SECURITIES REGULATION IN MALAYSIA: EMERGING NORMS OF GOVERNMENTAL REGULATION

Philip N. PILIAI *

The author examines the emergence of an alternative model of capital market regulation in developing countries. He argues that Western models, such as those in the U.S. and Great Britain, cannot be transferred outright to developing countries without considering factors that are unique to securities regulation in those countries. As an example of the approach used in one developing nation, the author examines the Malaysian model, which has emerged after many attempts to utilize and modify the British model of self-regulation.

1. Introduction

This article examines the emergence of an alternative model of capital market regulation in developing countries. Until now the options available to developing countries have been adaptations of (1) the British model of self-regulation or (2) the U.S. model of the Securities and Exchange Commission (SEC). The central thesis of this article is that developing countries usually lack the structural underpinnings of Western capital markets and that to focus only on adapting these Western models, without more, is to invite unanticipated atrophy or mutation of such models. The Western models are premised on the existence of a well-developed regulatory capacity and sufficient numbers of professionals and paraprofessionals in the public and private sectors, conditions lacking in most developing countries.

The alternative model examined here is that of Malaysia. The Malaysian model has developed after many attempts to utilize the British model of self-regulation. Modification of the British model to provide for government intervention followed a dramatic collapse of stock market prices in 1982 [1], coinciding with global recession and a dampening of the general investment climate. These events were accompanied by allegations that the price collapse resulted from short-selling and other manipulative activities of organized groups and from the failure or inability of the Kuala Lumpur Stock Exchange to adequately regulate the investment business. What has emerged from this

* Associate Professor, Faculty of Law, National University of Singapore.
experience is a system of securities regulation which, while modeled on British antecedents, is a mixture of operational autonomy and significant governmental regulation with reserve interventionary powers for the government.

This article begins with an overview of the British and U.S. models. Section 2.3 considers some factors unique to securities regulation in developing countries. Section 2.4 briefly outlines the Malaysian model. Section 2.5 compares the Malaysian model with the British and U.S. models. In the latter part of this article the focus is the Malaysian system itself. Section 3 presents historical and economic background. Sections 4 and 5 discuss the historical development and role of the securities market in Malaysia. Section 6 details statutory provisions for securities regulation in Malaysia. The concluding section places the Malaysian model of securities regulation in comparative perspective.

2. Choice of Models: Self-regulation and Governmental Regulation

When systems of securities regulation are designed for developing countries, the purposes of a capital market in a developing, as opposed to a developed, country seldom are considered. Not unnaturally, models of markets in developed countries are studied and modified for transplantation [2]. Two paradigms are routinely adapted for use in developing countries. The first, the British model, is self-regulation of “the City” (the financial community of the City of London) against a backdrop of usual investor protection legislation. The other model, that of the United States, is governmental regulation through the SEC [3].

2.1. The British Model

The British self-regulatory model depends upon the City. This community comprises the collective financial community of London, including the Bank of England, the Department of Trade and Industry, the Council for the Securities Industry, and the various associations of issuing houses, acceptance houses, merchant banks, the Stock Exchange, insurance companies, unit trust managers, investment trust companies, and others [4]. The City’s financial capabilities are combined with the well-organized legal, banking, and accounting services of London itself. This less formal system of self-regulation, the product of the growth of the financial community over three hundred years of national and colonial development, has the advantages of flexibility, expertise, and low operating costs.

Comprehensive national investor protection legislation and companies legislation – the Companies Acts [5], the Prevention of Fraud (Investments) Act [6], and the Licensed Dealers Act (Conduct of Business Rules) [7] – provide the
historical backdrop to the development of the British model. The interaction of the City with this legislation is responsible for the unique character of the British capital market. This model is currently under severe structural criticism, as evidenced by the Gower Review of Investor Protection [8]. The criticisms stem from the confusing myriad of self-regulatory agencies in various sectors, gaps in the scheme of regulation, and ineffective enforcement machinery [9]. The institutional framework and capacity of the City of London is itself well established. An international community of bankers, lawyers, accountants, and paraprofessionals developed during the years of British colonial power and has been enhanced in contemporary London by the universities, polytechnics, and professional institutes which today draw upon a pool enriched by the "brain drain" of developing countries.

