissible disclosure before or during a public offering of securities or a solicitation of proxies (Para. 9.05).</li> </ul> <p>An issuer may request trading be temporarily suspended by the Bursa. Bursa guidance lays out the terms for such suspensions:</p> <ul style="list-style-type: none"> <li>• Where time is required to prepare and release an announcement relating to a material transaction (such as a reverse takeover and change in significant business direction) – suspension for up to three market days;</li> <li>• Where the listed issuer intends to make a material announcement or hold a press conference to make material announcement before the close of trading – suspension for up to 1 market day; or</li> <li>• Any other reason which justifies suspension in the opinion of Bursa Malaysia – suspension period as deemed appropriate by Bursa Malaysia</li> </ul>
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	<p><i>Insider trading prohibitions</i></p> <p>Section 188 of the CMSA prohibits the trading of securities by a person who is in possession of inside information (insider). Insider is defined as person possessing information that is generally not available and on becoming available, would expect it to have a material effect on the price or value of securities, and ought to know that information is not generally available. Further, tipping by the insider is also prohibited. Breach of these prohibitions may attract criminal sanctions of imprisonment for up to ten years and a fine of not less than RM 1 million under the CMSA.</p> <p>Chapter 14 of the Listing Requirements governs the dealings in the securities of a listed issuer by a director or a principal officer (affected persons) of a listed issuer. General restrictions are placed on the trading by affected persons on the basis that they may be in possession of price sensitive information in relation to the securities. The affected persons may not trade in the securities of the related issuer –</p> <ul style="list-style-type: none"> <li>• From the time actual information is obtained up to one full market day after the announcement to Bursa Malaysia; and</li> <li>• In all cases, from one month prior to the targeted date of announcement up to the date of the announcement of the issuer’s quarterly results to Bursa Malaysia (closed period).</li> </ul> <p>The 4th Quarter results of a listed issuer include the cumulative unaudited results of the financial year. The closed period for the unaudited results of the financial year would therefore follow the closed period governing the quarterly results. Therefore, affected persons are required to comply with the general closed period rule with respect to the issuance of annual reports and the annual audited accounts.</p> <p><i>Foreign issuers</i></p> <p>The number and aggregate market capitalisation of foreign-incorporated issuers listed on Bursa Malaysia are not significant. As at 30 November 2011, out of 945 listed issuers with a total market capitalisation of RM1,228 billion listed on Bursa Malaysia, there are only 8 foreign-incorporated listed issuers with an aggregate market capitalisation of RM3 billion (representing less than 1% of the total market capitalisation of all listed issuers). In any event, any public offerings or listings by foreign issuers in Malaysia must comply with the Prospectus Guidelines.</p>
Assessment	Broadly implemented.
Comments	<p>In general, the requirements that apply to public issuers provide full, accurate and timely disclosure of financial and other material information. Most of these reporting requirements are comprehensive, timely and meet or exceed international standards as required by the Principles.</p> <p>However, the Listing Requirements only require the following reports to be made available for public release within the specified time period:</p> <ul style="list-style-type: none"> <li>• Annual reports within six months from the close of the financial year of the listed issuer;</li> <li>• Annual audited accounts together with the auditors’ and directors’ reports within four months from the close of the financial year of the listed issuer; and</li> <li>• Quarterly reports within two months from the end of each quarter of a financial year.</li> </ul> <p>These requirements only apply to listed companies, not other public companies and the time periods for annual reporting may not be as timely as international standards expect. Internationally, the general trend is to shorten the delivery time for public companies’ financial statements and other continuous disclosure reporting. At 60 days, the current deadline for interim statements is the same as or just slightly longer than that in many major jurisdictions (which vary from 45-60 days), but the deadline for audited annual</p>

	<p>financial statements (120 days) is longer; 90 days is more the norm and 75 days is becoming more common. The six-month period for delivering annual reports is very long. These periods are particularly long when compared with the requirements imposed on CIS in the jurisdiction. The audited statements of a CIS (wholesale or retail fund) must be made available within two months of the fund's year-end.</p> <p>The SC's Corporate Governance Blueprint 2011 recommended that a taskforce of industry and regulators to be formed to review the current framework for periodic disclosure of financial and non-financial information, including the need for shortening of the submission period for quarterly and annual reports. This initiative should be pursued. In particular, consideration should be given to requiring the audited annual financial statements to be published within 90 days of the year-end, with the annual report available promptly thereafter. Further, the obligations to make prompt public disclosure should apply to all public companies.</p> <p>Consistent with the expectations of the Assessment Methodology, civil liability is imposed under the CMSA on material misstatements in a prospectus. Civil liability does not extend to misstatements in continuous disclosure documents, nor are investors deemed to have relied on the misstatements in the prospectus. To apply a sufficient level of discipline to the continuous disclosure process, many jurisdictions have extended liability to the issuer and its officers and directors in connection with the contents of those documents. While it is not strictly required by the Assessment Methodology, the SC should consider whether the CMSA should be amended to provide for this sort of regime. Further, to make it easier for plaintiffs to establish the elements necessary for a civil liability claim, consideration should be given to including a provision in the law that investors are deemed to have relied on the misstatements in the prospectus.</p>
<b>Principle 17.</b>	Holders of securities in a company should be treated in a fair and equitable manner.
Description	<p><b>Rights and equitable treatment of shareholders</b></p> <p>In Malaysia, as for many other countries, the rights of shareholders are governed by a combination of companies and securities laws and the listing rules of the Bursa Malaysia <i>Voting for election of directors</i>. In Malaysia, the appointment of directors of a company is governed under the company's Articles of Association. A resolution to elect or re-elect a director is put to vote at an annual general meeting convened by the company. The Companies Act requires the appointment of directors to be voted on individually, unless otherwise agreed unanimously at the meeting (s. 126). Shareholders holding at least 10% of the total voting rights may requisition an extraordinary general meeting to nominate candidates to be directors (Companies Act, s. 144). Further, shareholders holding at least 5% may request the company include a nomination in the notice for the next annual general meeting.</p> <p>For a company listed on Bursa Malaysia, the Listing Requirements provide that:</p> <ul style="list-style-type: none"> <li>• Election of directors to the board of directors of the company must take place each year;</li> <li>• One third of the directors must retire or be re-elected each year, meaning each director can be in office for a maximum three years before being up for re-election;</li> <li>• A shareholder of the company is entitled to be present and to vote at the general meeting; and</li> <li>• A notice of each and every candidate for election to the board of directors should be served on the registered holders of shares at least seven days prior to the meeting at which the election is to take place.</li> </ul> <p><i>Voting on corporate changes.</i> Under the Companies Act, shareholders' approval is required for fundamental changes. These changes include:</p>

	<ul style="list-style-type: none"> <li>• Variation or abrogation of the rights attached to any class of shares in the company (s. 65)</li> <li>• Alteration of articles (s. 31)</li> <li>• Alteration of share capital (s. 62)</li> <li>• Reduction of share capital (s. 64)</li> <li>• Share buy-backs (s. 67A)</li> <li>• Issuance of shares (s. 132D)</li> <li>• Acquisition and disposal of the company's undertaking or property of a substantial value (s. 132C)</li> </ul> <p>A listed corporation is required under the Listing Requirements to obtain its shareholders' approval for substantial acquisitions and disposals (para. 10.07). Further, a listed corporation which intends to undertake a major disposal of assets must:</p> <ul style="list-style-type: none"> <li>• Appoint an adviser/ sponsor, who is a principal adviser before the terms of the major disposal are agreed upon;</li> <li>• Appoint an independent adviser who is a corporate finance adviser within the meaning of the SC's Principal Adviser Guidelines;<sup>13</sup></li> <li>• Include additional specified information in the announcement of the major disposal to the stock exchange and the circular issued to the shareholders; and</li> <li>• Convene a general meeting and obtain shareholder approval of at least 75% in value of the shareholders present and voting either in person or by proxy at the meeting for such major disposal (para 10.11A).</li> </ul> <p><i>Notice of shareholder meetings and voting decisions.</i> The Companies Act provides that:</p> <ul style="list-style-type: none"> <li>• At least 14 days' notice is required for calling of meetings to pass ordinary resolutions (s. 145(2)); and</li> <li>• At least 21 days' notice is given to shareholders for calling of annual general meetings or meetings to pass special resolutions (s. 145(2A) and 152(1)).</li> </ul> <p>Shorter notice is allowed with the agreement of shareholders holding at least 95% in nominal value of the company's voting shares/ 95% of the total voting rights of all members at that meeting. The SC's Corporate Governance Blueprint encourages companies to voluntarily extend the notice period to ensure investors have sufficient time to make fully informed decisions about the matters to be discussed at a meeting and to return their voting instructions in time.</p> <p>Further, under Listing Requirements, a listed issuer must immediately announce to Bursa Malaysia all resolutions put to a general meeting of a listed issuer and immediately after such meeting whether or not the resolutions were carried (para. 9.19).</p> <p><i>Voting by proxy.</i> Section 149 of the Companies Act provides for a proxy appointed to attend and vote at a meeting of the company to have the same right as the shareholder to speak at the meeting. However, unless the articles otherwise provide the rules governing the actions of the proxy and who may be appointed are fairly restrictive. The</p>
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<sup>13</sup> The role of the independent adviser is to comment as to whether the major disposal and its related proposals, if any, are fair and reasonable insofar as the shareholders are concerned and to advise the shareholders on whether they should vote in favour of the major disposal and its related proposals, if any.

	<p>SC's Corporate Governance Blueprint recommends that these proxy restrictions be eliminated.</p> <p>The Listing Requirements enhance the Companies Act rules regarding proxies to provide:</p> <ul style="list-style-type: none"> <li>• A proxy is entitled to vote on a show of hands on any question at any general meeting;</li> <li>• Where a member of the company is an exempt authorised nominee<sup>14</sup> which holds ordinary shares in the company for multiple beneficial owners in an omnibus securities account, there is no limit to the number of proxies which the exempt authorised nominee may appoint for each omnibus account it holds;</li> <li>• A member of a company entitled to attend and vote at a meeting of a company, is entitled to appoint any person as his proxy to attend and vote instead of the member at the meeting. There may be no restriction on the qualification of the proxy. In addition, a proxy appointed to attend and vote at a meeting of a company shall have the same rights as the member to speak at the meeting.</li> </ul> <p>All listed securities are required by the SICDA to be deposited with the central depository. Transfers of securities take place by way of book entry at the depository (Companies Act, s. 107C). A depositor whose name appears in the record of depositors maintained by the central depository will be deemed a member, debenture holder, interest holder or option holder of the company and be entitled to the number of securities stated in the record of depositors and be subject to all rights and obligations in respect of such securities (s. 107B). Under the Listing Requirements, a person will not be regarded as a shareholder entitled to attend any general meeting and to speak and vote unless his name appears in the record of depositors.</p> <p>The Companies Act requires dividends and other distributions payable to each shareholder be pro-rated to the shareholder's holding in the company (art. 102, Fourth Schedule). The Listing Requirements require a listed issuer to ensure that all dividends are paid not later than 3 months from the date of declaration or the date on which approval is obtained in a general meeting, whichever is applicable (Para. 8.26(2)).</p> <p><b>Take-over Regulation in Malaysia</b></p> <p>Activities of take-overs, mergers and compulsory acquisitions are regulated under Division 2, Part VI of the CMSA. The CMSA provides mandate and power to the SC to regulate take-over activities. The Malaysian Code on Take-overs and Mergers 2010 (Take-over Code) contains principles and rules governing the conduct of all parties involved in take-overs, mergers and compulsory acquisitions so that the activities are conducted within an orderly, transparent, competitive and efficient framework.</p> <p>The take-over provisions in Malaysia promote fair and reasonable treatment to all shareholders, equal opportunity for the offeree shareholders to participate in offers and sufficient time and information to shareholders in making their decision on the offers. The take-over regime generally is triggered requiring a mandatory offer to other investors when a party acquires the stated threshold position in securities of an issuer. However, an exemption from undertaking the mandatory offer may be granted by the SC provided the principles regulating the take-over activities are satisfied.</p> <p>In administering the Take-over Code, the CMSA requires the SC to have regard to the following-</p>
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<sup>14</sup> An exempt authorised nominee refers to an authorised nominee defined under SICDA that is exempted from compliance with the provisions of subsection 25A (1) of SICDA. In other words, an exempt authorised nominee refers to an authorised nominee who may hold deposited securities for more than one beneficial owner in respect of each securities account it holds, commonly known as an omnibus account.

- The shareholders and directors of an offeree and the market are aware of the identity of the acquirer and offeror;
- The shareholders of an offeree are supplied with sufficient information necessary to assess the merits of the offer and have reasonable time to consider the take-over offer;
- All offeree shareholders have equal opportunity to participate in the benefits accruing from the take-over offer, including the premium payable for control;
- All shareholders, in particular, the minority shareholders, are treated equally and fairly, in relation to the take-over offer, merger or compulsory acquisition; and
- The directors of the offeree and acquirer act in good faith in relation to the take-over offer and do not oppress or disadvantage the minority shareholders by their conduct.

In governing take-over activities, the SC has also issued practice notes to interpret the *Take-over Code* and offer guidance in the conduct of persons involved.

#### *Applicability of the Take-over Provisions*

The *Take-over Code* has the effect of law under the CMSA. It applies to any person carrying out a take-over offer, regardless of how the take-over offer is triggered (including by way of a scheme of arrangement, compromise, amalgamation or selective capital reduction). A take-over offer means an offer made to acquire all or part of the voting shares or voting rights in a company and this includes a transaction resulting in the control or a consolidation of control in a company; partial offer; take-over of a subsidiary by its parent company; or an arrangement or reorganization involving the voting shares or voting rights of a listed company.

The *Take-over Code* applies to public companies, listed on any stock exchange or otherwise; companies incorporated outside Malaysia but listed on any stock exchange in Malaysia; and any real estate investment trust that is listed on any stock exchange in Malaysia.

The mandatory offer (MO) obligation under the CMSA and the *Take-over Code* is triggered when a person acquires more than 33% of the voting shares of an issuer. It is also triggered where an acquirer who has obtained control (i.e. more than 33% but not more than 50% of the voting shares) in a company acquires an additional stake equivalent to more than 2% of the voting shares of a company in any period of 6 months.

The MO obligation requires the acquirer to undertake a MO for all the remaining voting shares not owned by him or his persons acting in concert (PAC). The acquisition may be effected by way of acquisition, holding of, or entitlement to exercise voting shares in a company, howsoever effected, which may include reverse takeover, share repurchases, scheme of arrangement or selective capital reduction as defined under section 216(1) of the CMSA.

#### *Exemptions.*

The Code sets out specific instances where exemptions from making a MO may be available on application. These would include situations arising from foreclosure of securities, rescue operations, purchase by a company of its own securities and issuance of new voting shares as consideration for acquiring assets from the vendor.

For take-over of companies arising pursuant to the issuance of new securities and in the case of offeree companies buying back their own shares, an applicant may seek an exemption from undertaking a MO in the offeree before the offer obligation is realized and fulfilling the “whitewash procedure” which includes:

- No disqualifying transaction by the offeror (refers to the vendor or the major shareholder who will trigger the MO obligation) and his PAC;
- Approval from independent shareholders of the offeree at a meeting to waive their rights from receiving the MO (the proposed exemption);

- The resolution for the proposed exemption is separate from other resolutions;
- The voting at the meeting is conducted by way of polls and the result must be confirmed by an independent auditor;
- All interested parties are to abstain from voting on the proposed exemption at the meeting;
- The shareholders are provided with competent and independent advice, via an independent advice circular (IAC) on the proposed exemption prepared by an independent adviser;
- The IAC (which sets out the details of the proposed exemption) is consented to by SC prior to its dispatch; and
- The IAC is dispatched at least 14 days prior to the meeting.

The above requirements essentially safeguard the rights of the shareholders and provide them with equitable treatment as they are given the opportunity to decide on waiving their rights for an MO after being provided with independent advice and sufficient time to consider the proposal. The offeror and his PAC are prohibited from increasing their interests in the offeree company pending the consideration of the proposed exemption and interested parties are also not allowed to participate in the voting.

If the exemption is not granted, the offeror may rescind the transaction that caused the offeror to trigger the MO obligation or proceed with the transaction and undertake the offer. In any circumstances, this information is to be included in the circular to the shareholders and taken into account in the recommendation made by the board of the offeree and the independent adviser as part of the effort in providing rights and equitable treatment in terms of information and knowledge to the shareholders before making a decision on the voting for the exemption at the meeting.

*Responsibility of directors and officers for breaches.*

If an offence against the CMSA has been committed by a body corporate, any person who at the time of the commission of the offence was a director, a chief executive, an officer or a representative of the body corporate or was purporting to act in such capacity, is deemed to have committed that offence unless he proves that the offence was committed without his consent or connivance and that he exercised all such diligence to prevent the commission of the offence as he ought to have exercised, having regard to the nature of his functions in that capacity and to all the circumstances (CMSA, s. 367).

For take-over matters, the SC may take criminal or administrative sanctions against a company, its directors or officers depending on the provisions breached.

Further, under section 317A of the CMSA, a director or an officer of a listed corporation or any of its related corporations shall not do or cause anyone to do anything with the intention of causing wrongful loss to the listed corporation or any of its related corporations irrespective of whether the conduct causes actual wrongful loss.

Under section 130 of the Companies Act, where a person is convicted of the following offences, he cannot thereafter be a director or promoter of a corporation:

- Offence in connection with the promotion, formation or management of a corporation;
- Offence involving fraud or dishonesty punishable on conviction with imprisonment for three months or more; or
- Any offence under the relevant sections of the Companies Act.

(See the discussions of sanctions under securities legislation in Principles 11 and 12.)

Part X Division 1–5 of the Companies Act sets out the provisions for the winding up of companies. Shareholders are treated alike under these provisions in the event of insolvency of the company.

*Disclosure of information.* The requirements for disclosure of material information for investment or voting decisions are prescribed in the Listing Requirements, as is the content of information that must be disclosed in announcements and circulars for new issue of securities, transactions, share buy-backs, arrangements and restructurings, and withdrawals of listing.

In addition, the Listing Requirements impose additional specific information to be included in relation to a significant change in business direction or policy of a listed corporation. For example, the issuer must disclose the new controlling shareholder's interest in all other corporations or businesses, principal activities of such corporations or nature of such businesses. If a conflict of interest exists or is likely to exist, the issuer must provide full disclosure of the nature and extent of the conflicts of interest or potential conflicts of interest, the parties to the conflict, and measures taken for resolving, eliminating, or mitigating the conflicts.

The information required to be provided to offeree shareholders is set out in the Take-over Code and the Guidelines on Take-over Applications which include, inter alia, the offer price, terms of the offer, identity and information of the offeror including the ultimate offeror and PAC, background of the relevant transactions, the interests of directors in the securities of the offeree and offeror, material contracts and litigation, the future intention of the offeror vis-à-vis the business, employees and assets of the offeree, meeting the public spread requirement (if the offeree is listed), maintaining the listing status of the offeree (if the offeree is listed), invocation of the compulsory acquisition provision and future prospects of the offeree.

The Take-over Code requires an offer document to be sent to shareholders of offeree after the take-over notice and a circular from the board of directors of the offeree (board's circular) and an IAC be dispatched to offeree shareholders after the posting of the offer document. The Take-Over Code requires an offeror, the board of directors of the offeree and the independent adviser to provide information as the offeree shareholders and their advisers would reasonably require and expect to find in the offer document, board's circular and IAC for the purpose of making an informed assessment on the offer and the risks involved before making a decision to accept or reject the offer.

In addition, minimum and pertinent information to be disclosed in the offer documents, board's circular and IAC is specified (Takeover Code, s .12, 14 &15).

The Takeover Code sets the timing that must be followed for the various steps in a takeover bid or MO to ensure that shareholders have time to consider the proposal, any competing bid or any amendment of the offer. Under section 17 of the Take-over Code, an offeror must fulfill the acceptance condition by the 60th day of the offer, failing which the offer will lapse. Under the timing requirements, the shareholders would have a minimum of 42 days and up to 95 days from the date of the announcement of the offer to consider and decide on the take-over offer. Under the whitewash procedures as described above, the IAC must be dispatched at least 14 days prior to the general meeting to be held to consider the exemption.

All shareholders in a take-over offer must have equal opportunity to participate in benefits accruing from a take-over offer including in the premium payable for control. To ensure this is fulfilled, public announcements are made to inform the market on the offer and documents (including take-over notices, offer documents and IAC) are sent to all shareholders pursuant to requirements under the Take-over Code. Interests of holders of other classes of share capital and convertibles are similarly safeguarded as the offeror is required to make a comparable offer to holders of other classes of share capital and convertible securities and treat the holders similar to offeree shareholders in all aspects including information and offer timetable (Take-over Code, s. 30(1) and 31(3)).

*Offer price.* The price at which the take-over offer is conducted must reflect the highest price paid by the offeror for shares of the offeree during the six months prior to the start of the offer period and during the offer period.

*Prohibition against favourable deals.* During a take-over offer, an offeror must not enter into any agreement, arrangement or understanding to deal in or make purchases or sales of voting rights of an offeree if such agreement, arrangement or understanding to deal contains favourable conditions that are not being extended to all offeree shareholders (Take-over Code, s. 29).

*Requirement for cash consideration.* Further, if an offeror has purchased ten percent or more of the voting shares of the offeree for cash within six months prior to the beginning of the offer period, the offeror must provide a cash sum as consideration for the take-over offer. In the case of a MO, it is obligatory for the offeror in all instances to provide a cash sum as consideration, or as an alternative consideration (Take-over Code, s. 22(2) and (3)).

Section 8 of the Take-over Code provides conduct requirements for parties to a take-over offer, merger or compulsory acquisition, including requiring the offeree board to act in good faith and safeguard the interests of the offeree as a whole. Under section 15(1) of the Take-over Code, the offeree board is also required to appoint an independent adviser to provide an independent view of the offer. In addition, under section 15(11) of the Take-over Code, the independent adviser is to provide confirmation on its independence within 3 days after its appointment and must ensure that it remains independent throughout the offer period. Further, sections 14(7) and 15(7) of the Take-over Code require the contents of the IAC and board's circular to obtain the SC's consent prior to dispatch to shareholders of offeree.

*Duties on Directors.* The Take-over Code specifically provides that the board of directors of an offeree shall safeguard the interests of the offeree as a whole; and not deny the holders of securities the opportunity to decide on the merits of the take-over offer.

Section 38 of the Take-over Code prohibits actions by the board of directors of offeree, without the approval of its shareholders in a general meeting, which could result in the frustration of a take-over offer. The prohibition is applicable during the offer period and even prior to the receipt of the notice of a take-over offer, if the board of directors of offeree has reason to believe that a take-over offer may be imminent. The prohibitions include–

- The issuance of any authorised but unissued shares of the offeree;
- The issuance or granting options in respect of any unissued shares of the offeree;
- The creation or issuance or permitting the creation or subscription of any shares of the offeree;
- The sale, disposal of or acquisition or agreement to sell, dispose of or acquire assets of the offeree of a material amount;
- The entering into a contract or allowing contracts for or on behalf of the offeree to be entered into otherwise than in the ordinary course of business of the offeree;
- The disposal of assets or liabilities that is a condition to the take-over offer;
- The selling of treasury shares into the market; or
- Any action which may cause the offeree or any subsidiary or associated company of the offeree to purchase or redeem shares in the offeree or provide any financial assistance for any such purchase or redemption.

If the offeree board is found not to have acted in good faith in making any recommendation on the proposal, the SC may take action under section 220 of CMSA. In this regard, the SC has reprimanded an offeree board for conduct that may have blocked an imminent offer.

**Disclosure of holdings of shares by substantial shareholders, directors and officers.**

Under the Companies Act, a shareholder is a substantial shareholder when his interest in

one or more voting shares and the nominal amount of that share, or the aggregate of the nominal amounts of those shares, is not less than 5% of the aggregate of the nominal amounts of all the voting shares in the corporation (section 69D). Also, if the company has more than one class of voting shares, a person who has an interest in more than 5% of any class of voting shares is a substantial shareholder. The person's direct and indirect shareholdings are included. The calculation of percentage ownership takes into account ownership of securities convertible into or otherwise equivalent to ordinary shares (including options on such shares), other than rights offered to the public generally. Substantial shareholders and their holdings must be disclosed in prospectuses under the Prospectus Guidelines.

The Companies Act and Listing Requirements provide for requirements relating to reporting and disclosure of identity and shareholding of a person once the person has reached the stipulated ownership threshold (i.e., 5%) as follows:

- A substantial shareholder is required to inform the company of his/her interests in the company within seven days of becoming a substantial shareholder.
- A copy of the notice must be given to the SC.
- Listed issuers are required to disclose the names of substantial shareholders and their direct and deemed interests in number and percentage of shares in which they have interest in the company's annual reports.
- Changes to substantial shareholding and circumstances giving rise to any change must be disclosed to the company within seven days of the date of the change.
- A person who ceases to be a substantial shareholder must inform the company within seven days of the date of ceasing to be a substantial shareholder.
- The listed issuer must make immediate disclosure to Bursa Malaysia of any of these notices. Disclosures to Bursa Malaysia would be posted on Bursa Malaysia's website.

*Holdings of directors and senior management.*

For initial public offering, the information on the direct and indirect shareholding in the corporation (before and after the offering) of the corporation's directors, chief executive and key management and key technical personnel is required to be disclosed in the prospectus (Prospectus Guidelines, para. 9.04 and 9.07). Under these guidelines, the cut-off date for information to be disclosed in the prospectus must be the latest practicable date available prior to the issue of the prospectus.

Once listed, the CMSA requires the chief executive or director (including his spouse, child or parent) of a listed corporation who has an interest in the securities of such listed corporation to immediately notify the listed corporation in writing of his/her interests in the securities of the listed corporation or associated corporation of the listed corporation or any change in that position. If the SC deems it necessary for the administration of securities laws, the SC may require the listed corporation to provide the same information to the SC (s. 317). The listed issuer, under Chapter 9 of the Listing Requirements, is obliged to make immediate disclosure of the notice to Bursa Malaysia. The announcement on changes of interests by directors to Bursa Malaysia is posted on its website.

The Listing Requirements require the listed issuer to disclose a statement showing the direct and deemed interests of each director in its annual report. The annual report also must contain details on the employee share scheme of the company, such as options or shares granted to the directors, chief executive and senior management during the financial year and since commencement of the scheme.

There is no immediate disclosure requirement under the CMSA for senior officers other than the CEO of listed companies or for the directors, CEOs or other officers of public companies that are not listed. There would be no prompt public disclosure of the

	<p>positions of these persons for non-listed companies. The Companies Act imposes an obligation on directors of all companies to report their ownership of shares and any changes in their positions within 14 days (s. 134-135). There does not appear to be any obligation under the Companies Act for officers to report their positions or for any timely availability of this information to the public.</p> <p>The SC has powers to take action for breach of any of the CMSA requirements and other disclosure requirements, such as under the Prospectus Guidelines.. Further, Companies Commission of Malaysia may take enforcement action for non-compliance with the Companies Act provisions.</p> <p>Foreign issuers with significantly different standards of shareholder protection may be allowed to list on Bursa Malaysia if it can provide that the standards are equivalent to those in Malaysia by means of varying the applicant's constituent documents. The foreign issuer must submit a comparison of the standards of laws and regulations of the jurisdiction in which the issuer is incorporated and those provided in Malaysia, together with the proposed variations to its constituent documents to address any deficiency in such standards (Chapter 5 of the SC's Equity Guidelines).</p>
Assessment	Broadly implemented.
Comments	<p>In general, the legal regime provides for fair and equitable treatment of shareholders and other investors. However, the law provides a fairly short notice period for shareholder meetings and there are some significant limitations in the law on the use of proxies which together may not allow shareholders to exercise their voting rights effectively. This is not in full compliance with the expectations of Key Questions 1(b) and (c) of the Assessment Methodology.</p> <p>The SC's Corporate Governance Blueprint contains recommendations that encourage:</p> <ul style="list-style-type: none"> <li>• Companies to voluntarily extend the notice period for shareholder meetings to ensure investors have sufficient time to make fully informed decisions about the matters to be discussed at a meeting and to return their voting instructions in time; and</li> <li>• The elimination of the restrictions in Section 149 of the Companies Act that place fairly significant limitations on the actions of the proxy and who may be appointed as a proxy.</li> </ul> <p>Given the increasing presence of international investors in the market, and to facilitate the full and informed participation of all investors in shareholder meetings, prompt implementation of these recommendations should be pursued. The assessor notes that the Listing Requirements were changed at Bursa Malaysia in response to the release of the Corporate Governance Blueprint to address the proxy limitations. Shareholders of listed companies may appoint multiple proxies and the qualification restrictions have been removed, effective 3 January, 2012.</p> <p>Consideration should be given to making these mandatory requirements for all public companies, whether listed on Bursa Malaysia or otherwise.</p> <p>Further, there are some gaps and inconsistencies in the disclosure regime for substantial shareholders, directors and senior officers of public companies, which are not in compliance with Key Questions 4 and 5 of the Assessment Methodology.</p> <p>Under the Companies Act, a shareholder is a substantial shareholder when his interest is not less than 5% of the aggregate of the nominal amounts of all the voting shares in the corporation or 5% of the aggregate amount of any class of voting shares. The person's direct and indirect shareholdings are included. However, while the calculation takes into account most interests in securities that are convertible to or otherwise equivalent to ordinary shares, the definition of 'interests in securities' in both the Companies Act and CMSA expressly omits rights that were publicly offered. Consideration should be given to widening the definition of what must be disclosed (by all of substantial shareholders, directors and officers) to include all interests in the securities of the issuer that may be</p>

	<p>convertible to or otherwise equivalent to ordinary shares.</p> <p>Under the Companies Act, the first notice of acquiring a substantial shareholding of securities must take place within seven days and a notice of change must be filed within seven days of the change. This is fairly long by international standards. Further, directors and the CEO of listed companies are required to make the equivalent disclosures immediately (CMSA, s. 317). The other senior management personnel of listed companies are not caught by the immediate disclosure requirement. For public companies that are not listed there is no applicable requirement that any senior management personnel, other than directors, must disclose their share positions to the company. The Companies Act directors' notice requirements give a 14 day notice period. If the company is not listed, no prompt public disclosure of the positions of any of these persons is available. Consideration should be given to bringing the requirements into alignment with the same, shorter time period applicable to all directors, senior officers and substantial shareholders of public companies. Requiring the reports relating to public but unlisted companies to be filed with the SC and published on its website would also be helpful.</p>
<b>Principle 18.</b>	Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.
Description	<p>The accounting standards in Malaysia are issued by Malaysian Accounting Standards Board (MASB). MASB was established under the Financial Reporting Act 1997 (FRA). There are two sets of accounting standards issued by MASB. Prior to 2012, the principles of FRS issued by the MASB were based on International Accounting Standards Board (IASB) standards. Beginning 1 January 2012, Malaysia is fully converged with the International Financial Reporting Standards (IFRS) with the issuance of Malaysian Financial Reporting Standards (MFRS) framework by the MASB. Under the MFRS Framework, IFRS is directly transposed into the Malaysian FRS. The MFRS framework comprises Standards as issued by the IASB that were effective on 1 January 2012 and the new/revised standards recently issued by the IASB that will be effective after 1 January 2012. The MFRS Framework is to be applied by all Entities Other Than Private Entities for annual periods beginning on or after 1 January 2012. Transitioning entities<sup>15</sup> must comply by 1 January 2013.</p> <p>The FRA defines “approved accounting standards” as accounting standards issued or adopted by the MASB. For foreign companies listed on a stock exchange in Malaysia, they must be acceptable internationally recognised accounting standards.</p> <p>Audited financial statements are required to be disclosed in -</p> <ul style="list-style-type: none"> <li>• Public offering and listing documents as stipulated under the various Prospectus Guidelines;</li> <li>• Publicly available annual reports;</li> </ul> <p>The audited financial statements and the annual reports are widely available on listed issuers' website, on Bursa Malaysia's website, or from the Companies Commission of Malaysia for a small fee, and other sources such as the issuers' registered office.</p> <p>Under MASB's Financial Reporting Standard (FRS) 101 - Presentation of Financial Statements, a complete set of financial statements consists of:</p> <ul style="list-style-type: none"> <li>• A statement of financial position as at the end of the period;</li> <li>• A statement of comprehensive income for the period;</li> </ul>

<sup>15</sup> Transitioning Entities include entities that are within the scope of MFRS 141 Agriculture and IC Interpretation 15 Agreements for Construction of Real Estate, including any parent, significant investor and venturer. Transitioning Entities will be allowed to defer adoption of the new MFRS Framework for an additional year.

- A statement of changes in equity for the period;
- A statement of cash flows for the period;
- Notes, comprising a summary of significant accounting policies and other explanatory information; and
- A statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

An entity must also disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Financial statements required in public offering and listing documents and publicly available annual reports must be prepared and presented in accordance with approved accounting standards or acceptable internationally recognised accounting standards.

