COLUMBIA JOURNAL OF ASIAN LAW
VOL. 14 SPRING 2001 NO. 2

REVISITING THE REGULATORY FRAMEWORK OF CAPITAL MARKETS IN MALAYSIA

CHEE KEONG LOW *

* Associate Professor in Corporate Law, School of Accountancy, The Chinese University of Hong Kong. The author is available at <cklow@baf.msmail.cuhk.edu.hk>.

I. INTRODUCTION

The structure of any financial system has one principal aim: to facilitate an effective use of funds. It is therefore important in the study of financial markets to understand where the funds come from and which sectors they pass through en route to their ultimate application within an economy. The sources of funds are savings in both the private and public sectors as well as the net inflow of funds from abroad. These are collectively channeled through intermediaries such as banks, provident and insurance funds, corporations, government agencies, and foreign institutions to generate a return that is commensurate with the risks taken on the investment. The latter represents the use of the funds that would generally fall into four categories, namely, private sector investments, public sector investments, accumulation of international reserves and unidentified private sector payments abroad. The last of the four would include remittances overseas for purposes of education and the maintenance of household expenditure. The diagram on the following page aptly illustrates this "stock" and "flow" concept of financial systems.[1]

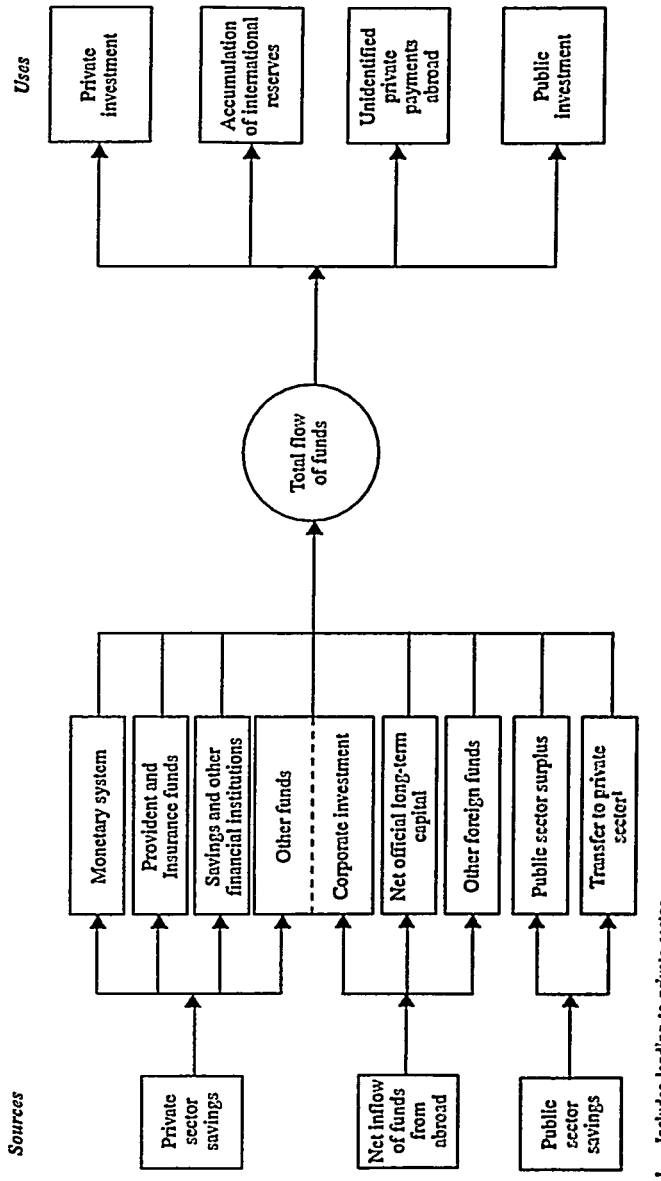
Issuers of securities are legal persons; the companies issuing those securities.[2] As a separate legal entity, a company enjoys a number of rights, including that of raising capital. Securities, unlike goods, are created rather than produced. They have no intrinsic value and are merely chose in action, namely, legally enforceable rights or interests in something else. They convey upon their holders an interest either as owners or creditors of the issuer.

The capital market of Malaysia comprises, inter alia, a primary securities market and a secondary securities market. The former describes a market in which new securities are sold, hence its association with initial public offerings, while a secondary market is one in which outstanding issues of securities are traded. Their distinction can be drawn by an assessment of their functions. The primary market is used to raise new capital for enterprises while the secondary market provides required liquidity for investors to arrange their portfolio to best meet their individual needs. New issues of corporate and government securities that are offered to the public through an initial public offer are governed under the

1. *See* C. K. Low, FINANCIAL MARKETS IN MALAYSIA, 2 (2000).

2. The genesis of modern company law can be traced to the decision of the English House of Lords in *Saloman v. Saloman & Co Ltd*, APP. CAS. 22 (1897), which enunciated the principle of the separate legal entity. This is statutorily recognized by the Malaysian Companies Act § 16(5) (1965).

Figure 1.1: Flow of Capital Funds



1 Includes lending to private sector

prospectus provisions of the Securities Commission Act of 1993.[3] The trading of listed securities in Malaysia is currently the domain of the Kuala Lumpur Stock Exchange, (hereafter the "KLSE"), and the Malaysian Exchange of Securities Dealing & Automated Quotation, (hereafter "MESDAQ").[4]

An emerging, but important, component of the capital market in Malaysia is the bond market. This market is composed of both government securities and corporate paper. Although it is not essential for these debt securities to be listed, a small number of such securities, usually in the form of convertible bonds, have been listed on the KLSE. The Asian financial crisis amplified the need for the establishment of a liquid secondary market for bonds so as to provide borrowers with access to alternative methods of financing as the banking sector attempted to cope with the problem of non-performing loans. The Malaysian Government Securities, Cagamas and Khazanah bonds[5] dominate the unlisted segment of the bond market. These have illiquid secondary markets because these securities are usually held to maturity by their holders so as to comply with the various regulations imposed under banking and insurance legislation in Malaysia. This in turn has contributed to an inactive bond market given the absence of a risk free benchmark yield curve against which corporate and other issues could be priced.

The Commodity and Monetary Exchange of Malaysia, (hereafter "COMMEX Malaysia"),[6] which was established on December 7, 1998

3. *See* Securities Commission Act ("SCA") § 41 (1993). This provision came into force on July 1, 2000, and prior to its enactment responsibility for the registration of prospectuses rested with the Registry of Companies. The latter is currently only responsible for the registration of prospectuses that are issued by unlisted recreational clubs.

4. The KLSE and MESDAQ are the only approved stock exchanges in Malaysia pursuant to the Securities Industry Act § 8(2) (1983). Both are self-regulatory organizations within the oversight ambit of the Securities Commission. The KLSE is the older of the two exchanges with its genesis as the Malayan Stock Exchange, which commenced the public trading of securities on May 9, 1960. MESDAQ was first envisaged in the Seventh Malaysia Plan (1996-2000) as a specialized exchange to bring growth and knowledge-based companies to the public. It is based on the concept of the NASDAQ Stock Exchange in the United States of America and was formally approved as a recognized stock exchange on October 6, 1997.

5. Cagamas bonds are securitized mortgage loans issued by Cagamas Berhad, the national mortgage corporation. It is modeled after the Federal National Mortgage Association (Fannie Mae) of the United States of America with the principal difference being that Cagamas acquires mortgages from banks on a full recourse basis. Khazanah bonds are issued by Khazanah Nasional Berhad, the investment arm of the Ministry of Finance. As the government of Malaysia implicitly guarantees both Cagamas and Khazanah, they are regarded as "risk free," against which the pricing of corporate bonds may be benchmarked. Both are classified as permissible low risk investments for institutional investors in Malaysia.

6. COMMEX Malaysia is governed by the Futures Industry Act (1993), which enactment repealed the Commodities Trading Act (1985) so as to facilitate the empowerment of the Securities

following the merger of the Kuala Lumpur Commodities Exchange and its wholly-owned subsidiary, the Malaysian Monetary Exchange, currently retains a monopoly to operate a commodities exchange. COMMEX Malaysia is a self-regulatory organization entrusted with primary responsibility for the maintenance of a market for the trading of commodity futures as well as for the provision of an exchange to facilitate the effective hedging of ringgit-denominated money market instruments.

Although primary commodities such as crude palm oil, tin, cocoa and rubber are traded on COMMEX Malaysia, the only actively traded contracts are in crude oil palm futures, which as a result of its liquidity, has become the premier global reference benchmark for oil palm pricing in the cash market. The sole ringgit-denominated product currently traded on COMMEX Malaysia is the 3-month Kuala Lumpur Interbank Offered Rate ("KLIBOR"), a futures contract that is based on a ringgit interbank time deposit in the Kuala Lumpur Wholesale Money Market having a principal value of RM1 million with a three-month maturity.[7] KLIBOR is therefore a useful financial instrument with which to cover interest rate risk at the short end of the yield curve.

