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"Enhancing governance and transparency in Malaysia's capital markets"

By

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Ladies and gentlemen, it is a great honour and pleasure to have been given this opportunity to address the Asia-Pacific Region Investors Conference, and I would like to thank Merrill Lynch for inviting me to speak to you today.

Signs of success

This conference is especially timely for Malaysia in that it has been arranged at a time when the Malaysian economy appears to be poised for recovery and when optimism over the outlook for 1999 is growing. Growth prospects appear to have improved, with the latest estimates from Bank Negara putting real GDP growth at around 1-2% this year; the current account balance has registered a surplus for four consecutive quarters now; and foreign reserves, at over US\$26b, are at their healthiest levels in recent years. I am sure that my colleague from Bank Negara will have more to say on the economy so I shall not dwell on this for too long.

I should like to note, however, that domestic confidence in Malaysia's economic prospects appears to have stabilised, with at least one global survey suggesting that domestic confidence in the Malaysian economy may be among the strongest in the region. We have certainly seen a marked improvement in the performance of the stockmarket, which as you know provides a barometer of confidence, so much so that Composite index, currently at around the 500-point level, has gained over 100% since the lows during the third quarter of 1998! While that figure may be more reflective of how much the market had been over-sold from the panic that ensued during the crisis, the point is that the market appears to have recovered its previous trend.

Importantly, there are signs that foreign investor sentiment appears to have improved. A string of positive recommendations has emerged over the last quarter, strongly approving of Malaysia's corporate restructuring efforts and noting the relative undervaluation of the equity market. There has also been broad approval of Malaysia's current economic policy mix for encouraging demand expansion. In addition, policy and

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economic developments have spurred a review of Malaysia's credit standing, while markets have begun pricing the country's sovereign risk more favourably. The benchmark yield spread of Malaysian international debt continues to decline substantially, from more than 1,000 basis points over US 30-year treasuries in September 1998 to 547 basis points at the beginning of this year to just under 280 basis points currently. Recently, Standard & Poor's upgraded Malaysia credit rating outlook to positive, citing among other things

- The government's pro-active policy response in a difficult domestic and external environment
- The halt in capital flight following the government's introduction of selective exchange controls
- Diminished risk that capital controls would be followed by imprudent credit policies and the government's success in managing inflation expectations
- The right focus of the government's recapitalisation and asset management agencies

It is encouraging to see strong indications that Malaysian equity will soon be reinstated into certain major global and regional benchmark stockmarket indices. The International Finance Corporation announced recently that it intends to count Malaysia in the calculation of its key indices later this year. The challenge, I believe, will be to see that Malaysian equity will return to other benchmark indices in the near future.

These indicators of success are to be welcomed and arguably provide a case in favour of an increased exposure to Malaysia. However, as a regulator, my aim here is not to provide you with investment advice that I am certain you would receive from your sales teams. Rather, what I intend to do is to give you an idea of some initiatives that I am leading at the Securities Commission aimed broadly at restoring investor confidence in the Malaysian market, which I believe will provide you with the assurance that the nascent recovery I have just described is based on real and substantial progress in addressing the substantial issues of the day.

With the onset of the financial crisis, the Securities Commission, and, where relevant, market institutions, have re-doubled efforts to

- maintain systemic stability
- restore market confidence
- facilitate the raising of funds
- rehabilitate the securities industry
- improve market transparency and corporate governance

What I wish to do for the next few minutes is to focus on the last of these efforts, that is, to improve market transparency and corporate governance, not because the others are not important but simply because I think this is an area that would be most relevant

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to the theme of my discussion. The commission has not lost sight of the fact that confidence in such structures is a mainstay of the long-term development of Malaysia's securities industry. Unfortunately with confidence, it is difficult to attain. And once lost, it is devilishly hard to regain. Therefore, I should like to spend the next few minutes focusing on the initiatives that are being taken to regain corporate credibility and raising investor confidence.