FRS 101 states that the objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users/investors in making economic decisions.

To reflect consistent application of accounting standards, FRS 101 requires an entity whose financial statements comply with FRSs to make an explicit and unreserved statement of such compliance in the notes. Otherwise, Paragraph 20 of the FRS requires that an entity which departs from a requirement in an FRS to disclose:

- That management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows;
- That it has complied with applicable FRSs, except that it has departed from a particular requirement to achieve a fair presentation;
- The title of the FRS from which the entity has departed, the nature of the departure, including the treatment that the FRS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the Framework, and the treatment adopted; and
- For each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.

FRS 101 also prescribes the basis for presentation of comparative information in the financial statements. An entity disclosing comparative information must present, as a minimum, two statements of financial position, two of each of the other statements, and related notes. When an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements or when it reclassifies items in its financial statements, it must present, as a minimum, three statements of financial position, two of each of the other statements, and related notes. An entity presents statements of financial position as at:

- The end of the current period;
- The end of the previous period (which is the same as the beginning of the current period); and
- The beginning of the earliest comparative period.

Where unaudited financial statements are included in the quarterly financial results announcement, the financial information presented is required to comply with MASB's FRS 134 - Interim Financial Reporting, which tracks the requirements under IASB's IAS 34. The interim statements would include a condensed balance sheet, income statement,

statement of changes in equity, cash flow statement and selected explanatory notes. MASB is established under the FRA as an independent authority to develop and issue accounting and financial reporting standards in Malaysia. MASB, together with the Financial Reporting Foundation (FRF), make up the framework for financial reporting in Malaysia. This framework comprises an independent standard-setting structure with representation from all relevant parties in the standard-setting process, including preparers, users, regulators and the accountancy profession.

The functions and powers of the MASB as provided under the FRA include:

- Issue new accounting standards as approved accounting standards and to review, revise or adopt existing accounting standards as approved accounting standards;
- Issue statements of principles for financial reporting;
- Sponsor or undertake development of possible accounting standards;
- Make such changes to proposed accounting standards as considered necessary; and
- Determine scope and application of accounting standards.

MASB is made up of eight members who are appointed by the Minister of Finance. It comprises the Chairman of the MASB, the Accountant-General and six other members who possess knowledge and experience in the matters of financial accounting and reporting, and in one or more of the fields of accountancy, law, business and finance. In addition, the Minister of Finance has appointed three advisors to the MASB, one each from the BNM, the SC and the Companies Commission of Malaysia.

MASB's processes are set out in its "Foreword to Malaysian Accounting Standards Board Standards and other Technical Pronouncements" (the MASB Foreword), which is available at its website. The Foreword explains the authority, scope and application of approved accounting standards and other technical pronouncements issued or adopted by the MASB. The Foreword also deals with the procedures and due process by which the MASB develops and adopts accounting standards. As part of its standard-setting due process, all new/revised standards and interpretations are issued as exposure drafts for public comments and must be approved by the MASB before they are issued as final standards or interpretations.

FRF is established under the FRA. The FRF contains representation from all relevant parties in the standard setting process, including preparers, users, regulators and the accountancy profession. FRF has no direct responsibility with regard to standard setting. This responsibility rests solely with the MASB.

The functions and powers of the FRF include:

- Providing its views to the MASB on any matter which the MASB seeks to undertake or implement with respect to the development and issue of accounting standards and a conceptual framework;
- Reviewing the performance of the MASB;
- Being responsible for the financing arrangements and operations of the MASB;
- Approving the MASB budget; and
- Administering the fund established to finance the ongoing operations of FRF and MASB including management of funds not expended on operations during any period;

FRF is made up of 19 members who are appointed by the Minister of Finance. Seven of the members are ex-officio representing the Minister of Finance, the BNM, the SC, the Companies Commission of Malaysia, the Bursa Malaysia Berhad, the Malaysian Institute of Accountants and the MASB. The other 12 members represent a broad spectrum of interest groups - principal officers of public listed companies, senior partners of public

	<p>accounting firms and persons with other relevant experience and background.</p> <p>The SC has a system in place for enforcing compliance with approved financial reporting standards by public listed companies, consisting of:</p> <ul style="list-style-type: none"> <li>• A financial reporting issues driven review, as required, with respect to specific financial reporting standards that may have a material impact on the capital market. The objective of this review is to ensure that the implementation of these standards is coherent and consistent especially when there are divergent views with respect to its interpretation/implementation.</li> <li>• An active review program on the disclosures made by companies with significant market capitalisation in connection with transactions. The review is skewed towards financial reporting disclosures and whether they are being made in accordance with the substance of transactions. If questionable issues that have a material impact on the financials are identified, these are raised with SC's management and/or passed to other line departments for further action.</li> <li>• An active review program of the financial statements submitted by public listed companies, focusing on those auditors' reports that contain qualification such as disclaimer of opinion, adverse opinion and those that contain emphasis of matter paragraph. The SC will engage the companies' officials and/ or auditors where appropriate.</li> </ul> <p>Under the Securities Industry (Compliance With Approved Accounting Standards) Regulations 1999, the SC may direct a listed company, its directors or its chief executive:</p> <ul style="list-style-type: none"> <li>• To rectify the relevant financial statements;</li> <li>• To provide relevant undertaking to the SC with regard to compliance with the approved accounting standards; and</li> <li>• To make such announcement as the SC deems fit in relation to any non-compliance or any rectification required.</li> </ul> <p>In addition, the SC may, take such administrative action as the SC deems fit against the listed company, its directors or chief executive. (See the discussion under Principles 11 &amp; 12). These powers have been exercised by the SC several times in recent years.</p> <p><i>Foreign Issuers.</i> As noted above, foreign issuers do not have a significant presence in the marketplace at the moment. However, the FRA allows foreign companies listed on the stock exchange to use acceptable internationally recognized accounting standards. The MASB approved the accounting standards issued by the following standards issuing bodies as acceptable international accounting standards:</p> <ol style="list-style-type: none"> <li>(a) International Accounting Standards Board;</li> <li>(b) Financial Accounting Standards Board, United States of America;</li> <li>(c) Accounting Standards Board, United Kingdom; and</li> <li>(d) Australian Accounting Standards Board, Australia.</li> </ol>
Assessment	Fully implemented
Comments	See the comment under Principle 16 regarding the timeliness of the requirements regarding reporting financial information.
<b>Principles for Auditors, Credit Ratings Agencies, and Other Information Service Providers</b>	
<b>Principle 19.</b> Auditors should be subject to adequate levels of oversight.	
Description	<p>There is a regulatory system in place in Malaysia that subjects auditors of public interest entities (PIEs) to appropriate levels of oversight.</p> <p>In 2010, the SCA was amended to extend the functions of the SC to include audit</p>

oversight. These added functions are to:

- Promote and develop an effective and robust audit oversight framework in Malaysia;
- Promote confidence in the quality and reliability of audited financial statements in Malaysia; and
- Regulate auditors of PIEs (SCA, s. 31B).

PIEs include companies listed on Bursa Malaysia and institutions that are subject to supervision by BNM or the SC.

The Audit Oversight Board (AOB) was established under section 31C of the SCA for the purposes of discharging these new functions. The AOB is structured as a business group of the SC. All staff of the AOB, including its Executive Chairman, are employees of the SC, remunerated by the SC and subject to all its policies and controls as discussed under the Regulator Principles.

The statutory responsibilities of the AOB are:

- To implement policies and programmes in ensuring an effective audit oversight system in Malaysia;
- To register or recognise auditors of public interest entities;
- To direct the Malaysian Institute of Accountants (MIA) - to establish or adopt, or by way of both, the auditing and ethical standards to be applied by auditors;
- To conduct inspections and monitoring programmes on auditors to assess the degree of compliance of auditing and ethical standards;
- To conduct inquiries and impose appropriate sanctions against auditors who fail to comply with auditing and ethical standards;
- To cooperate with relevant authorities in formulating and implementing strategies for enhancing standards of financial disclosures of public interest entities;
- To liaise and cooperate with oversight bodies outside Malaysia to enhance the standing of the auditing profession in Malaysia and internationally; and
- To perform such other duties or functions as the AOB determines necessary or appropriate to promote high professional standards of auditors and to improve the quality of audit services provided by auditors (s. 31E).

Auditors are required to be qualified and competent pursuant to minimum requirements before being licensed to perform audits and to maintain professional competency. The AOB requires all auditors (audit firms and individual auditors) of PIEs to register with the AOB. There are fit and proper requirements set out in the SCA, including being an approved company auditor under the Companies Act (as described below). As at 31 December 2011, there are 75 audit firms and 298 individual auditors registered with the AOB who may conduct statutory audits on PIEs.

The Minister, through the Audit License Committee, is responsible for licensing statutory auditors. In addition to being a member of the Malaysian Institute of Accountants (MIA) registered as a Chartered Accountant, a statutory auditor is required to –

- Be a resident of Malaysia;
- Have attended the Public Practice Programme organized by the MIA;
- Possess three (3) years of continuous audit experience (post membership of the MIA) during the four (4) years prior to submission of the application; and
- Attend and pass the Audit License Committee Interview.

Further, the person must be in compliance with the MIA's –

- Continuous Professional Education requirement;
- Professional Indemnity Insurance requirements;

- International Standards on Quality Control (ISQC1); and
- Practice Review requirements;

which are continuous obligations for audit licensing.

The statutory auditor license is required to be renewed every two (2) years and is subjected to comments on their performance from the SC, Companies Commission Malaysia, MIA.

*Membership of the AOB.* The AOB members are appointed by the SC. The AOB consists of seven members appointed by the SC including an Executive Chairman and six non-executive members. The SCA requires that the AOB be made up of a diverse group of individuals who –

- Possess knowledge and experience in finance, business or in any relevant discipline;
- Be individuals of integrity and reputation who have demonstrated commitment to the interests of investors; and
- Understand the responsibilities for and the nature of financial disclosures as required by PIEs (s. 31C(3)).

To ensure independence from the audit profession, the Board may not have more than two non-executive members who are members of the MIA. The current membership of the AOB is made up of individuals from the legal profession, investment community and regulators, all of whom possess qualifications in accounting, corporate finance, banking, business and/or law.

*Funding.* The AOB is funded principally by the SC. In addition, the AOB collects registration fees from the registered audit firms and individual auditors.

*Power to conduct inspections.* The AOB is empowered by section 31V of the SCA to conduct inspections on auditors registered with the AOB to assess the –

- Degree of compliance with the auditing and ethical standards by an auditor; and
- Quality of audit reports prepared by an auditor relating to the auditing of financial statements of PIEs.

The AOB has access to all books, accounts, working papers or other related documents of the audit firms or auditors. The AOB may make copies of or extracts from these records and request information by oral interview, in writing or in any other manner as required by an Inspection Officer (IO).

All inspections are carried out by IOs who are full time officers of the SC. All IOs are qualified and experienced investigation personnel. As employees of the SC, IOs are subject to the code of conduct of the SC. Prior to the commencement of every inspection, the IOs are required to confirm their independence and declare any potential conflict of interest to the AOB Executive Chairman.

*Scope of inspections.* Inspections are done both at the audit firm level and engagement (specific audit) level. The selection criteria are based on risk assessments of the audit firms and audit engagements. The firm review focuses on quality control, processes, risk management practices and compliance with ethical standards. Engagement review focuses on compliance with International Standards on Auditing (ISA).

*Type of inspections.* AOB adopts a risk-based inspection approach. The risk factors considered include the size of the firm, the number of PIEs audited and whether the firm audits financial institutions. There are two types of inspection that AOB may conduct.

- (a) Regular inspection - an inspection conducted on a routine basis to ensure that all audit firms of public interest entities are inspected within a pre-determined cycle. A regular inspection is conducted with a focus on high risk areas and generally considers the possible impact the audit firm or auditor's quality would have on the confidence of the market and investors; and

(b) Special inspection - one usually driven by specific concerns, either by events or industry issues that may pose a risk to investor protection or raise concerns over the quality and reliability of the related audited financial statements. For example, if the SC identifies a problem with the financial statements of a PIE, the AOB will be asked to follow up with the auditor concerned.

All registered audit firms are subjected to regular inspections. The top 6 audit firms (with more than 10 partners) are subject to annual inspections, while the remaining audit firms are to be inspected within a 3 year cycle, beginning January 2011. *Inspection reporting.* A draft inspection report is prepared and extended to the auditor who has been inspected at the conclusion of the inspection. The AOB discusses the findings of the inspection report with the auditor concerned and after taking into account the representations made by the auditor, the draft inspection report is finalized.

*Transparency of the AOB's annual work program and activity report.* The SCA requires the AOB to prepare an annual report containing overall findings of its inspection program together with its assessment of significant risks relating to the quality and reliability of financial statements of PIEs. The report is submitted to the SC and then sent to the Minister. The AOB Annual Report is made publicly available on the AOB website.

The SCA requires the AOB annual report to include:

- An assessment of the AOB's performance and effectiveness;
- An assessment on the significant risks relating to the quality and reliability of the audited financial statements of PIEs and key measures recommended by the AOB; and
- A description of the systems, etc. used by the AOB to evaluate the effectiveness of its operations (s. 31L).

*Independence of auditors.* The Companies Act lists conflicts of interest that preclude a person from acting as company auditor. These include being an officer, employee, or shareholder of the company or the partner of someone who is, or being indebted to the company for an amount exceeding RM 2,500 (s. 9). To supplement these requirements, the AOB has adopted the MIA By-Laws (On Professional Ethics, Conduct and Practice) and ISQC 1, which provide the detailed requirements for each type of threats to independence.

The AOB performs reviews on the independence of the auditor from its audit clients mainly through its regular inspections. The following are some of the examples of the regular assessments.

- Test the effectiveness of monitoring mechanism on independence, ascertaining whether the firm encounters possible threats to independence;
- Test to ensure a proper client acceptance process is in place. For example, AOB reviews the process for any gaps in the auditor's independence and conflict of interest checks, professional clearance correspondence with predecessor auditors and engagement letters, and to ascertain if the other services provided to the PIE client give rise to threats to independence.

*Power to sanction.* Part IIIA of the SCA gives the AOB the authority to stipulate remedial measures for problems detected, and to initiate and/or carry out disciplinary proceedings to impose sanctions on auditors and audit firms, as appropriate.

The AOB may publish the inspection report if the auditor fails to take the relevant remedial measures to address the findings raised in the inspection report.

In addition, the AOB may conduct an inquiry if there is a reason to believe that any auditor has contravened any provisions of Part IIIA of the SCA, any condition, written notice or guidelines. Where the breach is established, the AOB may impose the following sanctions:

- Directing the person in breach to comply;

	<ul style="list-style-type: none"> <li>• Reprimand;</li> <li>• Requiring professional education to be undertaken;</li> <li>• Assigning a reviewer to oversee an audit that is undertaken by the auditor concerned;</li> <li>• Financial penalty of not exceeding RM500,000;</li> <li>• Prohibiting the person concerned from auditing financial statements of a PIE for a period of not exceeding 12 months or permanently; or</li> <li>• Prohibiting the person concerned from accepting any PIE as its client for a period not exceeding 12 months (s. 31Z).</li> </ul> <p>In addition, the AOB may refuse to renew a registration, revoke and suspend the registration of an auditor if he is found to be not fit and proper as provided for under section 31P of the SCA.</p> <p>From April 2010 to December 2011, a total of 24 inspections have been conducted - 23 regular inspections and one special inspection, covering a total of 74 audit engagements. In addition, extensive discussions and reviews were carried out as part of the initial registration process. 13 remediation plans have been approved and the remaining 10 remediation plans are under discussion. As a result of the AOB's enforcement efforts,</p> <ul style="list-style-type: none"> <li>• four inquiries have been authorised by the Board to be conducted on four audit firms based on the outcome of the inspection;</li> <li>• six warning letters were issued to audit firms for failure to register on time with the AOB as required; and</li> <li>• the registration of five individual auditors has been shortened from 12 months to six months owing to significant deficiencies found during inspection.</li> </ul>
Assessment	Fully implemented
Comments	
<b>Principle 20.</b> Auditors should be independent of the issuing entity that they audit.	
Description	<p>The auditor independence requirements are set out in the MIA By-Laws (On Professional Ethics, Conduct and Practice), particularly section 290 on Independence, which requires auditors to have independence of mind and in appearance. The MIA has adopted the latest enhancement in the Clarified IFAC Code of Ethics with effect on 1 January 2011, with some local added requirements.</p> <p>The AOB has the authority to direct the MIA to establish or amend the auditing and ethical standards to be complied by an auditor where necessary. The AOB also may adopt auditing and ethical standards that are to be complied with by an auditor that is registered with the AOB.</p> <p>The audit firms are required to ensure in-build processes to demonstrate auditor's independence (where applicable) to the regulators. The onus is on the auditor to provide his or her independence. The AOB, through its inspection activities and subsequently via an inquiry, may take action against an auditor if a breach of independence rule is determined.</p> <p>In addition, Paragraph 15.12 of the Listing Requirements provides that the audit committee, which shall comprise a majority of independent directors, is to recommend the nomination of external auditors. As such, the audit committee is expected to ensure that the external auditors nominated are suitable including being independent.</p> <p>The relevant MIA By-Laws impose restrictions relating to audit firms and individuals within the audit firm regarding financial, business or other relationships with an entity that the firm audits. The major criteria in determining an auditor's independence are</p>

avoidance of the threats to independence posed by these sorts of relationships. MIA By-Laws impose higher standards than the IFAC Code of Ethics in the following areas –

- A member shall not be a key audit partner for more than 5 years as compared to the IFAC Code of Ethics requirement of 7 years;
- Total fees generated by the PIE audit client or its related entities should not exceed 15% of the firm's total fees in each year over 2 consecutive financial periods
- Auditors may not provide accounting services to PIE audit clients.
- Auditors may not provide internal audit services to PIE audit clients.

The MIA By-Laws govern the provision of non-audit services to an entity that an audit firm audits. For example, the By-laws provide:

- **290.158** - Before the firm accepts an engagement to provide a non-assurance service to an audit client, a determination shall be made as to whether providing such a service would create a threat to independence. In evaluating the significance of any threat created by a particular non-assurance service, consideration shall be given to any threat that the audit team has reason to believe is created by providing other related non-assurance services. If a threat is created that cannot be reduced to an acceptable level by the application of safeguards, the non-assurance service shall not be provided.
- **290.159** - Providing certain non-assurance services to an audit client may create a threat to independence so significant that no safeguards could reduce the threat to an acceptable level. However, the inadvertent provision of such a service to a related entity, division or in respect of a discrete financial statement item of such a client will be deemed not to compromise independence if any threats have been reduced to an acceptable level by arrangements for that related entity, division or discrete financial statement item to be audited by another firm or when another firm re-performs the non-assurance service to the extent necessary to enable it to take responsibility for that service.

The audit firm is required to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements as prescribed under ISQC 1. The policies and procedures must enable the firm to communicate its independence requirements to its personnel and identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement, where withdrawal is possible under applicable law or regulation.

In addition, ISQC 1 requires the audit firm to establish policies and procedures designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm is competent to perform the engagement; has the capabilities including time and resources to do so; can comply with relevant ethical requirements (independence and lack of conflicts of interest); and has considered the integrity of the client.

Further, ISQC1 requires the audit firm to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to its quality control systems are relevant, adequate and operating effectively.

The Revised Code on Corporate Governance (2007) requires that the board of directors of a public listed company establish an audit committee comprising at least three members, a majority of whom are independent. All members of the audit committee should be non-executive directors. An independent non-executive director is defined in the Listing Requirements as a director who is independent of management and free from any business or other relationship that could interfere with the exercise of independent judgment or the ability to act in the best interests of an applicant or a listed issuer. The

	<p>Code also recommends that the board should provide the audit committee with written terms of reference that clearly set out its authority and duties. All members of the audit committee should be financially literate and at least one should be a member of an accounting association or body. The duties of the audit committee are to include:</p> <ul style="list-style-type: none"> <li>• considering the appointment of the external auditor, the audit fee and any question of resignation or dismissal;</li> <li>• discussing with the external auditor before the audit commences, the nature and scope of the audit, and ensure co-ordination where more than one audit firm is involved; and</li> <li>• discussing problems and reservations arising from the interim and final audits, and any matter the auditor may wish to discuss (in the absence of management where necessary).</li> </ul> <p>The Listing Requirements reinforce these recommendations. Publicly listed companies are required to have an audit committee made up of a majority of independent directors, and whose functions include reviewing the resignation, reappointment and nomination of a person(s) as external auditors.</p> <p>The shareholders of a company must approve the appointment, reappointment and resignation of external auditors at the annual general meeting (Companies Act, s. 172).</p> <p><i>Notice of termination of auditor.</i> Under the Companies Act, shareholders may remove the company auditor via a resolution requiring special notice or by not being re-appointed at the following AGM (s. 172). The company auditor may only resign if:</p> <ul style="list-style-type: none"> <li>• auditor who wishes to resign is not the sole auditor of the company; or</li> <li>• the resignation is made at an AGM (s. 172(14)).</li> </ul> <p>The Companies Act and Listing Requirements require an immediate announcement be made about any change in the external auditors of a listed company (see Listing Requirements, para. 9.19). In addition, if external auditors are removed from office or give notice to the listed issuer of their desire to resign as external auditors of the listed issuer, the listed issuer must forward to Bursa Malaysia a copy of any written explanation made by the external auditor at the same time as copies of such are submitted to the Registrar of Companies (Para. 15.22).</p> <p><i>Enforcing compliance.</i> See the discussion under Principle 19 of the AOB's inspection program and sanctioning powers. There is evidence that the AOB has taken action to enforce requirements. For example, the AOB conducted a thematic review on partner's rotation and requirements of the MIA By-Laws and ISA to have an Engagement Quality Control Review ("EQCR") for all audit engagements of PIEs. It identified 15 individual auditors from six sole proprietorships and nine audit firms with two to four partners that might not comply with the five years partner rotation requirement of the MIA By-Laws if they continued to audit for FYE 2011. As a result, seven firms agreed to rotate partners in 2011, four agreed not to seek reappointment and four agreed to withdraw their firms from AOB registration due to their inability to comply with the partner rotation requirement.</p> <p>In 2012, the World Bank published a Report on the Observance of Standards and Codes ("ROSC") on Accounting and Auditing in Malaysia. The assessment concluded that the relevant auditing and ethical standards have been adopted and implemented in Malaysia as mentioned in Principle 21. The report is available publicly on The World Bank website.</p>
Assessment	Fully implemented
Comments	

<b>Principle 21.</b>	Audit standards should be of a high and internationally acceptable quality.
Description	<p>The regulatory framework in Malaysia requires that the financial statements included in public offering and listing particulars documents and publicly available annual reports be audited in accordance with a comprehensive set of auditing standards.</p> <p>The Malaysian Approved Standards on Auditing issued by the MIA are the International Standards on Auditing (ISA) issued by IFAC. The Clarified ISAs have been adopted in full and became effective for periods beginning on or after 1 January 2010.</p> <p>Other international standards that have been adopted are the ISQC 1, which became effective from 1 January 2010. The By-Laws on Professional Ethics, Conduct and Practice (“MIA By-Laws”) issued by MIA are substantially based on IFAC’s Code of Ethics.</p> <p>Audited financial statements are required to be disclosed in public offering documents under the SC Prospectus Guidelines (Chapter 14). Further, the Listing Requirements state that a listed issuer must issue its annual reports that include annual audited financial statements together with the auditors’ and directors’ reports of the listed issuer, and forward them to the Exchange and shareholders within 6 months from the close of the financial year of the listed issuer.</p> <p>As noted in Principle 20, a ROSC on Accounting and Auditing was conducted by the World Bank in 2011. The assessment concluded that the relevant auditing and ethical standards have been adopted and implemented in Malaysia.</p> <p>The MIA is responsible for the establishment and issuance of auditing standards in Malaysia. Section 6 on the “Functions of the MIA” states that the functions of the MIA should include “to promote, in any manner it thinks fit, the interests of the profession of accountancy in Malaysia”.</p> <p>In addition, the Auditing and Assurance Standards Board (“AASB”) Auditing Committee was established in June 2009 under the MIA to set high quality standards for auditing, review, other assurance, quality control and related services and to facilitate compliance with such standards. AASB has been an active constituent in international standard-setting, in addition to promulgating best audit practices in Malaysia.</p> <p>Further, the MIA, as a member of the IFAC, is obliged under a condition of its membership to support the work of the IFAC by informing its members of every pronouncement issued by the IFAC, to work towards implementation, when and to the extent possible under local circumstances, of those pronouncements and specifically to incorporate IFAC’s International Standards on Auditing in national auditing pronouncements.</p> <p>As noted above, the AOB may direct the MIA to establish or amend the auditing and ethical standards to be complied by an auditor. In respect of this, the AOB may undertake appropriate due process to direct MIA in the event there is delay in the issuance of and auditing or ethical standards.</p> <p>The AASB is a functionally independent standard-setting body designed by, and operating under the auspices of the MIA. The AASB considers new or revised pronouncements issued by the IFAC and issues these as exposure drafts for public</p>

	<p>consultation. Comments received will be considered, prior to their issuance as auditing standards and after final approval by the MIA Council.<sup>16</sup></p> <p>The AASB consists of a chairman and 14 members representing various sectors such as accounting firms, academia and public interest groups. Members are appointed by the MIA Council, based on recommendations from the MIA Nominating Committee. Five observers are appointed to AASB representing regulatory bodies and government agencies. All AASB members are volunteers and are required to sign a members' Code of Conduct declaring that they will act in the public interest and with integrity in discharging their roles. AASB is required to be transparent in its activities, and to adhere to due process as approved by the MIA Council.</p> <p>The AASB has extensive due process and working procedures in place to ensure all new standards are fully assessed and subject to an appropriate public comment process prior to being endorsed. To date, the MIA has adopted all of the IFAC's pronouncements, including the recently revised and redrafted by the IFAC based on its new clarity standards.</p> <p>See the discussion above in Principle 19 regarding the AOB's inspection and enforcement process.</p>
Assessment	Fully implemented
Comments	
<b>Principle 22.</b>	Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and on-going supervision.
Description	<p>The Guidelines on Registration of Credit Rating Agencies (CRA Guidelines) that were issued on March 30, 2011, define a credit rating agency (CRA) as</p> <p style="text-align: center;"><i>a registered person under the CMSA which provides credit rating services for issuance or offerings of debentures and Islamic securities.</i></p> <p>CRA's located in Malaysia and whose ratings are required for ringgit-denominated bonds are subject to registration requirements and supervision by the SC. However, even prior to the issuance of the CRA Guidelines, the SC had a supervisory framework in place for these agencies that included off-site review and engagement with management where deficiencies were noted.</p> <p>Under the Guidelines, a CRA seeking registration is required to submit to the SC certain specified corporate information and information pertaining to its operations, as well as a declaration that the CRA would comply with all the requirements provided in the Guidelines. Examples of documents required to be submitted for the SC's assessment in registering a CRA include the company's profile; information on shareholders, directors and senior management; code of conduct; rating policies, processes and methodologies; personal investment and trading policy; and whistle blower policy.</p> <p>In reviewing the CRA's submission, the SC focuses on the following areas:</p>

<sup>16</sup> Section 8 of the Accountants Act 1967 provides that the MIA Council is made up of the Accountant General, Malaysia, or his nominee; not more than five members appointed from the higher educational institutions; the President of the Malaysian Association of Certified Public Accountants; three members appointed from among the Presidents of the local branches of specified recognized accounting bodies; one appointed from among the members of the council of the Malaysian Association of Certified Public Accountants, other than its President; not more than nine other suitably qualified members; and 10 members elected by the annual general meeting of the MIA in accordance with the rules of the MIA. 18 of these are appointed by the Minister on the advice of the Accountant General.

	<ul style="list-style-type: none"> <li>• Compliance with the requirements in the Guidelines, including the CRA's capital requirement and financial resources, shareholding structure, as well as its policies on rating criteria, methodologies and processes.</li> <li>• Assessment of individuals to be nominated as directors, chief executive and Rating Committee members, particularly in relation to their fitness and properness, and expertise to serve as Rating Committee members.</li> </ul> <p>The SC may require the CRA to furnish any further information or clarification that the SC considers necessary for the purpose of considering the registration application.</p> <p>The Guidelines gave the existing local CRAs six months to be registered. One was registered in October of 2011 and one in March of 2012 after an extensive review of their submitted materials and engagement with their management.</p> <p>Under the Guidelines governing the issue of Private Debt Securities and Sukuk, all ringgit-denominated bond/sukuk issues must be rated by a CRA. As these issues are in the local currency, typically the rating would be carried out by a domestic CRA. However, rating by a foreign CRA is allowed for the issue of ringgit-denominated bonds/sukuk, provided that the issuer has a current issue of foreign-currency denominated bonds/sukuk that was rated by that foreign CRA. The foreign CRA will however be subject to the SC's review to ascertain that the foreign CRA is subject to registration and oversight by a recognised regulatory body. The SC has established internal parameters to review such foreign CRAs. These parameters include registration in home jurisdiction, and that the home regulator has the authority to supervise and the power to take enforcement action against the CRA if required. However, this is more a theoretical than practical issue as there are no affected foreign CRAs.</p> <p>A CRA is required to submit the information specified in the Guidelines to the SC on an annual, semi-annual, quarterly and on-going basis. The SC reviews the information submitted to ascertain the CRA's rating performance, financial strength and other compliance matters. Examples of such information include:</p> <ul style="list-style-type: none"> <li>• Latest audited annual financial statements, annual time-table on the proposed yearly credit review for the next calendar year;</li> <li>• Semi-annual CRA compliance report, staff training schedule; and</li> <li>• Written explanations on remedial actions taken on the CRA's rating policies and process upon the occurrence of a sharp downgrade, as these arise.</li> </ul> <p>There is evidence that reviews of the reports submitted have been conducted. A CRA must at all times undertake to comply with all the requirements set out in the Guidelines, and any additional terms and conditions as may be specified by the SC from time to time, besides adhering to the continuous reporting requirements to the SC.</p> <p>A CRA is subject to examination by the SC (SCA, s. 126(1)(f)). This examination power was granted only recently when the SCA was amended in October 2011. The annual examination framework for CRAs was finalized while the FSAP mission was in Malaysia. The examination framework builds on the existing extensive framework that is in place for supervision of market intermediaries. Audits are expected to begin this year. An on-site inspection of one of the two domestic CRAs was carried out, beginning in the first week of May 2012 and has since been completed.</p> <p>The SC has the power to refuse the registration application of a CRA if the relevant registration requirements have not been met. The SC also has the power to impose conditions on a CRA as the SC deems appropriate.</p> <p>The SC may withdraw or suspend a CRA's registered person status as provided in paragraph 5.2 of the Guidelines if the CRA or its controlling holding company</p> <ul style="list-style-type: none"> <li>• Commits a prescribed offence, such as has been convicted of an offence under the securities laws;</li> <li>• Contravenes any term or condition imposed by the SC;</li> </ul>
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- Does not comply with any directive issued by the SC; and
- Refuses to adhere to the action imposed by the SC.

In the event of any breach of the Guidelines, the SC can take a list of enforcement actions against the CRA such as:

- Issue a directive to the CRA;
- Issue a reprimand to the CRA;
- Impose a fine on the CRA;
- Limit or suspend the rating business of the CRA;
- Remove any director, key personnel or member of the Rating Committee of the CRA who is responsible for the breach;
- Withdraw or suspend the registered person status of the CRA; and
- Take any other actions the SC deems necessary to maintain the integrity of the rating process.

There was a recent case involving a complaint that the rating process at a prospective CRA registrant had been compromised by a lack of independence. The SC reviewed the matter upon receiving a complaint, and subsequently engaged with the CRA's board of directors. Based on the evidence, the senior executive involved retired.