The trading of financial futures and options is conducted through the Kuala Lumpur Options and Financial Futures Exchange ("KLOFFE"). It was launched in December 1995 and became a wholly owned subsidiary of the KLSE in January 1999, in line with the global trend towards consolidation of such exchanges. Currently two products are traded on KLOFFE, namely, the Kuala Lumpur Stock Exchange Composite Index Futures and the Kuala Lumpur Stock Exchange Composite Index Options. The availability of these derivative products allows both domestic and foreign investors to design and implement more effective risk and portfolio management. These products bode well for the development of the financial markets as they allow market participants to undertake three principal activities: to speculate, to arbitrage, or to hedge against adverse conditions in the cash market. KLOFFE recently completed the acquisition of COMMEX Malaysia, a move that effectively consolidates much of the securities and futures trading in Malaysia within the umbrella of the KLSE.[8]

Commission as the sole regulatory authority for both the securities and futures industries in Malaysia.

7. The RM is the acronym for the Malaysian Ringgit (or "Ringgit Malaysia" in the national language of Bahasa Malaysia) and is divisible into 100 sen (cents). It has been pegged at RM3.80 to US$1 since the imposition of selective capital controls on September 2, 1998.

8. The launch of the Capital Market Masterplan (CMM) on February 22, 2001 sets the necessary groundwork for further consolidation with a recommendation that the KLSE and MESDAQ be merged to establish a single Malaysian exchange. This exchange will then be demutualized and operated as a for-profit entity that will be eventually listed. The consolidation will allow for the creation of a common trading platform as well as an integrated clearing and settlement system for all

II. THE REGULATORY MATRIX

The presence of robust and vibrant financial markets has a positive effect on society. The financial markets in Malaysia consist of an intertwined body of related organizations, whose ultimate capitalist function is the creation of wealth. They provide issuers with ready access to a large pool of funds and investors with an acceptable rate of return for their capital. However, such markets will only flourish and provide enterprises with sufficient capital at a reasonable cost to expand if investors feel confident about the markets themselves.

The regulation of financial markets in Malaysia is essentially driven by three principal objectives: to provide a sound framework for the banking system, to create a vibrant capital market, and to establish an international offshore financial center. The authorities with the responsibility for the realization of these objectives are Bank Negara Malaysia, the Securities Commission of Malaysia and the Labuan Offshore Financial Services Authority respectively. The concept as well as the matrix that holds together the financial markets is succinctly illustrated by the diagram on the following page.

As evident from the diagram, the Minister of Finance exerts influence on the direction of the financial markets in Malaysia through two principal avenues, by the appointment of key personnel to the various regulatory organizations[9] as well as by the design and implementation of policies. In addition to the foregoing, the Minister may also issue directives to Bank Negara Malaysia (hereafter "BNM") that the latter is bound by law to follow and give effect. Such directives may relate to matters as diverse as policies with respect to banking and finance, exchange controls, and/or the various legislation enforced by BNM.[10]

---

exchange traded products thereby providing both enhanced risk management as well as reduced transaction costs. Such a move is consistent with global trends and reflects the vision of the authorities to establish an internationally competitive and highly efficient capital market in Malaysia. The CMM is a comprehensive plan that provides the blueprint for charting the strategic positioning and future direction of the Malaysian capital market over the next decade. Its implementation is designed to remove existing weaknesses within the capital market and assist in the creation of one that is more resilient and competitive to face the new challenges brought about by the globalization of financial markets. A copy of the CMM may be downloaded from the website of the Malaysian Securities Commission at <http://www.sc.com.my/html/cmp2001/fr_cmp2001.html> (visited March 16, 2001).

9. The Minister of Finance appoints all nine members of the Securities Commission pursuant to SCA § 4 (1993). The Minister may revoke any of these appointments at any time prior to the expiration of their three-year terms. SCA § 7 (1983). In addition, the Minister appoints the Executive Chairman of both the KLSE and MESDAQ as well as four of their nine-member board of directors pursuant to Securities Industry Act § 8 (1983).

10. BNM is vested with comprehensive legal powers to facilitate its regulation and supervision of the financial markets in Malaysia. These include the Central Bank of Malaysia Act (1958), the

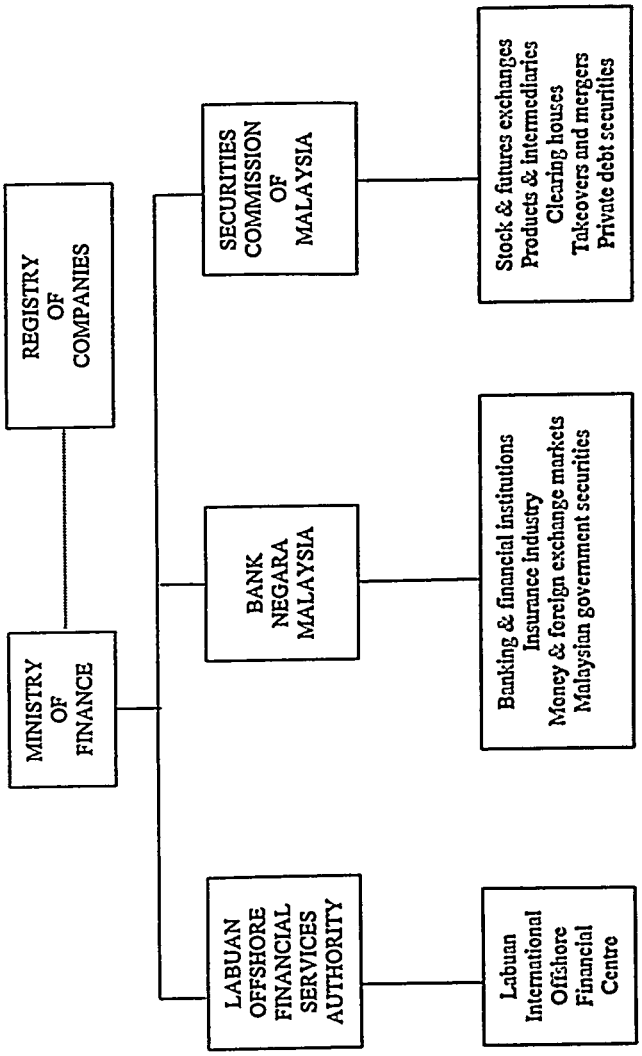


Figure 1.2: An Overview of the Regulation of Financial Markets in Malaysia

Islamic Banking Act (1983), the Banking and Financial Institutions Act (1989), the Insurance Act (1996), the Takaful Act (1984), the Exchange Control Act (1953) and the six pieces of legislation that collectively established Labuan as an international offshore financial center.

III. REGULATION OF THE CAPITAL MARKET

The Securities Commission, (hereafter "the SC"), is the single regulatory body entrusted with the responsibility for promoting and developing the capital market in Malaysia. It was established on March 1, 1993, and has the oversight for securities laws.[11] The SC is a self-financing statutory body corporate with perpetual existence.[12] It has extensive investigative and enforcement powers. It was modeled after what was then the Australian Securities Commission[13] as well as the Hong Kong Securities and Futures Commission. The diagram on the following page illustrates the regulatory oversight of the securities and futures industry in Malaysia.[14]

The SC has oversight of, and administers, securities law in Malaysia, comprised of four principal pieces of legislation: the Securities Industry Act of 1983, the Securities Industry (Central Depositories) Act of 1991, the Securities Commission Act of 1993 and the Futures Industry Act of 1993. The regulation of the market infrastructure of the securities industry is the domain of the Securities Industry Act. Its purpose (set forth in its preamble) is the establishment of "an Act to make provisions with respect to stock exchanges, and persons dealing in securities, and for certain offences relating to trading in securities, and for other purposes connected therewith."[15] The Futures Industry Act of 1993[16] performs a similar function regarding the futures exchanges, and trading in futures contracts as

11. On its establishment the SC assumed the functions of the Capital Issues Committee as well as the Panel on Takeovers and Mergers both of which were dissolved. Although the SC has broad oversight of the capital market it nonetheless has to take cognizance of the policies enunciated by BNM, the Foreign Investment Committee and the Ministry of International Trade and Industry.

12. *See* SCA § 3 (1993). Its principal sources of income are the levies that are imposed upon securities and futures transactions and the fees charged for the consideration of corporate proposals that come within the ambit of the SC pursuant to SCA § 32 (1993).

13. Presently called the Australian Securities and Investments Commission to better reflect its role in the capital market.

14. *See* C. K. Low, *supra* note 1, at 9.

15. Although the principal Act has been amended six times namely in 1987, 1991, 1993, 1996 and twice in 1998, its genesis lies with the Securities Industry Act (1975) of the state of New South Wales in Australia. The ambit of the Act includes such matters as the regulation of the stock exchanges and clearing houses, licensing of dealers and their representatives, conduct of securities business, maintenance of accounts and records, the establishment and regulation of the Compensation Fund, prohibited market activities, as well as enforcement and investigations.

16. The original Act was based on its Australian counterpart but substantial amendments were enacted in 1995 to better reflect the specific requirements of the domestic futures industry. The Act has subsequently been amended four times namely in 1997, twice in 1998 and again in 2000. Its ambit is similar to the Securities Industry Act (1983) except that it provides for the trading of futures contracts in a fair, efficient and transparent manner.