2.2. The U.S. Model

Under the U.S. model, governmental regulation of the securities markets, the SEC is charged with investor protection through approval of prospectuses, close market surveillance, and enforcement of the securities laws on a national scale. The SEC has quasi-judicial, regulatory, rule-making, and investigatory powers in securities regulation. The U.S. model does not entail governmental control of the day-to-day operations of the stock exchanges. Control of daily operations is left to market professionals.

Like the British model, the U.S. model derives from historical factors peculiar to that country: the Great Crash of 1929 when the stock market collapsed, and federal-state relations. First, the experience of financial institutions in the United States after the 1929 Crash resulted in two seminal pieces of federal legislation: the Securities Act of 1933 [10] and the Securities Exchange Act of 1934 [11]. The 1933 Act concerned the initial interstate distribution of securities and the 1934 Act created the Securities and Exchange Commission and invested it with power to administer both Acts, including the major provisions on securities frauds. The 1934 Act also required registration of brokers and dealers and extended the disclosure requirements of the 1933 Act to the secondary distribution of securities [12]. Second, federal-state relations have been an important factor in the development of the U.S. model. The United States has never had a federal company law; regulation of companies is a state matter. Also, the only securities legislation in existence prior to the 1933 and 1934 Acts was the complex of each state's "Blue Sky" laws, general provisions regulating all aspects of securities, which remain in effect today [13]. The efficacy of the U.S. model of securities regulation is, in part, the result of administrative capability. At present, the SEC has a staff of about 2000 professional personnel. The capabilities of private professionals are also vital for the U.S. model. That model to a large extent depends upon legal, accounting, banking and securities professionals and paraprofessionals in the
private sector. These private-sector participants are located primarily, but not exclusively, in New York and in Washington, D.C. The U.S. model has been promoted by an activist judiciary, a widespread taste for litigation, and the availability of contingency-basis representation and class action suits. The absence of contingency suits in most British common law jurisdictions [14] and the nascent development of class actions there [15] may render the U.S. model *sui generis*. Both the British and U.S. models, however, have features for investor protection and indicate in their design a preoccupation with the secondary trading market rather than the primary market for new issues of capital-raising securities. And in both countries, the pre-screening of prospectuses is dependent up on both private and public lawyers and accountants.

2.3. Developing Countries and New Capital Markets

When faced with the task of creating a securities market, developing countries have employed these paradigms [16] with little regard to the objects and preconditions of a working capital market. The objects of a working capital market are self-evident. A capital market provides a mechanism which allows capital to be mobilized for productive investments. Such a market displaces the unproductive hoarding of gold, cash, and other resources. Developing countries usually lack domestic savings and capital formation and rely upon foreign investment and loans from banks. In theory, the market also diverts capital from inefficient enterprises to efficient enterprises. If these functions are the primary reasons for establishing and maintaining capital markets in developing countries, what state resources need to be diverted to the secondary market and its regulation? What impact, if any, do highly volatile market prices, sharp practices in market manipulation, and insider trading in the secondary market have on the primary market and its capacity to mobilize capital [17]?