A CRA is required under the CRA Guidelines to:

- Develop and publish a set of written procedures and methodologies for each type of bond and industry. The procedures and methodologies must include the rating philosophy or approach adopted, the parameters or thresholds which will be considered for different rating categories, and benchmarks used. These procedures and methodologies must be published on the CRA's website, and are to be applied accordingly and consistently by the CRA;
- Keep proper records, including records to support credit ratings prepared by the CRA, for a period of not less than seven years;
- Have sufficient resources to carry out high-quality credit assessments. The CRA must employ analysts who are competent and qualified to carry out rating assignments and subsequent monitoring of bonds, and shall ensure that its analysts maintain sufficient high level analytical and monitoring standards.
- Conduct an annual rating review of a bond issue and publish the rating report within fifteen months from the last annual rating review.
- Monitor ratings such that any change in the issuers/issues' situation is reflected in the assigned rating on a timely and effective manner. Therefore, it must initiate an immediate review on rating status upon becoming aware of any information that may reasonably be expected to result in a rating action.
- Have adequate infrastructure and information systems to provide reliable rating services and maintain its operations with adequate security, system capacity and contingency arrangements, including business continuity plan.
- Publish on its website:
  - all information and documents required under the Guidelines including the rating criteria and methodologies for each type of bond and industry as well as a set of transparent policies, controls and procedures ;such information is to be made available to all market participants at the same time.
  - all credit rating opinions and make these easily accessible to the public. Detailed rating rationale reports may be provided only to its subscribers;
  - a list of bonds downgraded to default on an annual basis. In addition, a CRA must make available a historical record of this default list (at least

	<p>for the past five years) following a template set out in the CRA Guidelines.</p> <ul style="list-style-type: none"> <li>• Maintain the confidentiality of information obtained from its clients (including information that might lead to a downgrade) according to the confidentiality provisions or agreements entered into with its clients and establish written policies to monitor and prevent the misuse of non-public information; confidential information cannot be disclosed to any other person except when such disclosure is permitted by law or is made to the SC.</li> </ul> <p><i>Independence.</i> There are supervisory requirements that seek to ensure that credit rating decisions are independent and free from political and economic pressures. Under the Guidelines, a CRA is required to establish a Rating Committee whose chairman and at least one-third or two individual members (whichever is higher) must be external members, who are independent from the CRA, its holding company or its controllers. These external members of the Rating Committee can only serve for two terms, with each term not exceeding four years. A CRA must not appoint more than one individual who has or is perceived to have a business development function of the CRA, or who initiates or participates in fee negotiations with any client of the CRA, to be a member of the Rating Committee.</p> <p>Further, the CRA Guidelines state that where an analyst or any of his or her family members has any interest in a bond issue, the analyst must be excluded from the rating and monitoring processes and the rating decision. A CRA must also establish appropriate policies and procedures governing investments in and trading of securities by its employees. All analysts and Rating Committee members must publicly disclose all conflicts of interest, including those of the family members, in the CRA's rating report for all bond issues. Even if there is no conflict of interest to be disclosed, a CRA is required to include a statement in its rating report that the CRA, the analysts involved in the bond rating and members of its Rating Committee have not encountered nor are aware of any conflict of interest relating to the bond issue. Currently, both the registered CRAs in Malaysia have in place policies relating to investments and trading by their employees.</p> <p>A CRA's ancillary services relating to advisory, origination and structuring of securities must not be offered to any of its rating clients by its employees or by its related corporations at all times.</p> <p>A CRA must include a specific statement in its rating report if rating fees for a bond issuer or from a group of related issuers comprise five percent or more of its rating revenue from the preceding year.</p> <p><i>Timeliness.</i> Under the relevant guidelines, a CRA must disclose all rating opinions and adequately publish all information to support its rating opinions in a timely manner.</p> <ul style="list-style-type: none"> <li>• For initial ratings, the CRA must ensure that its rating reports are published as soon as the ratings have been finalised or at least seven working days prior to the issuance of bonds/sukuk that are being rated.</li> <li>• For subsequent rating reviews, a CRA must also publish its rating reports in a timely manner. In determining the CRA's timeliness in publishing a rating report, the SC will consider the surrounding circumstances leading to the rating action and benchmark against industry best practices. For example, if there is an industry-wide downgrade, it is expected that a CRA may require a longer time to issue a revised rating as opposed to a single issue downgrade.</li> </ul>
Assessment	Fully implemented
Comments	<p>CRAs are subject to a comprehensive regulatory regime in Malaysia. The SC has had a supervisory framework in place for these agencies since 2006 that included off-site review and engagement with CRA management where deficiencies were noted.</p> <p>Both domestic agencies have been registered with the SC (one last October and one in</p>

	<p>March of 2012) and the SC has full power to subject them to the full scope of oversight activities, including on-site and off-site examinations and to sanction the CRA if deficiencies are found. The CRAs have been subject to reporting requirements since 2006 and these were enhanced under the CRA Guidelines in 2011. There is evidence that these reports are reviewed and follow up actions are taken as necessary. There is also evidence that the SC has taken action in response to a complaint about the independence of a rating and that the matter was resolved satisfactorily.</p> <p>The CRAs are subject to off-site and on-site examinations by the SC as required by Key Question 2(b), but neither registered agency had been visited for this purpose at the time of the assessment. The SC's examination power was only granted when the SCA was amended in October 2011. The annual examination framework for CRAs was just finalized. The examination framework builds on the existing, extensive framework that is in place for supervision of market intermediaries. Audits are expected to begin this year. The SC has not pushed the timeline on this process as it wanted to give the two CRAs time to operate under the new requirements and refine their compliance systems before subjecting them to regulatory testing. The first audit should take place as soon as practicable.</p> <p>The assessor notes that an on-site inspection of one of the CRAs took place in early May 2012, after the completion of the FSAP assessment visit, and has since been completed. The inspection of the other CRA is expected to follow later in the year.</p>
<b>Principle 23.</b>	Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.
Description	<p>As described in the discussion of Principle 7, the SC reviews the parameters of regulation regularly, including by imposing regulation and oversight on relevant market participants such as the different types of entities that provide analytical or evaluative services, given their role in the capital market. Investment advisor/analyst, corporate finance advisor, bond pricing agency and property valuer have been identified as the entities that offer such services.</p> <ul style="list-style-type: none"> <li>• Investment and corporate finance advisory are considered as regulated activities and therefore entities that carry out these activities are subject to licensing requirements under the CMSA.</li> <li>• The CMSA states that a bond pricing agency (BPA) that provides investment advice in relation to the pricing of debentures must be registered with the SC under the Guidelines on the Registration of Bond Pricing Agencies (BPA Guidelines). "Registered person" status is granted by the SC to a BPA that makes an application and meets all the criteria set out in the Guidelines.</li> <li>• Property Asset Valuers. Valuers making submissions of property asset valuations to the SC and Bursa Malaysia must comply with the Asset Valuation Guidelines issued under the CMSA (s. 377). Property asset valuers are professionals registered with the Board of Valuers at the Ministry of Finance.</li> </ul> <p>When formulating regulations or oversight framework for entities in the capital market, the policy making process requires clear justification and rationale for imposing requirements. The significance of the role, risk and impact of such entities in the market, jurisdictional comparison and others are assessed and used to determine the level of regulation and oversight to be imposed on these entities. For example, the SC may impose a higher regulatory requirement on entities that may pose higher risk from the perspective of conflict management. For example, with respect to BPAs, the domestic bond market is traded over-the-counter (OTC) among sophisticated/ institutional investors and hence prices are negotiated directly between buyers and sellers. A BPA's prices are therefore mainly used and accepted by institutional investors for portfolio valuation and risk management purposes. These investors generally have other sources</p>

	<p>of valuation, including internal processes and market quotes. The regulatory framework recognizes these factors. As a result, a BPA is subject to the following oversight measures by the SC:</p> <ul style="list-style-type: none"> <li>• Pre-registration stage: minimum requirements on capital, bond pricing expertise, etc. together with established pricing methodologies, as set out in the BPA Guidelines, to qualify to be registered.</li> <li>• On-going supervision: continuous compliance by a BPA with the BPA Guidelines; in particular, a BPA must maintain a code of conduct and ethics to prevent any potential conflicts of interest, and submit its annual audited financial statements to the SC. It is also required to notify the SC upon the occurrence of any material change in its operations, fees charged to clients or controlling or majority shareholders.</li> </ul> <p>Sell-side securities analysts and the stockbroking entities that employ them need to be licensed by the SC. Before a licence is granted to the CMSL applicant to carry out any regulated activities, the Licensing Handbook requires:</p> <ul style="list-style-type: none"> <li>• A CMSL applicant to establish an organisational structure with a clear line of responsibility and authority as well as adequate internal control systems.</li> <li>• The stockbroking companies to have a compliance officer to ensure the company adhere to securities laws, regulations and guidelines as well as other applicable laws governing the regulated activities.</li> </ul> <p>The regulatory framework requires an intermediary to have an appropriate management and organisational structure and adequate internal controls, including matters on conflicts management. See the discussion in Principle 31 of the rules addressing conflicts of interest at licensed firms. Under the Licensing Handbook, a condition is imposed on a licensed intermediary to monitor and supervise the activities of its representatives, including the sell-side analysts.</p> <p>Sell-side securities analysts are required to comply with the minimum standards such as fit and proper requirements, examinations requirements and continuing professional education requirement as described under the responses to Principal 29.</p> <p>Similarly, sell-side securities analysts at registered persons (financial institutions), also are required to fulfill the minimum fit and proper criteria, pass the relevant examinations as well as meet the necessary continuing professional education requirement required under the Guidelines on Investor Protection.</p> <p>The SC conducts routine on-site examinations of market intermediaries that focus on evaluating the effectiveness of intermediaries' internal control system, procedures, resources and performance. (See discussion under Principle 12.)</p>
Assessment	Fully implemented
Comments	
<b>Principles for Collective Investment Schemes</b>	
<b>Principle 24.</b>	The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.
Description	There are clear criteria that apply to operators and marketers of collective investment schemes (CIS) – unit trust funds – and to the funds themselves when they are offered to the public, both for initial approval and for ongoing operations. (For a description of the rules that apply to funds that are offered <b>other than</b> to the public generally, see the description under Principle 28.) The requirements are set out in the CMSA, the Licensing Handbook and a series of guidelines. Under the CMSA -

	<ul style="list-style-type: none"> <li>• Any person who markets or distributes the securities of the funds must hold a Capital Markets Services License (CMSL) or be a registered person under the CMSA permitted to deal in securities<sup>17</sup>.</li> <li>• The fund manager, the entity that makes the investment decisions for the fund, whether the UTMC or a third party, must be licensed by the SC as a fund management company (FMC) (s. 58(1)).</li> <li>• The operator of a unit trust fund - commonly referred to as unit trust management company (UTMC) or management company must be approved by the SC to manage each specific fund on a fund by fund basis (s. 288(2)).</li> <li>• A trustee must be appointed for a CIS and the appointment must be approved by the SC (ss. 288 and 289).</li> </ul> <p>See the detailed description of the licensing process by the SC set out in Principle 29 and the general operational and organizational requirements on CMSL holders set out in the discussion on Principle 31.</p> <p><i>Marketing &amp; Distribution</i></p> <p>A UTMC may employ staff to market and distribute the funds directly and/or appoint-</p> <ul style="list-style-type: none"> <li>• Individual agents (known as “Unit Trust Consultants” or UTC);</li> <li>• Institutional Unit Trust Advisers (IUTA)<sup>18</sup>; and/or</li> <li>• Corporate Unit Trust Advisers (CUTA)<sup>19</sup>,</li> </ul> <p>to market and sell its unlisted unit trust funds to any investor.</p> <p>Detailed eligibility criteria (including the minimum financial requirements) of entities that wish to market a CIS (i.e. a UTMC, IUTA or CUTA) are set out in the Licensing Handbook. All of these entities are either licensed by the SC or are financial institutions authorized by BNM. These entities must, inter alia, ensure that they have an organisational structure with clear lines of responsibility and authority, and risk management policies and processes, as well as policies and processes on conflict management and the monitoring of unethical conduct and market abuse in place (Licensing Handbook, clause 4.02(3)). See the discussion of these licensing requirements set out in Principle 29. Where these entities are financial institutions licensed by BNM they are subject to similar requirements under their relevant licensing legislation and guidelines. In addition, they are required to comply with certain integral investor protection and conflict management provisions in the CMSA<sup>20</sup> in ensuring that minimum standards of conduct are observed.</p> <p>Individuals are allowed to market and sell unlisted unit trust funds. In administering and regulating these individuals, the SC requires that these individuals be registered with FIMM, instead of being licensed by the SC. The Marketing Guidelines also set certain standards and eligibility criteria for individuals who wish to be registered as a UTC, such as minimum age, qualification, fit and proper criteria and a requirement to take a qualifying examination. FIMM imposes requirements and rules on code of conduct and business ethics in its own guidelines for UTCs registered with it. It is also a requirement</p>
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<sup>17</sup> A registered person under the CMSA permitted to deal in unit trust securities includes licensed banks; licensed Islamic banks and licensed finance companies (licensed by BNM).

<sup>18</sup> An IUTA is financial institution or other regulated firm, such as a stockbroking company, that has been authorized to deal in unit trusts.

<sup>19</sup> A CUTA is a corporate entity licensed to provide financial planning services and to deal in unit trust products following a financial plan.

<sup>20</sup> These provision are those set out in ss. 91 (disclosure of interests in securities being recommended), 92 (reasonable basis for recommendations), 93(client orders have priority) and 97(dealing as principal with client) of the CMSA and any regulation or guideline made under these sections.

that UTCs be attached to a UTMC, CUTA or an IUTA, which firm is responsible for supervising the UTC's activities.

The Marketing Guidelines and UT Online Guidelines also set out the duties and responsibilities of persons that market and deal in units of unit trust funds in Malaysia, such as acceptable conduct, fair, and equitable dealing and use of promotional material that complies with relevant guidelines.

*Trustee.*

A trustee must be appointed for a CIS and the appointment must be approved by the SC (CMSA, s. 288 & 289). See the discussion under Principle 25 regarding the specific requirements for trustees.

*Operators*

The Malaysian regulatory framework sets standards for the eligibility and regulation of persons who wish to operate a CIS in Malaysia. The various requirements are contained in the:

- CMSA; and
- Guidelines for the specific type of funds:
  - Guidelines on Unit Trust Funds (UTF Guidelines);
  - Exchange-Traded Funds Guidelines (ETF Guidelines) for exchange-traded funds; or
  - Guidelines on Real Estate Investment Trusts (REIT Guidelines) for REITs.

In addition ETFs and REITs are subject to the Bursa Malaysia Listing Requirements.

The operator must be approved by the SC as a UTMC (see the process set out in Principle 29). The eligibility criteria for a CIS operator include:

- Honesty and integrity of the operator;
- Having appropriate and sufficient human and technical resources to ensure that it is capable of carrying out the necessary functions of CIS operator;
- Financial capacity that would allow the launching and operation of the CIS in appropriate conditions;
- Ability to perform specific powers and duties;
- Having or employing an appropriate identification, monitoring and management of risks, based on, among other things, the size, the complexity and the risk profile of the CIS; and
- Having internal controls and compliance arrangements sufficient to ensure it can carry out its business diligently, effectively, honestly and fairly

In addition the relevant guidelines impose additional specific requirements on the management company, such as a requirement to appoint an investment committee for a CIS made up of at least 3 members with no fewer than two independent members. The investment committee must maintain a minimum ratio of at least one-third independent members at all times (UTF Guidelines/ETF Guidelines, cl. 6.02(a) and 6.03). A REIT Manager is not required but encouraged to appoint an investment committee for the REIT.

The specific powers, duties, roles and responsibilities of a management company are stipulated under the CMSA and the respective UTF Guidelines, ETF Guidelines and REIT Guidelines. These include the duty -

- To carry on its business in a proper, diligent, and efficient manner;
- To carry on its business in accordance to the laws, regulations, and deeds;
- To make all financial records of a scheme available for inspection by the trustee or auditor;

- To make a copy of the deed available to unit holders;
- Not to act as principal in the sale and purchase of securities to and from the unit trust scheme;
- Not to make improper use of its position to gain, directly or indirectly, an advantage for itself;
- Not to invest any monies, without unit holders' approval, in any securities in which the UTMC or its officer has a financial interest;
- To lodge returns to the SC; and
- To replace a trustee under certain circumstances.

Further to the above, the roles and responsibilities of a UTMC are also stipulated in the respective UTF Guidelines, ETF Guidelines and REIT Guidelines.

The fund manager (operator of the fund or a third party) is required to comply with the Guidelines on Compliance Function for Fund Management Companies. Under those guidelines the company must

- Establish a risk management framework that is reviewed yearly and commensurate with the company's business (clause 5.05 – 5.08). The risk management framework should be extended to take into account the complexity and risk profile of the CIS;
- Establish, maintain and implement an effective internal control framework and conduct yearly review of the framework [clause 4.02(d)(i) and (ii)];
- Establish an internal audit function that is commensurate with its business (clause 5.01); The internal audit function must include:
  - Planning, controlling and recording all internal audit work performed;
  - Recording all findings, conclusions and recommendations of the internal audit work performed; and
  - Producing an internal audit report at the conclusion of each internal audit conducted (clause 5.03);
- The Board must ensure that one or more compliance officers are appointed and that all non-compliance matters raised by the compliance officer are properly addressed [clause 4.02(k) and (l)]; the duties and responsibilities of the compliance officer (clause 4.04) must include:
  - Establishing and maintaining a comprehensive compliance manual;
  - Establishing, maintaining and administering the implementation of compliance policies and procedures;
  - Reviewing and updating compliance policies and procedures;
  - Establishing a compliance programme and carrying out an annual review of the said programme;
  - Assisting in training and educating staff on compliance matters; and
  - Reporting directly to the Board and compliance committee (if any) on any compliance issues.

Where the company delegates or outsources certain functions to service providers, the internal controls and compliance arrangements are expected to extend and include the outsourced functions. Ultimately, the company is still responsible over any outsourced functions. Requirements that are similar to those stated above are also prescribed in the respective CIS guidelines.

All CMSL holders are required to make a yearly submission to the SC on their licence anniversary date that provides an overview of their financial performance, business direction and resources (Licensing Handbook, para. 6.05). This information assists the SC in assessing the CMSL holders' on-going compliance with all applicable

requirements. The SC also conducts on-site and off-site reviews of licensees. (See discussion under Principles 10 and 31.) Licensees are also required to give the SC prompt notice of any material changes in their operations or of the occurrence of any event that is a ground on which the SC can revoke their licence (CMSA, ss. 74 & 78).

The SC also requires a new UTMC that is approved by the SC to be the management company of a newly established CIS, to submit an independent operational audit report within 6 months after the CIS is launched. The objective of the operational audit is to evaluate the policies, procedures and systems that have been set up in order to manage the CIS. The appointment of the auditors and scope of work is subject to the SC's approval. The scope of work covers:

- Organizational Structure and Key Personnel (job functions, responsibilities, reporting structure of each department, responsibilities, authority and objective of each committee established etc.);
- Compliance Policies and Procedures (compliance manual and code of ethics, compliance with relevant laws and guidelines); and
- Key Operations Areas (administration and back-office functions, investment functions etc.);

A management company should adhere to good corporate governance principles and best industry standards for all activities conducted in relation to the CIS (and any matter arising out of its listing or trading on any stock exchange for an ETF/a REIT). The trustee, (property manager, independent qualified valuer for REIT) and any other delegate or service provider of the fund should observe the best corporate governance standards (see for example, clauses 11.80 & 11.81 of the UTF Guidelines).

A management company is required to exercise degree of care and diligence that a reasonable person would exercise in its position, act in the best interest of unit holders, giving priority to unit holders' interest (if there exists a conflict of interest) and observe high standards of integrity and fair dealing in managing the CIS to the best and exclusive interest of unit holders (see for example, clause 3.19 of the UTF Guidelines).

*Foreign entities and funds.*

The CMSA generally requires the management company and the trustee of a CIS marketed in Malaysia to be locally incorporated and most domestic CIS are marketed only to local investors. However, the proposal to establish a CIS may occasionally involve the appointment of a delegate located outside Malaysia. Such delegation must be approved by the SC. In assessing the application, the SC would consider whether there is international co-operation between the SC and the relevant foreign regulator. Where no co-operation exists, whether formal or informal, the SC may reject the application.

However, certain foreign incorporated CIS managed by foreign operators may be sold in Malaysia, if they meet specified conditions. These requirements are stipulated in the Foreign Fund Guidelines and include requirements on:

- The type of funds allowed to be marketed in Malaysia (e.g. a Recognized Fund from a Recognized Jurisdiction, regulated, etc.);
- Disclosure requirements for the offering documents; and
- The use of appropriately licensed or authorized persons to market and deal in the foreign CIS products in Malaysia.

In recognising a CIS and a jurisdiction, the SC takes into account the rules/laws/guidelines governing CIS in that jurisdiction to ensure that a similar approach to investor protection is adopted as well as mutual co-operation with the regulator. Upon a satisfactory outcome, the SC will sign a Mutual Recognition Agreement with the foreign regulator which allows cross-border marketing and distribution of CIS products between the two countries which also includes agreement on the exchange of information, cooperation and consultation where the respective regulators agree to work closely in the areas of supervision and enforcement to ensure adequate protection for investors. To

date, the SC has entered into such Mutual Recognition Agreements with Dubai Financial Services Authority and Securities and Futures Commission of Hong Kong.

*Authorization, oversight and reporting*

The Malaysian regulatory framework provides the SC with clear powers and responsibilities to approve a CIS and UTMC, inspect a UTMC, investigate any breaches and take remedial action in the event of a breach. These are clearly provided for under the SCA and CMSA. (See the discussion under Principles 10-12, 29 & 31.)

SC's supervision framework for UTMCs comprises off-site review/monitoring, routine on-site examinations and engagement. The SC focuses its regulatory resources on proactive and risk-based supervision focusing on high risk areas and high risk intermediaries. Where deficiencies are found, the SC takes appropriate enforcement or other actions. (See the discussion of these activities under Principle 12.)

Certain documents are required to be submitted to the SC on a regular basis and the SC reviews these documents regularly as part of its ongoing monitoring of the CIS and its management company. Among the documents submitted are—

- Annual and interim reports of the CIS and annual report of the management company;
- The prospectus or offer document for each CIS;
- The CIS's statistical and compliance reports; and
- Advertising and promotional materials.

In addition, the yearly filing by UTMCs on their licence anniversary date requires UTMCs to provide an overview of their financial performance, business direction and resources, as well as documents which include a copy of the director's report and a copy of the latest unaudited management's accounts. FMCs are also subject to extensive routine reporting requirements on a monthly, semi-annual and annual basis.

The SC has a supervisory manual that provides for the examination process and procedures specifically for CIS operators and funds. The examination focuses on –

- Corporate governance (board and senior management oversight);
- Client asset protection;
- Trading practices and operational processes at the UTMC;
- Compliance with regulatory requirements and internal policies and procedures;
- Anti-money laundering; and
- Financial statements analysis.

The CMSA and the Licensing Handbook require UTMCs to report to the SC when material changes occur such as the change in shareholding composition or paid-up capital not resulting in change of controller or changes to the CEO.

As the prospectus also contains information about the UTMC, any material change to the management and organisation would require a supplementary prospectus to be issued and existing unit holders to be informed of such changes. In addition, any material changes that require modification to the deed of the CIS would require the issuance of a supplementary deed that is required to be registered with the SC. When the SC received an application to register a supplementary deed, the SC may require the UTMC to send a notice to the CIS's unit holders after the registration of the supplementary deed but prior to the changes taking effect (CMSA, s. 295).

The management company is responsible for maintaining records of the operations of the CIS. A management company is required to maintain proper accounting records and other records in order to—

- Enable a complete and accurate view of the fund to be formed; and
- Ensure that the fund is operated and managed in accordance with the deed,

prospectus, guidelines and securities laws.

*Conflicts of Interest.* The regulatory framework includes provisions that prohibit, restrict or require the disclosure of certain conduct likely to give rise to conflicts of interest between a CIS and the management company or their associates and connected parties. The Guidelines and CMSA provide that:

- A director is prohibited from
  - Being a director of more than one UTMC at a time;
  - Holding office as an investment committee member of funds managed by another management company;
- A UTMC or its nominees are not allowed to hold units in the unit trust fund other than for complying with repurchase requests and/or creating new units to meet anticipated requests for units by investors subject to a maximum of three million units or 10% of the units in circulation whichever is lower;
- A management company must
  - Observe high standards of integrity and fair dealing in managing the fund to the best and exclusive interest of unit holders;
  - Ensure that neither it, nor its officers and delegates make improper use of information acquired to gain an advantage;
  - Conduct all transactions at arm's length;
  - Not vote at unit holders meetings;
  - Avoid conflicts of interest arising, and if one does, ensure that the fund is not disadvantaged; and
  - Not act as principal in the sale and purchase of securities, properties and assets to and from the CIS
- The fund's property must be held separately from the property of the management company;
- Any related-party transactions must be made on terms that are best available for the fund;
- Appointment of related-party delegate must be approved by the independent directors;
- Use of each broker/dealer for a unit trust fund should not exceed 50% of the unit trust fund's dealings in value in any one financial year of the unit trust fund.

The Guidelines on Compliance Function for Fund Management companies also provide requirements for fund management companies that focus on managing conflicts of interest and require compliance with several operational conduct standards to ensure that they act in the best interest of investors and treat all clients fairly.

In addition, there are also mandatory requirements under the relevant CIS guidelines for management companies to have a prescribed ratio of independent members in the board of directors and investment committee to protect unit holders. There must be at least two independent members, and at least one-third of the board and the investment committee must be independent members at all times.

The CIS Prospectus Guidelines impose extensive disclosure requirements on related-party transactions and conflicts of interest. The disclosure should include details of any related-party transactions and conflict of interest situations and policies governing investments by directors and employees (Chapter 17 of Part I and Chapter 14 of Part II). It also requires the disclosure of details of directors' and substantial shareholders' of the Management company direct and indirect interest in other corporations in similar businesses.

There are extensive requirements imposed on the operations of a CIS under the CMSA and the relevant guidelines to ensure it is run appropriately. The relevant guidelines (UTF

Guidelines/ETF Guidelines/REIT Guidelines) require the operator of a unit trust to carry on business in a proper, diligent and efficient manner in accordance with the laws, regulations and the deed of the fund. It is required to act in the best interests of unit holders and observe high standards of integrity and fair dealing in managing the CIS. Under the relevant guidelines, a CIS is required to comply with rules related to best execution. Any related party transaction, dealing, investment and appointments involving parties to a CIS must be made on terms which are the best available for the CIS and which are no less favourable to the fund than an arm's length transaction between the parties. The CIS's FMC must establish, maintain, and implement written policies and procedures that ensure "best execution" of trades for their clients. Further, the FMC must have policies and procedures to ensure fair and equitable allocation of orders among clients.

The UTF Guidelines provide that excessive dealings in the investments of the CIS are deemed inappropriate (note to clause 8.05). The compliance officer is required to report to the investment committee and Board of Directors of any dealing of this nature (clause 3.14(h)).

An FMC may not invest in any investment products where it does not understand the structure, pricing mechanism and nature of underlying assets (Guidelines on Compliance Function for Fund Management Companies, cl. 9.03). Effectively, this requires the FMC to conduct due diligence when selecting investments.

There are extensive provisions in relation to fees and expenses in the relevant guidelines (see for example, chapter 9 of the UTF Guidelines). They include mandatory provisions regarding:

- Charges for dealing in units (except for REITs);
- Management fee and trustee fee;
- Remuneration of the management company;
- Remuneration of the trustee; and
- Expenses of the CIS.

Generally these require disclosure of all fees in the prospectus and place conditions on how a UTMC may be compensated and a process if fees are to be increased.

Only expenses directly related and necessary in the operating and administering a CIS may be paid out of the CIS. The trustee is supposed to ensure all expenses charged to the fund are legitimate. In addition, a trustee should ensure that the quantum of expenses charged to the CIS is not excessive or beyond the standard commercial rates.

The relevant guidelines prohibit the UTMC, a trustee or its delegate to retain any rebate from, or otherwise share in any commission with, any broker/dealer for directing dealings in a fund's property. Accordingly, any rebate or shared commission should be directed to the account of the fund concerned (e.g. UTF Guidelines, cl. 11.33). However, goods and services (soft commissions) provided by any broker/dealer may be retained by a management company or its delegate, if the goods and services are of demonstrable benefit to unit holders and:

- Dealings with the broker/dealer are executed on terms which are the best available for the fund; and
- The management company's or delegate's soft commission practices are adequately disclosed in the prospectus and fund reports (including a description of the goods and services received by the management company or delegate) (UTF Guidelines, clause 11.34).

*Delegation/Outsourcing.*

The regulatory framework allows for delegation and outsourcing of functions by the management company to third parties (UTF Guidelines/ETF Guidelines/REIT Guidelines, cl. 5.02). Outsourcing requires the SC's prior approval, except where the function is

delegated to a SC licensee. Presently, the most common functions permitted to be delegated to third parties are fund management functions, fund accounting, fund valuations, and maintaining the unit holders' register.

Licensed entities are subject to the requirements set out in the SC's Guidelines on Outsourcing for Capital Market Intermediaries. These guidelines set requirements that must be complied with to ensure investors' interests are protected. The requirements include limitations on the entities to whom activities can be outsourced, prohibitions on outsourcing key tasks and controls that must be in place at the firm that is doing the outsourcing. For example, licensed intermediaries may not outsource decision-making functions or a function that involves direct contact with clients.

Outsourcing functions to third parties does not relieve either the management company or the trustee of their responsibilities. The management company and trustee is still responsible for the actions and omissions of the respective delegates as though it were their own actions or omissions. (UTF Guidelines/ETF Guidelines/REIT Guidelines, cl. 5.02). A similar requirement appears in the Guidelines on Compliance Function for Fund Management Companies (clause 5.17) and Guidelines on Outsourcing for Capital Market Intermediaries (cl. 3.06).

The SC requires the management company to have

- Adequate procedures in place to monitor the conduct of the delegate and ensure that the delegated function is performed in a proper and efficient manner; and
- Adequate controls in place to ensure compliance with the deed, prospectus, guidelines and securities laws (UTF Guidelines/ETF Guidelines/REIT Guidelines, cl. 5.03).

In its application to appoint a delegate, the management company is required to submit a declaration of compliance with the requirements of the relevant guidelines.

The regulatory framework allows a management company to terminate the delegation and make alternative arrangements, provided that requirements of the guidelines are complied with (e.g. new delegate receiving the SC's prior approval, meet criteria stipulated in the guidelines etc.). The service level agreement (SLA) between the firm and the delegate must contain provisions relating to the termination of contract, such as a minimum period to execute a termination, ownership of intellectual property following termination and specifications relating to transfer of information back to the market intermediary (Guidelines on Outsourcing for Capital Market Intermediaries, cl. 6.09(g)). A market intermediary must notify the SC or the Exchange (for listed CIS, such as REITs), as the case may be, of any variation or termination of the SLA within ten working days from the occurrence of the event.

Any delegation of function must be disclosed to investors in the prospectus. If there is a change in delegate, the CMSA requires the issue of a supplementary prospectus (s. 238).

In order to protect investors and not jeopardise SC's ability to regulate, the outsourcing guidelines require the intermediary to include terms in the SLA setting out -

- Provisions for proper reporting and monitoring systems between the intermediary and service provider;
- The rights of the intermediary to conduct examinations or inspections and to have access to books, records and documents relating to outsourced functions; and
- Provisions relating to the maintenance of books, records and documents for the time period stipulated in the Guidelines on Outsourcing for Capital Market Intermediaries, securities laws, rules and any other relevant laws or guidelines.

The SLA is reviewed by the SC prior to giving approval of any outsourcing application. In addition, the intermediary is required to submit a letter of undertaking from the service provider or sub-contractor to give the SC, the Exchange or their agents access to and

	the ability to make copies of information, records and documents relating to the outsourced function.
Assessment	Fully implemented
Comments	
<b>Principle 25.</b>	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	<p>In Malaysia, CIS are organized as unit trusts where –</p> <ul style="list-style-type: none"> <li>• A management company (UTMC) operates and manages the CIS; and</li> <li>• A trustee acts as custodian and safeguards the interest of unit holders.</li> </ul> <p>Investors hold units issued by the unit trust (unit holders).</p> <p>A trustee approved by the SC must be appointed (see the discussion under principle 24) and the management company must enter into a trust deed or ensure there is a deed in force registered with the SC (CMSA, s. 288).</p> <p>The trust structure ensures that the assets are properly segregated and kept in custody with the trustee who is the registered and legal owner of the assets, holding on behalf of the beneficial owners who are the unit holders. Any action initiated by or on behalf of the unit holders would be by the trustee who is the registered owner of the CIS's assets and has a fiduciary duty and capacity to ensure the rights and interests of unit holders are safeguarded and protected at all times.</p> <p>As described more fully in Principle 26, the prospectus must contain detailed information on the UTMC, trustee, salient terms of the deed and unit holders' rights and liabilities.</p> <p>In addition, in reviewing an application for approval of a CIS, the SC ensures that requirements on the legal form and structure are complied with before an approval is given. The SC also monitors compliance through disclosures in prospectuses and deeds upon registration and during annual renewal of the fund's prospectus. Furthermore, the trustee is to notify the SC of any irregularity or breach of provisions of the CMSA (s. 300(2)).</p> <p>The constitution of a CIS is the deed and investor rights are set out in that deed. Where a UTMC proposes to make changes/modifications to the deed (including investor rights), it must reflect the changes made via a supplementary deed, and register the supplementary deed with the SC (s. 295(1)).</p> <p>In registering a supplementary deed, the law requires that the document submitted to the SC for registration be accompanied by -</p> <ul style="list-style-type: none"> <li>• A resolution of not less than 2/3 of all unit holders at a meeting duly convened; or</li> <li>• A statement from the trustee and UTMC certifying that in their opinion, the changes/modifications do not materially prejudice the interest of the unit holders, and do not operate to release the trustee or the UTMC from any responsibility to the unit holders.</li> </ul> <p>Where the UTMC and trustee do not view the change as materially prejudicing the interest of the unit holders (and thus do not require unit holders' approval), the SC retains the right (when registering the supplementary deed) to–</p> <ol style="list-style-type: none"> <li>a. Require the management company/trustee to inform or notify the unit holders of the changes made before the changes take effect; or</li> <li>b. Instruct the management company to obtain a resolution from unit holders if the SC is of the opinion that the modification may prejudice unit holders' interests (CMSA, s. 295).</li> </ol> <p>In deciding whether to impose (a) or (b) above, the SC considers each case based on the materiality of the changes proposed and the extent to which the changes could/would</p>

affect unit holders' interests. If the SC is of the view that changes are material or would impact on unit holders' interests, the SC can compel the UTMC to obtain unit holders' approval.