Figure 1.3: Overview of Securities and Futures Regulation in Malaysia

a In exercising its power under the Securities Industry Act 1983 & the Securities Commission Act 1993 the SC may affect the operation of the Registry of Companies.
b The Registry of Companies is entrusted with the overall administration of the Companies Act which provisions apply to all companies that are incorporated or registered in Malaysia. As such the Registry of Companies has limited jurisdiction over the exchanges, their clearing houses and subsidiaries.
c MCD is a subsidiary of the KLSE and operates the Central Depository System pursuant to the Securities Industry (Central Depositories) Act 1991
d SCANS operates as the clearing house for the KLSE and MESDAQ and is a wholly owned subsidiary of the former.
e MDCH is jointly owned by KLOFFE and COMMEX and operates the clearing house functions for both exchanges pursuant to the Futures Industry Act 1993.

well as all matters related thereto.

In line with the international best practices as recommended by the Group of 30 (G-30) to enhance market transparency, full immobilization of share scrips have been effected by the KLSE. The Malaysian Central Depository Sdn Bhd[17] is the only recognized central securities depository under the Securities Industry (Central Depositories) Act of 1991. It deals primarily with the regulation of the central depository and the deposit, holding, withdrawal of and dealings in securities which have been deposited therein.[18]

The phrase "securities laws" is further expanded under the Securities Commission Act of 1993 to include references to "any regulations, rules, orders, notifications or other subsidiary legislation made under this Act or a securities law, as the case may be."[19] These regulations may be made either by the Minister or by the SC with the approval of the Minister.[20]

Another important source of its powers, albeit one which arises from a persuasive rather than legal foundation, are the guidelines which the SC issues to state its position with respect to a variety of matters.[21] Perhaps the

17. A 55 percent owned subsidiary of the KLSE.

18. Full immobilization has thus far only been attained by less than 40 percent of the central depositories worldwide. Malaysia attained this status on 1 December 1998, which facilitates the electronic clearing and settlement of securities transactions based on the fundamental principle of a book entry system. The Act has been amended four times since its enactment: in 1996, twice in 1998 and again in the year 2000.

19. *See* SCA § 2A (1993). To date regulations, orders and declarations have been pronounced on a number of matters including the compensation fund, approved accounting standards, reporting of substantial shareholdings, exempt dealers and fund managers, share buy-backs, unit trusts, fees and charges, shelf registration for debentures and compoundable offences. The definition of "securities laws" is set out in SCA §2(1) to mean the Securities Industry Act (1983), the Securities Industry (Central Depositories) Act (1991), the Securities Commission Act (1993) and the Futures Industry Act (1993), which encompasses all activities and transactions on the securities and futures markets. The term "security" is also widely defined to include debentures, stocks or bonds issued or proposed to be issued by any government; shares in or debentures of a body corporate or an unincorporated body; or unit trusts and prescribed investments; and any right, option or interest in respect thereof.

20. The authority to make the regulations, rules, orders or notifications is set out in the SCA. For example, section SCA § 159 empowers the SC to make regulations with the approval of the Minister on the prescription of forms and fees, the principles and rules with respect to takeovers and mergers, and for all corporate proposals in relation to the issue of securities as specified by SCA § 32(2). A form of extraterritorial application of the Act is exercised by the SC under SCA § 32(2)(b), which requires all persons to seek the approval of the SC before making available any Malaysian securities to investors outside of Malaysia.

21. The guidelines are particularly useful to issuers and practitioners as they state the minimum level of information that must be provided to the SC as well as the criteria to be used in the preparation of different proposals. The SC has issued more than 20 guidelines to date, which include the Guidelines for a Universal Broker, Guidelines on the Offering of Private Debt Securities, Guidelines on Contents of Prospectus for Debentures, Guidelines for Public Offerings of Securities of Infrastructure Project Companies and Guidelines for the Issue of Call Warrants. A full list of the

most important of these guidelines in so far as issuers and practitioners are concerned is the *Policies and Guidelines on Offer/Issue of Securities* which apply to all corporate proposals. This guideline is amended and revised regularly to facilitate the move towards a full disclosure based system of regulation by the end of 2001.[22]

A. Powers of the Securities Commission

Section 16 of the Securities Commission Act of 1993 provides that the SC "shall have all such powers as may be necessary for or in connection with, or reasonably incidental to, the performance of its functions under securities laws."[23] The SC is therefore regarded to reign supreme in matters that are specifically listed in section 15(1) with respect to its functions. As is common for most securities regulators, the SC has jurisdiction over, *inter alia*, the regulation of the exchanges, clearing houses, central depository, the licensing of intermediaries and products, the enforcement of securities laws, the promotion of self-regulation within the industry and development of the markets, the regulation of take-overs, mergers and the unit trust industry, as well as to advise the Minister of Finance with respect to the securities and futures industry.[24]

---

guidelines and its contents is available at <http://www.sc.com.my/html/publications/guide.html> (visited January 15, 2001).

22. Disclosure based system of regulation is the reference to a model that subscribes to the principle of efficient market hypothesis. Emphasis is placed upon full and accurate disclosure of all material information as there exists a positive co-relation between the movements in the prices of securities and availability of information. The other end of the spectrum is the merit-based system of regulation in which the regulator assumes the important role of protecting investors. This is generally achieved by ensuring that only offerings of securities that are judged to be "fair, reasonable and equitable" be allowed to proceed. The moral hazard of investing is therefore higher under the merit-based system of regulation, which is widely acknowledged to work best in emerging markets where there exists a high proportion of retail investors who lack the financial sophistication necessary to fully understand the risks associated with capital markets. The SC currently practices a hybrid form of regulation that straddles both merit and disclosure based systems. Although the SCA emphasizes disclosure so that the investor can make an informed decision the SC nonetheless continues to require the seeking of its approval for most things unless these are specifically exempted or excluded. For example, while the guidelines allow for the market-based pricing of securities it is still the practice to seek and obtain the approval of the SC for the same.

23. There are two possible interpretations of this section. The more restrictive view is that the powers of the SC are limited to those that are necessary for it to carry out its functions or risk being held as acting *ultra vires*. *See.* C. K. Low, SECURITIES REGULATION IN MALAYSIA, 38 (1997). A more liberal view was adopted in *City Realties v. Securities Commission*, 1 NZLR 74 (1982), wherein the New Zealand Court of Appeal opined that the expansive view of such powers ought to be favored if this is consistent with the statutory functions that are set out in the Act.

24. The functions and powers of the SC are based largely on those of the Australian Securities and Investments Commission and the Hong Kong Securities and Futures Commission. *See generally* K. Arjunan & C. K. Low, UNDERSTANDING COMPANY LAW IN MALAYSIA, 390-393 (1995).

While the comprehensive powers of the SC are not absolute, they have been progressively enhanced since its establishment in 1993, culminating with the enactment of the Securities Commission (Amendment) Act 2000, (hereafter "the Act").[25] The Act rationalizes the regulatory framework for capital raising in Malaysia and unequivocally establishes the SC as the single regulatory authority for the supervision and regulation of its capital markets. Of particular significance are the amendments which:

- Allow the SC to assume oversight of the corporate bond market in Malaysia and become the approving and registering authority for prospectuses in respect of all securities other than securities issued by unlisted recreational clubs as of July 1, 2000;[26]
- Refine the term "securities"[27] and empower the Minister of Finance to prescribe any instrument to be a security or a futures contract;[28]
- Enhance the powers of the Investigation Officer of the SC when carrying out investigations;[29]
- Allow the SC to recover losses or damages on behalf of a third party;[30] and
- Make it an offense to attempt to commit or abet or engage in a criminal conspiracy to commit offenses under the Act.[31]

The amendments by themselves appear innocuous as they simply establish the SC as the sole regulatory authority for all aspects of capital raising activities in Malaysia as it was envisaged to be at the outset. However, they raise a fundamental question whether the SC has become all-powerful and yet less transparent. Of particular significance to the issuer,

25. The Securities Commission (Amendment) Act ("SCAA") became effective on July 1, 2000. Prior to this the SCA was amended twice namely in 1995 and 1998. Its provisions were also amended by the enactment of the Futures Industry (Amendment and Consolidation) Act (1997), which inter alia abolished the Commodities Trading Commission and repealed the Commodities Trading Act (1985) to facilitate the SC taking over the regulation of the futures industry.

26. To enable the SC to attain this status consequential amendments were made to the Companies Act (1965), the Banking and Financial Institution Act (1989), the Futures Industry Act (1993), and the Securities Industry (Central Depositories) Act (1991) all of which also came into effect on July 1, 2000. In addition the enactment of the SCAA simultaneously repealed the Securities Commission (Unit Trust Scheme) Regulations (1996).

27. SCAA § 2(1) defines "securities" as meaning debentures, stocks or bonds issued or proposed to be issued by any government; shares in or debentures of a body corporate or unincorporated body; or unit trust or prescribed investments. The definition also extends to rights, options or interests in respect to any of the foregoing. This new definition makes it clear that the issue of shares and debentures by private companies come within the ambit of the SCA (1993) thereby extending the jurisdiction of the SC.

28. SCAA §§ 2B, 2C and 2D.

29. SCAA §§ 128, 134 and 152.

30. SCAA § 155.

31. SCAA § 157.

market practitioner and professional adviser are the enhanced powers of investigation and the procedure by which decisions of the SC are reviewed, on which the focus of the paper now turns.

