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S P E E C H E S

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Special Forum I
"Beyond the Crisis - Towards a More Efficient and Transparent Capital Market"

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Distinguished Guests,
Ladies and Gentlemen,

Introduction

The battering of Asia's capital markets from the effects of the financial crisis has been the primary topic of discussion over the past two years. As you know, a great deal of time and effort has been concentrated towards management of the crisis. It is only recently that investors have renewed their search for value in Asia's markets, so as to enable us to turn our minds to the way forward.

The crisis, as crises do, highlighted certain weaknesses or perceived in our corporates that have shaken the confidence of investors. The wake of the crisis therefore leaves us with many issues to address. In my presentation this morning, I am to address this one: **"how do we move towards a more efficient and more transparent capital market"?** The functions of the capital market include, after all, price discovery, which means that it also seeks to resolve issues of information asymmetry. Transparency is thus is a sina qua non of proper pricing and, consequently more efficient markets.

Let me begin by stressing that the SC has always worked towards ensuring and enhancing the integrity of the capital market, while being mindful of issues of systemic stability. The crisis has critically tested our efforts. Ensuring the highest standards of integrity, systemic stability and development remains high in the agenda of the SC and I would take this opportunity to reaffirm SC's commitment towards achieving these objectives.

Transparency

I will concentrate the first part of my speech to issues of transparency, and then, allow me a few moments to air my views on other aspects that go towards the makings of an efficient market.

Ladies and Gentlemen, as we all know, one measure the "integrity" of a capital market is the confidence that an investor can have that the companies in which he invests provides regular, timely and accurate disclosures. As I mentioned earlier, information is a key to enabling our investors to make sound investment decisions, permitting price discovery and ensuring that funds are raised in the most efficient manner.

I will like to describe some of the measures that the SC has taken, and will continue to take towards ensuring a more transparent capital market. These measures include (1) the **move towards a disclosure-based regulatory (DBR)** system; (2) enhancement of corporate responsibility and amendments in the regulations and laws to **protect investors**.

DBR

The SC first introduced the disclosure-based regulation (DBR) system in 1996, with the full system scheduled for completion with the commencement of Phase 3 from January 2001 onwards. The objective of DBR, as many of you will know by now, is to promote greater efficiency and transparency. Under this regulatory regime, transparency is to be enhanced through comprehensive and timely disclosures. **The onus of assessing the merit of any investment venture is restored to those whose capital funds are at risk**. The regulator, in this case, slips from the foreground to the background.

The economic crisis and stock market debacle accelerated the SC's implementation of certain measures under its three-phased DBR plan. Amendments to shareholding spread requirements and dispensations of profit forecasts and projections in public documents, originally scheduled for later implementation in third phase DBR, was brought into effect in April 1999.

The objective of DBR is not merely on increased disclosure of information by issuers, but is aimed at improving the quality, timeliness and relevancy of information disclosed as well as enhanced accountability among market participants. Indeed a survey conducted by the SC shows the recognition by market participants that:

- the enhanced responsibility and liability of issuers and advisors would have a positive impact on the market; and
- the shift in regulatory philosophy would create efficiencies in the market place.

This is particularly encouraging to the SC, as it is our belief that the success of this scheme depends, to a large extent, on this understanding and the willingness of participants to adhere to this system.

Enhancement of corporate responsibility and amendments in the regulations and laws to protect investors

As the regulator slips into (not quite oblivion) but the DBR background, the question of corporate responsibility becomes increasingly pertinent.

On our part several measures were taken over the course of the crisis to the promote cause of "transparency". These included the following:

- Amendments to the KLSE listing requirements requiring public-listed companies to provide financial statements on a quarterly basis to ensure corporate information is available on a timely basis.
- Rules on related-party and interested-party transactions have been changed to better protect minority shareholders. Amongst other things, the revised rules also call for enhanced disclosure to be made in the announcement and circular to shareholders in respect of such transactions, before such transactions may be approved by the investors.
- Amendments were made also to both the Companies Act and the Securities Industry Act, and now the reporting threshold with regard to a "substantial shareholder" has been reduced from 5% to 2%. Controlling owners may therefore be more readily identified, and reporting obligations have additionally become more stringent. Legislation also now prohibits persons from hiding behind nominees.
- The **Takeover Code** has also been amended to require higher standards of disclosure of information and to ensure the adequate and timely disclosures to minority shareholders.

This has addressed some of the measures that have already been taken over the course of the crisis. However, these measures in themselves should not be considered to be sufficient. The question is therefore, what else do can we do to enhance transparency, beyond the crisis?

Well, not that I like flogging live horses, but there are the proposals in the Finance Committee Report on Corporate Governance. To my mind, and objectively speaking of course, there are many forward looking recommendations in the Report that deal with the issue of transparency. Of note are some of the following:

- Legislation should have greater deterrents in relation to disclosure requirements. Thus, for instance, it will permit damages to be claimed for false or misleading dissemination of information, and well as for criminal and civil sanctions in relation to deliberate, reckless or negligent failure to comply with the obligations to disclose under listing rules. For example, at present, there is no civil liability imposed by statute for failure to make continuing disclosures pursuant to the listing rules. The Report proposes that the failure to disclose, as well as the

intentional, reckless or negligent failure to notify such information to the exchange, will be subject to both civil and criminal sanctions. Also, in relation to the continuing disclosures, it is proposed that securities legislation will provide for recovery of damages by the investor for misleading or deceptive statements or information. This will certainly encourage greater due diligence on the part of corporates submitting information to the exchanges, and consequently to exchanges.

