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"The Direction Of Securities Commission And Our Corporate Sector"

By

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**at a reception hosted by
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Yang Mulia Tunku Ya'acob bin Tunku Abdullah, Distinguished Guests, Ladies and Gentlemen, I am honoured to have been given the opportunity to speak at this reception of the National Insurance Association of Malaysia this evening on 'The Direction of the Securities Commission and the Corporate Sector'.

In light of the bottoming-out and the expected recovery of our economy in 1999, this topic is all the more pertinent for any number of reasons. In my previous life as a member of an international professional firm, I think that this crisis has exposed significant shortcomings in regulatory and corporate structures in Asia. I believe that all of us here tonight must address these weaknesses where relevant to strengthen our nascent economic recovery. I shall dwell briefly on some of the initiatives that are underway at the Commission which are broadly intended to restore confidence in our market and to facilitate capital-raising.

Perhaps the most topical of all our initiatives at this juncture is our efforts at enhancing the standards of corporate governance. To this end, the Securities Industry Development Centre held the opening of a seminar on corporate governance as a curtain raiser for the Finance Committee Report on Corporate Governance. Before I proceed any further, I would like to apologise if there are some of you here who attended yesterday's seminar. But I feel that the importance and relevance of corporate governance to the financial well being of Malaysian corporates is too significant to ignore in the context of this evening's topic.

Over the last two years, Malaysia along with some of her Asian countries has faced an avalanche of criticisms over the inadequacies of governance in both the public and private sectors. As a Malaysian regulator, I shall limit my speech to governance in the capital markets. Even before the crisis began, the Commission had recognised the relevance of good governance in the capital markets through [1st business plan]. But to be sure, it was only the crisis that underlined the importance of good governance to both the emerging markets and investors in the emerging markets. This said, I believe that while it is wrong to attribute the crisis to inadequate standards of corporate governance, weak governance nevertheless did not help matters. By the same token, however, I am certain that if Malaysian corporates could have demonstrated that they were close to ideal standards of corporate governance, the market reaction might have

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been less severe. So much for the soul-searching. What has the Commission done about this? What do we intend to do about it?

The report that was released yesterday is one product of the Commission's commitment to enhancing governance in Malaysia. The action plan on corporate governance will enhance market integrity by ensuring corporate credibility and restore investor confidence. While this is clearly an integral step towards the rehabilitation of our markets in the international community, I can well understand if you ask, "What's in it for my business?" Now more than ever, Asian corporates are hunting for capital in their bid to rebuild their balance sheets and to restructure their businesses in anticipation of renewed economic activity. Malaysian corporates will have to compete with other emerging market counterparts for such capital. Although it is always possible to attract capital by enhancing the returns to investors, it is an inefficient use of a company's financial resources when there is a cheaper alternative. Studies in developed markets have shown that good corporate governance can materially lower cost of capital. In the new paradigm that Asian companies are now operating, we have to weigh the cost of maintaining the status quo against the benefits of meeting the requirements of international capital funds. I strongly believe that those companies that embrace and are seen to abide by the concept of corporate governance will find it that much easier to attract funds at a lower risk premium than those that chose to ignore the new reality. For companies that seek international capital, the reality now is that funds are increasingly asking questions on corporate governance: how safe are these companies, how transparent are they, are there really checks and balances?

Let me give you another example of how I see corporate governance translates into the bottom line at the level of directors. We have heard the international community lecture Asia about the role of the board as a check and balance to protect minority investors. To me that captures only one aspect of good corporate governance. Yes, a well-composed board of independent and executive directors is there to provide a check and balance for times when things go off track. But more importantly the board can have a real economic purpose: directors are there to help to build better business strategies, to talk to each other on what the company can do better so that the company can be more attractive to investors. Good corporate governance can clearly have a positive impact on your bottom line.

Now let me turn to enforcement. To some, enforcement may have seemed an unwarranted intrusion in the capital-raising binge that preceded the crisis. The Commission's enforcement efforts in the years prior to the crisis were seen by some as an attempt to dampen the exuberance of the market. Far from that, enforcement is intended to reinforce confidence in our market, to reassure market participants that our market is well-regulated against abuse and is able to function in an orderly manner. We have now learnt that confidence, perception, call it what you will, is easily destroyed and not easily restored. With the loss of confidence in our markets, our corporates' ability to

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raise financing at an acceptable price has been adversely hamstrung at a time when it is most needed.

It is for this reason that I will do my utmost to ensure that the Commission is able to exercise the full extent of its enforcement powers as far as it is permitted under the law. Nothing short of that. The Commission will step its efforts to push for the amendments of the relevant laws and regulations and to take the necessary steps to prosecute breaches. For example, in November 1998, the Securities Commission Act (SCA) 1993 was amended to incorporate inter alia a new section 39C on the compounding of offences under the SCA to broaden the Commission's compoundable powers. The Securities Commission (Compoundable Offences) Regulations 1998, which prescribes certain offences under the SCA to be compoundable, came into effect on 1 January 1999. Since 1 January, the Commission has twice exercised its compounding powers. Such action is evidence of the Commission's resolve to take the necessary measures to safeguard the capital market for the greater good of Malaysian corporates.