B. Powers of Investigation

Investigations are a vital cog in the regulatory machinery that facilitates the efficient functioning of capital markets. Fraudulent conduct is a serious social evil, which tangled web of deception can only be discovered by a prolonged and painstaking journey through complex financial records. Investigations, therefore, serve an important and positive function in furthering the advancement of corporate governance, which philosophy is aptly summarized by Lord Denning in *Norwest Holst Ltd. v. Department of Trade*:[32]

> The whole management and control is in the hands of directors. Seeing that directors are guardians of the company, the question is asked: *Quis custodiet ipsos custodes* – Who will guard the guards themselves?[33]

The information obtained from such investigations often opens up opportunities for the prosecution and ultimate conviction of delinquent officers and of improper conduct within the company, thereby enhancing public confidence in the marketplace. This has gained significant importance since the dawning of the Asian financial crisis when corporate scandals imposed adverse financial effects on both creditors and shareholders alike.

However, against these advantages are the concerns that investigations may improperly interfere with the course of justice, especially in view of the extensive powers granted to the Investigating Officer under the Act. Any irresponsible exercise of this extensive power could very easily create a headless fourth branch of government, one that is neither elected nor accountable to any person but itself. It is for this reason that the enhanced powers of investigation should be of considerable concern for issuers, market practitioners and professional advisers alike.

The SC has the power to require, by notice in writing, any person to disclose to the SC "such information as the Commission may specify in the notice as it deems expedient for the due administration of Part IV."[34] In the

32. 3 ALL E.R. 280 (1978).
33. *Id.* at 291.
34. SCAA § 152(1). The section renders it an offence to provide false deceptive or misleading

course of any investigation, the Investigating Officer has the power to call for examination any person whom he or she suspects or believes on reasonable grounds to have relevant information on the matter being investigated.[35] The exercise of this power requires no preliminary publication of the reasons or grounds, nor is it subject to any prior application for an order from the courts. In addition to their customary powers of inspection and seizure, Investigating Officers of the SC are permitted to detain any person for no more than 24 hours at any place for the purposes of facilitating a search without the authorization of a Magistrate.[36] The failure to cooperate fully with the Investigating Officer renders the person guilty of an offense that is punishable upon conviction by a fine of RM1 million[37] and/or a term of imprisonment not exceeding 5 years.[38]

To ensure that the SC can effectively investigate all affairs within its purview as the principal regulator of the capital market, it was deemed necessary to curtail the operation of two established common law principles, namely, the privilege against self-incrimination[39] and legal professional privilege. The rationale for the privilege against self-incrimination lies in the principle that the law should accord general protection for the weak, the inarticulate and the suggestible from having to answer, thereby avoiding the risk of exposure to self-incrimination in a hostile and strange environment.

---

information. Such offenses are punishable on conviction with a maximum fine of RM1 million (approximately US$263,200) and/or a term of imprisonment not exceeding 10 years. Information that contains material omissions is also subject to the same sanctions. Part IV is the division of the Act that relates to issues of securities as well as takeovers and mergers. In short, it is the part of the Act that regulates all fund raising activities by both private and public companies in Malaysia.

35. SCAA § 134(1).

36. SCAA § 128(2). This power to search and detain may be exercised by the Investigation Officer where there exists a "reason to believe" that the person may have committed an offence under any securities law over which the SC exercises jurisdiction.

37. *See supra* note 7. With the ringgit currently pegged at US$1 to RM3.80, the maximum fine under this provision is approximately US$263,200.

38. SCAA § 128(7).

39. The equivalent Latin maxim is *nemo tenetur se ipsum accusare,* which means that no person is obliged to speak against himself or herself. *Nemo tenetur procere se ipsum* is the other Latin maxim that is sometimes used as it means that "no person is obliged to give himself or herself away." Although the privilege against self-incrimination has been "one of the inveterate principles of English law," *see* Bowen LJ in *Redfern v. Redfern,* ALL ER 524 at 528 (1886), and is a general principle of the law of evidence, its application has been specifically excluded by SCAA § 134(2), which mandates the answering of all questions put forth by the Investigating Officer. All statements made and recorded are admissible as evidence in any legal proceeding pursuant to SCAA § 134(4). The failure to cooperate with the investigation is an offense that renders the person liable to a fine of not more than RM1 million and/or a term of imprisonment not exceeding 5 years under SCAA § 134(5). For a sampling of the literature in this area *see e.g.*, I. Heydon, *Statutory Restrictions on the Privilege Against Self-incrimination*, 87 LQR 214 (1971); G. McCormack, *Self-incrimination in the Corporate Context*, JBL 425 (1993); K. Arjunan & C. K. Low, *Self-incrimination, Statutory Restrictions and the Hong Kong Bill of Rights*, SJLS 181 (1995).

Thus, the argument for the maintenance of practical and effective law enforcement cannot, and ought not, by itself be the sole reason to justify the encroachment of the rights and liberty of an individual. There has to be an appropriate balance between the two conflicting objectives. To this end, the application of the legislative removal of the privilege against self-incrimination to enhance the powers of investigation of the SC should be limited to prevent the establishment of an over-zealous regulatory regime. The latter may have the unintended consequence of impairing the further development of capital markets in Malaysia as entrepreneurs may simply seek funding from jurisdictions which regulatory framework are viewed to be more friendly and reasonable. These privileges are founded upon sound rationale that protects the rights of the individual against encroachment by the state. The essence of the privilege against self-incrimination is that no person shall be compelled to expose himself or herself to the peril of conviction as a criminal out of his or her own mouth while legal professional privilege ensures that clients will be able to obtain legal advice in confidence.

The legislative incursion into the privilege against self-incrimination is of particular repugnance as it marginalizes a doctrine of respectable antiquity that is firmly established within the common law. The privilege owes its origins to a popular reaction against the excesses of the Star Chamber, under which system confessions were often wrung out of accused persons by torture.[40] In fact, so deep-rooted is the privilege in English law that Lord Griffiths opined in *Lam Chi-ming v. R.* that "it is better by far to allow a few guilty men to escape conviction than to compromise the standards of a free society."[41]

The marked absence of any statutory controls or judicial supervision raises a legitimate concern that the SC may legally conduct "fishing expeditions"[42] which may, in the longer term, erode the confidence of entrepreneurs who feel that they have been unfairly persecuted.[43] However,

---

40. *See, e.g., Hammond v. Commonwealth of Australia* (1982) 56 ALJR 767; Dillion L.J. in *Re London United Investments plc*, 2 WLR 850 at 860 (1992); and Mustill L.J. in *R. v. Director of Serious Fraud Office; Ex parte Smith*, 3 WLR 66 at 75 (1992).

41. 2 AC 212 at 222 (1991).

42. *See e.g.*, A. Keay, *Gone Fishing: Is it Legitimate in an Examination Under Section 597 of the Corporations Law?*, 9 C&S L. J. 70 (1991).

43. In interpreting similar Australian corporate law provisions, Davies J. of the Federal Court suggested in *Little River Goldfields N.L. v. Moulds*, 10 ACLC 121 (1992), that a minimum requirement must be attained before inspectors may be appointed. The regulators should themselves have a reasonable bona fide belief that a contravention of applicable laws may have taken place. The failure to establish this requirement could give rise to a successful challenge on the part of the party under investigation on grounds of mala fides in the exercise of the power.

it has been repeatedly stressed by the courts that investigations are no more than impartial fact-finding missions, which determine no liability and seek to express no opinion as to the conduct of any party in any transaction.[44] These decisions echo the words of Lord Denning, whose opinion it was that inspectors or investigators "decide nothing; determine nothing. They only investigate and report."[45] It has therefore been argued that powers of investigation are not altogether overly harsh and are necessary in the circumstances to maintain an appropriate regulatory system that can deal effectively with increasingly sophisticated white-collar crimes.

The foregoing could, perhaps, have been justifiable if not for the procedure that the SC adopts for reviewing its own decisions.[46] This combination places an onerous burden upon the courts to tread very cautiously when interpreting section 134. While the courts are tasked with the responsibility to interpret a statute to give it true effect, there should nonetheless be a duty on the judiciary to balance the competing interests of the public against those of the individual.

It is conceded that the privilege should not be absolute, for there are perfectly legitimate grounds for this to be set aside in the interest of the public good. As illustrated by a trilogy of English cases,[47] there is an undeniable need to ensure that statutory objectives are not frustrated by the privilege against self-incrimination. However, there ought to be adequate safeguards for ensuring that the scales of justice are not unduly tilted towards unfairness, a crucial qualification that, in the opinion of the author, is not clearly articulated by the Act. In the circumstances, the better view would be to exercise prudence in interpreting the scope of section 134 to strike an appropriate balance.

The expansive wording of the section 134 raises a related issue, namely, whether the defense of legal professional privilege can be raised against the investigative powers of the SC. All communications between a client and his or her solicitor with a view to obtaining professional advice are presumed to be conducted in confidence, which is accorded privilege against disclosure. Although the general rule is that all relevant evidence is discoverable and admissible, there is a notable exception for legal

---

44. *See e.g., R. v. Director of Serious Fraud Office; Ex parte Smith*, AC 1 (1993); *Hamilton v. Naviede & Director of Serious Fraud Office* (The Independent Law Report, July 26, 1994); *NCSC v. News Corporation Limited*, 8 ACLR 843 (1984).