In considering the preconditions of a working capital market, it must be reiterated that developing countries have a shortage of professionals in both the private and public sectors. This lack of institutional capacity is a critical constraint on the tasks of government in general, and on regulation of the capital markets in particular. A capital market is not created and sustained merely by passing the necessary laws [18]. It is contingent upon the expertise of securities, banking, legal, and accounting professionals and paraprofessionals and competent regulators. A governmental framework for regulation depends, in part, upon private-sector expertise, as well as its own technical competence to administer and regulate a securities market. Company law that requires registration and maintenance of records is premised on a paraprofessional capacity for these tasks. While adequate in Anglo–U.S. markets, this infrastructure is wanting in most developing countries. The administrative infrastructure in most developing countries is that which exists in what Gunnar...
Myrdal calls a "soft state" characterized by:

a general lack of social discipline ... signified by many weaknesses; deficiencies in ... legislation and in particular, in law observance and enforcement, lack of obedience to rules and directives handed down to public officials on various levels; frequent collusion of these officials with powerful persons or groups of persons whose conduct they should regulate; and, at bottom, a general inclination of people in all strata to resist public controls and their implementation. Also within the concept of the soft state is corruption... [19].

2.4. The Malaysian Model

While a detailed picture will be presented below, a broad outline of the structure of the Malaysian securities market will aid comparison with the two Western models. The market developed privately, and significant governmental intervention was not present until 1973. Under the current system of securities regulation, the primary government actors in the market are the Finance Minister and Registrar of Companies, with supervisory responsibilities and reserve interventionary powers. A Capital Issues Committee, with both public and private representatives, reviews prospectuses. The Committee of the Stock Exchange, a five-member governing committee, has primary responsibility for day-to-day supervision of the activities of the Exchange. The membership of the Committee of the Stock Exchange is mostly private, but the Finance Minister can appoint government representatives to this Committee.

2.5. Developed and Developing Market Models: A Comparative Overview

It is helpful to identify the various levels of activity in a securities market and the key agencies involved in each sector. A comparison of the three models clearly reveals the paths of divergence (table 1).

All three models incorporate disclosure requirements and investor protection legislation. While the form of such legislative intervention is similar, practice indicates that the SEC is the most effective enforcement body. In the area of day-to-day market operations, operational autonomy is common to all forms: governmental intervention and an overlay of bureaucratic procedures would operate as a stranglehold on the market and indeed is the very antithesis of a market. Such operations are best left to market professionals.

Divergences appear in the way that securities exchanges are set up and governed. The British model of self-regulation allows the Exchange, more or less, to regulate itself, except that broker–dealers must be licensed under the Prevention of Fraud (Investments) Act [20]. The U.S. model requires similar licensing of broker–dealers, as well as registration of exchanges and oversight of their rules. The regulatory nature of that model is most apparent in the formidable market surveillance powers of the SEC. The Malaysian model
Table 1

