



**UNIVERSITI PUTRA MALAYSIA**

**THE SECURITIES INDUSTRY IN MALAYSIA: SPECIAL  
REFERENCE TO KLSE AND THE REGULATORY  
FUNCTIONS OF THE SECURITIES COMMISSION**

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**THE SECURITIES INDUSTRY IN MALAYSIA: SPECIAL  
REFERENCE TO KLSE AND THE REGULATORY  
FUNCTIONS OF THE SECURITIES COMMISSION**

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## PREFACE

The securities industry in Malaysia is a large area for research, and fraught with inadequate examples as the industry is still young, in terms of its legal and regulatory framework.

This study necessarily concentrates on the KLSE, which is the cornerstone of the securities industry in Malaysia and the role and function of the Securities Commission as the regulator of the securities industry. Left out are the futures industry, although some peripheral mentions are made, and the all-important Unit Trust industry, which ought to be a separate study by itself.

The sources used are usually primary sources as far as the law and regulations are concerned. Helpfully, both KLSE and SC publish a lot of guidelines and reports which are good reference materials and useful sources of information.

Due to the public fascination with the stock market, daily newspapers and regional magazines carry copious materials and stories on the capital market, thus, providing a lot of information on the latest developments.

This study lacks a round-up on the international scene both due to space and relevancy.



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The Resource Centre of the Securities Commission was well-stocked and provided me with a lot of reference and resource materials. The library and bookshop of the KLSE also proved to be good places to look for published materials.

A big thank you to YPM which made the course suitable for working adults and UPM for making available the MBA course in such an ideal manner.



## ABSTRACT

This paper deals with the securities industry in Malaysia, in particular the Kuala Lumpur Stock Exchange (KLSE), the new exchange, MESDAQ, which is yet to be established, and the development of the Securities Commission (SC) as the regulatory body supervising the development of the capital market in Malaysia

The role of SROs (Self-Regulatory Organisations) will also be examined, in particular the KLSE. The steps taken to achieve a full-disclosure regulatory environment will also be examined, in particular the frontline self-regulated organisations.

The regulatory structure overseeing the capital market in Malaysia will also be examined as will the relevant legislation governing the role of the SC, in the context of law reform and the effectiveness of enforcement actions taken thus far.

The overall benefit of this paper lies in its introductory nature into the securities industry in Malaysia and its treatment on the KLSE as well as the SC.



# Chapter I: INTRODUCTION AND THE KLSE

## 1.1 Introduction

The Malaysian capital market is approaching, if not already has attained, the status of a developed market on par with international standards as measured with the capital markets of advanced economies<sup>1</sup>. However, in the area of self-disclosure, it is still developing rules, policies and standards. It is envisaged that the capital market will achieve a full-disclosure regulatory environment by the year 2001.<sup>2</sup> It is in this context that this study proposes to deal with the development of the Securities Commission as the regulatory body supervising the development of the capital market in Malaysia and how effective it has been since its inception in 1993.

The Securities Commission (SC) was set on 1 March 1993 as a central authority in the regulation and development of the securities and future industries in Malaysia. Its role and functions have been defined in statutes. Part of this study will delve on the relevant legislation governing the SC role and functions and see how the various legislation have or have not been able to regulate the securities industry as a whole.

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<sup>1</sup> The IFC still considers KLSE as an emerging market based on the criteria of GDP/Capital, market and trading value concentrations, the institutional set-up, among others.

<sup>2</sup> **Chairman's Statement**, December 31 1996



## 1.2 Capital Market

It can be defined as any market in the long-term financial instruments such as shares and bonds that make up a company's capital.<sup>3</sup>

## 1.3 Security

A security is a written evidence of ownership conferring the right to receive property not currently in possession of the holder. The most common forms of securities are stock (or shares) and bonds. Both types of security are traded publicly on organised exchanges, in our case the Kuala Lumpur Stock Exchange (KLSE). Normally the public can buy or sell stock only through licensed dealers or stockbrokers. Transactions may also take place through auction or negotiation. In the Securities Industry Act 1983 ("SIA"), "securities" is defined as "debentures, stocks and shares in a public company or corporation, or bonds of any government or of any body, corporate or unincorporate, and includes any right or option in respect thereof and any interest in unit trust schemes."