45. *Re Permagon Press Ltd.*, 1 CH 388 at 399 (1971).

46. SCAA §§ 146, 147. While these provisions were merely renumbered in the amending legislation they have nonetheless assumed more significance in view of the enhancement of the powers of investigation of the SC as discussed under the heading "Review of Decisions" below.

47. *Re Jeffrey S. Levitt Ltd.*, 2 WLR 975 (1992); *Bishopgate Investment Management Ltd. v. Maxwell*, 2 WLR 991 (1992); *R. v. Kansal*, 3 ALL ER 844 (1992).

professional privilege as expressed in section 126 of the Evidence Act of 1950, which states:

> (1) No advocate shall at any time be permitted, unless with his client's express consent, to disclose any communication made to him in the course of and for the purpose of his employment as such advocate by or on behalf of his client, or to state the contents or condition of any document with which he has become acquainted in the course and for the purpose of his professional employment, or to disclose any advice given by him to his client in the course and for the purpose of such employment.

However, this privilege is not absolute, as not all communications made by a client to an advocate are so protected. In particular, the privilege does not extend to any communication that is made to facilitate, or in furtherance of, any illegal purpose. The rule is established to protect the client by providing the requisite background needed for the free and open conduct of legal business.[48] Given the expanded powers of the SC in enforcing laws with respect to the securities and futures industries, the central question is whether, and if so to what extent, legal professional privilege can be raised as a defense during the course of an investigation.

The foregoing should be of some concern since the solicitor may be a person who can give "information relevant to a matter" under investigation. In the absence of any express exclusion, and in view of the extensive powers of investigations of the SC, it is possible for the section to be interpreted as not binding the SC to a claim of such privilege. This issue remains to be judicially determined and is the subject upon which the ensuing paragraphs will turn.

The response must, once again, direct attention to two conflicting objectives, namely, to make available all relevant evidence, on the one hand, and to preserve the sanctity of solicitor-client communications, the latter of which goes to the very heart of the giving and taking of legal advice in strictest confidence, on the other. In short, one must raise the question as to whether the privilege is qualified or absolute.

Despite some recent attempts to limit the ambit of legal professional privilege,[49] the weight of judicial pronouncements suggests that the privilege is sacrosanct, such that it is absolute unless expressly waived by the client.

---

48. *Public Prosecutor v. Dato Seri Anwar Ibrahim (No 3)*, 2 MLJ 1 (1999).

49. *See Reg. v. Barton*, 1 WLR 115 (1973); *R. v. Craig*, 1 NZLR 597 (1975), and *R. v. Ataou*, QB 798 (1988), in which the courts allowed the disclosure of information that could assist the accused in proving his or her innocence, or where the client had no longer any recognized interest in the privileged material or communication.

The High Court of Australia affirmed this view in *Waterford v. The Commonwealth*[50] by holding that:

> Legal professional privilege is itself the product of a balancing exercise between competing public interests whereby, subject to well-recognized crime or fraud exceptions, the public interest in "the perfect administration of justice" is accorded paramountancy [sic] over the public interest that requires, in the interest of fair trial, the admission in evidence of all relevant documentary evidence. Given its application, no balancing is required.[51]

A similar view has also been adopted by the House of Lords in England, which opined that, once established, legal professional privilege cannot be overridden.[52] The views espoused by the courts are premised on the fundamental principle that strict confidentiality must be given to solicitor-client communications to facilitate the efficient functioning of the legal system. In fact, so entrenched is this privilege at common law that it cannot be exorcised by judicial decisions and any exception must therefore fall within the responsibility of the legislature to do so in unambiguous terms. As the Act does not provide for such exceptions, the only reasonable conclusion must be that legal professional privilege continues to apply absolutely and unfettered in Malaysia despite the enhanced powers of investigation accorded to the SC.

However, the foregoing is subject to an important caveat, namely, that legal professional privilege may be compromised by communications in the course of settlement negotiations. The general principle is encoded in section 23 of the Evidence Act of 1950, which provides that statements made by opposing parties with each other in the course of settlement negotiations are privileged and may not be used at trial without the consent of both parties. Unfortunately, as the said Act is silent as to the exact scope of the privilege, the courts have construed the same narrowly. The Federal Court held in *Malayan Banking Berhad v. Foo See Moi*[53] that communications in the course of negotiations are admissible where these lead to a settlement. This decision was premised on the rationale that it was necessary to determine the exact terms of the settlement to which the parties agreed. Application of the privilege is also restricted to circumstances where

50. 163 CLR 50 (1987).

51. *Id.* at 64-65. This view was subsequently reaffirmed by the majority in *Louis James Carter v. The Managing Partner, Northmore, Hale, Davey & Leake*, 3 CLJ 451 (1995).

52. *R. v. Derby Magistrate's Court*, 4 AER 526 (1995).

53. 2 MLJ 17 (1981).

there was an existing dispute,[54] and the use of the term "without prejudice" does not, by itself, automatically mean that the privilege will operate.[55] In addition, the protection of privilege may be waived by the court without the express consent of the parties in circumstances where it can be inferred by the conduct of the parties that they are either desirous of, or have no objections to, this being effected.[56] In arriving at its decision as to whether to give effect to a claim of privilege, the court must be guided by the principle that balances "the public interest in promoting settlements and the public interest in full discovery between the parties to the litigation."[57]

It is not uncommon for there to be an exchange of communication between the regulator and the party it seeks to investigate, especially at the outset when such matters as the scope of investigation and degree of cooperation are being determined. It is against this background that the qualified status of legal professional privilege gains prominence since the courts have admitted as evidence such communications under certain circumstances. Solicitors representing clients whose activities or conduct are being investigated should take cognizance of this important distinction as they could easily compromise the position of their clients by being overly generous with their assistance during the course of the investigation in the hope that the process may be expedited.[58] This may in turn lead to the solicitors to being the subject of a lawsuit by their clients for professional negligence as a result of their failing to meet the requisite duty of care.

---

54. *See Ted Bates (M) Sdn Bhd v. Balbir Singh Jholl*, 2 MLJ 257 (1979); *Re Sunshine Securities (Pte.) Ltd.*, 1 MLJ 57 (1978).

55. *See Rush & Tompkins Ltd. v. Greater London Council*, AC 1280 (1989). The operation of the privilege is dependent on an examination of the surrounding circumstances and intention of the parties by the court. Even if the "without prejudice" negotiations are genuine, the courts may nonetheless limit such communications to specific circumstances, such as, a decision as to costs. *See Cutts v. Head*, Ch 290 (1984).

56. *See A-B Chew Investments Pte. Ltd. v. Lim Tjoen Kong*, 3 MLJ 4 (1991).

57. *Id.* at 9.

58. This need not necessarily be limited to investigations as the privilege could be compromised in any matter that comes within the purview of the SC under Part IV of the Act titled "Issues of Securities and Takeovers and Mergers" which extensive scope governs practically all aspects of capital raising by companies in Malaysia as well as by Malaysian incorporated companies offshore. The SC is the primary regulator of the securities, futures and bond markets under the provisions of the Act, the Securities Industry Act (1983), the Futures Industry Act (1993) and related legislation. Given the wide ambit of the SC in regulating the capital markets in Malaysia it is not unreasonable to assume that those with dealings with the SC may be more inclined to cooperate perhaps on concerns that they be "cold shouldered" otherwise. Such actions may inadvertently prejudice the interests of their clients and expose the solicitor to a claim for damages that arise as a foreseeable consequence.

C. *Review of Decisions*

Another area of concern is the procedure adopted by the SC to review its decisions, which are set out in the following terms by sections 146 and 147 of the Act:

> 146(1): The Commission may review its own decision under this Act upon an application made by any person who is aggrieved by such decision.
>
> 146(2): An application to the Commission to review its own decision shall be made within thirty days after the aggrieved person is notified of such decision.
>
> 147: Except as otherwise provided by this Act, any decision made by the Commission under this Act, whether an original decision by it or a decision upon being reviewed under subsection 146(1), shall be final.

As a decision is by definition the culmination of an exercise of power, the foregoing raises two inter-related issues. First, the manner in which the sections are drafted creates the impression that there is no need for the SC to provide reasons for its decisions. Secondly, it appears to remove the possibility of the aggrieved person[59] seeking judicial review of the decision taken by the SC.

The extensive powers exercised by the SC in making a decision, and thereafter reviewing the same if this is sought by an aggrieved person, allow for the possibility that the SC may make what some may deem to be unnecessary incursions into, and therefore act as an impediment to the further development of, the capital market. One such example is the implementation by the SC of the Policy Framework on Stockbroking Industry Consolidation, which sought to compel the reduction in the number of stockbroking companies from 63 to no more than 15. The initial framework for consolidation called for the merger of at least four existing stockbroking companies into one entity, commonly referred to as the "Universal Broker,"[60] within a strict time frame.[61]

---

59. The term "person who is aggrieved" has been expansively interpreted to include a person who has a genuine grievance because an order has been made which prejudicially affects his or her interests. *See Attorney General of Gambia v. M'Jie*, 2 ALL ER 504 (1961).