To ensure that prudent diversification of the assets held by the fund, investment restrictions are imposed under the relevant guidelines (e.g., ch. 8 and Schedule A of the UTF Guidelines). For example,

- A unit trust fund's investment in ordinary shares issued by any single issuer cannot exceed 10% of the fund's NAV,
- Investment in transferable securities and money market instruments issued by any single issuer cannot exceed 15%.
- Borrowing is allowed for the purpose of meeting repurchase requests for units and for short-term bridging requirements and the aggregate borrowings of a unit trust fund cannot exceed 10% of the fund's NAV at the time the borrowing is incurred.

The SC requires the UTMC to submit statistical and compliance reports for each CIS it manages. Among the information that must be submitted electronically are the total units in circulation (unlisted CIS only), total number of accounts (unlisted CIS only), NAV of the fund, sales and repurchase per month (unlisted CIS only), value invested in foreign investment, investment portfolio, and the value of investment in each asset class in each CIS.

The trustee is responsible, at all times, to ensure that the CIS is operated and managed by the UTMC, in accordance with the deed, the prospectus, the guidelines and securities laws, and acceptable and efficacious business practices within the CIS industry (UTF/ETF/REIT Guidelines, Clause 4.10).

The regulatory framework has various provisions to ensure separation and segregation of CIS assets from assets of the UTMC.

For CIS specifically –

- The trustee must take custody and control of all securities, properties, and assets of the CIS and hold those assets in trust for the unit holders of the CIS (CMSA, s. 300(1)). This duty is also incorporated in the CIS's deed; and
- The UTMC must ensure that the fund's property is clearly identified as the fund's property and held separately from the property of the UTMC and any other CIS managed by the UTMC (e.g. UTF Guidelines, clause 3.19(e))

For fund management companies in general, section 122(3) of the CMSA requires that clients' assets be deposited into a trust account maintained by a custodian/trustee not later than the next bank business day or any other day specified by the SC, following the day in which the fund management company receives the client's assets.

Fund management companies may not withdraw the clients' assets from the trust account except for the purpose of making payment directly to the entitled person or that authorized by the law.

A trustee of a CIS must meet the eligibility criteria in Chapter 4 of the UTF Guidelines/ETF Guidelines/REIT Guidelines. To be a trustee of a CIS, an entity must:

- Be a trust company registered under the Trust Companies Act 1949 or incorporated under the Public Trust Corporation Act, 1995;
- Be registered with the SC;
- Have a minimum issued and paid up capital of not less than RM500,000;
- Have adequate human resources with the necessary qualification, expertise and experience to carry on business as a trustee to CIS; and
- Have adequate and appropriate systems, procedures and processes, to carry out its duties and responsibilities in a proper and efficient manner.

	<p>Under the guidelines, the trust deed for the CIS must include a covenant requiring the trustee to ensure that the management company does not use its position improperly in managing the unit trust to gain, directly or indirectly, an advantage for itself or for any other person or to cause detriment to the interests of unit holders of such a CIS (e.g. UTF Guidelines, Sch. C, para. 5(c)). The guidelines require a trustee to actively monitor the operation and management of the CIS by the management company, and take any other necessary measures to safeguard the interest of unit holders (UTF Guidelines/ETF Guidelines/REIT Guidelines, cl. 4.09).</p> <p>To ensure independence of the trustee from the CIS, clause 4.21 of the UTF Guidelines/ETF Guidelines and clause 4.22 of the REIT Guidelines prohibits a trustee from holding any unit or other interest in the CIS.</p> <p>In practice, the SC requires the trustee of a CIS to be independent of the UTMC. Section 290(1) of the CMSA allows a related party to the UTMC to be appointed trustee of a fund with the consent of the SC. The SC has issued the Guidelines for the Appointment of Related Party Trustees which sets out rules intended to mitigate or minimise conflicts of interest and to protect unit holders' interest that must be complied with by a trustee in seeking the SC's approval. However, the SC has taken a very strict view on the value of independence between trustee of a CIS and the UTMC and has not approved any appointment of a related party trustee to date. The SC has rejected applications to appoint related party trustees and believes the use of a related party is not consistent with good corporate governance principles.</p> <p>A trustee must ensure that a fund's property is clearly identified, held separately from any other asset/property held by or entrusted to the trustee and registered in the name of, or to the order, of the CIS (UTF Guidelines/ETF Guidelines/REIT Guidelines, clause 4.08). If the trustee delegates the custodial function for the fund's property, the trustee should ensure that it retains control of the fund's property at all times and there are adequate arrangements to prevent the delegate from releasing the custody or control of the fund's property without its prior consent (UTF Guidelines/ETF Guidelines/REIT Guidelines, clause 5.12).</p> <p>In ensuring an orderly termination or winding up of a CIS, the regulatory framework provides several requirements that must be observed. The CMSA (section 301) provides:</p> <ul style="list-style-type: none"> <li>• The situations in which a trustee should wind up a scheme;</li> <li>• The notices required to be given to unit holders for a unit holders meeting;</li> <li>• The resolution required; and</li> <li>• The need for court confirmation of the resolution.</li> </ul> <p>So far, all CIS wind downs have been voluntary transactions done by way of proposals to unit holders. In the case of some CIS, the wind downs were because they had reached their maturity date i.e. a close-ended fund.</p>
Assessment	Fully implemented
Comments	
<b>Principle 26.</b>	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	The regulatory framework provides that every CIS offering its securities to the public must issue and register a prospectus with the SC containing sufficient information to allow investors to make a proper evaluation of the CIS prior to making an investment. As noted under Principle 16, certain offerings, issues and invitations of securities are exempt from the prospectus registration requirement. These are set out in Schedule 6 and Schedule 7 (excluded offers or excluded invitations or excluded issues,

respectively). These schedules include many of the exemptions available in other markets, such as offers to sophisticated investors, such as high net worth individuals, licensed financial institutions or certain holders of CMLs. See the discussion of the regime that applies to funds only offered in the wholesale (or exempt) market under Principle 28.

The content of the prospectus is set out in section 235(1) of the CMA. Additionally, section 235(1) (f) allows the SC to require additional information to be included in the prospectus. The SC has issued the Prospectus Guidelines for CIS which detail the information required to be disclosed in a CIS prospectus that is material to an evaluation of the CIS. Among others, the guidelines require disclosure on general and specific risks involved for investing in the CIS; investment objectives, strategies and policies; investment restrictions; rights of unit holders; fees and charges; valuation methodologies; transaction information; historical performance (applicable for unlisted funds); details of the UTMC and its experience and expertise; etc.

Chapter 12 of the CIS Prospectus Guidelines sets out the general standard of disclosure for a CIS. A prospectus must contain information reasonably required by an investor for purchasing and redeeming units, as well as information on how investors can keep abreast on their investments in the CIS.

The prospectus (save for the prospectus of a close-ended unlisted fund with a maturity date) is subject to a yearly renewal (CMA, s. 235(1)(C)). In addition, as for other issuers, there is an obligation on the issuer (i.e. the UTMC) to submit a supplementary or replacement prospectus to the SC for registration as soon as practicable when the issuer becomes aware that there has been a material change in the information set out in the prospectus or it contains a misstatement or omission (CMA, s. 238). If the supplementary prospectus has been submitted before the securities are issued, the issuer must give notice to any existing subscribers and they have a right to withdraw from their purchase obligation (CMA, s. 239).

In situations where the SC is of the view that the existing unit holders of the fund are affected by the material change, the SC may direct the UTMC to send a notice (if a notice has not already been sent) to the existing unit holders informing them of the change and providing sufficient time for the existing unit holders to assess the proposed change before the implementation of such change e.g. increase in the fees and charges in a particular fund; changes in fund strategy, etc.

The CIS Prospectus Guidelines state that in determining the information to be disclosed in a CIS's prospectus, the following should be considered:

- Nature of the CIS;
- Persons likely to consider acquiring units of the CIS;
- Certain matters may reasonably be expected to be within the knowledge of professional advisers whom investors may consult; and
- Whether the persons to whom the offer is to be made currently are unit holders in the CIS, and if they are, whether any relevant information has previously been given to them by the applicant.

To create an easy to understand format, the CIS Prospectus Guidelines requires a standard format and sets out with some particularity what has to be disclosed and in what order. See for example the key data/information summary section that must appear in each prospectus (Part 1, Chapter 6). This key data section is to provide a quick overview of the fund being offered; in-depth details are covered in the respective sections of the prospectus. The information required to be set out in this section include, the name of the fund; category and type of the fund; investment objective; brief investment strategy; performance benchmark; brief description of the principal risks of investing in the fund; brief description of the investor profile most suitable to invest in the fund; fees and charges and other relevant information. A tabular format is also prescribed on the disclosure of fees and charges that an investor may directly incur when

buying/redeeming units of the fund and indirectly incur when investing in the fund.

The regulatory system requires that the offering documents, or other publicly available information, include the following information:

- The date of issuance of the offering document.
- Information concerning the legal constitution of the CIS and the rights of investors in the CIS.
- Information on the management company and its delegates.
- The valuation bases for all types of assets, including treatment for suspended securities and for REITs, the valuation policy for real estate.
- Procedures for purchase, redemption, and pricing are required to be disclosed in the prospectus. Among others, the guidelines require disclosure of valuation points, pricing policy adopted (e.g. forward or historic pricing), numerical illustration for investors, and where units can be purchased or redeemed.
- The full audited financial statements, historical financial highlights of the unit trust fund and extracts of the audited financial statements of the unit trust fund for the last three years.
- Information on the trustee of the CIS (and its delegates if any). Among the information required are the trustee's roles, duties and responsibilities.
- Information on the investment objectives, strategies and policies, investment focus, practice, technique and approach used in managing the investment portfolio, and risk management strategies and technique. Additional disclosures are required when a CIS invests in derivatives, such as the purpose of investing in derivatives, the risks involved, specific risk management strategies etc.
- Disclosure of all risks to investors, from general risks of investing in unit trust funds to risks specific to the fund the subject of the prospectus. Where a unit trust fund invests in warrants, options or structured products, the inherent risk of investing in such products should also be disclosed. For investments in derivatives, investors are to be informed of the likelihood of high volatility on the net asset value (NAV) of the fund. The prospectus is also required to disclose how the fund manager mitigates the risks.
- Where a delegate is appointed by the UTMC, the corporate information of the delegate and its roles and responsibilities must be disclosed clearly in the prospectus.
- The fees and charges must be summarised in the Key Data Section or Information Summary of the prospectus. UTMCs are then required to disclose clearly the fees and charges payable directly or indirectly by the unit holders in the prospectus. The fees and charges required to be disclosed include –
  - Transaction charges (entry and exit charges);
  - Annual management fees;
  - Annual trustee fees; and
  - Any other fee payable or imposed.

For an existing unit trust fund, the prospectus is also required to disclose:

- the total annual expenses of the unit trust fund in the preceding year, disclosing separately portions accounted for management fees, trustee fees, and CIS expenses; and
- the Management Expense Ratio for the past three years, with a brief explanation of any significant change.

As for other issues, the SC may refuse to register a prospectus if:

- The prospectus does not comply with any requirement or provision of the CMSA;

- The issuance or offering does not comply with any requirement or provision of the CMSA;
- The SC is of the opinion that the prospectus contains a statement or information that is false or misleading, or contains a statement or information from which there is material omission;
- The issuance or offering has not been approved by the SC or does not otherwise comply with any term or condition of approval;
- There has been a failure to comply with any term or condition in relation to an approval of the management company or trustee; or
- The SC views that the issuer has contravened any provision of the securities laws which casts a doubt on whether the issuer is a fit and proper person to make the issuance/offer/invitation to subscribe for or purchase the securities.

Where a prospectus has been registered, and the SC is of the view that:

- The prospectus does not comply with or is not prepared in accordance with any requirement or provision under the CMSA;
- The prospectus contains a statement that is false or misleading;
- The prospectus contains a statement or information from which there is a material omission; and
- An issuer has contravened any provision of the securities laws or the Companies Act 1965;

the SC may issue an order in writing, directing the management company not to allot, issue, offer, make an invitation to subscribe for or purchase or sell, further units to which the prospectus relates (CMSA, s. 245(1)).

There is a regime in place to govern advertising outside the offering documents that prohibits improper advertising and the SC may take action for any breach of these requirements. For example, an advertisement may be issued after the prospectus has been registered where the advertisement contains specified statements, such as that the issue of units of the CIS will only be made on receipt of an application form that is attached to a prospectus. In addition, the CMSA prohibits false or misleading advertising and empowers the SC to issue an order to the person responsible to cease advertising or direct the person to take other actions as the SC may specify (s. 241(10)).

In order to ensure that the prospectus is kept up to date, the SC restricts a UTMC from issuing any unit based on a prospectus **one year** after the date of the prospectus (clause 1.09 of Part I of the CIS Prospectus Guidelines). In renewing the registration, a UTMC has to update the prospectus to take account of any material changes affecting the CIS, UTMC, etc.

The UTMC is required to send a copy of the annual report of the CIS to every unit holder within two months after the end of the financial year. (CMSA, s. 298(3)). In addition, the SC requires a UTMC of unlisted CIS to send a semi-annual interim report to unit holders within two months of the end of the interim period (UTF Guidelines, cl. 12.01 and REIT Guidelines, cl. 16.01).

The SC has issued guidelines on the contents required in the annual and semi-annual reports so that investors can make a proper evaluation of the value of their interests in the CIS. The guidelines require that the annual reports include details on the CIS, its performance, the manager's report, the trustee's report, the auditor's report, and the audited financial statements of the CIS. No auditor's report is required for interim reports and the financial statements would be unaudited. The guidelines state these reports should avoid unnecessary jargon and use terms which are easily understood by unit holders.

For Shariah-compliant CIS, in addition to the above, the Shariah adviser/panel of advisers for the Islamic CIS is required to prepare a report stating its opinion on whether

	<p>the CIS has been operated and managed in accordance with the specific principles set out for the CIS. If it has not been operated and managed according to the specific principles, then the steps taken to address the situation and/or to prevent the recurrence of the situation are required to be disclosed.</p> <p>In addition, the report by the Shariah adviser must also include –</p> <ul style="list-style-type: none"> <li>• Its opinion whether the CIS has been managed in accordance with applicable guidelines, rulings or decisions issued by the SC pertaining to Shariah matters; and</li> <li>• A statement to the effect that the investment portfolio of the CIS comprises securities which has been classified as Shariah compliant by the Shariah Advisory Council (SAC) of the SC. For securities not certified by the SAC, a statement stating that the status of the securities has been determined in accordance with the ruling issued by the Shariah adviser.</li> </ul> <p>All financial statements relating to a CIS must comply with approved accounting standards - IFRS (See the discussion under Principle 18, above.)</p> <p>CIS Prospectus Guidelines require disclosure on the investment objectives; strategies and policies; investment focus; practice, technique and approach used in managing the investment portfolio; and risk management strategies and technique. The SC may take action against the UTMC under Section 246 of the CMSA if the CIS is not managed in accordance to the information as disclosed in the prospectus of the CIS.</p> <p>In addition, the respective CIS Guidelines prescribe the investment restrictions and limits on the CIS's investments according to its category. For example, a money market fund's property must only consist of debentures, money market instruments and placement in deposits. A feeder fund's assets are restricted to units/shares of a single CIS (Schedule A of the UTF Guidelines). The SC may take action against the UTMC for breaching any of the requirements of the guidelines.</p>
Assessment	Fully implemented
Comments	
<b>Principle 27.</b>	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>The SC requires that the property of a CIS be fairly and accurately valued and the NAV of the scheme be correctly calculated. The guidelines require:</p> <ul style="list-style-type: none"> <li>• The UTMC to take all reasonable steps, and exercise due diligence to ensure that the CIS's assets are correctly valued. (clause 3.23 of the UTF Guidelines, clause 3.27 of the ETF Guidelines and clause 3.34/3.36 of the REIT Guidelines);</li> <li>• The trustee to ensure that all systems, process and procedures employed by the UTMC are adequate to ensure that the CIS's assets are valued correctly (clause 4.18 of the UTF Guidelines/ETF Guidelines/REIT Guidelines); and</li> <li>• That a fair and accurate valuation of the CIS assets and liabilities (and indicative optimum portfolio value for exchange-traded fund) must be conducted and should be based on a process that is consistently applied and leads to an objective and independently verifiable valuation (clause 10.31 of the UTF Guidelines, clause 11.01 of the ETF Guidelines and clause 10.01 of the REIT Guidelines).</li> </ul> <p>The SC also prescribes the valuation methodology in the relevant guidelines that must be strictly adhered to by the UTMC to ensure there is fair and consistent valuation for all CIS assets across all funds. The guidelines include requirements that:</p> <ul style="list-style-type: none"> <li>• Listed securities be valued at market price;</li> </ul>

- Unlisted ringgit bonds be valued based on prices quoted by an independent Bond Pricing Agency (BPA);
- Other unlisted bonds be valued at fair value by reference to the average indicative yield quoted by 3 independent and reputable institutions;
- Other CIS be valued based on the last published repurchase price; and
- Any other asset be valued based on fair value determined in good faith by the UTMC on methods and bases verified by the auditor and approved by the trustee.

For REITs, the bases and methods of valuation of real estate are prescribed under the Asset Valuation Guidelines issued by the SC.

*NAV calculation frequency.* To determine the NAV of an unlisted CIS, the SC requires a UTMC to conduct valuations at least once every business day (clause 10.32 of the UTF Guidelines). For listed REIT, the REIT Manager should announce the NAV per unit of the REIT to the Exchange on a quarterly basis [clause 10.24(a) of the REIT Guidelines]. A UTMC may carry out additional valuations during the business day, where it considers necessary (clause 10.34 of the UTF Guidelines and clause 11.02 of the ETF Guidelines and clause 10.18(b) of the REIT Guidelines).

For an unlisted CIS with limited repurchase arrangements, valuation of the CIS' assets must be conducted at least once a month and must be disclosed to investors clearly (clause 10.35 of the UTF Guidelines and clause 10.18(c) of the REIT Guidelines).

The CMSA also prescribes that all financial statements relating to a CIS must comply with approved accounting standards (s. 298(4)). As such, management companies and the auditors have a duty and responsibility to ensure that the NAV of the CIS is calculated and valued based on accepted accounting standards. As of the beginning of this year, IFRS must be followed.

The relevant guidelines provide that if market prices for listed securities are not available, then the assets should be valued at fair value. In determining the fair value, the UTMC must act in good faith and use methods and bases approved by the trustee after appropriate technical consultation. During the inspection process, the SC verifies that the trustee has given its approval where required and that the valuation methods are consistently applied.

The financial statements of the CIS are required to be audited by an independent auditor (clauses 12.10 and 12.11 of the UTF Guidelines, clauses 14.06 and 14.07 of the ETF Guidelines and clauses 16.10 and 16.11 of the REIT Guidelines). In auditing the financial statements, it is the duty of the independent auditor to check the valuations of the CIS assets. The auditor also confirms that the assets are held by the trustee.

A UTMC is required to include a mandatory covenant in the trust deed of unlisted CIS that states that it must not sell any unit of the CIS other than at a price calculated according to the deed, and that it should, at the request of the unit holder, redeem units held by unit holders at a price calculated according to the deed.

The CIS prospectus must contain information reasonably required by an investor for purchasing and redeeming units, as well as information on how investors can keep abreast on their investment in the CIS (CIS Prospectus Guidelines, Part 1, clause 12.01). Instructions and procedures on how to purchase and redeem units of the fund must be clearly disclosed. The instructions/procedures include information, such as minimum initial investment, minimum additional investment, minimum repurchase amount, switching, transfer of units, etc.

Since July 2007, the SC has adopted a single-pricing regime for unit trust funds, whereby units are redeemed and subscribed at the NAV per unit of the unlisted CIS.

The UTF Guidelines and REIT Guidelines provide that the NAV per unit used for redemption and subscription of units should be the NAV per unit as at the next valuation point after the application is received (forward pricing). However, for unit trust funds,

historic pricing is also allowed but not encouraged. Where historic pricing is used, clause 10.41 of the UTF Guidelines requires additional valuation to be conducted on the CIS assets at midday of business and where the NAV per unit differs by more than 5%, the UTMC is required to re-price the units. The very small number of funds using historical pricing are funds that were in existence prior to the advent of the relevant provisions and have been 'grandfathered'. In the view of the SC, their number and size is so small as to make the cost of forcing them to change to forward pricing far higher than the overall benefit that would result.

*Publication of NAV.* The SC requires unit prices to be published daily in at least one national language and one English newspaper (clause 10.51 of the UTF Guidelines and clause 12.36 of the REIT Guidelines). Currently, as an alternative to publication in the newspaper, the SC allows the UTMCs to publish the unit prices on FIMM's website.

For ETFs, Clause 13.48 of the ETF Guidelines requires a UTMC to provide the following information to the public based on the stipulated time as provided below via the ETF's own website:

- Indicative Optimum Portfolio Value per unit on a real time basis or on a frequency agreed with the SC;
- Portfolio deposit and NAV per unit on daily (end of day) basis;
- Number of units in circulation on a monthly basis;
- Annual rate of management fee;
- Annual rate of trustee fee; and
- Any other transaction charges.

A UTMC is also encouraged to provide this information through:

- A hyperlink from the ETF's own website to the website of the stock exchange;
- Information pages of information vendors which disseminate trading information of the fund's units in their ordinary course of business and are accessible by retail investors;
- Electronic medium for information dissemination as provided by the stock exchange from time to time; or
- Any other channel considered acceptable by the SC.

*Mispricing.* The UTF Guidelines/REIT Guidelines requires the UTMC to take remedial actions to rectify any incorrect valuation and/or pricing of the CIS units. The UTMC also has an obligation to notify the trustee and the SC (clause 10.42/closure 10.21) when incorrect valuation/pricing occurs. Where incorrect pricing/valuation occurs, rectification must extend to the reimbursement of money as required:

- By the UTMC to the unlisted CIS;
- From the unlisted CIS to the UTMC; and
- By the UTMC to the unit holders and /or former unit holders (clause 10.43/closure 10.22).

Reimbursement is not required if the trustee is satisfied that the incorrect pricing is of minimal significance.

Further, FIMM defines occasions when incorrect pricing is deemed to have occurred and sets out standard practices to follow in situations when incorrect pricing of CIS takes place and when reimbursement is required (see Investment Management Standard (IMS) IMS-7). The IMS sets out a significance threshold for reimbursement, the cumulative effect of unit pricing errors and the requirement to disclose the significant threshold adopted by the UTMCs in the prospectus and deed of the CIS.

The Malaysian regulatory framework provides for general or specific circumstances for suspension or deferral of regular redemption.

	<p>For unlisted CIS, a trustee may suspend dealings in units (sales/redemption) where–</p> <ul style="list-style-type: none"> <li>• The trustee considers that it is not in the best interest of unit holders to permit the fund's property/CIS assets to be sold or that the CIS's assets cannot be liquidated at an appropriate price or on adequate terms to meet redemption requests. The trustee is required to immediately call for a unit holders' meeting to decide on the next course of action; or</li> <li>• Due to exceptional circumstances where there is good and sufficient reason to do so, considering the interest of the unit holders. The suspension must cease as soon as practicable after the exceptional circumstances have ceased, and must not in any event exceed 21 days. (Clauses 10.24 to 10.26 of the UTF Guidelines and clauses 12.21 to 12.23 of the REIT Guidelines).</li> </ul> <p>During the period when dealing in units is suspended, the trustee should not create and/or cancel units and should immediately notify the SC in writing stating the reasons for the suspension. (Clauses 10.27 to 10.28 of UTF Guidelines and clauses 12.24 to 12.25 of the REIT Guidelines).</p> <p>Before resuming dealing in units after any suspension, the UTMC is required to notify the SC in writing of the proposed resumption with the date of the proposed resumption.</p> <p>In circumstances where trading in a particular company's shares is suspended and therefore market price is unavailable, the relevant guidelines provide that if the suspension exceeds 14 days, or a shorter period as agreed by the trustee, then the company shares should be valued at fair value. Routine valuation of unlisted CIS' assets must still be conducted daily and unit price must still be made available to investors for sale and redemption purposes, unless the trustee suspends dealing in units for reasons stipulated above.</p> <p>A breach of any of the provisions in these guidelines may attract sanctions under section 354 of the CMSA. The SC has taken against a UTMC for mispricing of units. As provided under Section 354 of the CMSA, the SC reprimanded the UTMC and its compliance officer and the UTMC was directed to rectify the breach.</p> <p>Where the interest of unit holders is likely to be jeopardised, the SC has general powers to direct the trustee to carry on the business in a specified manner. [Section 125(2) of the CMSA]. This section of the law allows the SC to take action, to demand, delay or stop the suspension or deferral of dealings.</p>
Assessment	Fully implemented
Comments	
<b>Principle 28.</b>	Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.
Description	<p>The regulatory framework for CIS in Malaysia is separated into two categories i.e. those offered to the public generally (retail funds) and those only offered to qualified investors. The discussion under Principles 24- 27 above describes the framework for retail funds. "Hedge fund" is not a defined term in the jurisdiction.</p> <p>A hedge fund can be set up under the Malaysian wholesale framework to offer securities only to qualified investors. Qualified investors include:</p> <ul style="list-style-type: none"> <li>• A financial institution, such as a bank, insurance company or Islamic bank;</li> <li>• A pension fund approved by the Director General of Inland Revenue under section 150 of the Income Tax Act 1967;</li> <li>• A holder of a CMSL carrying on the business of dealing in securities;</li> <li>• An individual whose total net personal assets exceed RM3 million or its equivalent in a foreign currency;</li> </ul>

	<ul style="list-style-type: none"> <li>• A corporation with total net assets exceeding RM10 million or its equivalent in a foreign currency, based on its last audited accounts;</li> <li>• A unit trust scheme or prescribed investment scheme; and</li> <li>• A company registered as a trust company under the Trust Companies Act 1949 which has discretion in the investment of trust assets of a trust with total net assets exceeding RM10 million or its equivalent in foreign currencies (Guidelines on Wholesale Funds, s. 2.01).</li> </ul> <p>Those who wish to operate wholesale funds must hold a CMSL in fund management (as in, licensed to provide discretionary portfolio management). While they are not required to be approved as UTMCs or be members of FIMM, the requirements that apply to them as fund management companies (FMCs) do not differ from FMCs dealing with retail customers or CIS offered to the public, (See the discussion of these requirements set out in Principles 24 and 29-31.) The FMC must have knowledge and exercise reasonable judgment when managing and/or valuing the investments to be held by the wholesale funds, which may consist of securities and/or other assets that are not securities. Chapter 7.02(18) of the Licensing Handbook requires fund managers who wish to invest in these other assets<sup>21</sup> to obtain SC's prior approval for such investments.</p> <p>All fund managers, whether they operate wholesale funds or provide fund management to retail CIS, are required to have minimum paid-up capital and shareholders' funds (net assets) of RM2 million each. Other requirements that apply to all FMCs are detailed in Chapter 4 of the Licensing Handbook. (See also the discussion in Principles 29 and 30.)</p> <p>In addition to the licensing requirement discussed above, the Guidelines on Wholesale Funds set out the requirements to be complied with by any person intending to establish a wholesale fund.</p> <ul style="list-style-type: none"> <li>• The operator of a wholesale fund (the fund manager) must manage the wholesale fund in a proper, diligent and efficient manner, in accordance with the securities laws, the Guidelines on Compliance Function for Fund Management Companies (FMCs), any other relevant guidelines issued by the SC and the information memorandum of the wholesale fund.</li> <li>• The issue of the securities of the fund must be approved by the SC before any proposed issue, offer or invitation in respect of a wholesale fund is made to qualified investors. The SC reviews the information memorandum on the wholesale fund as part of that approval process.</li> </ul> <p>Submissions made to the SC applying for the establishment of all wholesale funds, including hedge funds, must include an information memorandum that complies with the minimum content/disclosure requirements as set out under the Appendix 2 of the Guidelines on Wholesale Funds. This includes information on the objective of the fund, investment style and strategy, investment restrictions, types of financial instruments, risks, key personnel of the managers, income distribution policy, frequency of redemption and creation of units, income distribution policy etc.</p> <p>All FMCs are required to comply with the Guidelines on Compliance Function for Fund Management Companies. See the discussion of these Guidelines under Principles 24, 29 and 31. Under these Guidelines, the Board of the FMC must ensure that the company establishes, maintains and implements an effective internal control framework. Also, the FMC must establish a risk management framework that is reviewed yearly and commensurate with the company's business (clause 5.05–5.08). This framework must include:</p>
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<sup>21</sup> These are assets other than conventional and Shariah-compliant securities, derivatives, money market instruments and deposits in conventional and Shariah-compliant deposit accounts.

- Continuous identification, assessment and monitoring of risks;
- Managing and monitoring risks assumed by the company on behalf of its clients (which includes CIS); and
- Mitigation actions to address such risks.

For example, chapter 10 of the Guidelines stipulates requirements that must be met to safeguard client assets, including requirements that each FMC must appoint a custodian, such as a bank or trust company, to hold client assets in a trust account.

The regulatory system sets standards for managers/advisers of wholesale funds to manage conflicts of interest, and provide disclosure to the regulator and investors (including potential investors) about such conflicts and how they manage them. The Licensing Handbook provides that fund managers operating wholesale funds must ensure there are policies and processes on conflict management and the monitoring of unethical conduct and market abuse (Chapter 4.02(3)). See also the discussions of management of conflicts of interest under Principles 8, 29 & 31.

As noted in Principle 10, the SC has the power to obtain books and records, and request data or information from regulated entities without judicial action, even in the absence of suspected misconduct, in response to a particular inquiry (ad-hoc) and on a routine basis (on-site or off-site examination). Further, the SC has wide power to request and obtain data or information, including the power to require any person to disclose any information it deems expedient for the due administration of the securities laws (SCA, s. 152).

The Guidelines on Wholesale Funds set out requirements for reporting to holders of the funds. These include:

- Providing each investor with a monthly statement of accounts.
- Submitting monthly statistical returns as set out in the Wholesale Fund Returns to the SC.
- Publishing (whether in printed copy or otherwise) and sending to every investor and to the SC quarterly reports and annual audited reports of the wholesale fund, within two months of the end of the fiscal period.

The quarterly and annual reports must provide investors with a regular snapshot of the key risk factors faced by the wholesale fund and the wholesale fund's investment outlook for that reporting period. They must include the wholesale fund's financial performance, credit risk (including the periodic assessment of the risk implication of borrowings), the level of borrowing (extension of credit and other forms of lending), market outlook, changes in key investment team (including any delegates), illiquid holdings, details on portfolio exposure and information on fund performance and volatility.

All fund managers, including those operating wholesale funds such as hedge funds, must ensure that they meet the ongoing prudential requirements provided in Chapter 4 of the Licensing Handbook, such as organizational competence (e.g. risk management policies and processes), adequacy of financial resources and representative's competencies.

The SC will assess whether they comply with these requirements via the yearly submission on the licence anniversary date of the fund manager and via the SC's on-site inspection program.

As CMSL holders, FMCs are subject to inspections by the SC and other off-site monitoring (SCA, s. 126). (See the discussion of the SC's inspection program for FMCs and enforcement activities set out under Principle 12.) If they are in breach of any requirement, the SC has the full range of sanctions available as described in Principle 12.