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities exchanges</td>
<td>Set by exchange</td>
<td>Set by exchange but preconditions set by the Minister of Finance (Minister)</td>
<td>Set by exchange but registered under the Securities Exchange Act of 1934</td>
</tr>
<tr>
<td>(a) Membership, trading rules and listing requirements of exchange</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Representation on governing body of exchange</td>
<td>Exchange members elect</td>
<td>Exchange members elect but Minister may appoint persons to represent public interest</td>
<td>Exchange members elect</td>
</tr>
<tr>
<td>(c) Alteration of rules of exchange</td>
<td>By exchange</td>
<td>Primary responsibility of exchange but alteration subject to Ministerial approval</td>
<td>SEC has oversight of altered rules of exchange</td>
</tr>
<tr>
<td>(d) Effect of rules of exchange</td>
<td>Binding on members qua members and internally enforceable</td>
<td>Binding on members qua members, and enforceable by court order at instance of Registrar or exchange</td>
<td>Binding on members qua members</td>
</tr>
<tr>
<td>(e) Day-to-day operation of the market</td>
<td>Exchange responsible</td>
<td>Exchange responsible</td>
<td>Exchange responsible</td>
</tr>
<tr>
<td>(f) Dealing in securities and broker-dealer licensing</td>
<td>Exchange approves dealers and representatives under Licensed Dealers (Conduct of Business) Rules 1983 and Prevention of Fraud (Investments Act) 1958</td>
<td>Exchange approval of all dealers and representatives and Securities Act licensing of all dealers and representatives</td>
<td>Registration of broker-dealers</td>
</tr>
<tr>
<td>(g) Market surveillance and enforcement of rules</td>
<td>Exchange responsible influenced by City</td>
<td>Exchange responsible but Registrar has right to keep surveillance of trading floor</td>
<td>Exchange responsible with SEC surveillance and power to compel exchange to enforce its rules</td>
</tr>
<tr>
<td>Section</td>
<td>Description</td>
<td>Law/Rule/Source</td>
<td></td>
</tr>
<tr>
<td>---------</td>
<td>-------------</td>
<td>-----------------</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Conduct of securities business</td>
<td>(a) Maintenance of records Stock Exchange Rules and basic company law; informal but significant influence of Board of Trade and Bank of England Prescribed by Securities Industry Act and restated by exchange rules Securities Act of 1934</td>
<td></td>
</tr>
<tr>
<td>(b) Accounts and audit and trust accounts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(c) Trust funds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(d) Fidelity funds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Secondary trading and securities frauds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Securities regulation/advisory agency and its legal origins</td>
<td>Department of Trade administers Company Law London Panel on Takeovers and Mergers administers the City Code on Takeovers and Mergers Registrar of Companies administers the Companies Act and Securities Industry Act; Capital Issues Committee advises Registrar and Minister on securities regulation; proposed panel on Takeovers and Mergers SEC has rule-making powers and regulation powers under the 1933 Securities Act and 1934 Securities Exchange Act</td>
<td></td>
</tr>
</tbody>
</table>
deviates from the British norm by imposing a licensing structure on exchanges as well as broker-dealers and their representatives. The Malaysian model also provides power for the Minister of Finance to appoint members to the governing committee of an exchange, and ministerial power to approve alteration of rules. Surveillance of the trading floor is the responsibility of the exchange and the Registrar of Companies, who has administrative control over securities as well as companies regulation.

In the area of conduct of the securities business, the three models are similar except that the Malaysian model uses legislation with criminal and delicensing sanctions to effect its norms of accounting and financial accountability to clients.

The above representation of the critical features of each regulatory model reveals that the concept of self-regulation is imprecise and should be either defined or abandoned. Self-regulation does not mean, under any regulatory scheme, an absence of statutory control. On the one hand, if self-regulation is defined as total autonomy on the historical model of the London Stock Exchange, then it does not exist today. On the other hand, even the U.S. model of governmental regulation may be characterized as self-regulation with an overlay of governmental regulation. Professor Louis Loss has described governmental regulation as cooperative regulation: "The task will be largely performed by representative organizations of investment bankers, dealers and brokers, with the Government exercising appropriate supervision in the public interest, and exercising supplementary powers of direct regulation" [21].

What appears to be a common emphasis is the nature of self-regulation and government supervision. Where the market is sufficiently developed and undertakes all operational and regulatory tasks itself, as in Britain and the United States, day-to-day autonomy may be present. But where, as in most developing countries, self-regulation by market professionals is weak because of infrastructure incapacity [22], then government intervention and the availability of reserve powers to compel market discipline constitute a viable alternative.

Several reasons explain the shortcomings of self-regulation in developing countries: market professionals do not discipline themselves because they are reluctant to punish peers; they have inadequate staff and investigatory resources; and they are myopic in not perceiving the wider public interest or the wider impact of that may appear normal business practices [23].

No matter which model is adopted by a developing country, modifications become necessary as a result of each country's experience, and structural divergences from the chosen paradigm are unavoidable. What is common to such divergences in the developing countries is the absence of institutions styled upon the SEC. The SEC model involves high direct administrative costs and professional capabilities beyond those available in developing countries. Even where the elaborate U.S. model has been adopted, as in Japan [24], compared to the U.S. experience, securities regulation has undergone a peculiar
transformation [25]. Private civil actions are rare and, instead of actions by the agency, the unique Japanese phenomenon of administrative guidance has emerged as a major device of securities regulation. Intervention appears by way of governmental representation on stock exchange committees, controls over rules and licensing procedures, residual investigatory powers, and the co-opting of the judicial process. The Japanese experience is not surprising because in many developing countries the state has emerged as the only domestic organization that can marshall the resources of capital and trained individuals for economic activity [26]. In like manner, the government rather than an SEC-type body becomes the only agency of regulation available, even where it avoids direct intervention.