60. A number of incentives were provided to encourage the mergers. These included permission for universal brokers to offer a full range of capital market services such as the undertaking of corporate finance work, managing of private debt securities and trading in fixed income products as well as derivatives. In addition they would be allowed to open branches and make submissions of corporate proposals to the SC on behalf of clients, which was previously the exclusive domain of merchant banks in Malaysia. Stockbroking companies that merged to become universal brokers were

While the rationale for the consolidation is evident, namely, to strengthen the stockbroking industry ahead of the anticipated competitive challenges brought about by globalization and the liberalization of trade in financial services, the central question must be whether the SC should predetermine an appropriate level of competition. By impeding the forces of the free market, the SC may unintentionally contribute to a misallocation of resources in the stockbroking industry. One must therefore pose the question of which is better: the existence of the proposed 15 universal brokers, with the possibility that some may carry the financial burden of the weaker stockbroking companies that it was compelled to merge with,[62] or letting the market decide on the appropriate number by favoring those which are well-capitalized and well-managed. In short, is size really everything in the stockbroking industry?[63] Why should we not allow the smaller stockbroking companies to serve the particular needs of its niche markets without the compulsion of mergers, or in a worst case scenario, allow some of these companies to be liquidated if they fail to generate the requisite level of profitability? Unfortunately, the existing regulatory framework is one that promotes benign compliance for there are few realistic avenues to review a decision of the SC, save perhaps by an appeal, whether directly or indirectly, to the Minister of Finance.

These concerns are further amplified by the status of the SC as the primary regulator of the capital markets in Malaysia as well as by its enhanced powers of investigation. As the regulatory emphasis shifts towards

---

also given tax concessions, which allowed for the utilization of tax losses as tax credits as well as exemptions from stamp duty and real property gains tax.

61. When announced on April 21, 2000 the initial proposal mandated the entry into firm merger agreements of the stockbroking companies by December 31, 2000. Failure to do so was to have resulted in the non-renewal of the licences thereby effectively putting these companies out of business. The proposal also set the maximum valuation of stockbroking companies at 150 percent of its net tangible asset, and prohibited any individual from having effective control in both a financial institution and a stockbroking company at the same time. These restrictive parameters were subsequently relaxed in June 2000 following representations by the industry. For further details see <http://www.sc.com.my/html/publications> (visited January 19, 2001).

62. As the policy framework was to achieve industry-wide consolidation, an entity would only be accorded universal broker status if it had minimum paid-up capital and core capital of RM250 million, a minimum capital adequacy ratio of 1.5, practiced good governance standards and management capabilities, as well as undertook consolidation which would lead to a reduction in the number of stockbroking companies.

63. The SC subsequently relented to the pressures brought on by the industry through the representations of the Association of Stockbroking Companies in Malaysia. The compromise agreement calls for the mergers to be effected in line with the objective for consolidating the stockbroking industry. However, while there is no longer the requirement for an entity to merge with three other stockbroking companies, the failure to do so means that universal broker status will not be accorded. As the incentives as stated in footnote 60 are only applicable to universal brokers, the entities that do not meet this definition will be deprived of the former.

quality and timeliness of disclosure, and the eradication of fraud, with the implementation of a full disclosure-based system of regulation, there will be even more concerns about the perceived powers of the SC. By then, all activities of the capital markets will be subject to scrutiny by the SC in the discharge of its function to ensure that the incentives and structure of the market are consistent with efficiency, fairness and safety. This regulatory framework, by and of itself, does not differ much from that practiced in more developed capital markets. However, the principal difference is the role of the SC in arriving at, and the implementation of, its decisions. The foregoing provisions appear to allow the SC to assume the roles of judge and jury, with it being the final arbiter of its own decisions.[64] A liberal reading of sections 146 and 147, in conjunction with enhanced powers of investigation, as set out by the provisions of section 134, may possibly put the SC outside of the jurisdiction of the courts over a wide range of matters pertaining to the administration of securities laws. While this may not have been the objective of the legislature, it could be an unintended consequence, establishing the SC as all-powerful, accountable only to the Minister of Finance,[65] in all matters with respect to the securities and futures industry in Malaysia.

If this is indeed so, it would put the SC completely at odds with the three core objectives in the regulation of securities markets as agreed to by the members of the International Organization of Securities Commissions,[66] (hereafter "the IOSCO"):

- The protection of investors;

64. The precise interpretation of the terms "shall" and "shall be final" holds the key to this vexed issue. Subba Rao J. opined in *State of UP v. Babu Ram*, AIR 1961 SC 751 at 765, that "when a statute uses the word 'shall', prima facie it is mandatory, but the court may ascertain the real intention of the legislature by carefully attending to the whole scope of the statute." This decision was cited with approval in *Cheong Seok Leng v. Public Prosecutor*, 2 MLJ 481 (1988). However, the judiciary is divided on the proper definition of "shall be final." In *Overseas Chinese Banking Corporation Ltd. v. National Union of Bank Employees & Anor*, 1 MLJ 338 (1986), the court held that the words do not have the effect of ousting the inherent supervisory power of the High Court to quash the decision by certiorari proceedings if the inferior court has acted without jurisdiction or in excess of its jurisdiction or if the decision is a nullity. In contrast, the court held in *South East Asia Fire Bricks Sdn Bhd v. Non-Metallic Mineral Products Manufacturing Employees Union*, 2 MLJ 165 (1980), that "final meant final" by giving a strict interpretation to the statute. Both cases pertained to awards by the Industrial Court under the Industrial Relations Act (1967) and while the view in Overseas Chinese Banking Corporation is preferred, it remains to be seen which of the two judicial pronouncements will be adopted for the interpretation of securities laws in Malaysia.

65 The Minister is empowered to appoint or remove any of the nine members of the Commission pursuant to sections 4 and 7. In addition, the Minister may give such binding directions to or seek such information from the SC as provided for under section 19. Save for these provisions, the SC is largely independent in line with the rationale behind its establishment in 1993.

66. Extracted from <http://www.iosco.org> (visited January 19, 2001).

- The ensuring of fair, efficient and transparent markets; and
- The reduction of systemic risks.

As transparency of markets is multi-faceted (as viewed from the perspective of the investor, the issuer or the regulator), the IOSCO proposed that the exercise of powers by regulators be accomplished in a comprehensible and transparent manner. The IOSCO further proposed that regulators state their responsibilities explicitly within their governing legislation so as to enhance the acceptance of market regulation and to meet a basic principle of securities regulation.

As a preliminary step towards meeting the core objectives of securities regulation as set out above, the Act should be amended to reflect not only the functions, but also the objectives of the SC. The latter would be a significant development given its potential impact on the powers of the SC, which have been steadily enhanced in tandem with the progressive extension of its functions since its establishment in 1993. The SC has extensive powers provided that these are exercised *bona fide* in connection with, or reasonably incidental to, the performance of its functions under securities laws.[67] The inclusion of a set of statutory objectives would compel the SC to take cognizance not only of its functions, but also of its objectives, when exercising its powers to ensure that its actions are both *intra vires* and conducted in good faith. To this end, some guidance may be derived from the *Securities and Futures Bill* 2000 in Hong Kong, which sets out six regulatory objectives[68] for the Hong Kong Securities and Futures Commission:

1. To maintain and promote fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
2. To promote understanding by the public of the operation and functioning of the securities and futures industry;
3. To secure an appropriate degree of protection for members of the public investing in or holding financial products;
4. To minimize crime and misconduct in the securities and futures industry;
5. To reduce systemic risks in the securities and futures industry; and
6. To assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

67. Section 16. *See also supra* note 19.
68. Clause 4 of the Blue Bill as introduced to the Legislative Council on November 27, 2000.

The foregoing do not differ significantly from the stated aims of the government in establishing the SC in 1993, namely, to act as a single regulatory body to promote the development of the capital market, and to take responsibility for streamlining the regulations of the securities markets so as to speed up the processing and approval of corporate transactions. These twin goals encompass most of the essence of the six proposed regulatory objectives of the Hong Kong Securities and Futures Commission, the principal difference being that while the latter will enact these objectives, the SC confines it to being a part of its mission. A statutory approach mandates compliance while a mission statement is, at best, an aspiration.

A further advantage in enhancing the transparency of the SC is that such a move will bode well for the implementation of the full disclosure-based system of regulation.[69] This move is partly premised on high standards of corporate governance, to which the SC can contribute substantially by providing unequivocal leadership with its own transparent governance structure. The information asymmetry between suppliers and users of capital will be further minimized as the regulator keeps the markets fully apprised of its policies and decisions, together with the reasons thereto, on a timely basis. The SC will then attain its objective of slipping to the background, with its role transformed from that of an intermediator to that of a facilitator in line with the philosophy of a true disclosure-based system of regulation.

IV. PROPOSALS FOR REFORM

This section of the paper turns upon the issue most aptly summarized by the Latin maxim *Quis custodiet ipsos custodes* — who will guard the guardians?