Enforcement, however, takes on multiple dimensions. The Commission and front-line regulators such as the exchanges provide one line of enforcement. In my mind, however, enforcement starts at the corporate and advisory level. Directors and officers have a legal, economic and national duty to ensure that their organisations comply with rules, regulations and codes not just in form but in substance. Advisors - merchant bankers, lawyers, and accountants to name but a few - are also agents of enforcement. Due diligence is not simply a compliance responsibility that arises out of the advisors' legal obligations, it must extend beyond such a simple perspective. Due diligence practices must lead to higher professional standards for all, greater disclosure of information and more accurate representations. Without effective 'enforcement' on each of these dimensions, our capital market will remain stymied and without depth; our companies' ability to compete with other companies to raise funds at a lower cost of capital will be hampered; and, most important of all, our economic recovery will be undermined.

Enforcement is particularly important to the credibility of our capital market if we are to continue to move towards a disclosure-based regime (DBR). As most of you are aware, the Commission has, for a long time, taken the lead in moving our capital market from a merit-based system of regulation to a disclosure-based framework of regulation. I believe that this progression will facilitate capital raising activity of corporates.

One early example of DBR is the "freeing" of pricing of securities in initial public offerings and rights issues. Previously, the Commission determined such pricing issues. Today, issuers, together with their advisers/underwriters, now price these issues without regulatory intervention. In 1998, the Commission introduced various other initiatives in these difficult times which also represented an acceleration of the Commission's DBR programme, including:

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- a revision to the shareholding spread requirements for new listings;
- a liberalisation of the limits and rules governing the issue of warrants and convertible securities;
- allowance for dilution in earnings per share resulting from acquisition proposals;
- a granting of dispensations of profit forecasts and projections in public documents; and
- allowance for the undertaking of 2-call rights issue by listed companies whose share prices are trading around or below par values.

In the course of the Commission's second business plan, there are plans for further liberalisation in the areas of securities pricing, valuation of assets and utilisation of proceeds from capital-raising exercises.

However, high standards of due diligence, disclosure and corporate governance practices are the pre-requisites for the new regulatory system to work. The Commission by itself cannot ensure that these standards are met without the co-operation and complicity of all market participants. It is everybody's responsibility to comply with the rules and standards in substance to help to restore and enhance investors' confidence in our capital market. Hence the importance of the enforcement. This said, there has been a discernible shift in mindset in the market. If the market previously believed that the maintenance of confidence was the sole responsibility of the regulator, the industry-driven Due Diligence Guidelines is evidence that the private sector is now reacting positively to our call for collective responsibility. In the case of due diligence, it started life an imposition of responsibility under Section 32B of the SCA and as a Commission-originated guidance notes on how the industry may proceed to carry out these obligations in practice. The recent launch of the recent industry effort is undoubtedly a step in the right direction.

From a more strategic angle, the Commission intends to streamline capital market regulation and to develop the depth and breadth of the capital market. Ever since the establishment of the Commission in 1993, many have asked for better co-ordination and a more consistent approach to regulation and to the strategic development of the financial sector. Indeed, it is now commonly accepted that one cause of the crisis has been the overdependence on the banking sector. By the same token, it is also accepted that the capital market must play a pivotal role in revitalising the economy and in mitigating such dependence in the future. For this reason, even as we pick up the pieces after the storm, the Commission is already reviewing ways to ensure that the capital markets can address the need of the real economy.

I believe that the capital market has to play a larger part in the growth of the real economy by providing the necessary funding to finance the needs of the real economy. Only a well-developed, efficient, innovative and competitive financial system, of which the capital market plays an integral part, is capable of sourcing and mobilising financing requirement of such magnitude at the lowest possible cost. A second reason is that



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financial services contribute directly to real gross domestic product. At the present moment, contribution of the financial services industry, is disproportionately low vis-à-vis its pivotal role in the continued success of Malaysia's economic dynamism.

Crisis-afflicted Asia requires significant refinancing. As such, the scope for the export of financial services is tremendous. This latter fact is not lost on our regional competitors such as Singapore and Hong Kong as can be seen from their recent actions. Our lack of capacity in providing financial services has hampered our efforts to become a regional financial centre and a leading provider of financial services in East Asia where a huge post-crisis market now awaits. All of us together can and should address whatever obstacles there may be to ensure that Malaysian institutions can take advantage of this unique opportunity.

I hope that I have given you a flavour of the direction of the Commission. I hope that I have conveyed to you the optimism in the Commission that we shall with your help rebuild our capital market and lift onto a higher plane in the course of the next three years. And, perhaps, more importantly, I hope that I have communicated the importance of the role of all market participants.

Thank you once again for having given me this opportunity to speak at this forum on a subject that is important to all of us who have a stake in Malaysia.