## 1.4 Kuala Lumpur Stock Exchange (KLSE)

The KLSE is a company limited by guarantee, without a share capital and incorporated under the companies Act 1965. It was incorporated on 2 July 1973 and known as the KLSE Berhad. When the SIA came into force in 1976, a new company was incorporated on 14 December 1976 and took over the KLSE Berhad on 27 December 1976 and became known as The Kuala Lumpur Stock

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<sup>3</sup> Pocket Finance, London: The Economist Books, 1994

Exchange, but its name was changed in 1994, to Kuala Lumpur Stock Exchange.

At present, in terms of market capitalisation, it is the fourth largest in the Asia-Pacific, after Tokyo, Hong Kong and Osaka. At the moment, the KLSE is the only body approved by the Minister of finance (MOF) under the SIA as the stock exchange of Malaysia.

Its main objective is to provide and maintain a market place or facility for the trading of shares in companies. The main function of the KLSE is to supervise and exercise regulatory control over the work of its stockbrokers members. From time to time it establishes new rules and regulations for the quotation of the shares of listed companies.

The business of dealing in securities is carried out by stockbroking companies with limited liability. However, the members of the KLSE are either natural persons or corporations who must be the shareholders of the stockbroking companies. For a natural person, an applicant for KLSE membership must:

- a. be at least 21 years of age as at date of application;
- b. be a person of good character and high business integrity;
- c. be a citizen of Malaysia. However, a non-citizen can be a member if the KLSE recommends to the MOF;
- d. have relevant working experience of a certain number of years and relevant academic/professional qualifications.

A natural person must also have a Dealer's Representative Licence issued by the Licensing Officer of the Ministry of finance.

Corporate members can either be a local corporation or a foreign stockbroking house. A local corporation is required to have at least 51 % equity of the stockbroking house. It must have shareholder's fund of not less than RM 100 million. If the corporation is a financial institution, it has to obtain approval from Bank Negara. A foreign stockbroking house must have a good reputation.

Corporate members need not hold any dealing licence, but it has to nominate a corporate Nominee to act on its behalf in the stockbroking company. The Corporate Nominee is required to hold a Dealer's Representative Licence and his appointment must be approved by the Licensing Officer.

### **1.5 KLSE Management and Administration**

There is a nine-member committee headed by an executive chairman. Four of the nine committee members, including the executive chairman, are appointed by the MOF, while the remaining five are elected from among the members of the exchange. The operations are handled by 13 departments, namely:

Corporate and Legal Affairs;

Publications

Communications

Market Development

AWAS (Advance Warning & Surveillance)

Library Services

Listing

Membership Services

Human Resource and Administration

Security and Building Services;

Finance and Accounts

Trading Service; and

Training

## **1.6 Member companies**

**1.6.1 SCANS** (Securities Clearing Automated Network Services) provides facilities for clearing contracts between all the stockbroking houses, as a central clearing house. SCAN has two subsidiaries, KLSE-Bernamea Real Time Information Services Sdn Bhd and KLSE Chilong Systems Sdn Bhd. The former is 55 % -owned by the KLSE and exists to compile, provide and disseminate real time share price and other relevant financial and economic information obtained from the KLSE to subscribers of MASA<sup>4</sup> terminals and other vendors of information.

Prior to the setting of SCANS in 1984, clearing and settlement of scrip was done on an interbroker basis. With SCANS, the stockbroking companies do not deal with one another for delivery and settlement purposes but with SCANS. SCANS is now the clearing house for all transactions done through the KLSE.

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<sup>4</sup> MASA is an acronym for Maklumat Saham, the real-time share prices reporting system that was installed for brokers from 1.7.87 and officially launched on 14.8.87

A clearing fee of 0.05 % of the contract price is levied on all contracts done through the SCORE trading system and cleared through SCANS.

SCANS was conferred the status of a Recognised Clearing House by the SC pursuant to the amended SIA in 1996. With this recognition, SCANS is now under the regulatory oversight of the SC to ensure that the clearing and settlement activities are conducted efficiently and effectively.