As described under the discussion in Principles 13-15, the SC has wide power to collect and exchange information on the activities of FMCs, hedge funds and other wholesale funds with domestic and foreign regulators. See also the discussion under Principle 6 regarding the ability of the SC to obtain information and direct any person to take

	measures to address systemic risk in the capital market (CMSA, s. 346B and 346C).
Assessment	Fully implemented
Comments	
<b>Principles for Market Intermediaries</b>	
<b>Principle 29.</b>	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>Market intermediaries and their representatives must be licensed in order to carry on regulated activities under the CMSA.</p> <p>No person is permitted to carry on a business in any regulated activity or hold itself out as carrying on such a business or act as a representative of a market intermediary, unless it holds a CMSL or is a Registered Person (see below) to carry out the regulated activities (CMSA, s. 58 &amp; 59). Under the licensing system, companies are issued a CMSL while individuals are issued a Capital Markets Services Representative's Licence (CMSRL). Generally only a company may be issued a CMSL. However, a CMSL to carry on financial planning may be issued to an individual who is fit and proper and meets the other requirements set out in Chapter 5 of the Licensing Handbook,</p> <p>There are seven (7) categories of regulated activities set out in Schedule 2 of the CMSA. These activities are:</p> <ul style="list-style-type: none"> <li>• Dealing in securities;</li> <li>• Dealing in derivatives;</li> <li>• Fund management;</li> <li>• Advising on corporate finance;</li> <li>• Investment advice;</li> <li>• Financial planning; and</li> <li>• Dealing in private retirement schemes.</li> </ul> <p>Certain institutions licensed and supervised by BNM under the banking and insurance laws are categorized as Registered Persons under the CMSA and are permitted to carry on specified regulated activities (as set out in Schedule 4 of the CMSA) without separate registration with the SC. These institutions include Islamic banks, commercial banks and insurance companies. Registered Persons are required to comply with a number of the obligations imposed on CMSL holders, including the duties related to disclosure of certain interests in securities, making recommendations, giving priority to clients' order and dealing as principal (CMSA, s. 91 - 93 and 97). In addition, the SC and BNM jointly issued Guidelines on Investor Protection which contain details on competency and entry requirements of employees of Registered Persons in order to ensure parity between CMSL holders and employees of Registered Persons who carry out regulated activities.</p> <p>Unit trusts may be marketed to the public by entities that have been licensed or approved by the SC for that activity or by Registered Persons, such as banks. Unit trusts may be marketed:</p> <ul style="list-style-type: none"> <li>• By the UTMC (operator of the fund) directly (See the discussion of the requirements for approval as a UTMC set out in Principle 24);</li> <li>• Through: <ul style="list-style-type: none"> <li>○ Corporate Unit Trust Advisers (CUTAs), licensed as CMSL holders by the SC to provide financial planning services and deal in unit trust products following a financial plan; and</li> <li>○ Institutional Unit Trust Advisers (IUTAs), which are: <ul style="list-style-type: none"> <li>▪ Registered Persons licensed as banks, insurance companies</li> </ul> </li> </ul> </li> </ul>

	<p style="text-align: center;">etc. by BNM</p> <ul style="list-style-type: none"> <li>▪ Other categories of CMSL holders, such as stockbrokers, licensed by the SC.</li> </ul> <p>All CUTAs and IUTAs must be registered with FIMM. FIMM requires an applicant for registration as an IUTA or CUTA submit a report on a 'readiness audit' performed by an external auditor following a checklist prescribed by FIMM as part of the approval process. The focus of this audit is on whether the entity has business processes in place to support the sales of unit trusts.</p> <p>Chapter 4 of the SC's Licensing Handbook details the licensing criteria for both companies and individuals in all categories. Before a licence is granted to the CMSL applicant to carry out any regulated activity, the Licensing Handbook requires all CMSL applicants to -</p> <ul style="list-style-type: none"> <li>• Have in place an organisational structure with a clear line of responsibility and authority as well as adequate internal control systems, necessary IT systems and infrastructure and risk management policies and processes;</li> <li>• Have policies and processes: <ul style="list-style-type: none"> <li>○ On conflict management and the monitoring of unethical conduct and market abuse;</li> <li>○ To ensure compliance with applicable laws and regulations; and</li> <li>○ To monitor and supervise the activities of their representatives.</li> </ul> </li> <li>• Obtain the SC's prior approval for the appointment of a chief executive officer and other key management personnel such as the head of regulated activity, head of compliance and the compliance officer.</li> <li>• Have at least one (1) director with a minimum of ten (10) years relevant experience.</li> <li>• If a stockbroking, futures broking or fund management company, have a compliance officer to ensure the company adheres to securities laws, regulations and guidelines as well as other applicable laws governing the regulated activities.</li> </ul> <p>In addition, if an intermediary carries out more than one regulated activity, it needs to demonstrate that it has control procedures in place to monitor any conflict of interest, unethical conduct and market abuse across the activities. It also needs to have the requisite systems and procedures to monitor all relevant activities within the organization (Licensing Handbook, chapter 4.02(4)).</p> <p>These requirements are assessed as part of the application review. The assessment includes a detailed review of:</p> <ul style="list-style-type: none"> <li>• Capabilities and capacities for the performance of the licence holder's functions and duties (which requires a demonstration of appropriate knowledge, business conduct, resources, skills and ethical attitude). The SC vets the internal control manuals submitted by corporate applicants to ensure that they have sufficient controls in place in key areas such as disclosure of interest (s. 91), procedure for making recommendations to clients (s. 92) and record keeping (s. 108). It</li> </ul>
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	<p>also reviews the corporate applicant's business plan and assesses it vis-à-vis the company's resources and skills;</p> <ul style="list-style-type: none"> <li>• Appropriate level of financial resources, including evidence of the company's authorized and paid-up capital, details of the capital structure and to whom the shares are allotted. The bankruptcy records are also reviewed; and</li> <li>• Qualification, experience and fitness and properness of controllers<sup>22</sup>, directors and key management.</li> </ul> <p>During the assessment period, the SC engages closely with key management, directors and CMSRL applicants.</p> <p>For CMSL applicants that intend to be registered as Participating Organizations (dealing in securities) (POs) or Trading Participants (dealing in derivatives) (TPs) with Bursa Malaysia, Bursa Malaysia carries out a parallel detailed on-site and off-site assessment of the applicant's readiness to commence business. The SC takes Bursa Malaysia's readiness report into consideration in the assessment of the new licence application and will not approve a license for such firm until Bursa Malaysia is satisfied with the applicant's systems and controls.</p> <p>For a new UTMC, an independent operational audit is required to be submitted to the SC within six months after the launch of the unit trust fund. Approved CUTAs must ensure that their business operations commence within 6 months from the date of registration with FIMM and they must be prepared to furnish FIMM with the CUTA's operational and internal audit and due diligence reports within a reasonable time. As part of the licence application, the SC requires submission of, <i>inter alia</i>, the applicant's management and organizational structure as well as its operational and compliance manuals that must include details of risk management policies and internal audit procedures (Licensing Handbook, Appendix 3). These are subject to detailed reviews and the CMSL applicant must demonstrate that it has proper internal controls, risk management and supervisory systems in place before it commences business.</p> <p>All market intermediaries are required to meet and maintain the prescribed minimum capital requirements at all times. Minimum capital requirements for each regulated activity are stipulated in the Licensing Handbook (Table 2 of chapter 4.04). These vary based on the nature of the activities undertaken by the holder of the CMSL.</p> <p>(See the detailed discussion of what is required as set out under Principles 30 &amp; 31.)</p> <p>The SC's processes to review licence applications are detailed out in the Licensing Department's Standard Operating Procedures. The Licensing Department's processes for licence applications are subject to International Organization for Standardization (ISO) certification, which are also subject to internal audits and external yearly audits by the national standards and quality development agency.</p> <p><i>Individuals.</i> Generally, the individuals at market intermediaries who carry on the regulated activities must also be approved by the SC as CMSRL holders. The licensing requirements are set out in the Licensing Handbook. The SC conducts fit and proper assessments on individuals such as CMSRL applicants and the key personnel and controllers of CMSL applicants. These assessments (including reviews of past conduct) are done via the SC Adverse Record System (SCAR), which captures all actions taken by the SC and market institutions. The SC also conducts external vetting with foreign</p>
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<sup>22</sup> "controller is defined in the CMSA, a person who—

(a) is entitled to exercise, or control the exercise of, not less than 15% of the votes attached to the voting shares in the CMSL holder;

(b) has the power to appoint or cause to be appointed a majority of the directors of the CMSL holder;

or

(c) has the power to make or cause to be made, decisions in respect of the business or administration of such CMSL holder, and to give effect to such decisions or cause them to give effect to. (s. 60(7))

regulators (if the company or person has prior history in foreign jurisdictions) and local regulators, such as the police, insolvency authorities and BNM.

Any individuals who market and distribute units of unit trust funds are required to be registered with FIMM. These individuals, known as Unit Trust Consultants (UTCs) are subject to the requirements set out in various guidelines issued by FIMM and the SC governing registration, marketing and distribution of unit trust funds. These requirements cover the usual fit and proper considerations for individuals, including passing the requisite qualifying exams. FIMM documents are available on FIMM's website.

Bursa Malaysia's rules set out minimum requirements that must be met for individuals associated with a broking firm who are required to be registered with Bursa Malaysia. These registered individuals include the Chief Executive Officer, directors, Head of Operations, Head of Dealing and Head of Compliance, Compliance Officer, Dealer's Representatives, and others. These requirements include fit and proper, appropriate experience and approval from the SC to assume these roles.

*Right to reject.* If the required criteria and requirements are not met, the SC has the right to reject a licensing application. The reasons for refusal include if the SC is not satisfied with the financial standing of the applicant or the SC has reason to believe that the applicant or any of its officers or controllers may not be able to act in the best interest of its clients (CMSA, s. 64 and 65). The Bursa Malaysia and FIMM have similar rights to reject applicants that do not meet the required criteria.

The process ensures that the applicant understands the reason for any refusal to grant a licence. In all cases, the applicant has the right to appeal the decision. Also, the refusal may be subject to judicial review and the court may quash the decision if the principles of natural justice and procedural fairness have not been followed. There has been no appeal by any applicant whose application for a licence was refused that resulted in judicial review.

*On-going requirements.* The general licensing conditions in the Licensing Handbook require licensed persons to meet regulatory and other requirements on an ongoing basis. These requirements include requiring licensed intermediaries to seek the SC's prior approval for change in control. Approval is given if the SC is satisfied with the rationale for such change. If there is a failure to meet this requirement or if the other licensing requirements are not met on an on-going basis, the SC may vary, withdraw, suspend or impose condition(s) on the licence (CMSA, s. 62, 69, and 72). An opportunity to be heard must be provided before revocation or suspension of the licence (CMSA, s. 72).

The controller, directors, the chief executive officer, key management and CMSRL holders must be fit and proper and are subject to assessment before a license is granted and on any material change. Action may be taken against these persons on grounds of breaching the fit and proper requirement. The SC may remove them from their position and prevent them from engaging in the regulated activities.

Bursa Malaysia may terminate a broker's membership for any breach of the Bursa's rules and requirements. FIMM may revoke the membership or registration if the person is no longer fit and proper (such as a UTC convicted of any offence under securities laws) or for a breach of FIMM's by-laws. (See the discussion under Principle 9.)

*Reporting.* Market intermediaries are required to provide extensive periodic submissions to the SC, including:

- A yearly report submitted by all licensed intermediaries and representatives on their licence anniversary date;
- Reports on capital position; and
- An auditor's report submitted by all licensed intermediaries within three (3) months after the close of their financial year (CMSA, s. 127).

Market intermediaries are required to report any material changes, including any change in information submitted to the SC pursuant to an application for licence. The Licensing

	<p>Handbook specifies the type of material changes that just require notification or that require prior approval of the SC. For example, notice is required for establishment of a new business other than one involving capital market-based activities. Prior approval is required for more significant changes such as establishing a new capital-markets business or a change in controller.</p> <p>Licensees are required to give immediate written notice to the SC of any event that would involve a ground for possible revocation of the person's licence. Where a notice indicates a breach of the licensing requirements, the SC will exercise its powers to vary, suspend, revoke or impose conditions on the licence. Similar requirements and authority apply to Bursa Malaysia.</p> <p><i>Public availability of information.</i> Information on the status and category of all CMSL holders is made available on the SC's website, including the scope of regulated activities for licensed persons, identity of senior management and names of other licensed individuals. The SC updates the information monthly to reflect any changes including the name, directors and secretary of the corporation, principal place of business and branch office(s). More recent information is available by calling the SC.</p> <p>Bursa Malaysia's website contains a list of all intermediaries (including addresses and contact details) that are brokers on the securities or futures exchange, members of Bursa Malaysia Bonds and all market makers.</p> <p>FIMM has set up an online verification function on its website which allows the public to ascertain whether the person whom they are dealing with is registered with FIMM as a UTC and the scope of their permitted activities.</p> <p><i>Investment advisers</i></p> <p>In Malaysia, entities licensed to carry on only investment advisory activities do not deal in securities on behalf of clients, hold or have custody of client assets or manage portfolios. If they carry on other activities, such as acting as a unit trust fund manager, they must meet the requirements set out in the CMSA for those activities. They must meet the general requirements set out above (and discussed further under Principles 30 and 31) with respect to organizational structure, fit and proper personnel, capital, etc. that apply to all CMSL holders.</p> <p>All CMSL holders must maintain accounting records and other books that sufficiently explain the transactions and financial position of the intermediary's business and that enable them to be conveniently and properly audited. The intermediary is required to maintain such records for a period of not less than seven (7) years.</p>
Assessment	Fully implemented.
Comments	
<b>Principle 30.</b>	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	<p><b>Capital requirements</b></p> <p>There are specific initial and on-going minimum capital requirements for all categories of licensees involved in each regulated activity as listed below. The minimum financial requirement varies and depends on the nature and amount of business expected and actually undertaken by the applicant/licensee. The level of risk assumed and whether the intermediary handles clients' assets are also taken into consideration.</p>

Nature of Firm	Capital – initial and on-going
Stockbroking company	<ul style="list-style-type: none"> <li>• Minimum paid-up capital of RM20 million</li> <li>• Maintain at all times:               <ul style="list-style-type: none"> <li>• Minimum shareholders' funds of RM20 million; and</li> <li>• Minimum Capital Adequacy Ratio (CAR) of 1.2.</li> </ul> </li> </ul>
Universal Broker	<ul style="list-style-type: none"> <li>• Minimum paid-up capital of RM100 million;</li> <li>• Maintain at all times:               <ul style="list-style-type: none"> <li>• Minimum shareholders' funds of RM100 million ; and</li> <li>• Minimum CAR of 1.2.</li> </ul> </li> </ul>
Futures Broking Company	<ul style="list-style-type: none"> <li>• Minimum paid-up capital of RM5 million; and</li> <li>• Maintain at all time minimum Adjusted Net Capital (ANC) of the higher of –               <ul style="list-style-type: none"> <li>• RM500,000; or</li> <li>• 10% of aggregate margins required.</li> </ul> </li> </ul>
Fund Management Company (FMC) - discretionary portfolio management	<ul style="list-style-type: none"> <li>• Minimum paid-up capital of RM2 million; and</li> <li>• Minimum shareholders' funds of RM2 million to be maintained at all times.</li> </ul>
Corporate Finance Adviser and Investment Adviser	<ul style="list-style-type: none"> <li>• Minimum paid-up capital of RM500,000; and</li> <li>• Minimum net tangible assets of RM50,000 at all times.</li> </ul>
Financial Planner	<ul style="list-style-type: none"> <li>• Minimum paid-up capital of RM50,000; and</li> <li>• Minimum net tangible assets of RM50,000 at all times.</li> </ul>
Financial planner (CUTA) - dealing in unit trust products following a financial plan)	<ul style="list-style-type: none"> <li>• Minimum paid-up capital of RM100,000; and</li> <li>• Minimum shareholders' funds of RM100,000 to be maintained at all times.</li> </ul>
Fund Supermarket Dealing in unit trust products as a principal business (for own products and/or third-party products)	<ul style="list-style-type: none"> <li>• Minimum paid-up capital of RM5 million; and</li> <li>• Minimum shareholders' funds of RM5 million to be maintained at all times.</li> </ul>
Unit Trust Management Company (UTMC) - CIS operator/ management company approved under CMSA, s. 289 to manufacture unit trust products	<ul style="list-style-type: none"> <li>• Minimum shareholders' funds of RM10 million to be maintained at all times.</li> </ul>
Note: If an intermediary carries on more than one regulated activity, the highest of the minimum financial requirements applies.	
Source: Licensing Handbook, Chapter 4.04 and Guidelines on Unit Trust Funds, Chapter 3	
<p>Investment Banks (IBs) are dually licensed and co-regulated by the SC and BNM and are subject to Investment Bank Capital Adequacy Framework (IBCAF). IBCAF is based on a Risk Weighted Capital Ratio Framework (in accordance with the Basel II requirements) imposed by BNM and the minimum requirements are:</p> <ul style="list-style-type: none"> <li>• Minimum capital funds unimpaired by losses of RM500 million or minimum capital funds unimpaired by losses of RM 2 billion on a banking group basis; and</li> <li>• Minimum Risk-Weighted Capital Ratio (RWCR) of 8%</li> </ul> <p>In essence, the IBCAF covers market, credit and operational risks. It also requires specific risk charge on counterparty and large exposure risks. In addition, BNM's</p>	

Liquidity Framework applicable to IBs covers the liquidity risk of an IB. As the lead prudential regulator, BNM conducts the monitoring of the IBCAF. The capital adequacy information is also shared with the SC for its notation purpose.

For FMCs and distributors of unit trusts, such as UTMCs, CUTAs and fund supermarkets, the capital requirements are currently set at specified amounts of shareholders' funds (total assets less total liabilities) which reflect scope of their operations and the types of risk they are exposed to in undertaking their activities. For all of these intermediaries, client assets are held at custodians and so the exposure of clients to a failure of the intermediary would be minimal. (See also the discussion in Principle 32 regarding compensation fund coverage.)

Close monitoring of compliance with capital requirements forms part of the risk profiling review of these companies. At present, the reviews conducted by the SC of capital positions and operations show that the capital requirement is adequate to meet the operational demands.

Only FMCs are permitted to engage in trading for their own account (proprietary trading) and so potentially create risk to other market participants in the event of failure. However, as at the end of 2011, only a third of the FMCs had proprietary positions, most of these in low risk investments (61% in money market securities and 23% in cash). The balance was invested in equities and collective investments schemes (i.e. unit trust funds and wholesale funds). All such investments are required to be marked to market and included as current assets on the firm's balance sheet. The SC conducts extensive monitoring of these proprietary positions to mitigate the risks that these activities might create. (See the discussion under Monitoring, below.) In addition, the SC requires that proprietary investments and client assets to be managed by different licensed persons in order to facilitate supervision and reduce the opportunities for conflicts of interest.

The stockbroking companies are subject to Capital Adequacy Requirements (CAR) as prescribed under rule 1105 of the Bursa Securities Rules. It is a risk-based capital adequacy requirement designed to ensure stockbroking companies have adequate capital to support the level of risk to which they are exposed. CAR is measured by dividing liquid capital with total risk requirement.

Essentially, the total risk requirement is the sum of the requirements for operational risk, counterparty risk (credit risk), position risk (proprietary positions), underwriting risk and large exposure risk. Position, large exposure and underwriting risks cover market risk exposures. In calculating the detailed risk requirement, stockbroking companies are required to mark their exposures to market and apply the prescribed haircut and risk charge. For example, the haircuts on securities listed on the Bursa Malaysia vary from 15 to 21%. Securities listed on recognized foreign exchanges are subject to haircuts of 12-16%. Other securities are subject to a 100% discount (Bursa Malaysia Securities Rules, Sch. 8C). Currently, calculation of these risk requirements is based on prescribed fixed models as, in the view of the SC, these models provide a fair representation of Malaysian capital market.

Only certain sources of capital are allowed to be included in the computation of liquid capital, which is the numerator for the calculation of CAR. Off-balance sheet exposures are considered contingent liabilities and need to be deducted from the calculation of liquid capital. Crystallised off-balance sheet exposures would attract capital charge in the form of position risk or large exposure risk requirements. Core capital includes equities, approved subordinated debt and preference shares, providing these are non-cumulative and non-redeemable.

In addition, the stockbroking companies are also required by Rule 1107.1 of the Bursa Securities Rules to maintain the Net Surplus Requirement at all times. (See the discussion below of liquidity requirements.)

For futures broking companies, the adjusted net capital (ANC) requirement is applicable to standalone futures broking companies (those that are not also stockbroking

companies). It follows a net capital approach to allow for the maintenance of sufficient liquid funds to protect clients and creditors.

The ANC requirement is calculated based on permitted assets less total liabilities and additional deductions. In deriving at the permitted assets, illiquid assets such as unsecured advances, prepaid expenses, inter-company loans and intangible assets have to be excluded. In addition, all futures and options contracts must be marked to their current market value to reflect the most current risk exposure (Rule 602 of the Bursa Derivatives Rules and Rule 208A(c), Rule 210 and Schedule 2 of the Bursa Derivatives Clearing Rules).

In addition, futures broking companies with proprietary positions in futures or options on futures must deduct from their net capital 100% of the margin requirements for such positions.

Under rule 208A(c) of the Bursa Derivatives Clearing Rules, the Clearing House may establish higher minimum financial requirements for one or more Clearing Participants (CPs) on the basis of volume, open positions carried, nature of business conducted and/or such other criteria as the Clearing House considers relevant

*Liquidity Standards.* Stockbroking companies and IBs are required to comply with liquidity standards set by Bursa Malaysia Securities and BNM, respectively. The stockbroking companies are subject to the Liquidity Risk Management Framework (LRM Framework). They are required to manage their liquidity risk by categorizing their liquid assets into different maturity buckets, from realizable within 3 days, up to 30 days. The firm must maintain at all times a cumulative net liquid asset surplus of at least the minimum prescribed levels from the Bursa's Securities Rules, which vary from 3% to 9% depending on the maturity of the assets (Net Surplus Requirements, rule 1107.1). As part of the LRM Framework, Bursa Malaysia Securities has also issued the Best Practice Guidelines on key principles in managing liquidity risks. Non-IB stockbroking companies presently are encouraged to adopt these guidelines, which will come into force on 31 March 2014. The IBs' liquidity risk requirements are dictated by the Liquidity Framework and supervised by BNM.

For futures broking companies, the ANC requirement also serves as an estimation of the liquidity of the entity. The ANC requirement is calculated based on permitted assets less total liabilities and additional deductions. In deriving at the permitted assets, illiquid assets such as unsecured advances, prepaid expenses, inter-company loans and intangible assets are excluded.

*Sensitivity to risks.* The capital adequacy requirements are sensitive to market movements to the extent that exposures are marked to market and the risk requirement or risk weighted assets will increase in accordance with increase in risk exposure. In addition, the haircut and risk charge are linked to the risk and volatility of the exposure. CAR and IBCAF also take into consideration large exposure risks and there is a specific risk charge on these exposures.

The ANC requirement for trading in exchange traded derivatives is sensitive to the quantum of risks undertaken as it requires all open positions to be marked to market. In addition, as derivatives trading is margin based, the Clearing House will calculate the contract margin requirement on a continuous basis to ensure the margin imposed commensurate with market volatility. The futures broking companies are required under rule 614.1 Bursa Derivatives Rules to ensure all their open positions are fully covered by the required margins.

*Capital buffers & shortfalls.* The existing capital requirements are put in place to ensure intermediaries have enough capital to sustain operating losses while still managing to carry out the regulated activity uninterrupted. They allow the intermediary to absorb some losses and to wind down its business over a relatively short period without loss to its clients or disrupting the orderly functioning of the markets.

A licensed intermediary must immediately give notice to the SC and cease carrying out

regulated activities if it does not comply with the minimum financial requirements, unless a written consent is obtained from the SC. This allows the SC to take very swift action to suspend the intermediary's licensed business if appropriate (such as if its failure may affect the orderly function of the market or create systemic concerns for other market intermediaries or the market).

In addition, under normal circumstances, where a market intermediary surrenders its licence to the SC, the SC must be satisfied that adequate arrangements are in place to meet all its outstanding liabilities and obligations before accepting the surrendering of the licence. The surrendering of licence must not avoid or affect any agreement, transaction or arrangement relating to the regulated activities entered into; or affect any right, obligation or liability arising under such agreement, transaction or arrangement (CMSA, s. 81)

For stockbroking companies, the CAR operates on the basis that the liquid capital of the company should be at least 1.2 times of the risk assumed. The 20% buffer allows the intermediary to absorb some losses and to wind down its business.

In addition, an intermediary must ensure that its liquid capital is at all times greater than its total risk requirement and its core capital is at all times greater than its operational risk requirement [rule 1105.3(1) of the Bursa Securities Rules]. The liquid capital requirement provides readily realisable financial resources to an intermediary to meet its total risk requirements in a relatively short period of time. The liquid assets refer to securities or other current assets which have a ready market, or which are capable of realisation within 30 days.

The LRM Framework also enables better monitoring of the liquidity positions of the stockbroking companies to ensure they have sufficient liquidity to fulfil obligations that fall due.

In the derivatives market, a futures broking company will be suspended from trading if its ANC falls below RM500,000 or it fails to pay the margin call on the next business day.

The SC may also take two other actions against a futures broking company that failed to meet ANC requirement or margin:

- liquidate all open positions; and
- transfer clients' open positions of derivative contracts to other futures broking company.

The weekly projection of ANC serves as an early warning system that enables the ANC to be monitored before futures broking companies' ANC falls below the minimum requirement.

### **Books, Records and Reporting**

The CMSA requires a licensed intermediary to maintain accounting records and other books in a manner that will sufficiently explain the transactions and financial position of its business and enable true and fair profit and loss accounts as well as balance sheets to be prepared from time to time. In addition, the SCA in sections 151 and 152 allows the SC to require the disclosure of any information including the capital level.

Stockbroking companies are required to calculate and monitor their CAR on a daily basis (Bursa Securities Rules, rule 1105.3(3)(a)). In addition, that rule requires stockbroking companies to submit the information and records that are relevant to CAR calculation to the Bursa.

The Bursa Securities Rules requires reports to be submitted to Bursa Malaysia Securities and the reporting interval is based on the level of capital adequacy of the broker. The reports are due the business day after the period end. More stringent capital monitoring and reporting requirements are imposed on an intermediary if its capital deteriorates as follows:

Level of CAR	Frequency of Reporting to Bursa Malaysia Securities
CAR < 2.0 times	Daily reporting
CAR ≥ 2.0 times but < 4.0 times	Reporting every two weeks
CAR ≥ 4.0 times	Monthly reporting

A stockbroking company is required to calculate and monitor its CAR on a daily basis and this process is carried out via a centralised system i.e. Automated Risk Management and Decision Making System (ARMADA) operated by Bursa Malaysia Securities. The SC has direct access to the ARMADA system and this allows the SC's daily monitoring of large exposures risk of the brokers.

If there is a significant change in the CAR resulting in a change in the reporting frequency, the stockbroking company is required to report that fact immediately to Bursa Malaysia Securities. Where an intermediary's liquid capital is equal to or less than its total risk requirement, or where its core capital is equal to or less than its operational risk requirement, it must immediately notify Bursa Malaysia Securities and take the necessary steps to increase its liquid capital or reduce its risk exposure. Bursa Malaysia Securities may at any time require ad-hoc or more frequent submissions by the intermediaries in respect of CAR as it may determine in consultation with the SC (Bursa Securities Rules, rule 1105.3).

LRM is reported to the Bursa on a weekly basis with sufficient details covering different liquidity buckets to give sufficient disclosure of risk of deterioration so that the regulators have sufficient time to intervene.

For futures broking companies, similar computation and submission requirements on ANC are found in rule 602 of the Bursa Derivatives Rules.

IBs are required to submit the RWCR returns on a monthly basis. The Liquidity Framework for IBs are also reported monthly. They are also required to calculate the ratios as and when required.

IBs, stockbroking and futures broking companies are required to maintain the relevant data/records for the computation of CAR, RWCR returns and ANC. As such, the capital levels can be readily determined at any time.

Investment management intermediaries (UTMCs, fund supermarkets and FMCs) must send the SC financial data and information on their positions every month. They are also required to file their financial statements and capital position with the SC on a semi-annual basis, via filings of a prescribed form that stipulates provision of very detailed information about the business and the positions held (Form A). Their capital levels are disclosed in those forms. The firms must also file a compliance report (which stipulates the companies' regulatory compliance status) every end June and December. This information will provide prompt disclosure of any significant deterioration in the capital position of the companies. (See also Monitoring, below.)

**Audit requirement.** The financial position of each CMSL holder is subject to audit by independent auditors to provide assurance that the financial position set out in the financial statement provides a true and fair view. Section 126(3) of the CMSA requires the intermediary to appoint an independent auditor to audit its accounts. Section 128(1) of the CMSA states the duties of statutory auditors include reporting on any breach of the securities laws, irregularities, inability to meet the minimum financial requirement, offences and any matter in contravention of the rules of a stock exchange, a futures

<p>exchange, an approved clearing house or a central depository.</p> <p>Bursa Malaysia's on-site examination scope also includes verification of the accuracy of the capital adequacy returns. This provides additional assurance that the financial position reflects the risks that intermediary undertakes. In addition, the SC can also require the same auditor to carry out additional work that the SC may deem necessary to ensure any concerns are addressed.</p> <p>Further, as a CMSL holder is a Public Interest Entity (PIE), its auditors must be registered with the AOB. AOB oversees the auditors of PIEs, protecting investors' interest and promoting confidence in the quality and reliability of audited financial statements of PIEs. (See the discussion in Principle 19.)</p> <p>Finally, the SC has the authority to appoint an independent auditor where necessary to protect investors (CMSA, s. 130 and 131).</p> <p><i>Monitoring.</i> As noted above, the capital levels of stock broking or futures broking companies are monitored on a continuous basis by the SC, Bursa Malaysia Securities and Bursa Malaysia Derivatives (Bursa Malaysia). This is done via regular reports submitted by the market intermediaries via the ARMADA system.</p> <p>The SC regularly monitors the financial position of investment management intermediaries (UTMCs, fund supermarkets and FMCs), paying close attention to shareholder's funds and, in the case of FMCs, proprietary investments. As noted above, these intermediaries report monthly and semi-annually to the SC. For proprietary investments of the FMCs, the SC monitors the following risk indicators, intervening when indicators breach the thresholds specified:</p> <ul style="list-style-type: none"> <li>• Proprietary investments to total assets under management – 20% or more</li> <li>• Proprietary investments to shareholders' funds<sup>23</sup> – 30% or more</li> <li>• Proprietary investment allocation and changes in cash and money market placement – changes in cash or money market allocations of more than 20% of total cash and bank balances.</li> <li>• Resources committed to proprietary investment vs. managing client assets</li> <li>• Revenue contribution of proprietary investment/client asset management activities – 20% or more of total revenue from proprietary investment activities.</li> </ul> <p>In addition, the SC monitors the asset profile of FMC proprietary portfolios for riskier, speculative and alternative investments.</p> <p>Triggering one of these thresholds or otherwise having a risk profile that raises concerns would attract one or more of: more frequent monitoring; engagement with the SC; a direction to the FMC to reduce its proprietary holdings generally or its risk exposure to higher risk investments; or return its fund management licence for a more relevant one.</p> <p>In addition, the SC also reviews the capital levels of all market intermediaries during their yearly submission on their licence anniversary date, where intermediaries are required to provide an overview of their financial position, which includes providing its paid-up capital, shareholders' funds, CAR and ANC.</p> <p>The SC has an Intermediaries At Risk Intervention Framework that provides guidance on the appropriate interventions/actions that may be taken by the SC in the event of deficiencies of an intermediary. The intervention framework prescribes various intervention stages and the possible steps that can be taken by the SC. The framework provides the parameters of the various stages of intervention.</p> <p>Where the review indicates material deficiencies, the SC can take a series of steps,</p>
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<sup>23</sup> The SC also monitors proprietary position less cash and money market placements against shareholders fund to measure the amount of shareholders' funds at risk from proprietary investments in less liquid .assets

ranging from suspending the licensed activities or ordering the transfer of clients' assets to other intermediaries.

If an intermediary does not meet the minimum financial requirement, the CMSA prohibits it from carrying out any regulated activity unless a written consent is obtained from the SC. This allows the SC adequate time to assess the situation and initiate restrictions or preventive actions, if necessary, in order to accomplish the objective of maintaining a fair and orderly market (s. 67).

The SC has specific authority to impose conditions or restrictions on CMSL holders (CMSA, s. 62). The authority is further strengthened by the authority to revoke or suspend a licence ((s. 72).

In addition, the CMSA empowers the SC to direct CMSL holders and others:

- Not to deal with monies and properties of its clients or members;
- To transfer monies and properties of its clients or members to other person specified by the SC; and
- To transfer records or documents in relation to monies or properties to other person specified by the SC (s. 125).

The SC may also apply to the courts for certain orders in the interest of investor protection. This includes a court order for: vesting of securities, requiring the licensed intermediaries to undertake or refrain from certain actions and the appointment of a receiver.

Under the Bursa Securities Rules and Bursa Derivatives Rules, Bursa Malaysia has the disciplinary powers to impose restrictions, fines, suspensions or conditions on any of the intermediaries' activity to reduce their risk exposure.