- Also, corporates will be required to disclose in their annual report, the extent to which they have complied with corporate governance principles of best practice - another incentive that should focus the minds of boards and management on the necessity to comply with governance standards.
- The Listing requirements require companies to ensure that the notice calling the meeting contains sufficient information to enable a reasonably prudent member to decide whether or not he will attend a meeting.
- In addition, the SC is looking into an "incentive" scheme that will encourage corporates to comply with good corporate governance standards.

However, you may ask, what is the use of so much disclosure, if investors do not make use of the information imparted to them? Well, measures are also being proposed to educate the general investors and we believe with increasing awareness through the media, discussion forum and university programmes, educational pamphlets, investors may be encouraged to be more retrospect in their ways of investments.

The SC on its part, is committed to taking a meaningful role in investor education. It is methods to make education affordable and accessible, while maintaining its quality, as well as urging market practitioners to work together in order to ensure a proper balance and perspective.

Efficiency

Now I would like to turn to some of my other thoughts on how, apart from greater transparency, markets may be made more efficient. This includes (1) improving market structure for increased efficiency (2) improving front-line regulation for greater market operational integrity and (3) technological advances.

Insider trading On improving market structures, insider trading laws were substantially amended in 1998. The new framework covers a broader definition of persons who can be caught as an "insider". Firstly, any person who possesses inside information is prohibited from trading in the relevant securities. Secondly, a person who possesses inside information is also prohibited from communicating that information. Insiders are no longer limited to persons with fiduciary duties such as CEOs or directors but can include all persons who have in their possession information that is not generally available. Such persons may include a member of a director's family, a body corporate that is associated with that director, or a substantial shareholder. In addition, a person

who communicates inside information to enable another person to use it for his advantage, the second-mentioned person, known as a "tippee", can also be charged for insider trading. With adequate enforcement, I believe, the inefficiencies and imperfections caused by the unequal distribution of information, particularly by persons who in any event control the company, can be reduced.

Our insider trading laws are now comprehensive and at least on par with those in some of the developed nations. Penalties have also been increased, entailing punishment on conviction of both imprisonment and a maximum fine of RM 1 million.

Front line regulation

As an ongoing measure, the SC has been working with industry to develop a framework for front line regulation (FLR). I am pleased to report that the draft blueprint on front-line regulation (FLR) was completed in 1998. The SC and the KLSE in a joint Task Force is now working on the implementation of the programme, and is progressing well. The SC is still dedicated to achieving full FLR, by the KLSE in the year 2001 and other institutions in the ensuing years, which will give the exchange extensive responsibility in both primary and secondary markets.

A front-line regulatory framework follows a self-policing approach and it is premised upon the compliance of members with their own rules and ensuring responsible action in the interest of the investing public. The fact that members participate directly in the formulation and enforcement of rules, regulations, practices and procedures that govern the operations of the market, not only ensure the market develops according to commercial needs but is the best incentive for compliance.

What role, then, remains for the SC? The statutory regulator is intended to play a crucial role in providing leadership on broad policy matters and strong enforcement whilst market institutions, as the front line regulator determine detailed operational matters. This is indeed the basis for the development of DBR. For the system to work efficiently, the statutory regulator must have sufficient regulatory oversight to ensure that FLRs enforce securities regulations as well as their own market conduct rules and that they act to minimise potential conflicts of interest and restraints on competition.

Code of conduct for market institutions.

In this connection with codes of conduct, there has been a great deal of talk with regard to corporate governance of listed corporations. I believe that governance is not limited to corporations.

Similar principles of accountability should pervade at all levels of the securities industry, including market intermediaries such as brokers, investment managers and market institutions. Governance can only be effective if all parties fulfil their respective responsibilities to carry on their business in a fair and efficient manner.

In particular, regulatory decisions must be taken and seen to be taken with full information and exercised in the interests of good regulation rather than for the personal purposes of individuals concerned including members of the board and management. Market institutions should have their own code of conduct. These provisions should set out the fundamental obligations and overall governance structure of market institutions. Each institution must evaluate its governance structures and have its own arrangements to discharge its affairs in a manner that commands public confidence.

The SC, as part of its efforts to promote good governance, is setting up a Steering Committee, comprising myself as Chairman of SC and the Executive Chairmen of KLSE, MESDAQ, KLOFFE and COMMEX to develop a Code of Conduct for market institutions. The Code will principally aim to ensure that regulatory decisions are not improperly influenced by conflicts of interest.

Technological advancements

Finally, on the efficiencies that technology can offer us, there is so much evidence that technological developments will spur innovation, structural changes in the capital market and create greater efficiencies that to go into them in detail would be clearly unnecessary. The SC considers E-commerce is an area where the regulatory infrastructure should respond in a positive and timely manner to facilitate market developments and not hinder innovation in market products and processes. Indeed, the implementation of the integrated electronic system is one of the many benefits towards meeting investor needs at lower costs. In the area of E-commerce, the SC's efforts are concentrated on developing a framework for its orderly and effective implementation in the capital market, in line with national initiatives and international developments. An underlying principle of this framework is that regulation does not impede the development of technology in this field, bearing in mind issues of investor protection, and also that companies are not disadvantaged over another in the same field, by virtue of regulatory inconsistencies. We will soon be consulting industry on this framework.

Conclusion

In closing, let me emphasize that the SC and its constituents are taking steps to enhance market efficiency, transparency and integrity and will continue to do so. After the crisis, it has become all the more crucial to restore corporate credibility and growth of the capital market. Investor confidence in market and regulatory infrastructure should therefore be a prime objective of all market participants. No matter how hard the SC can attempt to instil confidence by regulation, enforcement, prescription and exhortation, much will depend on market participants themselves.

Thank you.