Clearing and settlement will become even more efficient when the Central Depository System (CDS) (see below) is fully implemented.

**1.6.2 MCD** ( The Malaysian Central Depository Sdn Bhd) is 55 % owned by the KLSE and operates the Central Depository System (CDS). CDS brings about an efficient clearing and settlement system that eliminates the problems associated with the physical scrip-based system. Lost, misplaced and forged scrips will no longer be a problem and the automatic registration results in savings from registration fee and stamp duty payment. For listed companies and their share registrar, there will be savings in registration costs and from being able to know at any point of time the actual beneficial shareholders.

From the legal point of view, the operations of the CDS is governed by the Securities Industry (Central Depository) Act 1991 which aims to ensure maximum protection for the investor. The MCD itself has a set of rules which complements the Act and makes the legal framework complete.

### **1.6.3 Mismatch in Settlement Period**

In discussing the CDS and SCANS, it is pertinent to discuss the settlement cycle, as the mismatch is serious, and only starting at the third quarter of 1997, will this mismatch be resolved. The Seller's CDS account is debited on T + 5 but he does not get paid by his broker until T + 6. However, the buyer does not pay his broker until T + 7. The new settlement period stipulates that at T + 5, the seller's account will be debited; and he is paid by his broker. Meanwhile the buying broker will also pay SCANS.

### **1.6.4 RIIAM**

The Research Institute of Investment Analysts is a company limited by guarantee and is deemed to be an affiliate of the KLSE. RIIAM's objectives are to upgrade the investment research standard in Malaysia and to enhance the level of knowledge of the securities industry among the investing public through holding courses and seminars.

### **1.7 KLSE as an SRO**

As a self regulatory organisation (SRO), it is responsible for the surveillance of the trading in the exchange and for the enforcement of its listing requirements, such as listing requirements, disclosure requirements and reporting standards of listed companies.

The Malaysian Securities Industry is governed by a number of Acts of Parliament (statutes), namely:

- Securities Industry Act 1983 (SIA)
- Securities Commission Act 1993 (SCA)
- Securities Industry (Central Depositories) Act 1991 (SICDA)

Briefly, the SIA provides the regulatory framework of the securities industry and lays down provisions relating to the stock exchange, stockbroking houses and persons dealing in securities. Specifically, s. 9 provides for the duties of a stock exchange, which include:

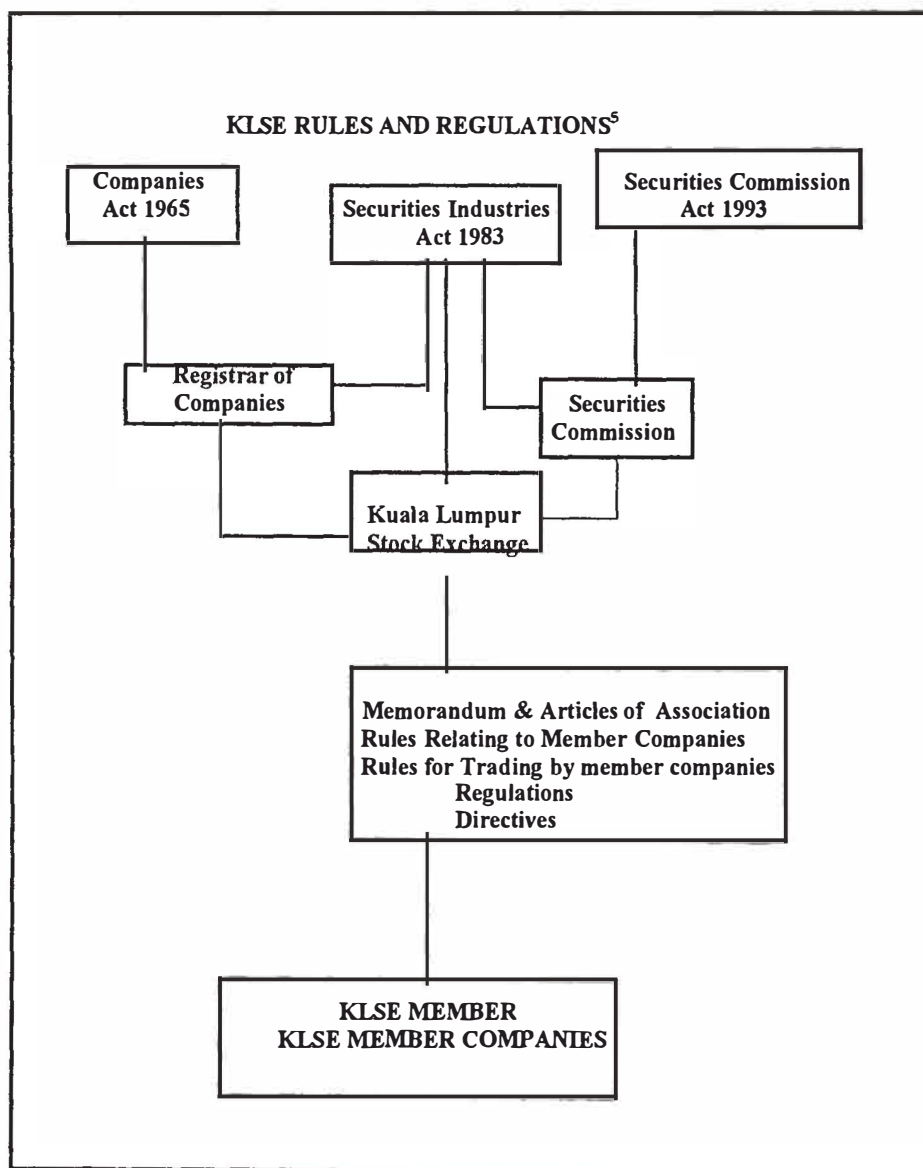
- to approve a stock exchange
- to give recognition to a clearing house
- to approve amendments to the rules of a stock exchange and clearing house
- issuing licenses to dealers, fund managers, investment advisers and their respective representatives
- provisions against false market and market rigging

The SCA establishes the SC, which is the body that regulates the securities industry as a whole. It sets out the powers and functions of the SC, and contains provisions for Take Over and Mergers. The SC also has investigative and enforcement responsibilities.

SICDA provides for the regulation of a central depository in respect of the deposit, holding, Withdrawal and dealing in securities deposited and related matters. The Central Depository System (CDS) operated by Malaysian Central

Depository (MCD) was established under SICDA to maintain a central depository.

The Companies Act 1965 is the principal act for the regulation of companies in Malaysia. The Act regulates the pre-incorporation incorporation, operations and duties of a companies and its directors. The Registrar of Companies is the body responsible for the registration and incorporation of companies.



<sup>5</sup> KLSE Homepage



Section 9 of the SIA clearly spells out the duties of the stock exchange, which includes.

1. Ensure an orderly and fair market in the securities that are traded .
- 2 The Stock Exchange shall act in the public interest and ensure that where any interest that is required to serve under any law relating to corporations conflict with the public interest, the latter shall prevail.
- 3 To ensure that the members of the stock exchange, member companies and corporations whose securities are listed comply with the rules of the stock exchange that apply to such members, member companies or corporations.
- 4 To notify the Commission if it becomes aware of:
  - a. any matter which adversely affects, or is likely to adversely affect the ability of any member company to meet its obligations in respect of its business of dealing in securities, including the ability of any member company to comply with the minimum financial requirements as may be prescribed under this Act; or
  - b. any irregularity, breach of any provision of the securities laws or the rules of the stock exchange or recognised clearing house, or any other matter which, in the opinion of the stock exchange indicates or may indicate, that the financial standing or financial integrity of any member company or of the chief executive may be, is in question or may reasonably be affected.

- 5 When a stock exchange expels, or suspends the membership of any of its members or otherwise disciplines any of its members, it shall, within seven days, give to the Commission in writing the following particulars:
  - a. the name of the member;
  - b. the reason for and the nature of the action taken;
  - c. the amount of the fine;
  - d. the period of suspension, if any; and
  - e. any other disciplinary action taken.
  