Enhancing standards of corporate governance

One of the most significant initiatives at this point in time is current efforts at enhancing standards of corporate governance. Over the last 18-24 months, Malaysia, among other Asian countries, has faced a critical onslaught over the inadequacies of public and private sector governance. Yet, it was the crisis that emphasised the importance of good governance to both the emerging markets and to investors in emerging markets. While I believe that it is wrong to attribute the crisis to inadequate standards of corporate governance, weak governance nevertheless did not help matters. By that token, I am certain that if Malaysian companies could have demonstrated that they were close to ideal standards of corporate governance, the market's reaction might have been less severe.

Efforts to enhance standards of corporate governance in Malaysia have been on-going. Long before the start of the crisis, relevant regulators have been reviewing and strengthening the various laws, regulation and listing rules with a view to enhancing the standards of corporate governance in the country. But to be sure, these efforts have been piecemeal in nature. The formation of a high-level Finance Committee on Corporate Governance last year-on which I am honoured to have first sat in my previous life as a president of the Malaysian Association of Certified Public Accountants and now as a regulator-was a watershed, bringing together top-ranking members of the government, the corporate sector, industry organisations and regulatory agencies to undertake a comprehensive review of corporate governance in Malaysia.

Their work has culminated in a report, released to the public on March 25th this year after a period of consultation, providing explicit recommendations on strengthening the statutory and regulatory framework for corporate governance, and to enhance the self regulatory mechanisms that promote good governance. In addition, the report recommends the need for training and education programmes to ensure that the framework for corporate governance in Malaysia has the necessary human and institutional capital support. This is also with a view towards inculcating a philosophy and culture of good corporate governance within all market participants including Malaysian boards. All in, the report makes some 70 recommendations covering areas ranging from legal reform to best-practice codes to enforcement, education and training. Initial reactions to the report has, to say the least, been positive and therefore encouraging. One commentator has suggested that the report's recommendations " ..

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serve as a model for other markets within the Asia-Pacific Economic Co-operation (APEC) group."

In the area of codes of best practice, the report proposes a Malaysian code on corporate governance, which establishes a set of principles and best practices for good governance directed principally at boards of listed companies. It is aimed at increasing efficiency and accountability of boards by making their decision-making processes independent. The need for a code was inspired in part by a desire for the private sector to initiate and lead a review, as well as to establish reforms of corporate governance standards at a micro level. This is borne out of the belief that, in some aspects, self regulation is preferable and that the standards developed by those to whom they apply would be more acceptable and thus more enduring. The establishment of a Malaysian code was also driven by the perceived need for domestic companies to be more efficient and well-managed than ever before to meet existing and anticipated competition from abroad.

Recommendations on the reform of laws, regulations and rules embrace key aspects of corporate regulation, including

- clarifying the responsibilities of key corporate participants
- enhancing obligations of those participants especially in related-party transactions
- improving the accuracy and timeliness of disclosures
- enhancing the value of general meetings
- enhancing the efficiency of shareholder redress for grievances
- enhancing the enforcement of good corporate conduct

It is important to note that at this stage the corporate governance report marks a beginning and not an end. It provides a comprehensive action plan, identifying various paths for moving ahead with improving standards of corporate governance. The next stage, involving the timely and effective implementation of the recommendations is extremely crucial, and in this regard the government has agreed to the Finance Committee's recommendation for the formation of various implementation committees, as well as for the continued existence of the Finance Committee to oversee and report on their programmes and progress. The Securities Commission will continue to act as secretariat to the committee for this next phase.

Other initiatives aimed at investor protection, and transparency and disclosure

The commission has however taken on various other key initiatives to ensure that the issues of increased transparency and minority shareholder protection, higher standards of business and greater due diligence are addressed. For instance:

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Strengthening rules on related-party and interested-party transactions

In response to previous episodes where related-party and interested-party transactions were undertaken without due regard for the interests of minority shareholders, the SC reviewed rules on such transactions and announced in July last year that it would be strengthening them by directing the KLSE to incorporate several changes to its listing requirements. These changes related to a widening in the scope of rules, enhancing disclosure, voting rights, the appointment of corporate advisers and directors' responsibilities.