The SC has exercised these powers. For example,

- In 1998, the SC revoked the stockbroking licence of Omega Securities Sdn Bhd and suspended the stockbroking licences of MBf Northern Securities Sdn Bhd and Labuan Securities Sdn Bhd. During the 1997 Asian financial crisis, trading restrictions were imposed on 13 stockbroking companies.
- In 2005 and 2007, two (2) companies (FA Securities Sdn Bhd and Jupiter Securities Sdn Bhd) which were previously placed under trading restrictions rectified their financial positions and their trading restrictions were lifted.

*Other risks.* The capital adequacy requirements take into consideration off-balance sheet and contingent liabilities, as well as risk exposure from outside the regulated activities.

In addition, the Licensing Handbook requires a CMSL holder to obtain the SC's prior approval when establishing a new business or acquiring shares or interests in or outside Malaysia in relation to capital market-based activities (chapter 4.02). Where the intermediary establishes a new business or acquires shares or interests in non-capital market-based activities, it would need to notify the SC. These requirements allow the SC to take the necessary measures to manage or mitigate any potential risk that could arise from the new business or ventures.

Rule 602.2(1) of the Bursa Securities Rules requires all POs keep proper records of all off-balance sheet transactions entered into by the firm. Reports on off-balance sheet transactions must be provided to Bursa Malaysia on a monthly basis (Bursa Securities Rules, rule 602.4).

Exposure to unregulated firms via inter-company loans would attract a full deduction from the calculation of liquid capital, the numerator of CAR. Similarly, off-balance sheet transactions are excluded from the calculation of liquid capital (Bursa Securities Rules, rule 1105.4).

In addition, stockbroking companies are required to develop adequate policies to manage credit limits and authorities in extending credit facilities to related corporations. Adequate risk management in respect of lending to related corporations must be also

	<p>carried out.</p> <p>The Guidelines on Credit Transactions and Exposures with Connected Parties issued by BNM also set out the broad parameters and conditions relating to conduct of credit transactions with related parties to ensure an appropriate level of prudence is practised by the licensed institutions, including the IBs.</p> <p>For futures broking companies, the computation of ANC is derived from permitted assets less additional deductions less total liabilities. Inter-company loans to unregulated affiliates are excluded from the calculation of permitted assets. In addition, futures broking companies must have in place adequate policies to manage credit limits and authorities in extending credit facilities to related corporations. Adequate risk management in respect of lending to related corporations must also be carried out.</p>
Assessment	Fully implemented
Comments	<p>The largest market intermediaries and those that might pose a risk to clients or to other market participants in the event of a failure are subject to fairly sophisticated capital requirements that vary with the specific types of business undertaken and the nature of the positions held. The capital requirements and formula that apply to other types of market intermediaries are much simpler, reflecting the nature of their businesses and the risk they pose to clients. In all cases, the capital requirements and other protections in the system (such as holding client assets with custodians, compensation fund coverage and margin requirements at the derivatives exchange) should allow for the orderly wind-down of a firm without losses to clients or disrupting the orderly functioning of the markets.</p> <p>The capital requirements that apply to FMCs raised some question of full implementation of this Principle, as these firms are permitted to engage in proprietary trading and thus their investment activities may expose them to significant market or other risks. The Assessment Methodology for this Principle (in Key Questions 2 and 3) expects that these intermediaries would be subject to capital requirements that are more sensitive to the nature and size of the risks posed by these proprietary positions. However, no downgrade was imposed because the present investment programs undertaken by the FMCs (as discussed above) pose few risks of substance and the amount of shareholder funds (net capital) that they are required to hold is quite high for discretionary portfolio managers when compared to many other jurisdictions. Further, the SC keeps a very close watch on the regular reports filed by the FMCs and so would have prompt notice of any change to their risk profiles. If the proprietary positions raise concerns, the SC intervenes promptly on a case by case basis. In the longer term, consideration might be given to re-examining the capital requirements for these intermediaries and moving to a risk-based formula that is more sensitive to risks of the specific positions held. This would add clarity for all market participants on the regulatory approach to proprietary positions, reduce the need for case-by-case intervention and provide equivalent treatment for such activities to that undertaken by other categories of intermediaries, such as stockbrokers or investment banks. The need for this change may become more pressing if the types of investments under taken or the scale of their proprietary trading change significantly.</p>
<b>Principle 31.</b>	Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.
Description	<p>Before a licence is granted to the CMSL applicant to carry out any regulated activity, the Licensing Handbook requires the applicant to -</p> <ul style="list-style-type: none"> <li>• Have in place an organisational structure with a clear line of responsibility and</li> </ul>

authority as well as adequate internal control systems.

- Have policies and procedures to monitor and supervise the activities of its representatives.
- Obtain the SC's prior approval for the appointment of a chief executive officer and other key management personnel such as the head of regulated activity, head of compliance and the compliance officer.
- Have at least one (1) director with a minimum of ten (10) years relevant experience.
- If a stockbroking, futures broking or fund management company, have a compliance officer to ensure the company adheres to securities laws, regulations and guidelines as well as other applicable laws governing the regulated activities.

In addition, if an intermediary carries out more than one regulated activity, it needs to demonstrate that it has control procedures in place to monitor any conflict of interest, unethical conduct and market abuse across the activities. It also needs to have the requisite systems and procedures to monitor all relevant activities within the organization (Licensing Handbook, chapter 4.02(4)).

There are outsourcing guidelines that place clear responsibility and accountability on the Board of Directors and senior management of licensed market intermediaries for any outsourced function carried out by a service provider or a sub-contractor. In addition, market intermediaries must perform an assessment on the service provider on a periodic basis as part of its monitoring mechanism required under the guidelines. This assessment report is to include an assessment of the adequacy of resources and ability to efficiently conduct the outsourced function. Apart from this, market intermediaries also have rights to conduct examinations, inspections and have access to books, records and documents relating to the outsourced functions (Outsourcing Guidelines, para. 6.09(e)).

*Supervision and control.* Paragraph 3.0 of the Guidelines on Market Conduct and Business Practices for Stockbrokers and Licensed Representatives (Guidelines on Market Conduct) sets out 11 core principles of supervision to be complied with by stockbroking intermediaries. They include supervision and control, conflict of interest and establishment of a compliance culture. In addition, paragraph 10 of the same guidelines requires stockbroking companies to put in place appropriate supervisory and internal controls, procedures and systems.

Stockbroking companies are required to have an appropriate management and organisation structure [rule 506.5 of the Bursa Securities Rules]. This should include segregation between its activities of dealing in securities, middle and back office operations and avoid any situation that may create a conflict of interest, whether potential or actual. The Rule also prescribes the best business practices to be adhered to by the stockbroking companies, which include the requirement to maintain a proper supervisory programme and a system of internal controls on the operations, financial soundness, proper conduct of business and risk management. Rule 509.6 of the Bursa Securities Rules also prescribes that written policies and procedures on internal control of a stockbroking company should be established and maintained at all times. In addition, the Audit Committee of a stockbroking company is tasked to oversee the company's internal control structure and its financial reporting process.

Rule 601.2E of the Bursa Derivatives Rules requires a futures broking company to put in place structures, policies, procedures and internal controls to -

- Facilitate the supervision of its business activities and the conduct of its employees and agents;
- Identify, monitor and manage conflicts of interest and risks that may arise in the conduct of its business;
- Achieve compliance with securities rules, directives, laws and the firm's written

	<p>policies, procedures and internal controls; and</p> <ul style="list-style-type: none"> <li>• Provide for investor protection.</li> </ul> <p>Rule 610.1 of the Bursa Derivatives Rules also requires each futures broking company to establish and maintain a proper system to supervise the activities of its representatives, agents and other personnel to achieve compliance with the laws and rules.</p> <p>Similar requirements are imposed on the board of directors of FMCs by the Guidelines on Compliance Function for Fund Management Companies and UTMCs under the Guidelines on Unit Trust Funds.</p> <p>Generally, the regime holds the board of directors of a CMSL holder ultimately responsible to ensure the market intermediary complies with all securities laws, regulations and relevant guidelines, including appropriate standards of conduct and adherence to proper procedures as set out by the company.</p> <p><i>Information to management.</i> As per the SC's Guidelines on Market Conduct (paragraph 3.0(a)), the core principle on supervision and control requires market intermediaries to ensure timely and adequate information is provided to senior management. These requirements are supplemented by specific requirements in other guidelines and rules. For example, the Bursa Securities Rules (in Rule 509.5(5)) impose a duty on a stockbroking company to maintain records and provide to the management its financial and business information in a prompt and appropriate manner which will enable its management to –</p> <ul style="list-style-type: none"> <li>• Identify, quantify, control and manage its risk exposures;</li> <li>• Make timely and informed decisions;</li> <li>• Monitor the performance of all aspects of its business on an up-to-date basis;</li> <li>• Monitor the quality of its assets; and</li> <li>• Safeguard its assets and assets belonging to other persons for which it is responsible.</li> </ul> <p>The IT Security Codes established by the Bursa Malaysia requires each PO and TP to adopt a policy setting out the high level IT security requirements for the firm's IT security standards - the minimum controls that must exist within each company, with the objective of ensuring confidentiality, integrity and availability of its IT systems, facilities and compliance with the company's regulatory and statutory requirements.</p> <p><i>Periodic evaluation of internal controls.</i> The regulatory framework requires a market intermediary to be subject to an objective, periodic evaluation of its internal controls and risk management processes. However, the manner in which the evaluation is conducted may vary depending on the type of regulated activity carried out by the market intermediary.</p> <p>Stockbroking companies must carry out a periodic evaluation of their internal controls and risk management processes. The Bursa Securities Rules prescribe that market intermediaries must ensure internal audit functions are carried out in accordance with the Rules (Rule 510.1). The required internal audit functions include the evaluation on the adequacy and efficiency of intermediaries' management operations and internal controls. These companies must conduct a minimum of one internal audit annually. The internal auditor must report to the Audit Committee, which is a board committee. Hence, similar to compliance function, the internal auditor is able to exercise independence in its work. In addition, both functions have direct access to the board or board members.</p> <p>The Bursa Derivatives Rules require futures broking companies to conduct an annual internal audit to assist in detecting and preventing violations of and achieving compliance with the Bursa Derivatives Rules and the CMSA.</p> <p>An FMC is required to conduct at least a yearly review on the effectiveness of its internal control framework and report to the shareholders on any findings from the review as provided under paragraphs 4.02(d)(ii) and (iii) of the Guidelines on Compliance Function</p>
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for Fund Management Companies. Paragraph 5.08 of the same guidelines further stipulates that a FMC must also conduct at least a yearly review of its risk management framework.

Paragraph 3.15 of the Guidelines on Unit Trust Funds states that a UTMC should maintain an internal audit function to report on the adequacy, effectiveness and efficiency of the management, operations, risk management and internal controls.

The internal auditor of the market intermediary may carry out these evaluations. The SC is of the view that the requirements that are imposed on the internal audit and compliance functions (including the requirement to report to the board of directors and monthly compliance reporting to the SC), coupled with the oversight provided by the regular examinations performed by the SC and Bursa Malaysia provide adequate assurance that these internal control examinations are performed with an acceptable level of independence. Further, the external auditors have a positive obligation to report immediately to the SC if they find any breach of securities laws in the course of their audits. Finally, if in the course of an examination, the SC finds that the internal control or compliance functions are inadequate or operate with inadequate independence, the market intermediary concerned will be subject to an independent audit by an external auditor.

*Compliance function.* Under the Licensing Handbook, anyone licensed as a stockbroking company, futures broking company or FMC is required to have a compliance officer. This person must carry out the compliance function pertaining to the securities laws, regulations and guidelines and any other applicable law governing the regulated activities. To avoid conflicts of interest, the compliance officer must not deal in securities, deal in derivatives or manage funds. The compliance officer has to be registered with the SC. As a pre-condition for registration, the compliance officer also needs to pass the necessary examinations.

During the course of the supervisory examinations, the SC reviews the market intermediaries' compliance functions and highlights any deficiencies in supervisory letters sent to the market intermediaries.

The Guidelines for Compliance Officers require stockbroking companies to have a Compliance Department and the size of the department depends on the size and complexity of the business activities and operations of the company. A similar guideline applies to futures broking companies. In addition, Bursa Securities Rules and Bursa Derivatives Rules require each branch office of the broking intermediaries to have at least one (1) compliance officer.

The compliance function of the stockbroking and futures broking companies is also subject to the on-going assessment by the SC and Bursa Malaysia. These companies are also required to submit monthly compliance reports to Bursa Malaysia and an analysis of these reports is delivered to the SC.

FMCs must maintain adequate resources, including compliance resources that are commensurate with their business and maintain policies and procedures to ensure a sound compliance framework.

UTMCs must appoint a compliance officer to ensure compliance with the deed, prospectus disclosures, guidelines and securities laws. They also must have adequate human resources with the necessary qualifications, expertise and experience to carry on business as a management company.

*Systems to ensure integrity.* The regulatory framework requires a market intermediary to establish and maintain appropriate systems to ensure the integrity of the firm's dealing practices through general conduct of business requirements that are prescribed under Division 3 (Conduct of Business) of the CMSA and through various guidelines. For example, Principle 1 of the Guidelines on Market Conduct on integrity requires a licensed person to act in a fair and consistent manner and to treat all clients fairly, equitably and equally. Similar standards of conduct are prescribed for FMCs and UTMCs in their

respective guidelines.

The regulatory framework requires a market intermediary to establish appropriate framework for segregation of key duties and functions performed by the same individual. For example, Principle 3 of the Guidelines on Market Conduct requires stockbroking companies to have clear segregation in their key duties and functions. The Bursa Securities Rules require firms to ensure there is a clear segregation of duties and reporting lines between employees dealing in securities and those involved in operational or administrative activities. Chinese walls are required for every firm that carries on more than one regulated function; it must maintain proper segregation of those functions within its organisation to prevent the flow of "information" between the different parts of the organisation to prevent any conflict of interest that may arise. Similar requirements apply for derivatives firms. FMCs are required to have written policies and procedures in place to provide clear line of reporting, authorization and proper segregation of functions. If the FMC conducts proprietary trading, the relevant guidelines require the establishment of information barriers or firewalls; and close supervision of internal communication to prevent flow of information (Guidelines on Compliance Function for Fund Management Companies).

*Conflicts of interest.* The Licensing Handbook requires that an intermediary that carries out more than one (1) regulated activity, needs to demonstrate that it has control procedures in place to monitor any conflict of interest, unethical conduct and market abuse; besides the need to ensure there are requisite systems and procedures to monitor all relevant activities within the organisation (chapter 4.02(4)). Further, the CMSA contains several sections that address conflicts of interest, etc. For example, section 91 of the CMSA requires CMSL holders who carry on investment advisory activities to disclose their interest in securities to clients, via a concise statement of the nature of any relevant interest in, or any interest in the acquisition or disposal of, those securities or securities included in that class that the licensed person or a person associated with him has at the date on which the licensed person last sends the circular or other communication. Section 94 of the CMSA requires that the personal trading of an analyst must be carried out through their principal to enable to appropriate approval and conflict checks prior to trading.

In addition to the above, all market intermediaries are required to manage conflicts of interest to ensure compliance with Core Principle 6 ("Priority to the client's interest") and Core Principle 8 ("Conflict of interest") of the Guidelines on Market Conduct.

Under the Guidelines on Compliance Function for Fund Management Companies, FMCs must address conflicts of interest through written policies on clear line of reporting, authorisation and proper segregation of functions. Similar 'client first' requirements apply to UTMCs under the Guidelines on Unit Trusts.

*Direct Market Access (DMA).* The Bursa Securities Rules require firms to have appropriate automated risk filters to check or screen a DMA order before it is executed in the trading system to ensure that the order does not exceed the position or limits set by the firm. These limits must include trade exposure, order size and price limits. Similar provisions apply in the Bursa Derivatives Rules for the derivatives market under Rule 617.3.

*Protection of client assets.* There are regulations for proper protection of clients' assets imposed on market intermediaries that have control or responsibility over such assets. Generally, these requirements are set out in the CMSA (s. 111 to 124) and include requirements for segregation of clients' assets and holding client cash in trust accounts and assets in a custodian account.

The Bursa Securities Rules emphasise that in the course of doing business with clients, stockbroking companies need to ensure that clients' assets are adequately safeguarded and the accounts of these assets comply with the law and requirements imposed by the Exchange. They also stipulate the details on how clients' trust accounts should be maintained, including the requirement that all clients' monies or assets needs to be

deposited into the designated trust or custodian accounts by the next banking day after receipt.

The CMSA and rule 608 of the Bursa Derivatives Rules stipulate the details on how futures clients' segregated accounts should be maintained and that assets and cash must be segregated as required by the next banking day.

For FMCs, the CMSA and the Guidelines on Compliance Function for Fund Management Companies stipulate that assets of the FMC and its clients must be properly identified and maintained in a separate trust account. The FMC must ensure that client's assets are properly safeguarded from conversion or inappropriate use by its employees and the FMC must appoint a custodian to maintain a trust account for clients' assets to ensure that clients' assets are properly safeguarded. The custodian must be a licensed or supervised entity listed in s. 121 of the CMSA (bank, stock broker, trust company, etc.). It does not have to be at arm's length to the FMC, but must be functionally separate (separate board of directors, separate resources, etc.).

To ascertain the accuracy and authenticity of the FMC's records, it is required to provide semi-annual filings. The SC will reconcile this information against filings by custodians. Discrepancies noted will be followed-up by way of engagement or examination of the fund management company by the SC.

For UTMCs, the CMSA requires a trustee that is independent of the UTMC to take custody and control of all securities, property and assets of a unit trust fund and hold it in trust for the unit holders in accordance with the deed of the fund. The trustee has a fiduciary duty and capacity to ensure the rights and interests of unit holders are safeguarded and protected at all times. (See the discussion under Principle 25.)

*Investor complaints.* The regulatory framework requires the intermediaries to provide for an efficient mechanism to address investor complaints. Both the SC and Bursa Malaysia also have dedicated departments to handle investor complaints.

The Bursa Securities Rules require every firm to establish and implement written procedures for handling complaints and designate an officer at the assistant manager level or above to handle such matters. These procedures and practices must be reviewed by the compliance officer and this performance report must be delivered to the board of directors of the firm. Similar provisions apply to futures brokers under the Bursa Derivatives Rules. Futures brokers are also required to forward a report to the exchange if more than 10 complaints are received in a particular month. The Guidelines on Compliance Function for Fund Management Companies provides that an FMC and UTMC must establish, maintain and implement written policies and procedures to ensure that complaints from their clients are handled in a timely and appropriate manner and that the complaints are satisfactorily resolved.

*Know your client.* Market intermediaries are required to know their clients, both under AML and capital markets legislation.

The AMLATFA requires market intermediaries to identify and verify the client's identity, using reliable documents such as identity card, passport, birth certificate, driver's licence and constituent document, or any other official or private document (s. 16(2)).

The Guidelines On Market Conduct specify that a stockbroking company and its representatives must take all reasonable steps to establish client's identity, to know its client and where there is suspicion or doubt on a client's identity, the stockbroking company and its representative must undertake additional due diligence to identify the ultimate beneficial owner.

Market intermediaries must ensure that the "one beneficial owner for one securities account" (CDS account) condition is fully complied with before opening a client's account (SICDA, s. 25(4) and 25A(1)). In addition, firms are required to take all reasonable steps to ensure that they obtain all essential particulars and information about their trading clients (including but not limited to the clients' financial standing or credit worthiness and clients' investment objectives), including information as to whether the client is trading for

himself as a beneficial owner or on behalf of another person. Firms must satisfy themselves that such information is accurate before opening any trading account..

The CMSA prohibits a licensed person from making a recommendation with respect to any securities or futures contracts to a person without having a reasonable basis for that recommendation. To determine that the recommendation is appropriate, a licensed person must take all practicable measures to ascertain that the information possessed and relied upon concerning the investment objectives, financial situation and particular needs of the person is accurate and complete. The specific guidelines and rules governing a particular type of intermediary reinforce these requirements. For example, the Bursa Securities Rules on "Doing Business with Clients" require firms to have sufficient knowledge about their clients and require the implementation of appropriate guidelines by intermediaries to assist them in learning essential facts about their clients' backgrounds, including the clients' investment objectives.

*Books and records.* The regulatory framework requires market intermediaries to keep records for not less than seven years. Books and records must be maintained in a manner that can sufficiently explain the transactions and financial position of its business (CMSA, s. 108). The Bursa Malaysia rules also impose an obligation on their members to keep detailed and complete books and records of their business and transactions undertaken (see for example Bursa Malaysia Securities Rules, rule 1102). In addition, the AMLATFA requires market intermediaries to maintain any record for a period of not less than six (6) years from the date an account has been closed or the transaction has been completed or terminated (s. 17).

*Contracts with clients.* The regulatory framework requires the intermediaries to provide to the client a written contract of engagement or account agreement or a written form of the general and specific conditions of doing business. For example, under the Bursa Securities Rules, stockbroking companies must ensure that their clients are fully aware of the terms and conditions upon opening a trading account. Firms must establish proper written procedures on opening of trading accounts for their clients and agreements need to be executed (rule 404.4(1)). Agreements are also needed between a market intermediary and its clients for any margin account (rule 703.9).

FMCs must ensure that they enter into a written investment management agreement (IMA) with each client before providing any fund management services or transacting on behalf of a client. The IMA must include:

- Client's risk profiles, investment objectives, limitations, restrictions or instructions;
- Clear authorization from the client for discretionary mandates;
- Scope of services to be provided by the fund management company; and
- Fees and charges.

*Information for investment decisions.* The regulatory framework requires market intermediaries to disclose or make available information to their clients so that the client can make an informed investment decision. Section 92A of the CMSA requires an intermediary to explain the key characteristics of the product, obligations assumed by the parties dealing in the product, risks associated with the product and the essential terms of the product to its client. These general requirements are supplemented by detailed provisions set out in guidelines issued by the SC and in Bursa Malaysia rules. Further, the rules on prospectus disclosure provide extensive information for decision making on the purchase of a new issue of securities or a unit trust.

*Statements of account.* The regulatory framework requires market intermediaries to provide clients with statements of account either monthly or semi-annually, depending on the type of firm. Monthly statements, which explain the movement of the clients' assets are required to be issued by the stockbroking or futures broking firms to their clients. These statements must include clients' assets (monies, other assets or collateral), as well as charges imposed on the clients (commissions etc.). Monthly statements of

account must be sent to each client of an FMC.

S. 90(1) of the CMSA requires a CMSL holder to issue contract notes to its clients. The information required in the contract notes include fees and commissions associated with the client's transactions. The Capital Markets Services Regulation (CMSR) stipulates the types of information to be included in the contract note. The information required includes the commission charged, stamp duty payable, levies, other fees and taxes payable.

*Acting with due care in the best interests of clients.* The CMSA requires market intermediaries to act with due care and diligence in the best interests of their clients. For example, under s. 356(1), a licensed person has committed a breach if the licensed person performs or omits to perform any act that is likely to jeopardise the interest of the clients. See also the discussion above regarding the requirements imposed under the CMSA and Bursa Malaysia rules on conflicts of interest, segregation of client assets, etc.

*Regulatory supervision program.* (See also the discussion under Principles 9, 10 and 12 of the supervision programs to ensure compliance by market intermediaries.)

The SC's supervision of market intermediaries is risk-based. The SC undertakes a risk profiling exercise in formulating its supervisory plan for the year. The SC's Risk Profiling Framework considers risk from both qualitative and quantitative perspectives. From the quantitative aspect, the SC places emphasis on the risk-based capital adequacy requirements as well as other prudential and capital limits that are imposed on market intermediaries.

Typically, intermediaries categorised under high risk are subject to yearly audit, while intermediaries categorised under medium high and medium low risk would be subject to an audit once every two (2) and three (3) years, respectively. Low risk intermediaries are subject to four (4) year audit cycle. In addition, regardless of the intermediary's risk category, if it is identified as a SIFI, the intermediary is subject to a two year audit cycle.

The SC's primary focus is on the company's controls and procedures and the effectiveness of such controls. Where controls are found to be weak and ineffective, or non-existent, the entity is considered high-risk, and will be subject to more frequent and in-depth examinations.

To complement the on-site examinations, the SC also conducts off-site monitoring on all stockbroking and futures broking companies to enable early detection of areas of concern. Off-site supervision is also responsible for monitoring and providing analysis as part of the preliminary desk review to the examiners before initiating an on-site examination.

In addition to the above, the SC also conducts diagnostic engagements to assess the compliance status of fund management and unit trust management companies. These engagements mainly focus on intermediaries that pose medium high to medium low risk.

Intermediaries also are required to make filings to the SC and Bursa Malaysia periodically. The filings include financial statements, self-assessment questionnaires, compliance reports and others that support the effectiveness of the SC's supervision framework. As part of its internal processes, the SC maintains comprehensive data from the above filings to determine the risk profiling on the intermediaries.

Routine inspections of stockbroking and futures broking companies are conducted by Bursa Malaysia. Bursa Malaysia also adopts a risk-based approach in carrying out inspection of its participants. A risk profile is maintained of the intermediaries and there are four (4) risk groups, namely high risk, medium high risk, medium low risk and low risk. Intermediaries that fall into the high risk category are inspected every year. Intermediaries in the other three (3) categories are inspected at least once every three (3) years. The assessment criteria are based on the regulatory focus and responsibilities of Bursa Malaysia. (See also the description of the Bursa Malaysia's oversight of member firms set out in Principle 34.)

The SC takes an oversight role in the supervision and inspection functions of Bursa Malaysia. Bursa Malaysia will furnish the SC with a copy of the inspection/audit reports,

	<p>and the actions taken against their participants, if any. Bursa Malaysia will take disciplinary action against their participants if there is non-compliance of their respective rules. However, if the matter involves a breach of securities laws, it will be referred to the SC for further action.</p> <p>The on-site inspections conducted by Bursa Malaysia cover the head office and branches of its intermediaries. In the course of conducting the on-site examination, Bursa Malaysia will review books and records and ascertain the adequacy of policies, procedures and risk management systems of its participants to ensure compliance with internal and external requirements. Among other things, the books and records are reviewed and reconciled to confirm their accuracy, detect any omission and identify possible conflicts of interest and internal control weaknesses. Transactional testing on sampled basis will be performed by Bursa Malaysia to ascertain whether these controls are functioning.</p> <p>Bursa Malaysia also conducts off-site monitoring including monitoring of financial standing and review of other financial and non-financial measures through periodic returns submitted by intermediaries.</p>
Assessment	Fully implemented.
Comments	<p>Malaysian market intermediaries are required to have in place organizational and operational structures to ensure compliance with the law, manage risk and protect the interests of their clients and their clients' assets.</p> <p>A key support to achieve these aims is the periodic evaluation of the risk management and internal controls processes within the firm. The Assessment Methodology notes that</p> <p style="padding-left: 40px;">“This should be conducted by someone of sufficient autonomy so as not to compromise the evaluation. SROs and third parties, such as external auditors, may be used to assist in this process.”</p> <p>The Malaysian regulatory framework requires a market intermediary to be subject to a periodic evaluation of its internal controls and risk management processes. However, the manner in which the evaluation is conducted varies depending on the type of regulated activity carried out by the market intermediary.</p> <p>Generally, intermediaries are required to do an annual assessment of their systems. These evaluations are permitted to be carried out by the internal auditor of the market intermediary. The SC is of the view that the requirements that are imposed on the internal audit and compliance functions (including the requirement to report to the board of directors and monthly compliance reporting to the SC), coupled with the oversight provided by the regular examinations performed by the SC and Bursa Malaysia provide adequate assurance that these internal assessments are performed with an acceptable level of independence. Further, the external auditors have a positive obligation to report immediately to the SC if they find any breach of securities laws in the course of their audits. If it found that the internal audit and compliance functions are inadequate or operate with inadequate independence, the market intermediary concerned will be subject to an independent audit by an external auditor.</p> <p>An internal function, no matter how structured, is less likely to provide the level of independence to the review process that can be applied by someone from outside the firm. Given the current frequency of on-site examinations by the SC and Bursa Malaysia, the overall process presently may provide sufficient assurance of an independent review of stock broking or futures broking companies' systems. However, if the frequency of review declines, consideration should be given to requiring these assessments be done by external auditors, at least for the largest intermediaries, meaning the POs and TPs in Bursa Malaysia.</p>
<b>Principle 32.</b>	There should be a procedure for dealing with the failure of a market intermediary in order

to minimize damage and loss to investors and to contain systemic risk.	
Description	<p>The SC has plans in place for dealing with a firm's failure. The plans are flexible to include action to restrain conduct, to ensure client's assets are properly managed and to provide relevant information to the regulators and the general public.</p> <p>There is an internal guideline (Intermediaries At Risk Intervention Framework) that sets out actions and procedures on dealing with the eventuality of a firm's failure. The framework provides guidance on the stages of intervention and the steps that can be undertaken by the SC. A communication protocol with other regulators and dissemination of information to the public are also included in the framework.</p> <p>As noted, the CMSA empowers the SC to take a wide range of regulatory actions in the event of an intermediary's failure. Such actions include imposing restrictions or conditions on a licence (s. 62), suspending licensed operations (s. 67), suspending or revoking licence (s. 72), issuing directives including transfer of monies and properties of clients (s. 125) or applying to court for the appointment of a receiver or liquidator (s. 360 and 361).</p> <p>The framework also takes into account the actions that Bursa Malaysia can undertake. The SC and Bursa Malaysia also work closely in handling a firm's failure. Bursa Malaysia takes action allowed under its rules while the SC takes action vested under the securities law. There is clear communication with each other and where possible, duplication of regulatory actions is avoided.</p> <p><i>Early warning systems.</i> There are early warning systems in place to alert the SC of a potential default by a market intermediary and allow the SC to have sufficient time to address the problem and take corrective actions. The SC and Bursa Malaysia monitor the capital adequacy and financial positions of the broking intermediaries at regular intervals through frequent reporting by those intermediaries, including exposure levels, gearing level, availability of banking facilities, clients' monies in trust and other information that may provide advance warning of potential concerns, including potential default. CAR is calculated on a daily basis and any material deviation needs to be reported to the SC and Bursa Malaysia Securities. Projected ANC requirements for futures firms are calculated on a weekly basis to allow early intervention, if required. Further, the clearing houses at the Bursa Malaysia continuously monitor the positions of their clearing members.</p> <p>Early warning signals on potential default by a fund management company are detected from off-site reviews of complaint histories, changes in assets under management, financial statements and compliance and other reports. For example, the SC reviews reports filed by fund managers and custodians relating to confirmation of clients' asset holdings by both entities to ensure that all assets are accounted for. Information from these reviews is factored into the risk assessment framework.</p> <p><i>Powers to act.</i> As noted above the SC has wide powers to restrict activities by the intermediary to minimize damage and loss to investors. For example, the CMSA empowers the SC to take the following actions to protect client's assets –</p> <ul style="list-style-type: none"> <li>• prohibition from entering into transactions of specified description, in specified circumstances or to a specified extent;</li> <li>• prohibition from soliciting business from persons of a specified description; and</li> <li>• prohibition from carrying on business in a specified manner (s. 125).</li> </ul> <p>The SC may also appoint an independent auditor (sections 130 and 131 of CMSA) or such other person to examine, audit and report the books, accounts and records of, and assets held by the market intermediaries.</p> <p>Further, the Bursa Depository Rules allow Bursa Malaysia Depository to assume total control of the management of all securities accounts maintained with the authorised depository agent (which is a stockbroking company) and transfer the operation of the</p>

agent to another location determined by Bursa Malaysia Depository (Rule 3.01(2)). The SC has the power to apply to the courts to appoint manager, receiver and liquidator for the property of a licence holder. The CMSA empowers the courts to make an order, upon application made by the SC and any other specified persons, to appoint a receiver for the property of a licence holder. This also applies to the property held by a CMSL holder on behalf of another person (s. 360). It also allows the SC to apply to the court to wind up a CMSL holder (s. 361). The Bursa Securities Rules give Bursa Malaysia Securities the power to appoint a receiver or manager to clear all outstanding contracts by a defaulting stockbroking company and the Bursa Derivatives Rules allow Bursa Malaysia Derivatives to order the futures broking company to transfer its existing open positions to another futures broking company or to direct liquidation of such open positions.

Measures designed to minimise customer, counterparty and systemic risk include the Compensation Fund for the equity market and the Fidelity Fund for the derivatives market. In addition, the Clearing Guarantee Fund aims to ensure the integrity of the clearing system is intact.