6. It shall provide and maintain to the satisfaction of the Commission:
  - a. adequate and properly equipped premises for the conduct of its business;
  - b. competent personnel for the conduct of its business; and
  - c. automated systems with adequate capacity, security arrangements and facilities to meet emergencies

### **1.8 Types of Securities**

The various types of securities traded on the KLSE include Ordinary Shares, Preference Shares, Bonds, Loan Stocks, Loan Notes, Property Trust Units, Warrants, Call Warrants, Closed-End Funds and Transferable Subscriptions Rights (TSRs). The stock market is actually a secondary market of the securities industry as companies first sell their new share issues to institutions or individuals who then resell them in the stock market. Subscriptions to new listing, or the primary market, is through Initial Public Offers (IPOs). In order

to have its shares listed, a company must fulfil the listing requirements of the KLSE.

KLSE has three Boards: Main Board, Second Board and the Call Warrants Board. The companies of the Main Board are classified into the following sectors: Industrial Products, Consumer Products, Construction, Trading/Services, Infrastructure Project Companies, Finance, Hotel, Property, Plantation, Mining, Closed-End Funds and Property Trust.

### 1.9 Listing Requirements

At present, the listing requirements of the Main Board of the KLSE state, inter alia, that a company must have a minimum paid-up capital of RM 50 million, out of which 25 % of the shares must be in public hands with a minimum percentage to be in the hands of 500 shareholders holding 500 to 10,000 shares as follows:

<u>Issued and Paid-Up</u>	<u>Minimum %</u>
Not exceeding RM 50 m	15 %
Not exceeding RM 100m	12.5 % or RM 8 m whichever is the greater
RM 100 m and above	10 % or RM 15 m whichever is the greater

To qualify for the Second Board, the company must have a minimum issued and paid-up capital of RM 10 million but less than RM 50 million. At least 25 % but not more than 50 % of the shares should be in the public hand, of which at least

15 % should be in the hands of 500 shareholders holding between 500 to 10,000 shares.

### **1.9.1 Historical Performance**

A Main Board listing requires either:

- a. a track record of three financial years with an after-tax profit of not less than RM4 million per annum and an aggregate after-tax profit of not less than RM 25 million for the three years, OR
- b. a track record of five years, with an after-tax profit of not less than RM 2 million per annum and an aggregate after-tax profit of not less than RM 25 million over the five years.

The Second Board requirement is for a three-year track record with average after-tax profit of not less than RM 1 million per year, and an average after-tax profit of not less than RM 2 million per annum over the three years..

### **1.9.2 Future Profit**

Future profit performance should reflect an increasing trend, and the forecast after-tax profit should be at least RM 6 million for a Main Board listing and RM 2.5 million for a Second Board listing.

The listing requirements are important because they are aimed at securing the confidence of investors in the market by ensuring that a listed company fulfil specified minimum capitalisation requirement and has a good performance

record. Further, it also ensures that trading of securities is conducted in a fair and open basis and that investors are treated with proper consideration.<sup>6</sup>

### 1.9.3 Requirements for other companies

- **Debt Securities**

- At least RM 75,000 of issued loan securities
- At least 100 holders
- To be governed by a trust deed to be approved by the Exchange

- **Property Trust**

- At least RM 750,000 of issued loan securities
- At least 10 % or RM 10,000,000 (whichever is the greater) is in the hands of at least 500 holders holding not more than 50,000 units each
- To be governed by a trust deed to be approved by the Exchange

- **Infrastructure Project Companies**

- Must be a public company having investment in an infrastructure project
- Paid-up share capital must be at least RM 40 million
- At least 25 % of the nominal issued and paid up capital and not more than 49 % of the nominal issued and paid-p capital would be in the hands of the public at the time of the Applicant's admission to the Main Board
- Of the 25 % of the nominal issued and paid-up capital of the applicant which is in the hands of the public, at least a minimum percentage of the

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<sup>6</sup> Faridah Ali, **Effective Stock market Investment in Malaysia**, K.L: Berita Publishing, 1997, p.5

nominal issued and paid-up capital must be held by not less than 500 investors holding not more than 10,000 shares each and not less than 500 shares each, as follows;

Issued and Paid-Up Capital	Minimum Percentage
Not exceeding RM 50 m	15 %
Not exceeding RM 100 m	12.5 %
Not exceeding RM 200 m	10 %
Exceeding RM 20 m	Such percentage as may be approved by the Securities Commission but in any case not less than RM 20 m

### **1.10 Size of Market**

The number of companies listed grew from 262 in 1973 to 621 as at 31.12.96. On 1.1.90, all 53 Singapore companies were delisted from KLSE's Official List. There are currently 768 companies (as of August 6 1997 ) listed on the KLSE.