In relation to possible abuses by large or controlling shareholders in connection with related party transactions, KLSE listing rules now require a company to appoint an independent corporate adviser to advise minority shareholders, and prevent directors, substantial shareholders or interested parties from voting on the transaction.

Enhanced corporate disclosure and the move towards disclosure-based regulations

Reporting and disclosure requirements for listed companies have been stepped up. Public listed companies must now provide quarterly reports of their financial statements to help provide timely information to assist investors in their decisions and to increase the accountability of public listed companies, with a view to enhancing corporate governance. The move is in line with our emphasis on greater corporate disclosure in terms of both content and frequency. The contents of quarterly reports will include information relating to companies' balance sheet, income statement and explanatory notes. This is of course in addition to the audited annual accounts, together with the auditors and directors reports, which are required to be issued within four months from the end of the financial year.

It should be noted that the emphasis on disclosure has been present since even before the crisis occurred. The commission has for a long time taken the lead in moving the securities markets from a merit-based system of regulation to a disclosure-based framework. Previously, the commission determined the pricing of securities in initial public offerings and rights issues. Today, issuers, together with advisers and underwriters, now price these issues without regulatory intervention. I believe that this progression will, among other things, facilitate capital-raising activity by companies.

The introduction of the new "Policies and Guidelines on Issue/Offer of Securities" in December 1995 kick-started the process. The guidelines include specific chapters on the maintenance of high standards of disclosure, as well as due diligence and professional responsibility expected of promoters, directors and management of public companies and their corporate advisers. The emphasis on disclosure by the public company, its officers, its financial advisers and experts is further amplified in the new guidelines particularly in respect of the contents and style of presentation of prospectuses. For example, prospectuses issued should contain all such information that is reasonably

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expected by investors to enable them to make an informed assessment of the company and the rights attached to the securities that are being issued or offered, while the style and presentation of the prospectus should be such that it would be easily comprehended and understood by potential investors.

In relation to improved disclosure, I should like to highlight to you the establishment of the Malaysian Accounting Standards Board (MASB) in March 1997 as a technically independent authority with the responsibility for the development of financial accounting and reporting standards in Malaysia. The situation is unique in that Malaysia is the only jurisdiction outside of the key developed markets to have established such an institution. MASB, together with the Financial Reporting Foundation, makes up the new framework for financial reporting in Malaysia, which consists of an independent standard-setting structure with representation from all relevant parties in the standard-setting process, including preparers, users, regulators and the accounting profession.

Improved regulation in relation to take-overs and mergers

The introduction of a new Code on Take-overs and Mergers will enhance previous deficiencies, especially in the area of transparency and minority interests. In particular the new code seeks to give minority shareholders a fair opportunity to consider the merits and demerits of an offer and to allow them to make informed decisions. To support the new code and to facilitate its interpretation, the commission has released practice notes that govern the treatment of specific situations or elaborate on the interpretation of certain sections of the Code. The notes also list the circumstances or transactions to which the commission would consider granting exemptions. The practice notes carry the weight of rulings and their breach carries severe penalties. The commission has also approved a proposal submitted by the KLSE to amend its Listing Requirements, which were amended consequential to the coming into force of the new Code.

Moreover, a new regulatory framework on take-overs and mergers includes provisions imposing criminal liability on the relevant parties to a take-over offer for providing false or misleading information to the commission and shareholders. Additionally, relevant provisions have been amended to reduce the time taken to "creep" into control of the company. Amendments to the Securities Commission Act 1993 have made the commission as the sole authority to grant exemptions from provisions of the new code, and I should like to emphasise that the commission must and will observe the principles and objectives specified under law in exercising its statutory powers-including when granting an exemption. Moreover the commission will also ensure that take-overs and mergers will take place in an efficient, competitive and informed market.