The significance of the foregoing is amplified by section 147 of the Act, which appears to exclude the judiciary from any role in reviewing decisions taken by the SC. However, this may not be altogether inappropriate given that the existing judicial infrastructure may not necessarily be the best forum to determine issues pertaining to the intricacies, complexities and constantly evolving environment of capital markets. The principal disadvantage against the courts is the generally lengthy duration it takes for any case to be brought to trial. As time is often the essence in the determination of issues pertaining to the securities and futures industry, any delay in having the case heard is, in effect, justice

69. *See supra* note 22.

denied.

As public trust and confidence are the cornerstone of any vibrant capital market, the better approach would be to subject the decisions of the SC to scrutiny by an independent Process Review Panel, (hereafter "the PRP"), comprised of experts from a diversity of academic and professional backgrounds, as well as the Chairman or a Director of the SC.[70] The majority of the members of the panel would be prominent public persons with a sound working knowledge of the capital markets in Malaysia. However, the membership need not be restricted to Malaysians, as eminent persons from overseas may be invited to be on the panel, whether as part of its composition or on an ad hoc basis, depending on the circumstances. The underlying criteria must be independence, without which the PRP will have no credibility.

The PRP will be chaired by a Justice of either the Federal Court or of the Court of Appeal, who will be supported by full-time team of administrators with the SC providing the requisite infrastructure for the Secretariat. Funding of the PRP will be derived from two principal sources, namely, an annual recurrent grant from the government as well as from a percentage of the levies imposed on securities and futures transactions. To ensure expediency, this panel will be non-statutory and proceedings will be conducted in less formal surroundings, designed to ensure that aggrieved persons are not intimidated. The PRP must also be bound by a predetermined schedule, such that all cases brought before it will be resolved within two months of the lodging of the initial complaint.

The principal function of this panel is to ensure that the powers of the SC are exercised with care and precision, having due regard to its functions and objectives, and to report its findings to the Minister of Finance. In essence, the PRP will conduct audit reviews of files, actions and decisions that are taken by the SC to ensure that all internal due process procedures have been complied with. It will also determine whether these actions and decisions were taken as a result of consistency in application of the procedure. It is also envisaged that the PRP may make recommendations to the Minister to streamline procedures with a view to enhancing transparency should this be necessary. The Minister may table these to the Federal Parliament as he or she deems appropriate bearing in mind the conflicting objectives of maintaining secrecy and confidentiality, and

70. This is necessary to ensure that the principles of natural justice are adhered to given that the PRP will review the decisions of the SC. It will also assist in keeping the members of the panel fully apprised of the work of the SC and expedite the hearings as the Chairman or the Director can provide the requisite expertise as well as access to documents, or call upon the relevant person(s) to assist with the inquiry.

facilitating an assessment of the performance of the SC by the investing public.

The PRP will convey the distinctive message that no person or organization is above the law. To ensure its efficient operation, the members of the panel should be allowed unfettered access to confidential files and details pertaining to all aspects of the internal operations, investigative process and procedures of the SC. However, the ambit of the panel should be limited to the review of decisions made by the SC in the exercise of its powers, and the panel should be empowered to conduct such reviews regardless of whether there are any applications by aggrieved persons.

All members of the PRP must abide by strict confidentiality clauses to prevent their divulging any matter under their purview. The vow to secrecy must continue to be enforced for a specified period, even if the person ceases to be a member of the PRP, for there may be some issues for which selective disclosure could impair the smooth functioning of the capital markets. To ensure that this is so, all appointees to the PRP must be screened for their independence and be required to attest that their appointment will not place them in any situation where conflicts of interest, whether actual or perceived, would arise. The breach of any of the terms of appointment, be this with respect to the confidentiality clauses or conflicts of interest, will subject the appointee to a fine as well as a term of imprisonment. While this may impose rather onerous responsibilities upon the appointees, this framework is necessary to ensure public confidence in, and acceptance of, the PRP.

In the interest of justice, and to ensure that justice is not only done but also seen to be done, the SC should be required to keep in abeyance the implementation of any of its decisions that are subject to review by the PRP. However, there should be at least two important caveats to the foregoing. First, the Minister should retain the discretion to grant the SC the power to enforce its decisions during the period of review by the panel where there exist substantial grounds for doing so to preserve the integrity of the markets. Secondly, the panel must conclude its review and make its recommendations to the Minister within a specified period of time. The Minister can then consider the report and/or call for further representations from the panel and/or the SC. The decision of the Minister shall be final and should be expedited where possible to ensure that neither the interests of the applicant nor those of the SC are prejudiced by the passage of time.

The establishment of the PRP as an effective check and balance mechanism is vital towards promoting confidence in the markets especially in light of the enhancement of the powers of the SC. The structure as

proposed above would not only allow the SC to implement the proposals of the IOSCO, but it will also provide a reasonable and practical framework within which the interests of the regulator and the market participant can be adequately preserved.

As the PRP will focus strictly on the procedural process, rather than the merits of complaints that are lodged with it, there is a corresponding need to establish a more formal arrangement to attend to the matters that are outside of the purview of the panel. To this end, it is proposed that a specialized "Securities Court" be created,[71] with an exclusive mandate to hear and determine securities law cases relatively quickly and efficiently by adopting civil procedures, and to thereafter impose such sanctions as are necessary and appropriate. This court will be empowered to issue a more comprehensive range of orders to befit the breach of securities law including, but not limited to, "cold shoulder" orders[72] as well as "cease and desist" orders.[73]

Apart from performing its oversight function of the actions of the SC, the Securities Court may also assume an equally important role, namely, to combat the rise in the incidence of securities fraud. Provisions should be incorporated to facilitate it acting as an effective deterrent against market misconduct.[74] To this end, the enabling legislation should permit findings

71. This must by definition be a longer term objective as it would require an amendment to the Federal Constitution. This court will be similar to the Industrial Court and the Shariah Court, which deal with industrial and Islamic matters respectively. A key difference would be that the Securities Court will have exclusive jurisdiction over securities laws as defined under the applicable Acts and will therefore be the final arbiter of such cases with no avenue of appeal to the Federal Court. This is necessary in view of the speed at which the securities and futures markets operate. A timely decision is vital to ensure and sustain the vibrancy of capital markets and although it may be unfair to some, the majority is likely to benefit from such expeditious determinations.

72. This refers to an order that freezes a person from undertaking any business with the SC, including the submission of proposals, whether on behalf of a client or on its own account. To avoid circumvention of the order, no licensed person or persons may act or continue to act for any person who is the subject of a cold shoulder order for the entire duration of the period specified thereby. The effectiveness of this sanction is principally market driven namely that it generates undesirable negative publicity for the person who is subject to such an order as well as possibly preventing them from undertaking any fee earning corporate advisory work for the duration of the order.

73. Although uncommon in Asia, this is an administrative act exercised by the Securities and Exchange Commission of the United States of America to compel a party to stop and refrain from a particular conduct. Proceedings for breach of an order are brought before a court and may be punished by a civil penalty and/or a mandatory injunction directing compliance with the order. However, unlike its American counterpart the "cease and desist" order can also be imposed against the SC to prevent it from pursuing an action or implementing a decision against an aggrieved person.

74. Market misconduct is the term used to encompass all forms of activity which purpose is to disrupt the smooth functioning of the capital market. As such it would include insider dealing, manipulation of the stock and/or futures markets through false trading or price rigging, and inadequate or incorrect disclosure of information.

of the Securities Court to be used by victims[75] to seek compensation from "market manipulators"[76] where it is fair, just and reasonable to do so. In short, victims of market misconduct should be allowed to "piggy-back" on decisions of the Securities Court where these involve a finding of liability on the part of the market manipulator.[77]

The principal advantage of this proposal is that it would allow victims to sue the market manipulator, as a matter of right, in the civil courts where the latter is found guilty of any form of market misconduct by the Securities Court. This would simultaneously reduce the onus of proof on the part of the victim, while enhancing the burden of proof on part of the market manipulator. It is, therefore, envisaged that the framework would comprise two inter-related steps:

1. For the alleged victim to show that he or she traded in the securities and/or futures markets within the period which the alleged market misconduct is supposed to have taken place; and
2. For the alleged market manipulator to thereafter adduce evidence to establish that he or she did not do the particular trade whether directly or through his or her agents.

As the case between the victim and the market manipulator is a civil matter, the standard of proof would be that of a civil standard, namely, on the balance of probability on both the part of the alleged victim as well as the alleged market manipulator. The foregoing has its merits if based solely on the ground that it would reduce the costs of litigation since the alleged victim can "piggy-back" on any finding of the Securities Court against an alleged market manipulator to discharge his or her evidentiary burden.

Time will always be of the essence for the determination of matters brought before the Securities Court, given the fluidity of the capital markets and of financial instruments. However, to prevent the court from being inundated by cases, and possibly defeating one of its key objectives of handing down prompt decisions, it is proposed that the Court only consider cases which meet two principal criteria:

1. The matter must involve securities law as defined in the applicable legislation; and

75. This refers to investors who suffer losses as a consequence of the market misconduct by the market manipulator.

76. This term is used generically to refer to those who have been found liable for market misconduct.

77. This creates a right of civil action in respect for which the plaintiff can claim compensation for loss and other remedies devoid of the obstacles that are common to such actions.