Yearly trading volume which stood at only 0.5 billion units in 1973 increased over the years to 13.2 billion units in 1990, and touched an unprecedented level of 107.7 billion units in 1993. During 1993, market sentiment was very bullish and new records were set. On 15.4. 93, daily trading activity touched an all-time high of 1.039 billion units (RM 2.475 billion) and daily value hit a staggering

RM 5.568 billion (953.9 million shares) on 5.1.94. The total volume for 1996 stood at 66.5 billion units worth RM 463.3 billion.<sup>7</sup>

With a market capitalisation of US \$318 billion (RM 795 billion) as at end December 1996, the KLSE is the largest bourse in ASEAN, third largest in Asia Pacific and among the top 15 in the world.

### 1.11 MESDAQ

Perhaps the most exciting development for the securities industry for 1997 for the investing public is the announcement of the establishment of a new market known as Malaysian Exchange of Securities Dealers and Automated Quotation (MESDAQ). However, MESDAQ will operate as a stock exchange under the SIA and MESDAQ Bhd, the company that will be administering the new market, will be frontline self-regulatory organisation (SRO) with statutory responsibilities to regulate its members and monitor market activities. MESDAQ Bhd will be a wholly member-owned non-profit organisation.

This self-regulation framework gives members direct participation in the formulation and enforcement of rules, regulations, practices and procedures that govern the operations of the market. The role of the SC is merely to oversee the operations of the frontline SRO and to ensure it enforces member compliance of its own rules and the securities laws in Malaysia.

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<sup>7</sup> KLSE, *Investing in the Stock Market in Malaysia*, p.E1

It should also be noted that unlike the official market, all proposals to raise capital on this new market will be vetted and approved by the new exchange. This is significant because MESDAQ will be independent of the KLSE. The reason is due to the difference in the types of companies that will be admitted into the respective markets. Companies admitted into MESDAQ may not have much of a track record and may not even have commenced business operations. Thus, MESDAQ is a “higher” risk market, compared to KLSE. In a speech at the opening of the “Over-the-Market” conference, the Minister of Finance said that “a large and liquid stock market alone is not sufficient to constitute a credible capital market centre. There have to be other markets to meet the risk reward profiles of investors, market players and corporate issuers.”<sup>8</sup>

In order to attract strong and good quality companies, a MESDAQ Industry Action Group (IAG) has been set up, to conduct forums with companies that have subsidiaries dealing in hitech.

One very important feature of MESDAQ which will have a lot of ramifications for the regulatory structure and framework is that merchant banks and Malaysian-owned asset management companies are allowed membership in MESDAQ, not just the traditional stockbroking firms.

Another feature of MESDAQ is that companies who seek a listing are not required to have a track record. It should be noted that MESDAQ is a new

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<sup>8</sup> **New Straits Times**, February 2 1997





exchange for trading of shares of technology companies and not an over-the-counter (OTC) market. The authorities have prioritised nine technology areas for companies to be listed, which include:

- Advanced electronics and information technology;
- Equipment/instrumentation, automation and flexible manufacturing systems;
- Biotechnology, bio-conversion and genetic engineering;
- Electro-optics, non-linear optics and optoelectronics;
- Advanced materials;
- Energy source;
- Aerospace;
- Transportation; and
- Service Sectors.

Companies involved in the above industries will be accorded priority status for listing. In monetary terms, the admission criteria include having a minimum share capital of RM 2 million as well as adviser, sponsor and at least two market makers. Market participants have to be educated to understand the difference between the two markets.

### **1.11.1 Regulatory Features of MESDAQ**

The regulatory implications for such a new market are enormous. In order to protect investors, MESDAQ will operate under a full disclosure-based environment. In exchange for lenient access to the market, the rules on