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Improved regulation and enforcement in relation to insider trading activities

In relation to insider trading, legislation has been amended to resolve weaknesses in insider trading rules in Malaysia and introduced civil enforcement provisions in legislation regarding insider trading. And in order to achieve greater transparency of ownership, several amendments to the Securities Industry (Central Depositories) Act 1991 now prohibit shareholders from hiding behind nominees in general by requiring securities accounts to be opened in the name of beneficial owners or of authorised nominees.

Strengthening enforcement

I have spent the last few minutes on the enhancement of corporate governance standards, investor protection laws and transparency. For such efforts to be truly effective and worthwhile, market participants must of course comply with standards, codes of conduct, rules and regulations, and in this respect effective surveillance and enforcement is crucial. It is for this reason that I wish to stress that I will ensure that the commission seeks to exercise the full extent of its enforcement powers as far as it is permitted under law. In particular, 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.

With this in mind, the SC is bolstering its supervisory and enforcement capabilities to focus on the protection of potential and current investors, and has stepped up efforts on enforcement. In particular, the SC is undertaking steps to increase its capacity in this area by boosting the strength and quality of its enforcement staff. Their role has been facilitated by amendments to five securities laws-including the Securities Industry Act 1983 and the Securities Commission Act 1993-which among other things provides for improved enforcement powers.

The commission is aware, however, that enforcement takes on multiple dimensions. While the commission and front-line regulators, such as exchanges, provide one level of enforcement, in my mind enforcement starts at the corporate advisory level. The commission recognises that it cannot ensure higher standards of due diligence, disclosure and corporate governance by itself and that responsibility for complying with rules and standards in substance requires complicity on the part of everyone involved with the market-including the government, regulatory agencies, professional bodies, standard setters, corporate leaders, board members and the investors themselves. It is therefore encouraging to note a discernible change in mindset of the market. If the market previously believed that the maintenance of confidence was the sole responsibility of the regulator, the release of industry-driven Due Diligence Guidelines is evidence that the private sector is now reacting positively to the commission's calls for collective responsibility.

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Other initiatives by the Securities Commission

As I mentioned earlier, the commission is pursuing major initiatives in a variety of other areas as well. While time does not permit me to relate all of them to you, allow me to touch upon several which I believe to be of particular significance. One particular concern of the commission throughout this crisis has been to guarantee the strength of market intermediaries under its jurisdiction. In relation to the stockbroking industry, the commission is actively involved in the restructuring of stockbroking companies with the Kuala Lumpur Stock Exchange and Danaharta Nasional, the national asset management company, to ensure recapitalisation and regularisation of the financial positions of distressed brokers.

Prudential standards in the Malaysian stockbroking industry have been raised to a level that is in line with best international practices and certainly among the highest if not the highest in the region today. On December 31st last year, the commission approved a new risk-based system of capital adequacy requirements which will replace the current system of minimum liquid funds. Moreover, the commission is directing the establishment of a client asset protection framework by the KLSE to enhance investor protection and to increase public confidence in the industry.

Efforts are also being made to improve the clearing and settlement system, and to strengthen the market microstructure. For example, the commission is overseeing the implementation of a full delivery-versus-payment (DVP) system, and we are examining the viability of having the existing clearing house for share trading as a central guarantor to all trades.

Closing remarks

Ladies and gentlemen, there is an increasing body of opinion which is recognising Malaysia's efforts. If you look closely, substantial progress is being made in addressing substantive issues. In the last 20 minutes or so, I have elaborated upon some of the key measures that have been aimed at restoring confidence in Malaysia securities industry and markets. Now I leave you to judge for yourselves Malaysia's potential as an investment opportunity.

Thank you.