Currently the CMSA provides four separate compensation regimes for investors who have dealings with CMSL holders. They are:

- The Compensation Fund established and administered by Bursa Malaysia Securities, that covers investor dealing with stockbroking companies (POs);
- The Fidelity Fund established and administered by Bursa Malaysia Derivatives that covers investors dealing with futures brokers (TPs);
- Deposits lodged with the SC by FMCs or CMSL holders licensed for dealing in securities but which are not stockbroking companies (CMSA, s. 70) which deposits are administered by the SC; and
- Deposits lodged with the SC by TP or FMCs dealing in derivatives on specified exchanges (CMSA, s. 106), which are also administered by the SC.

The Compensation Fund covers investors in the event of defalcation or fraudulent misuse of monies or insolvency and the Fidelity Fund covers investors in the event of defalcation or fraudulent misuse of monies. Deposits lodged by fund managers can be used to compensate investors who suffer monetary loss in the event of defalcation or fraudulent misuse of monies or insolvency of the CMSL holder. The deposits lodged pursuant to section 106 of the CMSA for trading in specified exchanges are to be applied on a default by the CMSL holder or where the CMSL holder is being wound up.

The current maximum claim limit allowed to be made against the Compensation Fund for stockbroking companies is RM100,000 per claimant basis, whereas the claim limit against the Fidelity Fund is RM500,000 for each futures broking company (CMSR, reg. 22 and 32). For FMCs, the coverage is only up to RM150,000 per fund manager (CMSR, reg. 7).

The SC is currently in the process of establishing a consolidated compensation fund framework for the Malaysian capital market to consolidate and replace the fragmented compensation schemes currently existing in the capital market. The new compensation framework will streamline processes, procedures and criteria for awarding compensation to retail investors investing in the capital market. The consolidated compensation fund will be known as the Capital Market Compensation Fund (CMC) and it is envisaged that the establishment of the CMC as a statutory fund will further promote investor confidence by encouraging fair and consistent dealing in addressing claims for compensation by retail investors. The CMC bill has been passed by the Parliament in May 2012 and currently awaiting royal assent for the Bill to come into force. The SC has the power and practical ability to take action against an intermediary. The SC has been and is able to carry out these actions independently without any interference. Bursa Malaysia has the power and authority to take action against its participant firms.

	<p>For example,</p> <ul style="list-style-type: none"> <li>• In September 2010, Bursa Malaysia suspended Sunny Futures' participation on Bursa Derivatives as it failed to comply with a Bursa Malaysia's directive. Sunny Futures was required to either liquidate all clients' open positions or transfer all open positions and funds to other clearing participants within 14 market days from the effective date of suspension.</li> <li>• In 1998, Halim Securities failed to meet the minimum liquid fund requirement (which was subsequently replaced by CAR) prescribed by the stock exchange and trading restrictions were imposed on the company to prevent further increase of risk and exposure. The company subsequently failed to adhere to the trading restriction and defaulted to the clearing house. After consultation with the SC, the stock exchange took control of Halim Securities.</li> </ul> <p>The SC has a number of arrangements with domestic and foreign regulators that serve as channels for communication and co-operation in the event of supervision or financial disruption related matters. See the discussion above under Principle 14 on the MOUs that are in place. For example, the 32 bilateral MOUs entered between SC and foreign regulatory counterparts would include general provisions on information sharing which would extend to sharing information to address financial disruption.</p>
Assessment	Fully implemented.
Comments	
<b>Principles for the Secondary Markets</b>	
<b>Principle 33.</b>	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>The establishment of securities and derivatives markets in Malaysia is governed by Part II of the CMSA. In addition, the Guidelines on Regulation of Markets that were issued pursuant to the CMSA, outline the regulatory approach to the regulation of markets as provided for in Part II of the CMSA.</p> <p>The securities and derivatives markets operated, provided or maintained by a facility operator can be classified into three types of markets that are subject to different levels of regulation. The three types of markets include approved market, registered electronic facilities (REF) and exempt market. The level of regulation imposed on a type of market corresponds with the risk posed by that market. The SC, in deciding the appropriate level of regulation, considers factors such as size and structure of the market; nature of services and securities or derivatives contracts traded on the market; nature of investors or participants to the market; whether the facility operator is presently regulated by the SC; and if approval of such market is in the interest of the public. In the case of an operator who provides access to an overseas market, the SC would take into account whether the overseas market is subject to requirements and supervision comparable to that under the CMSA.</p> <p>Bursa Malaysia has been approved by the Minister under s. 8 of the CMSA as:</p> <ul style="list-style-type: none"> <li>• an exchange holding company;</li> <li>• a stock exchange;</li> <li>• a futures exchange;</li> <li>• a clearing house for securities;</li> <li>• a clearing house for futures (all under the CMSA); and</li> <li>• a central depository under the SICDA.</li> </ul> <p>Further, the CMSA provides that an electronic facility, which falls within the meaning of</p>

“stock market” but is not intended to operate as a stock exchange or derivatives exchange, must be registered by the SC as an REF (s. 34).

The SC has registered two REFs:

- Bursa Malaysia Bonds Sdn Bhd (Bursa Malaysia Bonds), wholly-owned subsidiary of Bursa Malaysia, is the operator of the Electronic Trading Platform (ETP Bond) for the trading of bonds. The ETP Bond system presently functions primarily as reporting system for all trades in Malaysian corporate and government bonds. Virtually all trading in bonds takes place OTC, however, ETP Bond also is available to operate as an alternative trading system for the bond market.
- Citibank Berhad, operates the LM eTrading system, an electronic front end system that facilitates the display of quotes, communication of orders and acceptance of orders of Malaysian Government debt securities between Citibank and its clients. There is limited facilitation and not a total market where the display of quotes is made generally. The system is provided to clients of Citigroup and its affiliates via the Bloomberg platform. Trades based on this information are executed OTC, not on the system. Access to the information is only available to Citibank clients.

An exempt market is a securities market or derivatives market that has been declared to be exempt by the Minister. Applying the conditions mentioned above, a market may be exempted when the market operator is already otherwise regulated to avoid duplication of regulation or the operator is an entity that does not require regulation by the SC. The Minister, on recommendation by the SC, may impose terms and conditions as he deems reasonable when declaring a securities or derivatives market to be an exempt market. Currently only FAST (Fully Automated System for Tendering) and RENTAS (Real Time Electronic Transfer of Funds and Securities) systems, both of which are established and operated by BNM, are considered as exempt markets. FAST is used by BNM in the issue of government debt to the primary bond dealers. RENTAS is a transfer system for cash and securities.

The CMSA sets out criteria that must be considered in approving an entity as a stock exchange, derivatives exchange or REF. The SC assesses the application against these criteria in formulating its recommendation to the Minister regarding an exchange and when assessing an REF application. The criteria for an exchange include:

- Operating, as far as is reasonably practicable, an orderly and fair market in relation to the securities and derivatives contracts traded on the exchange;
- Managing any risks associated with its business and operations prudently;
- Not acting contrary to the public interest and interest of investors;
- Able to take appropriate actions against its member firms (POs or TPs) or affiliates to whom the rules apply for any breach of its rules;
- Including satisfactory rules to maintain fair and orderly market, proper regulation and supervision of its POs/TPs and the listing of securities and derivatives on its exchange;
- Having sufficient financial, human and other resources to ensure adequate and properly equipped premises, competent personnel, automated systems with adequate capacity, security arrangements and facilities to meet emergencies (CMSA, s. 8).

In formulating its recommendations for authorizing the establishment of an exchange, the SC would receive an application providing detailed materials on which to assess the fulfilment of these conditions, such as:

- Evidence of operational competence to ensure that the exchange has adequate and properly equipped premises and competent personnel for the conduct of its

	<p>business and automated systems with adequate capacity, security arrangements and facilities to meet emergencies;</p> <ul style="list-style-type: none"> <li>• Copies of the proposed rule book(s);</li> <li>• Business plans; etc.</li> </ul> <p>The SC would engage in detailed and extensive discussions with the principals of the exchange throughout the process. The exchange would also have to undergo a readiness audit to confirm that all systems were in place and operative, prior to being given final authorization to start business.</p> <p>In registering Bursa Malaysia Bonds Sdn Bhd (the operator of the ETP for Bonds) as a Registered Electronic Facility, the SC had made an assessment of the reliability of its arrangements based on the findings of a system readiness review prepared by independent external auditors and an Internal Audit Report on System Readiness. Bursa Bonds is further required to submit to the SC a post-implementation review of the system 6 months after the system goes live. The SC had reviewed and approved the rules governing trading of bonds through the ETP for Bonds and its participants. The said rules also contain provisions on dispute resolutions and action for breaches (Rule 901 of the Bursa Bonds Rules).</p> <p>In considering Citibank's application to be registered as a REF, the SC assessed information on the company's security processes and procedures, capacity of the system, business continuity plan and procedures and record keeping and audit trail features and procedures, information on key personnel and the Terms of Use which users have to agree to before they are allowed to utilize the system.</p> <p><i>Prudential requirements.</i> The exchanges themselves do not assume principal, settlement, guarantee or performance risk. These are assumed by the two clearing houses: Bursa Malaysia Securities Clearing and Bursa Malaysia Derivatives Clearing. Bursa Malaysia Securities and Bursa Malaysia Derivatives and their member firms are required to comply with prudential and other requirements, as provided in the rules of the exchanges and clearing houses. The requirements that are aimed at reducing the risk of non-completion of transactions include -</p> <ul style="list-style-type: none"> <li>• For the <b>equity market</b>, the securities clearing house established a Clearing Guarantee Fund (Bursa Malaysia Securities Clearing Rules, Rule 6.01). Currently, the fund stands at RM100 million, made up of contributions from Bursa Malaysia (60%), Bursa Malaysia Securities Clearing (25%) and its trade clearing participants (TCPs) (15%).</li> <li>• Any PO that fails to deliver the relevant securities to the securities clearing house by the Scheduled Delivery Time will be subject to an automatic buy-in, with the bidding price at 10 ticks higher than the closing price on the previous day or the last price for a completed transaction for the previous trading session and a levy of one percent (1%) of the buy-in contract will be charged to the defaulting PO (Bursa Malaysia Securities Rules, Rule 803.1).</li> <li>• For the <b>derivatives market</b>, the Derivatives clearing house must maintain and establish a <b>Clearing Fund</b> to cover any failure of a clearing participant (CP) to perform any of its obligations under the rules (Bursa Malaysia Derivatives Clearing Rules, Rule 400). This fund currently stands at RM26 million, made up of contributions from CPs (81%) and Bursa Malaysia Derivatives Clearing (19%).</li> <li>• Bursa Malaysia Derivatives Clearing Rules require       <ul style="list-style-type: none"> <li>○ Each General CP to lodge a Security Deposit of at least RM1 million in the form of cash and/or approved collateral to cover any amount owing by the affected General CP in the event of default.</li> <li>○ Each Direct CP to lodge a Direct Clearing Participant Deposit in cash and/or approved collateral, the amount to be maintained at all times the</li> </ul> </li> </ul>
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	<p>higher of RM500,000 or 10% or such percentage as may from time to time be determined by the clearing house of the total amount paid by the Direct CP to the clearing house (Rule 206B).</p> <ul style="list-style-type: none"> <li>• CPs are also subject to mandatory margin assessment and collection requirements by the derivatives clearing house. The margin rates vary with the type of derivatives contract and are determined based on historical price volatility, current and anticipated market conditions and other relevant factors that the Risk Management Division of Bursa considers relevant. The margin levels are monitored continuously.</li> <li>• All POs and TPs are subject to capital requirements (see the discussion under Principle 30);</li> </ul> <p>All of the rules of the clearing houses and the exchanges are posted on the Bursa Malaysia website.</p> <p>Under the CMSA, the SC may recommend to the Minister to amend, revoke or impose new terms and conditions on the holding company, stock exchange or futures exchange, if it is satisfied that it is appropriate to do so for the protection of investors or in the public interest or for the proper regulation of the stock market and derivatives market (s. 8(5)).</p> <p>The SC may, after consultation with the exchange, require it to amend any of its rules in such manner as the SC recommends (s. 9(9)). The Regulatory Guidance also provides for the SC to direct Bursa to take immediate remedial or corrective actions within the stipulated time in the event of any non-compliance by Bursa Malaysia and/or its subsidiaries with the securities laws or provisions of the Regulatory Guidance.</p> <p>Further, via the annual regulatory audit process the SC can make recommendations for improvement to Bursa's rules, policies and procedures in relation to any issues or shortcomings found during the audit. Such recommendations have proactively been taken up by Bursa and implementation of such will be reviewed at the next annual regulatory audit. (See the discussion under Principle 9.)</p> <p>An operator of a REF is required to ensure that there is an orderly and fair market in relation to transactions carried out through the electronic facility. The SC may add, vary, amend or revoke any condition imposed on an REF (CMSA, s. 34).</p> <p>The regime in place requires the SC conduct a regular assessment of the reliability of all arrangements made by Bursa Malaysia for the monitoring, surveillance and supervision of an exchange and its members or participants, to ensure fairness, efficiency, transparency and investor protection, as well as compliance with securities legislation.</p> <p>Bursa Malaysia monitors the day-to-day operation and trading in their exchanges under supervision by the SC. The monitoring activities conducted by Bursa Malaysia would include conducting real-time surveillance of the market and supervision of its participating members and clearing members. Bursa Malaysia also has in place mechanisms to manage disorderly or unusual market movements such as trading halts, circuit breakers and other trading safeguards. Bursa Malaysia is also entrusted with the enforcement of its Rules and must report to the SC where it is unable to meet its obligations, or where it is in a position of conflict.</p> <p>Parallel surveillance activities are also carried out by the supervision departments within the SC to ensure that Bursa undertakes its responsibilities for real time surveillance of the equity and derivatives market. In the event the SC (through the Market Surveillance Department) finds any gaps in the exchange's surveillance function, the SC will proactively engage the exchange to close the gap accordingly. (See also the discussion under Principle 9 of the supervision of Bursa Malaysia and under Principles 10 &amp; 12 of the supervision of trading on their markets conducted by the SC.)</p> <p><i>Dispute resolution and appeals.</i> Bursa Malaysia's Rules and the Guidance on the Regulatory Role of Bursa Malaysia provide for dispute resolution procedures and the establishment of an Appeals Committee to hear appeals from certain decisions made by</p>
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<p>committees of the exchanges etc.</p> <p><i>Technical system standards and procedures related to operational failure.</i> Bursa has a technical system policy and standards that set out the principles of information security policy and controls to ensure the following:</p> <ul style="list-style-type: none"> <li>• Information is protected against any unauthorized access;</li> <li>• Confidentiality of information will be assured;</li> <li>• Integrity of information will be maintained, and;</li> <li>• Availability of information for business processes will be maintained.</li> </ul> <p>Bursa Malaysia also has a Business Continuity Plan (BCP) for both the securities and derivatives market which is reviewed annually by the Business Continuity Management Department of Bursa Malaysia.</p> <p><i>Record keeping system.</i> Bursa Malaysia is required to keep extensive books and records of all matters related to its business and transactions that take place on the exchanges and at the clearing houses.</p> <p><i>Reports on suspected breaches of law.</i> Under the CMSA and the Guidance on the Regulatory Role of Bursa Malaysia, Bursa Malaysia is required to report to the SC immediately all alleged or suspected violations of securities laws or of codes, rules, regulations, directives or guidelines issued by the SC relating to the securities or derivatives industry or the AMLATFA which it detects. For example, if Bursa Malaysia finds evidence of suspected manipulation during its market surveillance activities, it would report this promptly to the SC.</p> <p><i>Arrangement for holding client funds/securities.</i> The CMSA requires the stock exchange and the derivatives exchange to establish and maintain a compensation fund and fidelity fund (respectively), keep assets of the funds separate from the exchange's other properties and hold the assets in trust. In addition, the exchanges are required to keep proper accounts of the funds and appoint an auditor to audit the accounts of the funds. Participant's cash, such as money from margins and security deposits, securities borrowing and lending collateral, is kept in separate bank accounts and invested separately from Bursa Malaysia Group's funds. For accounting purposes, this money considered trade payables in Bursa Malaysia's Group accounts.</p> <p><i>Disorderly trading conditions.</i> The exchanges are required to establish mechanisms to identify and address disorderly trading conditions and to deal with any contravening conduct. Mechanisms employed include Bursa conducting real time surveillance of trading activities for both markets as well as its participants through a fully automated surveillance system called ARAMIS. This includes inter-market surveillance monitoring, for both derivatives products and their underlying securities that are traded in the securities markets.</p> <p>In the equity market, measures and remedial actions may be taken to address disorderly trading conditions and to deal with any contravening conduct, including:</p> <ul style="list-style-type: none"> <li>• Issuing an Unusual Market Activities (UMA) query on the listed issuer to make an immediate announcement to clarify the cause of unusual market activities in the trading of its securities.</li> <li>• Issuing a Market Alert to the investing public on the possible irregular trading activities of a particular security to urge investors to exercise caution and due diligence on the trading of the said securities. The Market Alert is published via media release and Listing Circular.</li> <li>• Declaring a "Designation" of listed securities when excessive speculation occurs or there are abnormal trading patterns that impact fair and orderly trading of the affected securities. With the designation, trading in the securities continues but Bursa may impose conditions on the dealing of the Designated Securities, such as requiring all trades in these securities to be conducted on the basis of</li> </ul>
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delivery before sale.

- Suspending all trading in the listed securities.

Where irregular trading is seen on the derivatives exchange, the Bursa may take a range of actions as appropriate. For example, it may impose a trading restriction to direct that no new open positions be created with immediate effect until further notice from Bursa.

In addition, under the Bursa Malaysia Derivatives Rules, trading of any contract on the market may be halted or suspended whenever the Exchange deems such action to be appropriate in the interest of maintaining a fair and orderly market to protect investors (Rule 707.7).

In the course of surveillance by the Bursa, upon detection of breaches of:

- Bursa's business and listing rules, it will take appropriate enforcement action in accordance with its own processes and procedures, and;
- Securities laws, it is required to refer the matter to the SC.

*SC Oversight.* The operation of these procedures, rules etc. is assessed as part of the Bursa Malaysia oversight program that the SC has in place, that includes on-site examinations, off-site reviews of reports and filings and the rules review and approval process. (See Principle 9.)

Note that the Bursa Malaysia does not outsource any of its key functions.

#### **Instruments Traded**

*Securities.* Bursa Malaysia Securities operates two markets namely the Main Market and the ACE Market. The SC's approval is required for issues and offerings of equity securities and listings of corporations or quotations of securities on the Main Market of Bursa Malaysia Securities (CMSA, s. 212 and the Equity Guidelines).

The SC approves other issues of securities (both conventional and Islamic) such as debentures/sukuk, asset backed securities, structured products, unit trusts, Real Estate Investment Trusts (REITs) and exchange traded funds, which may be listed on the exchange wholesale funds, closed end funds and foreign collective investment schemes.

Bursa Malaysia sets out the criteria for admission of securities for listing on its Main Market and the continuous listing requirements through the Main Market Listing Requirements.

The Equity Guidelines do not apply to proposals undertaken by corporations seeking listing on the ACE Market. Bursa Malaysia Securities' approval is required for such proposals, which are governed by the ACE Market Listing Requirements. These Listing Requirements set out the criteria for admission of securities onto the ACE Market and the continuous listing requirements. A written protocol between the SC and Bursa Malaysia was established to notify the SC of the securities that are to be traded on ACE Market.

The SC approves all rules including the Main Market Listing Requirements and ACE Market Listing Requirements (CMSA, s. 9).

*Derivative Contracts.* Any new derivatives contract to be traded on the derivatives exchange would require the SC's approval. The SC approves the Rules in relation to the trading of any derivatives contract on the derivatives exchange (CMSA, s. 9).

*Instruments on REFs.* The bonds permitted to be traded on the ETP Bond system are the bonds that are permitted to be traded on the OTC market. The SC approves the issue of corporate bonds. The SC has access to the types of securities traded (if any) on the Bursa Malaysia Bonds through its direct access to the ETP Bond system. Citibank, as a condition of the registration of its REF, is required to inform the SC if there are any changes to the financial instruments that are displayed on LM eTrading.

*New product considerations.* In considering proposals for the introduction of new exchange traded products, the SC would generally consider:

- Suitability of the product to be invested and marketed to retail investors.
- Susceptibility of the product to trading manipulation.
- Market readiness and awareness of the product.

Bursa Malaysia would consider several factors in admitting an exchange traded product for trading on its exchanges. For derivatives these would include:

- Commercial interest and economic function of the product. Products should meet risk management (hedging) need of users in investing in the market.
- Size of the underlying market. Market size would indicate the number of potential users of the derivative products.
- Correlation with cash market. Contract terms and conditions should reflect the operation of the underlying cash market and avoid impediments to delivery.
- Settlement and delivery reliability. Settlement and delivery procedures should reflect the underlying cash market and promote price convergence.

*Oversight of fair access.* Access to facilities operated by Bursa Malaysia, such as the trading platforms and the clearing and depository systems, require a party to apply to the relevant entity in Bursa Malaysia to be approved a participating member in accordance with the relevant Bursa Malaysia Business Rules.

The SC maintains oversight over access to the exchanges as all rules and any subsequent amendments require SC's approval. In the event Bursa Malaysia makes a decision to disallow or reject any application from market participants or registered persons(s) that do not satisfy the minimum criteria prescribed in the relevant Business Rules, Bursa Malaysia must notify the SC together with reasons for the rejection.

*Order routing.* All trading related rules are prescribed in the Rules of the Bursa Malaysia and are made available via Bursa Malaysia's website. The exchanges' routing procedures are applied fairly and are consistent with the relevant securities regulation. The securities laws and rules require that all clients' orders take precedence over proprietary orders and prohibit front running or trading ahead of customers. Under the Bursa Malaysia rules, each order entered into the trading system during the trading hours as prescribed by the rules must be considered for a possible match in accordance with the trading rules. Orders are matched in priority of price and then time.

Bursa Malaysia submits the trade matching or execution algorithms that are built into the trading system - Bursa Trade Securities (BTS) - for SC's approval when it proposes to implement a new trading engine or when it makes any modifications to the existing algorithms. There is no specific SC review of trade matching or execution algorithms for fairness though the overall review would cover the impact of the algorithm on the integrity of the price discovery process. *Connection to the trading system.* The ability to connect and maintain the connection to the electronic trading system of Bursa Malaysia is dependent on the communication lines to the system and the software of the trading system. Connection to the trading system on the stock exchange or derivatives exchange must be through access points approved by the Exchange (Bursa Malaysia Securities Rules, Rule 701.2 and Bursa Malaysia Derivatives Rules, Rule 701.1). Connection to the trading system is dependent on the connectivity bandwidth available to the participant firms through their independent telecommunication providers. Once the orders reach the trading system level, all orders are executed as per the order matching rules.

Bursa Malaysia also provides co-location hosting services to their participants that allow them to place their servers within the same physical data centre as the exchange. This enables high speed trade execution with low network latency. This arrangement is subject to terms and conditions as well as a subscription fee to be paid to Bursa Malaysia.

*Risk management controls.* The Bursa Malaysia Securities Rules contain controls for

order execution in the equity market:

- Orders for board lots and odd lots are subject to upper and lower price limits.
- POs must have appropriate automated risk filters to check or screen a DMA order before the order is executed in the automated trading system to ensure that the order does not affect the orderliness and fair functioning of the stock market.

In addition, there are controls in the Bursa Trade Securities (BTS) system that limit order size to not more than 5000 board lots per order.

The Bursa Malaysia Derivatives Rules contain controls for order execution in the derivatives market:

- The exchange may stipulate in the Rules and/or in the Trading Procedures the upper and lower price limits at which an order in respect of a contract may be entered.
- TPs must have appropriate risk filters for DMA orders.

In addition, in migrating Bursa Derivatives' trading operations to CME's Globex electronic trade execution system, Bursa Derivatives adopted specific CME Globex trading functionalities which control order execution. Such functionalities serve to protect the market and traders from orders that would execute outside the expected extreme market volatility. There is also a pre-execution credit check functionality located in the system operated by CME Globex that controls the orders executed in the trading system by number of contracts per order and by overall credit limit set.

*Access to rules.* All market participants and the public have free and equitable access to market rules through Bursa Malaysia's website. In addition, all rules, circulars, trading manuals and procedures, directives and guidelines are also posted in Bursa's E-Rapid system that is accessible to all participants of Bursa Malaysia.

*Audit trail records of trading.* There are adequate records available for the SC and Bursa to reconstruct trading activity within a reasonable time. Audit trail information captured would include the time of the order entry and execution, the buying and selling participants, the price, number of securities, client code, CDS account number and dealer representative's code, etc.

Orders and trade information captured by the ARAMIS system are provided to the SC through a feed into SC's SMART surveillance system. The SMART system can replay trades if required.

*Trading information disclosure.* The BTS system disseminates two types of trade messages:

- Private messages that are only made available to the respective broker for which the trade is matched (buying and selling broker). The information includes stock code, price, quantity and the counterparty broker code of the trade.
- Public messages include information such as stock code, price and quantity only (counterparty code is not available to the public).

Information such as client code, CDS account number and dealer representative's code are not disseminated, but are retained at Bursa Malaysia to preserve confidentiality.

CME Globex electronic trade execution system disseminates two types of trade messages:

- Private messages that are only made available to the exchange/clearing house and the respective futures broker for which the trade is matched. Both buying and selling brokers will receive separate buying and selling messages. The information includes product, trade entity, price, quantity, client account code, trader id and the trading time stamp. The system does not reveal the counterparty details to the trade to the buying or selling broker, as the clearing house is always the counterparty to either side of the trade under the novation

	<p>process.</p> <ul style="list-style-type: none"> <li>Public messages include information such as product, trade entity, price and quantity. This information is disseminated via the information vendors or parties who subscribe to these messages.</li> </ul> <p>The ETP Bond system when used for trading is able to provide pre-trade and post-trade trading information to its members. The ETP system and the ETP Bond Surveillance System have security features that limit the ability of Bursa to see the counterparties' clients. Such information is only made available to the SC and BNM to protect confidentiality of the clients.</p> <p>The LM e-Trading system is only offered to Citibank's clients. LM eTrading is a Request for Quotes (RFQ) system, whereby Citibank will be displaying its quotes on selective bonds with amounts and indicative prices via the Bloomberg platform. Prices and sizes are uploaded from the Citibank Trader terminal to a Bloomberg Offering Page. The RFQ functionality will allow authorised clients to request a trade (buy/sell) for a quantity and price (at Citibank's displayed price). The system allows a trader to "accept" that trade which will entail a trader sending a message to the client confirming the deal, or respond to the client with an amended price, or decline the trade. The trade will also time out if the trader does not respond within a stipulated time. The trading relationship is a one to one relationship between Citibank and its contracting client. Citibank is the counterparty to the client and acts as principal to all buy and sell transactions. A client would not be able to view other clients' buy and sell quotes.</p> <p><i>Access to trading information for risk management purposes.</i> Bursa Malaysia Securities provides access to pre-trade and post-trade information to its member intermediaries through the PO Order Management System on a real time basis. The information available to the POs include pre-trade information of five levels of best bids and offers comprising price and volume information and post trade information of the last completed price and volume.</p> <p>Bursa Malaysia Derivatives provides pre-trade and post-trade information to its member intermediaries through the TPs' Order Management System on a real time basis. The information available to the TPs include pre-trade information of five levels of best bids and offers comprising price and volume information and post trade information of the last completed price, volume and settlement price for each contract month.</p>
Assessment	Fully implemented
Comments	
<b>Principle 34.</b>	There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	<p>Section 15 of the SCA provides the SC with broad powers to conduct or supervise surveillance of the trading activities on authorized exchanges and regulated trading platforms. Under this provision, the SC conducts a wide range of supervisory activities including monitoring of the day-to-day trading activities on the exchange, monitoring of the conduct of the market intermediaries and the collection and analysis of the information gathered through these activities.</p> <p><b>Surveillance of trading activities</b></p> <p>The SC conducts surveillance of trading activities on the stock market and derivatives market as appropriate to the level of risk posed. On the stock market, which represents the bulk of trading activities and exposure of retail investors, both the SC and Bursa Malaysia conduct parallel surveillance of trading activities.</p>

<p>The SC carries out surveillance activities for the following purposes -</p> <ul style="list-style-type: none"> <li>• To detect and prevent irregular trading practices;</li> <li>• To pre-emptively, proactively and promptly intervene when there is cause to believe that a possible trading irregularity or breach of securities laws is occurring or about to occur.</li> </ul> <p>A number of surveillance tools are employed in carrying out the surveillance of trading activities including through SMARTS, the automated surveillance system, which is used to detect unusual trading activities based on price and volume movements. Surveillance of trading activities is also carried based on themes, market intelligence sourced from the media, complaints, tip-offs etc.</p> <p>Bursa Malaysia also undertakes front line surveillance, i.e. day-to-day real time monitoring of trading activities for both the securities and derivatives markets as well as its participants through its fully automated surveillance system called ARAMIS. The system incorporates alerts to highlight suspicious transactions for further enquiry.</p> <p>Surveillance carried out by Bursa Malaysia is aimed at preserving and protecting the integrity of the market place in accordance with the duties of the exchange to maintain an orderly and fair market.</p> <p>When sharing or referring trading anomalies or abnormal trading patterns detected in the course of its surveillance operations to the SC, Bursa shall apply the scope, criteria and/or internal procedures as agreed with the SC, in particular where such activities may give rise to or are tantamount to a breach of the securities laws or AMLATFA.</p> <p>Bursa Malaysia Bonds has the ETP Surveillance System built into its system functionality that would allow it to conduct surveillance over bond market trading on the marketplace. However there is currently no trading of bonds on the ETP Bond, as bonds are predominantly traded OTC. (The ETP Bond is being utilised as a repository system for the reporting of all OTC bond trades.) The information from the system is used to analyze information reported on these OTC bond trades.</p> <p>As part of the oversight role, the SC has conducted assessment of Bursa Malaysia's surveillance functions through the annual regulatory audit process as provided for in section 16(4) of the CMSA. The scope of the 2009 annual regulatory audit included the assessment of Bursa's process and procedures for supervising the equity market through the ARAMIS system. The audit focused on how alert data are processed and followed up, the handling of watch-list stocks, the issuance of surveillance query and the quality of the surveillance report. Based on the findings, the SC made specific recommendations to strengthen the surveillance process conducted by Bursa Malaysia.</p> <p><b>Monitoring conduct of market intermediaries</b></p> <p>Both the SC and Bursa Malaysia regulate market intermediaries including equity, bond and derivatives brokers. However the SC has wider regulatory reach over intermediaries having powers over fund managers, investment advisers, corporate finance advisers, and financial planners.</p> <p><i>Supervision by SC.</i> See the discussion of the SC's oversight of intermediaries set out under Principles 10, 12, 29 &amp; 31).</p> <p><i>Supervision of intermediaries by Bursa Malaysia.</i> Bursa Malaysia conducts both on-site inspections and off-site monitoring of their participants. Rule 1203.1 of Bursa Malaysia Securities Rules and Rule 515.1A of Bursa Malaysia Derivatives Rules require every participating member from time to time, with or without notice, be subject to inspections and/or audits by the Exchange to ensure and appraise the member's compliance with provisions of the Rules and the member's internal policies and procedures and/or other rules and regulations related to its business in dealing in securities and trading in derivatives contracts.</p> <p>The on-site inspection and off-site monitoring activities include inspection of the business premises of participants, monitoring of financial standing and review of other financial</p>
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and non-financial criteria through periodic returns submitted by participants. Bursa Malaysia's on-site inspection reviews records within a timeframe of 12 months from the inspection reference date and the scope of the on-site inspection would cover:

- Compliance with the Bursa Malaysia Securities Rules, Bursa Malaysia Securities Clearing Rules, Bursa Malaysia Derivatives Rules, Bursa Malaysia Derivatives Clearing Rules and Bursa Malaysia Depository Rules;
- Conduct of trading in shares in compliance with the Rules and measures to minimise conflicts of interest in underwriting services;
- The effectiveness of compliance, internal audit and risk management functions;
- The disciplinary policies and procedures governing the conduct of staff;
- Compliance with IT standards and codes, and;
- Compliance with financial requirements i.e. CAR.

Bursa has also established a risk-based approach in profiling and selecting intermediaries for on-site inspection. Under the risk-based approach, the participants are profiled based on internally established financial and non-financial factors. The risk-based assessment is carried out annually to prioritize Bursa's resources in carrying out the on-site inspection. The frequency of inspections is determined by the risk category i.e. all high-risk intermediaries are inspected every year, inspections of medium-risk intermediaries are spread over a period of 3 years while low risk intermediaries are inspected once in 3 years.

In addition to routine inspections, Bursa Malaysia conducts non-periodic (ad-hoc/surprise) inspections based on complaints, market issues or events. Between 2008 and 2011, a total of 51 routine inspections and 18 surprise inspections were conducted on POs and 26 routine and 7 surprise inspections on TPs.

The reports and analysis from the inspections are forwarded to the SC. Information gathered during the inspections of market intermediaries is used to develop examples on best practices which are shared with other market intermediaries as well as to determine participants' risk profile which allows Bursa to target/select high risk intermediaries for annual inspections.