2. One of the parties must be the SC or a self-regulatory organization.[78]

The second requirement is necessary as litigation between two individuals,[79] or that which does not involve a regulator, should best be classified as a civil matter to be determined in the customary manner. The ambit of the Securities Court extends primarily to issues pertaining to the governance of securities laws, that is, the interpretation of these laws and, through them, an assessment of the conduct of the regulators. Its jurisdiction, therefore, starts where the ambit of the PRP's conclude, and it will consider the merits of cases in the same way as any other court.

To expedite the judicial process, the Securities Court should also be empowered to order that certain matters be referred to arbitration, particularly where these involve a degree of complexity beyond the resources of the court in terms of time. Although the arbitration proceedings are likely to be less formal, there will be no compromise on the either the onus or the standard of proof that is required of the parties. The findings and recommendations of the arbitrator will then be submitted to the court, which decision on the matter will be final.[80] While this is a novel proposal, and admittedly one that lends itself to being termed as "sub-contracting by the judiciary," the perceived benefits are evident. It provides for an infrastructure whereby acknowledged experts, whose independence must be beyond reproach, make a preliminary assessment of the merits of complex cases without usurping the powers and responsibility of the court. The latter remains the final arbiter and would not be abdicating its judicial role as it must review the recommendations of the arbitrator, and thereafter provide reasons why it chose to accept, reject, amend or vary the same.

V. CONCLUSION

As capital markets become increasingly complex with the introduction of sophisticated financial instruments, and advances in the use of electronic commerce, the regulator risks being marginalized unless it adapts to these changes. In addition, regulators of capital markets must take cognizance of two particular challenges, namely, the need to cope with large

78. This would include the Kuala Lumpur Stock Exchange, the Malaysian Exchange of Securities Dealing and Automated Quotation, the Commodity and Monetary Exchange of Malaysia, and the Kuala Lumpur Options and Financial Futures Exchange.

79. This includes an action by the victim against the market manipulator for losses brought about by the market misconduct of the latter.

80. The court need not accept the recommendation of the arbitrator and may, with the provision of its reasons in writing, amend or vary the same. No further appeals on the matter will be possible, and any change of the law must thereafter be pursued through the normal legislative process.

and complex financial institutions,[81] which cross traditional industry sectors, and the need to adapt to the growth of cross-border business as a result of globalization. In fact, such is the trend that it is conceivable that many regulators will move the way of the Financial Services Authority of the United Kingdom, which was itself established following the merger of ten previously separate regulators.[82]

An effective regulatory framework must be proactive, with the objective being to strike an appropriate balance between the often-competing interests of protecting the investing public, and allowing market forces to dictate the speed and direction of healthy competition and innovations. In short, regulators should view their role as more of navigators, as opposed to being watchdogs, if they are to remain relevant in a constantly changing global environment.

The authorities recognize this challenge and have incorporated the same as a key objective of the Capital Market Masterplan ("CMM") that was launched by the Minister of Finance on February 22, 2001.[83] In aspiring towards a vision of establishing an internationally competitive and highly efficient capital market, the CMM advocates a stronger and more facilitative regulatory regime.[84] To this end, full functional regulation will be implemented: a system where capital market activities are regulated according to their functions rather than institutional forms. This will minimize regulatory gaps and overlaps, with the resultant "seamless" regulatory framework reducing the scope for regulatory arbitrage. This will also provide the necessary platform from which risk-based supervision may be implemented to augment the disclosure-based system of regulation that

81. The historical distinction between banking, insurance and securities industries is becoming increasingly blurred as a result of mergers and/or acquisitions. The rapid growth of such behemoths whose scope of business is both multi-functional and cross-sectoral places the traditional structures of regulation under strain. An example of such a financial supermarket is Citigroup, which counts financial services, banking, insurance, fund management and securities dealing as amongst its core businesses.

82. The British legislation underpinning banking, insurance and securities regulation were completely rewritten by the Financial Services and Markets Act of 2000, repealing and consolidating various statutes. On its establishment, the Financial Services Authority assumed regulatory powers previously exercised by, amongst others, the Treasury, the Bank of England, the Friendly Societies Commission, the Registry of Friendly Societies, the Personal Investment Authority, the London Stock Exchange, and the Securities and Investment Board.

83. The full version of the CMM may be downloaded from <http://www.sc.com.my/html/cmp2001/fr_cmp2001.html>.

84. The CMM represents the response by the authorities in Malaysia towards the challenges of the new millennium in line with its move towards a knowledge-based economy. For a discussion of this meta-strategy *see* G. R. Walker, *Globalization and the K-Economy: Malaysia's Strategic Response*, 18 C&S L. J. 289 (2000), and G. R. Walker, *Globalization and Malaysia*, in C. K. Low, FINANCIAL MARKETS IN MALAYSIA, 343-367 (2000).

takes effect from the year 2002. The CMM also proposes the establishment of a Capital Market Advisory Council whose ambit is to advise the SC on the implications of new and potential developments in the capital markets, as well as to provide an independent view on the progress of the implementation.

However, regardless of the ultimate structure of the regulator, it must be couched upon transparency and accountability. Both elements are crucial towards promoting, and maintaining, confidence in the regulator, without which capital markets are unlikely to prosper. While the powers of the SC have been steadily enhanced over the years, there is a perception that it has become increasingly opaque and much less accountable in view of provisions such as sections 146 and 147. Its initial relatively tough stance on the rigid timetable of its Policy Framework on Stockbroking Industry Consolidation and the establishment of universal brokers won the SC few friends.

The introduction of the disclosure-based system of regulation, the principal objective of which is to facilitate the establishment of a more efficient and transparent securities market, will further enhance the powers of the SC as it will assume two important roles. First, it will regulate the quality, accuracy, and timeliness of material information both during the initial public offering as well as throughout the tenure of these securities. Secondly, it will assume a more active role in ensuring strict compliance with disclosure requirements through a combination of strengthened surveillance and enhanced enforcement.

The SC is already facing a challenge to its powers in a case that is scheduled to be heard in mid-2001.[85] The facts of the case are briefly thus: In March 1997, IOI Limited, a publicly listed company, and Mr. Lee Shin Cheng, its major shareholder and managing director, bought slightly over 33 percent of the shares of Palmco Limited. The making of a general offer for the balance of the shares in the target company is required under the Malaysian Takeovers Code when this threshold is breached. The SC initially ordered IOI to make the general offer but subsequently reversed its decision following an appeal by the company. In its place, a public reprimand was issued against IOI and Mr. Lee after the SC took into account their standing as "good corporate citizens." A minority shareholder is now seeking a court order to compel the SC to reinstate its initial decision that a general offer for the remaining of the shares in Palmco be made. This case has enormous implications for securities regulation in Malaysia for it provides an

85. *See* S. Jayasankaran, *Revolt of the Small Investors*, FAR EASTERN ECONOMIC REVIEW, November 2, 2000.

unparalleled opportunity to test the jurisdiction of the court on the SC.

The foregoing is, perhaps, just the first case to surface and does not bode well for the development of the market given the manner in which the SC reversed its own decision. A restrictive interpretation of the current provisions would effectively mean that there is no recourse for any person, as the decision of the SC is final. Such "ouster clauses"[86] have been struck down by the English House of Lords in *Anisminic v. Foreign Compensation Commission,*[87] a decision that was cited by the Judicial Committee of the Privy Council when handing down its judgment in *South East Asia Fire Bricks v. Non-Metallic Mineral Products Manufacturing Employees Union.*[88] While the Privy Council ruled in favor of upholding the ouster clause in the latter case, it nonetheless left the issue to be definitively resolved by the domestic courts when said:

> But if the inferior tribunal has merely made an error of law which does not affect its jurisdiction, and if its decision is not a nullity for some reason such as breach of natural justice, then the ouster will be effective.[89]

To allay the fears of issuers and investors, the Act should be amended with appropriate checks and balances incorporated to ensure that the SC does not become all-powerful, or at least prevent the perception that it is so. This would remove a potential uncertainty that looms over the capital markets, namely, the transparency and accountability of the SC, which will not only prove attractive for issuers but also for investors, both domestic and foreign.

---

86. These would include terms such as "shall be final," "shall not be questioned," "shall not be reviewed by any court" and "shall have effect as if enacted in this Act." These are now in disuse and disapproved of in England.

87. *See* 2 AC 147 (1969), wherein Lord Wilberforce noted "What would be the purpose of defining by statute the limit of a tribunal's powers, if by means of a clause inserted in the instrument of definition, those limits could be safely bypassed?" (at 208).

88. 2 Malayan L.J. 165 (1980).

89. *Ibid.* at 167. The dicta of Edgar Joseph Jr. FCJ in *Petaling Tin Berhad v. Lee Kian Chan,* 1 MLJ 657 (1994), provides support for the *Anisminic* approach. Therein, his Lordship opined "it is clear law that there is in cases of statutory delegation a 'residual area' which is reserved for the courts" (at 672). These comments are relevant to the issue at hand as they pertained to the jurisdiction of the Panel on Takeovers and Mergers under the *Code on Takeovers and Mergers*. The former has since been dissolved with its functions assumed by the Securities Commission, while the erstwhile Code is now replaced by Part IV Division 2, "Takeovers, Mergers and Compulsory Acquisitions," namely sections 33 to 34C, of the Securities Commission Act of 1993.