*Oversight of the Exchanges & Trading Systems.* See the discussion under Principle 9 for the SC's oversight of the activities of Bursa Malaysia.

The SC performs regulatory oversight of Bursa's surveillance of bond trading activities via the ETP Bond Surveillance system. In addition, as the system is operated by Bursa Malaysia Bonds, the Regulatory Guidance gives the SC the discretion to examine Bursa Malaysia Bonds.. The SC determines the scope and schedule for such examination. Under the Regulatory Guidance, SC also has the authority to require Bursa Malaysia Bonds to make necessary improvements pursuant to the findings of the examination. (Part II, Para. 3.4).

*Access to trading information.* The SC is provided with online, real-time access to information pertaining to trading activities on both the equity and derivatives market (pre-trade and post trade information), which is fed through a system called Bursa Station by the Exchange.

SC has access to the ETP Bond and ETP Bond Surveillance systems to extract all relevant trade information. For LM eTrading, a condition has been imposed on Citibank to provide daily published and historical data of bid and ask prices, yield and size quotes as provided on the LM eTrading system. For post trade data, Citibank is also required to report executed trades to the ETP Bond system.

*Rule Review.* The CMSA requires a stock exchange, derivatives exchange and approved clearing house to submit or cause to be submitted any proposed rules or any proposed amendments to the existing rules of the entity, for the approval of the SC. In addition, the SC may, from time to time, by written notice require these entities to amend or

	<p>supplement any of their rules as specified. Between 2008 and 2011, the SC considered and approved 46 proposals for rules amendments from Bursa.</p> <p>Under the Regulatory Guidance, as a subsidiary of Bursa Malaysia, any proposed amendments to the Rules of the ETP Bond are to be submitted to the SC for prior approval. Between 2008 and 2011, the SC considered and approved 2 proposals from Bursa Malaysia Bonds to revise its rules.</p> <p><i>Available regulatory actions for non-compliance.</i> The SC is able to impose a range of actions including placing restrictions or conditions on Bursa Malaysia as provided under the CMSA. The SC may:</p> <ul style="list-style-type: none"> <li>• Issue directions to the exchange holding company, stock exchange, derivatives exchange, approved clearing house, central depository or relevant body corporate if conflict exists between the interest of operating an exchange with the interest of statutory duties as an exchange under CMSA and if it is necessary to ensure fair and orderly markets, maintain investor protection, ensure integrity of capital markets and effective administration of securities law (s. 26)</li> <li>• Discharge any of the duties of the stock exchange and derivatives exchange in relation to the supervision of the capital market and market participants and enforcement of the listing requirements and business rules (s. 26).</li> <li>• In the interest of the public, protection of investors or to maintain fair and orderly market, give a written notice to a stock exchange, a derivatives exchange or an approved clearing house, impose the necessary prohibitions or restrictions such as prohibiting the trading of particular securities or a particular class of securities, to terminate or suspend trading on the stock exchange or derivatives exchange (s. 28).</li> <li>• Take administrative sanctions against the stock exchange, derivatives exchange or exchange holding company for non-compliance with conditions of its approval or the provisions of the law (Part XI).</li> </ul> <p>For REFs, the CMSA grants the SC wide powers to prescribe any conditions it deems appropriate when considering an application by an operator of an electronic facility. It also permits the SC to add, vary or revoke any such conditions imposed, as and when deemed necessary (s. 34).</p> <p>Under the CMSA, the Minister may, on the recommendation of the SC:</p> <ul style="list-style-type: none"> <li>• Withdraw an approval granted under section 8 to an exchange, or;</li> <li>• Direct the exchange to cease to provide or operate such facilities, or to cease to provide such services.</li> </ul> <p>The Minister, instead of withdrawing the approval, may direct that trading on the exchanges be suspended until such time as Bursa Malaysia has complied with such term or condition, or rectified the matter forming the basis of the recommendation by the SC, or until the Minister revokes the direction (s. 12).</p> <p>The CMSA gives the SC the authority to withdraw the registration of an REF, if it is satisfied that it is in the interest of the investors, in the public interest or for the maintenance of an orderly and fair market (s. 36). Similar provisions are found in the Guidelines on Regulation of Markets.</p>
Assessment	Fully implemented
Comments	
<b>Principle 35.</b>	Regulation should promote transparency of trading.
Description	Bursa Malaysia provides pre-trade information and post-trade information through the

	<p>PO and TP Order Management System and to authorised information vendors on a real time basis. It also provides information on completed transactions to all its market participants through this system.</p> <p>Investors are able to view</p> <ul style="list-style-type: none"> <li>• Pre-trade information (up to 5 levels of bid and offer quotes); and</li> <li>• Post-trade information (last sale price and volume of transaction, and settlement price for derivatives market)</li> </ul> <p>via the Bursa Station shared information display system maintained by the POs and TPs. Investors who subscribe to the authorised information vendors' services e.g. Bloomberg can also view the pre- and post-trade information through their Bloomberg terminals.</p> <p>Bursa Malaysia also provides post-trade price and volume information for listed securities and derivatives on its public website on a 15 minute delay.</p> <p>At the present time, the ETP Bond system only functions as a post-trade repository system, in that all transacted financial instruments, either on the platform or off ETP, by its trading participant members and executing participant members are required to be reported to the ETP system within 10 minutes of a transaction. Therefore such information is made available to all its members. In addition, Bursa Malaysia and BNM also publish the post trade bond information on their website but with a 15-minute delay from the time the trade is reported.</p> <p>The Citibank LM eTrading system (described under Principle 33) displays information on quotes and facilitates communication among clients of the system. Trades based on this information are not executed on the system. LM eTrading will facilitate trade execution "manually". Back office confirmation, clearing and settlement for transactions conducted with Citibank are not activated or available on LM eTrading. Access to the information is only available to Citibank clients. Executed trades must be reported by Citibank to ETP Bond, as for all other OTC trades.</p> <p>Direct Business Transactions (DBTs) are permitted to take place without first entering the orders into the automatic trading system at the exchange. These include "crossing" transactions where two POs are involved or "married" transactions (trades within one PO –between the broker and its client or between two clients of the same PO). These transactions are subject to specific requirements set out in Chapter 9 of the Bursa Malaysia Securities Rules. The transactions are permitted to take place without pre-approval of the exchange provided that the trade involves a block of more than 50,000 securities and the price falls within a prescribed range (+/- 15%) around the prior trading day's volume weighted average price.</p> <p>Transactions which have been agreed upon by the parties must be keyed in into the trading system within 15 minutes of the counterparty's input for clearing and settlement purposes and is made transparent through the trading system. The POs also have to report DBTs to the Exchange if the transacted price is out of the prescribed range (+/- 15%), by 12:30 p.m. (at the latest) on the following trading day. Additional information must be provided to the exchange where a pre-approval of a transaction is required. Both the exchange and the SC have access to all necessary information to assess these transactions. The Exchange's monitoring of DBTs is focussed on ensuring that the price at which a DBT takes place is not too far from the on-market price.</p> <p>There are no dark pools operating in the jurisdiction.</p>
Assessment	Fully implemented
Comments	
<b>Principle 36.</b>	Regulation should be designed to detect and deter manipulation and other unfair trading practices.

Description	<p>The regulatory system prohibits all manner of conduct that may lead to market abuses. These are provided in the CMSA and the rules of the exchange relating to conduct of participants as well as the Listing Requirements.</p> <p>Part V of the CMSA sets out the forms of prohibited conduct and offences on both the equities and derivatives market relating to:</p> <ul style="list-style-type: none"> <li>• False trading and market rigging (sections 175, 202 &amp; 204),</li> <li>• Market and price manipulation (sections 176 &amp; 205),</li> <li>• Making false or misleading statements (sections 177 &amp; 207),</li> <li>• Fraudulently inducing persons to deal in securities (section 178),</li> <li>• Using manipulative and deceptive devices to defraud (sections 179 &amp; 206)</li> <li>• Dissemination of information about illegal transactions (section 181),</li> <li>• Insider trading (subdivision 2),</li> <li>• Front running (sections 93 &amp; 104).</li> <li>• Any other fraudulent and deceptive conduct, or market abuse governed under Part V of the CMSA.</li> </ul> <p>Bursa Malaysia Securities Rules prohibit various market abuses, including:</p> <ul style="list-style-type: none"> <li>• Engaging in, or being a party to unethical practices that may damage the confidence of investors and hamper the sound development of the stock market;</li> <li>• Participating in any act or practice which might lead to a false or misleading appearance of active trading; or directly or indirectly tantamount to stock market manipulations;</li> <li>• Allowing any form of irregular and/or unhealthy practice to exist or prevail in its daily and professional business conduct;</li> <li>• Accepting a share in the profits of a client's accounts or having any arrangement with a client to share in the profits of the client's account; having any arrangement with a third party to allocate profits or losses in a client's account; and leading a client to believe that the client will not suffer loss as a result of opening an account or dealing in securities;</li> <li>• Executing personal trades in the account of a client or using a client's account to trade for a third party (Chapter 4).</li> </ul> <p>Additional prohibitions apply to market makers in Chapter 3A of the Bursa Malaysia Securities Rules. A market maker must avoid any act or practice which might:</p> <ul style="list-style-type: none"> <li>• Lead to a false or misleading appearance of active trading in any securities on the stock market of the Exchange or a false or misleading appearance with respect to the market for, or the price of, any such securities.</li> <li>• Be tantamount to stock market manipulation, and shall not participate in any operation by others which might have the same result.</li> </ul> <p>Similarly, Bursa Malaysia Derivatives Rules have provisions prohibiting market malpractices and market abuses. Major offences include:</p> <ul style="list-style-type: none"> <li>• Fraud or any act of bad faith or any dishonest conduct;</li> <li>• Making or reporting a false or fictitious trade;</li> <li>• Knowingly acting as both buyer and seller in the same transaction except when permitted under the Rules;</li> <li>• Manipulating prices or attempting to manipulate prices or to corner or attempt to corner any contract in the market;</li> <li>• Making a material misstatement to Bursa Malaysia; and</li> <li>• Knowingly disseminating false or misleading reports concerning market</li> </ul>
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	<p>information or conditions that may affect the price of any instrument (Rule 510.2).</p> <p>The Bursa Securities Main Market Listing Requirements, that apply to listed issuers and their directors and advisers, contain rules that require accurate, adequate and timely disclosure of information (para 2.18, 9.16 and 9.32) and a prohibition on insider trading (para 14.04). The Listing Requirements also impose disclosure requirements on dealings in listed securities by directors and principal officers of listed companies (Chapter 14).</p> <p><b>Mechanism to deter and detect</b></p> <p>The mechanisms adopted to detect and deter market abuses include:</p> <ul style="list-style-type: none"> <li>• Monitoring compliance through a combination of real time surveillance of market, inspection of intermediaries, investigation of abnormal and suspicious transactions and reporting requirements;</li> <li>• Imposing trading safeguards such as position limits, price limits or market halts; and</li> <li>• Appropriate product listing and product design requirements.</li> </ul> <p><i>Surveillance.</i> See the previous discussions of market surveillance activities in Principles 9-12 and 34.)</p> <p><i>Supervision of intermediaries.</i> The other regulatory tool adopted to detect and deter market misconduct is through inspection of market intermediaries. As discussed above, both the SC and Bursa conduct inspection of market intermediaries.</p> <p><i>Reporting.</i> POs and TPs are required to provide extensive information to Bursa Malaysia, including the following:</p> <ul style="list-style-type: none"> <li>• Monthly Compliance report;</li> <li>• Internal audit report to be submitted upon completion of audit and minutes of the Audit Committee meeting on a quarterly basis;</li> <li>• Off balance sheet report on a monthly basis;</li> <li>• Margin report on a monthly basis; and</li> <li>• CAR/ANC reports.</li> </ul> <p>In addition, the Compliance Officer of each PO and TP is required to report to Bursa Malaysia when there is a breach of Bursa's Rules and to the SC when there is a breach of the securities law or AMLATFA. Bursa Malaysia will review the reports to ensure that the POs and TPs are in compliance with its Rules.</p> <p>Bursa Malaysia periodically provides the SC with:</p> <ul style="list-style-type: none"> <li>• Inspection reports - upon completion of an inspection;</li> <li>• Enforcement action reports - within 3 days of the date of action taken; and</li> <li>• CAR/ANC reports - as and when reports are received from POs and TPs</li> </ul> <p>The SC reviews the reports to ensure that the POs and TPs are in compliance with the securities law. The SC also has access to the information in Bursa Malaysia's ARMADA system.</p> <p><i>Product listing requirements.</i> The CMSA requires all securities products to be approved by the SC before they are made available to investors. The SC also approves the rules in relation to the trading of any derivatives contract on the derivatives exchange. All new products are vetted by the SC to ensure the product is not readily susceptible to trading manipulation.</p> <p><i>Position limits.</i> The SC and Bursa Malaysia may impose a limit on the positions that any one person may hold or control in any one contract or all contracts combined to prevent the concentration of positions (CMSA, s. 101 and Bursa Malaysia Derivatives Rules, Rule 613).</p> <p>In addition, the SC may specify the position size in relation to positions held by a person</p>
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in excess of which the person must report to the SC (CMSA, s. 102).

*Price limits.* The rules of Bursa Malaysia Securities provide that orders for board lots and odd lots are subject to an upper price and lower price limit. The rules of Bursa Malaysia Derivatives provide that the exchange may stipulate in the Rules and/or in the Trading Procedures the upper price and lower price limit at which an order in respect of a derivatives contract may be entered. No order of a contract may be entered above the upper limit or below the lower limit.

*Sanctions* Section 354 of the CMSA empowers the SC to take action on any persons for breaches of securities laws, including the rules of the stock exchange, approved clearing house or central depository; any written notice, guidelines issued or conditions imposed by the SC; or any rule of a recognized SRO.

Section 8(2)(d) of the CMSA requires Bursa Malaysia to take appropriate action against its POs or affiliates for any breach of its rules. Bursa Malaysia has extensive provisions for disciplinary procedures and can take action as provided for in the relevant Chapters/sections of the Listing Requirements and Business Rules against POs, TPs and their officers and directors, and against listed issuers, management companies or trustees and directors and officers of a listed issuer.

Rule 1301.2 of Bursa Malaysia Securities Rules and Rule 508 and 511 of Bursa Malaysia Derivatives Rules also sets out the type of actions that can be taken against above persons for breaches of the provisions in the rules of the Bursa Malaysia, including:

- Caution or reprimands, both private and public;
- Imposition of fines;
- Imposition of a period of suspension or restrictions on any activities; and
- Striking off or termination.

The total number of sanctions imposed by Bursa Malaysia pursuant to Bursa Malaysia's Listing Requirements for 2008 to 2010 include -

- 160 sanctions were imposed in 2008 against public listed companies and/or directors and included 106 public and private reprimands and 54 public reprimands with fines amounting to RM1.3 million
- 308 sanctions were imposed in 2009 and included 117 public and private reprimands and 191 public reprimands with fines amounting to RM3.8 million
- In 2010, 280 sanctions were imposed and included 173 public and private reprimands and 107 public reprimands with fines amounting to RM7.47 million

The total number of sanctions imposed by Bursa Malaysia pursuant to Bursa Malaysia's Business Rules for 2008 to 2010 include -

- In 2008, 127 sanctions were imposed and included approximately 47 fines amounting to RM610,000; 47 reprimands (private and public); 1 suspension and 1 striking off.
- 133 sanctions were imposed in 2009, which included approximately 65 fines amounting to RM1,512,700; 34 reprimands (private and public); and 7 suspensions.
- In 2010, 212 sanctions were imposed and included 107 fines amounting to RM793,200; approximately 50 reprimands (private and public); 3 suspensions and 3 striking off.

There are arrangements in place for the continuous collection and analysis of information concerning trading activities by both the SC and Bursa Malaysia.

To ensure fair and orderly market, Bursa Malaysia has a real-time surveillance system that captures real time as well as historical trading information on both the equity market and the derivatives market. Information concerning trading activities is provided to the

<p>SC through a feed into SC's SMARTS system.</p> <p>The information concerning trading activities includes amongst others date, time, security/contract name and code, price, transaction volume, transaction value, broker name and ID, client name and ID for orders and trades.</p> <p>The ARAMIS system adopted by Bursa Malaysia's for surveillance of the equity market provides alerts that highlight suspicious trading patterns and transactions. On detection of any irregular trading activities, including significant and unexplained changes in the price and/or trading volume of the securities, Bursa will investigate further</p> <p>For the equity market, in addition to monitoring stocks that triggered alerts on ARAMIS, online screen monitoring is also conducted on active stocks. For these stocks, review is conducted on the trading patterns which would include -</p> <ul style="list-style-type: none"> <li>• Any prior direct business transactions on these issues;</li> <li>• Identifying the parties involved with large transactions;</li> <li>• Concentration by brokers, dealers or clients; and</li> <li>• Change of beneficiary ownership.</li> </ul> <p>Announcements on the stocks are also reviewed to determine whether the information disclosed in the announcement is price sensitive that would have led to the possible unusual trading activity.</p> <p>If the review reveals possible violations, further analysis on the stock or contract is conducted. Analysis on such information would include trend analysis, identification of major buying/selling broker and detail transaction enquiry that may reveal trading patterns that point to possible violations such as stock market manipulation, false trading, insider trading and short selling.</p> <p>For the derivatives market, depending on the different possible trading violations, analysis conducted would include -</p> <ul style="list-style-type: none"> <li>• Reviewing the client's background and its core business activities;</li> <li>• Studying the trading pattern and the patterns of open positions;</li> <li>• Analysing client's orders, frequency of cancellation and changes in price and volume of the contract;</li> <li>• Comparing price spread of contract month with other contract months' price spread within the product group; and</li> <li>• Establishing counterparties to the trade.</li> </ul> <p>There are arrangements for Bursa Malaysia to provide the results of such analysis to the SC to take remedial actions, if necessary.</p> <p>Bursa Malaysia is empowered to take enforcement action when results of the analysis of trading activities show a possible breach of their Rules. However if the results of the analysis show a possible breach of the securities law, Bursa Malaysia is required to refer to the SC for the SC to take remedial action.</p> <p>In situations where there are potential breaches to both the securities laws and Bursa's rules, there is a process to coordinate the actions of the SC and Bursa Malaysia. In such a situation, parallel enforcement may be taken. Further, there are provisions dealing with co-operation in the Regulatory Guidance. The exchange holding company must provide the co-operation and assistance as requested to assist the SC to perform its functions under the securities laws and applicable laws.</p> <p><i>Cross-market issues.</i> Domestic cross-market trading on Bursa Malaysia include trading of derivatives products with underlying assets in the equity market or physical commodity market, e.g. Kuala Lumpur Composite Index Futures (KLCI) contract with the underlying of FTSE-Bursa Malaysia (FBM) KLCI or Crude Palm Oil (OPO) futures contract with the underlying CPO spot market.</p> <p>Bursa Malaysia conducts the day-to-day monitoring of both the equities and derivatives</p>
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	<p>markets through ARAMIS. Internal arrangements are in place to monitor cross market trading abuses, including by:</p> <ul style="list-style-type: none"> <li>• Conducting ad-hoc and monthly domestic cross market surveillance to detect possible cross market abuses by checking on unusual patterns of price and volume movements, correlations between underlying cash and futures contract prices, impact to both the cash and derivatives and the participants involved;</li> <li>• At the end of each month, particularly 30 minutes prior to closing of the cash market, cross checking between equities and derivatives trading done by market participants involved in the major component stocks against those in the derivatives market with large exposures; and</li> <li>• Conducting cross-market checks as and when an inter-market issue arises, such as unusual movements in the underlying cash markets or vice versa, or if the circuit breaker is triggered.</li> </ul> <p>For derivatives with underlying assets in the commodity market, Bursa Malaysia monitors build ups of positions, unusual price movements and irregular delivery patterns in the derivatives market. If there are any trading concerns, Bursa would initiate an inquiry with the traders in the commodity market.</p> <p>Bursa Malaysia currently does not have any foreign trading or clearing linkages with any other exchanges or clearing houses. However, the presence of foreign investors is sizable. For November 2011, the Bursa estimated that foreign investors trading in their equity market represent 27.7% in value and 6.1% in volume of the market. Foreign shareholdings in the companies listed on the market accounted for 22.9% in value and 17.2% in number of shares of total shareholdings held at the depository.</p> <p>The SC has been a signatory to the IOSCO Multilateral MOU since May 2007, as well as a signatory to the Boca Declaration on Cooperation and Supervision of International Futures Markets and Clearing since 1997. In addition, the SC has entered into 32 MOUs with foreign regulatory counterparts.</p> <p>Further, Bursa Malaysia has MOUs with 23 established exchanges to share general information. Bursa Malaysia also has been a member of Inter-market Surveillance Group (ISG) since 2010. ISG is an information-sharing group, governed by a written agreement that requires every member to represent that it has the ability to obtain and freely share regulatory information and documents with other ISG members in order to assist in investigations and/or pursue disciplinary actions.</p> <p>The SC has access to information at the client level both on the equity and derivatives market, which allows it to identify concentrations and understand the overall composition of the markets. See the discussion of monitoring of large exposures under Principle 37 below.</p>
Assessment	Fully implemented
Comments	
<b>Principle 37.</b>	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	<p>Bursa Malaysia has the mechanisms and triggers in place to monitor and evaluate the risk of large open positions and credit exposures that might be a risk to the market or to a clearing house.</p> <p>With respect to the equity market, Bursa monitors:</p> <ul style="list-style-type: none"> <li>• Clearing participants' ability to meet their net amount due to the Bursa Malaysia Securities Clearing for three market days. The assessment is based on cash and banking facilities, underlying securities, CAR ratio position and Clearing Guarantee Fund contributions.</li> </ul>

- Each participant's CAR ratio.
- Each participant's Large Exposure Risk Return (LERR) to a single client or where debt exceeds 30% of Effective Shareholders' Funds (ESF) and LERR to single equity where it exceeds 250% of ESF.
- Clearing Guarantee Fund at risk through stress testing for the single largest projected liquidation loss.

All monitoring activities are automated in Bursa Malaysia's proprietary ARMADA system that automatically provides reports and/or alerts to the supervision team when warnings/violations have been triggered. POs are required to upload their data from their back-office system into the ARMADA system at end of business day. The SC has direct access to the ARMADA system and thus allows the SC to conduct additional daily monitoring of large exposures risk of the brokers.

Bursa Malaysia Derivatives Clearing monitors the concentration of open positions held by a CP in the market. If the concentration level is seen to pose a risk to the Clearing Fund, the derivatives clearing house may require the CP to make an additional deposit. Currently such monitoring is carried out using information on open positions that is extracted from the derivatives clearing system.

Market Surveillance in Bursa monitors the concentration of open positions held by clients in the market. They monitor the single client exposure and the alert trigger level is set at 30%. Once the alert is triggered, Market Surveillance calls the relevant broker to inform it to closely monitor its client's trading patterns. If the exposure continues to rise beyond a level determined by the Market Surveillance team, the broker will be instructed to cease creating new positions for that client. Currently such monitoring is carried out using information on open positions extracted from the ARAMIS system.

The derivatives clearing house also determines the initial margin payable in respect of open positions of CPs. The clearing house can also initiate an intraday margin process that would entail the revaluation of all open positions and the calculation of margins using the latest price and open position information available. The intraday margin process is initiated if considered appropriate by the derivatives clearing house after due consideration of changes in market prices, price volatility, trading activity and/or such other matters which may adversely affect the risk exposure of the clearing house.

In practice, the derivatives clearing house initiates the intraday margin process when the margin erosion is greater than 60% for any product and/or any contract month. The derivatives clearing house will then advise the affected CPs to pay the clearing house the necessary additional margin amounts.

Both the SC and Bursa Malaysia have access to information on the size and beneficial ownership of positions held by clients of intermediaries. For the equity market, this information is available from the Central Depository System, operated by Bursa Malaysia Depository. For the derivatives market, the required information is available within the ARAMIS surveillance system. For securities or positions held through omnibus accounts, requests for size and beneficial ownership information can also be made to participants, if necessary.

Under the CMSA, the SC has authority to take appropriate action against a market participant that does not provide relevant information needed to evaluate an exposure. Failure to provide information to the regulator is an offence and exposes a market participant to substantial fines and possible imprisonment (see for example, CMSA, s. 353 and 346B).

Further, Bursa Malaysia has the power to take action against any participant who fails to comply with its rules, including failure to provide relevant information. As discussed above under Principle 12, Bursa Malaysia may take an array of enforcement actions against a defaulting party, including imposing restrictions or conditions on any activities of the participant to reduce its risk exposure.

In general, under the CMSA, if an intermediary fails to meet the minimum financial requirements as specified by the SC or as provided in the rules of the stock exchange or a derivatives exchange, it must cease carrying on the licensed regulated activity immediately and inform the SC. It may not continue business unless a written consent is obtained from the SC. This is to allow the SC time to assess the situation and initiate intervention actions (such as imposing restrictions or corrective actions) if necessary, to protect clients' assets before the situation worsens.

The Bursa Malaysia Securities Rules impose pre-determined exposure limits on participants (Rule 1105.3). These include maintaining

- Liquid capital above total risk requirement;
- Core capital above operational risk requirement; and
- Minimum capital adequacy ratios for brokers and risk weighted capital ratios for investment banks, which are defined in the Bursa Malaysia Securities Rules.

The Total Risk Requirement is the sum of the Operational Risk Requirement, Counterparty Risk Requirement (credit risk), Position Risk Requirement, Underwriting Risk Requirement and Large Exposure Risk Requirement.

Where at any one time its Liquid Capital is equal or less than its Total Risk Requirement; or its Core Capital is equal or less than its Operational Risk Requirement, the participating organization must immediately notify the Exchange and take all necessary steps to increase its Liquid Capital or reduce its risk exposures. The Exchange may at its discretion upon receipt of the notice, give such directions to the participating organization as it deems fit and/or impose the appropriate conditions. See the discussion of the capital requirements under Principle 30 and the actions that may be taken on a decline in capital described under that Principle and Principle 31.

The Bursa Malaysia Derivatives Rules allow the exchange to order a TP to liquidate a portion of the TP's open position in its proprietary and/or client's account or to transfer existing positions to another CP or prescribe restrictions on positions. The Bursa Malaysia Derivatives Clearing Rules state that the margining will be determined by the derivatives clearing house for the purpose of managing foreseeable risk using a risk-based algorithm. The derivatives clearing house may also determine the margin required from each CP having regard to the open position of that CP. The derivatives clearing house may call for intraday margin, particularly when the margin erosion is greater than 60% for any product and/or any contract month. The clearing house will require the affected CPs to pay the additional amounts as additional security against the non-performance of obligations by the CPs under the open contracts.

*Information sharing.* Arrangements exist in both the domestic market and cross border that enable markets and regulators to share information on large exposures of common market participants or on related products with other regulators and markets. For example, the SC is signatory to the Boca Declaration on Cooperation and Supervision of International Futures Markets and Clearing Organisations. In addition, as a signatory to the IOSCO Multilateral MOU, the SC is obligated to share information with other MMOU signatories in relation to enforcement activities. See the discussions under Principles 13 – 15 and 36.

*Default Procedures.* The default rules and procedures are prescribed in Bursa Malaysia Business Rules and rules of the respective clearing houses and are made available to market participants through Bursa Malaysia's website. These rules set out when action may be taken; by whom (the clearing houses); and the scope of actions that may be imposed. In the case of the OTC bond market, default procedures or failed settlement procedures are set out in the Rules on Scripless Securities under the RENTAS system, administered by BNM.

Default procedures available in the Business Rules allow the clearing house to promptly

isolate the problem of a failing firm by addressing its open positions, as follows:

- the securities clearing house can settle the defaulting TCP's novated contracts through liquidating the contracts at the best prevailing market price and terms available and give instructions for transfers of securities to be effected into or out of a securities account of the depositor who is a party to the contract for the purposes of settlement (Bursa Securities Clearing Rules, Rule 4.2.2).
- For the derivatives market, the derivatives clearing house can liquidate the open contracts and/or novate the rights and obligations under the open contracts of the CP in default. (Bursa Malaysia Derivatives Clearing Rules, Rule 1001 and 1002).

For the equity market, all trades conducted on Bursa Malaysia Securities are subject to strict settlement procedures. If a selling CP fails to make the securities available for settlement by T+3, the Exchange upon advice from the securities clearing house can institute an automatic buy-in against the defaulting CP (Bursa Malaysia Securities Clearing Rules, rule 5.2).

The CMSA provides for modifications to the laws of insolvency and miscellaneous provisions in relation to the default procedures of the clearing house (Part II, subdivision 6). If any participant of Bursa Malaysia becomes insolvent, trades on the stock and derivatives exchanges continue to be enforceable. The CMSA states that the default proceedings of Bursa Malaysia Securities Clearing and Bursa Malaysia Derivatives Clearing take precedence over law of insolvency (s. 43).

See also the discussion under Principle 31 on the segregation of client assets and the range of actions the SC may take under the CMSA to protect client assets.

If a market participant is a member institution of the Perbadanan Insurans Deposit Malaysia (PIDM - the Malaysian deposit insurer), under section 115(3) of the Perbadanan Insurans Deposit Malaysia Act 2011 (PIDM Act), upon notification by BNM that a member institution has ceased to be viable, PIDM may proceed to assume control of that particular member institution. Upon assumption of control, PIDM will facilitate the transfer of agreements to clear or settle securities, futures, options or derivatives transactions held by the non-viable member institution to a bridging institution or a qualified third party to ensure that the rights and obligations under the agreement can be exercised and manage the stability of the financial system. The invocation of Part VII of the PIDM Act does not affect the ability of the clearing house to enforce the default procedures promptly to isolate the problem of a defaulting participant.

There are arrangements in place that allow market authorities for related products to consult with each other in order to minimize the adverse effects of market disruptions.

There are regular consultations and sharing of information between Bursa Malaysia and the SC. There are also both formal and informal arrangements in place to enable SC and BNM to consult each other in order to minimize the adverse effects of market disruptions.

There are controls in place in the equity markets to minimize risks to the stability of those markets, including strict buy-in procedures, trading limits and price limits as described above. In addition, Bursa Malaysia Securities has rules imposing circuit breakers. The Exchange may suspend trading in all securities traded on the stock market of the Exchange in the event of significant changes to its benchmark index. This is intended to moderate excessive volatility in the stock market. Trading in the entire market is halted temporarily in the entire market during normal trading hours. The circuit breaker is triggered when the FTSE based Composite Index (FBM KLCI) declines 10%, 15% and 20% below its closing index of the previous market day. A decline of 10% in a day triggers a one hour halt; a further decline of 5% triggers a further one hour halt. If, when trading resumes, there is another 5% decline (for 20% overall drop in the day), trading ceases for the rest of the day and resumes the next morning as scheduled. The trading halt(s) are immediately announced to the public.

*Short selling.* Short selling is governed by section 98 of the CMSA and the Bursa

	<p>Malaysia Securities Rules. Naked short selling is not permitted. Other types of short selling are permitted, subject to specific conditions.</p> <ul style="list-style-type: none"> <li>• Regulated short selling (RSS) is allowed. RSS means the selling of approved securities where the seller has, prior to the execution of the sale, borrowed the approved securities.</li> <li>• Permitted short selling (PSS) is also allowed. PSS means the short selling of units of an ETF and/or its constituent securities by market makers in the ETFs. The PSS activities are subjected to specified limits (Bursa Malaysia Securities Rules, Rule 305A.4(1)).</li> <li>• Short selling for day trading activities is allowed. Day trading is the taking of proprietary positions by a PO on an intraday basis.</li> </ul> <p>RSS and short selling for day trading activities are subject to specific requirements for timely reporting.</p> <ul style="list-style-type: none"> <li>• Currently the short sale turnover for a particular approved RSS security is displayed on a real-time basis through the price dissemination system of BTS. Short sale activities conducted by a client are transparent to the exchange and the regulators as RSS (including PSS trades) are tagged to a designated CDS account.</li> <li>• POs that undertake proprietary day trading must report when net Sell positions are not closed off by the end of the trade date and net Buy positions are not closed off by T+2. In addition, Bursa Malaysia's surveillance system has the ability to detect whether these positions are closed as required.</li> </ul> <p>There is no requirement for reporting of short selling activities under the PSS framework as these activities are limited to market makers of ETFs only. The activities of market makers are monitored closely through the Bursa's market making monitoring system. The Bursa has systems in place to monitor compliance with these requirements.</p>
Assessment	Fully implemented.
Comments	
<b>Principles Relating to Clearing and Settlement</b>	
<b>Principle 38.</b>	Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	No longer assessed under IOSCO methodology; subject to separate assessment under CPSS-IOSCO methodology for securities settlement systems, if appropriate.
Assessment	Not assessed.
Comments	