The Malaysian choice of an intermediate model which combines government representation and reserve powers enables the state to generate the desired regulation, and if such regulation fails, the reserve power of intervention may be invoked. Such a system does not require public investment in a regulatory system and enables the state to use state enterprise officials and other private-sector personnel as government watchdogs to ensure some degree of self-regulation. While the SEC model is not interventionist on its face, it is quite interventionist in practice. In part, this is the result of its institutional capacity and its ability to rely on private lawyers and accountants who participate in securities regulation. By contrast, a highly interventionist legislative model is present in India [27]; but the reality in India indicates an inability to change the quality of performance of the key actors. The intermediate Malaysian model avoids the other alternative – depending upon private sector self-regulation, because self-discipline is unavailable.

3. The Malaysian Political and Economic Context

The population of Malaysia is 14.26 million with an ethnic distribution of over half Malay, about 35% Chinese and 10% Indian [28]. British colonial policy in Malaysia was designed to preserve political and administrative power in the hands of the Malays while allowing the Chinese to maintain control of the local non-plantation economy [29]. When they departed in 1957, the British left behind well-organized national and state bureaucracies and transportation and communication networks, all of which were necessary to the trade patterns between Malaysia and Britain [30].

The Malaysian economy has historically relied on tin mining and plantation production of rubber and palm oil. Malaysia is a major world supplier of these commodities. Since 1957, the Malaysian economy has developed in the areas of petroleum resources and industrial products. The gross national product per capital is U.S. $1258.21, and the fixed capital formation per capita is U.S. $314.40 [31]. The colonial economy of Malaysia was dominated by British
companies listed on the London Stock Exchange, whose plantation, mining, and import–export activities were centered in Malaysia and Singapore. In 1969, a series of race riots showed Malay dissatisfaction with the high degree of native poverty and low degree of native ownership of business and industry [32]. This resulted in the formulation of the New Economic Policy designed to redistribute ownership and control of the Malaysian economy to achieve "[t]he ownership and management by Malays and other indigenous people of at least 30% of commercial and industrial activities in the economy and an employment structure at all levels of operation and management that reflects the racial composition of the nation by 1990" [33]. This is to be achieved in part by quotas and preferences for Malays in education, jobs, and share ownership. In addition, state enterprise is supposed to undertake significant economic activity which ultimately would be transferred to private hands in a manner that would satisfy the redistribution formula [34]. In the meantime, some ownership for lower-income Malays is to be achieved through a unit trust scheme.

Activism on the part of the government in securities regulation should be understood within the context of the New Economic Policy. The existing administrative infrastructure is being extended through state enterprise in terms of both human and financial resource needs. The Malaysian economy, though severely affected by the global recession and the drop in commodity prices, has been able to meet these needs, sustaining annual growth rates of 9.2% in 1979, 7.8% in 1980, 6.9% in 1981, and 3.9% in 1982 [35].

Conditions are ripe for corruption and abuse of power where economic expertise is in the hands of foreigners and local Chinese, and where administrative power, government contracts, licenses, and concessions are in political hands. While corruption is not as common in Malaysia as in most other developing countries, it surfaced publicly under the new political leadership of former Prime Minister Hussein Onn and the current Prime Minister, Dr. Mahatir. The leadership was undertaken measures to investigate corrupt civil servants and politicians [36]. The tendency of the Chinese to gamble with stock investments is well documented in Malaysia as well as in Singapore and Hong Kong [37]. A Bank Negara (Central Bank) report issued in the first decade of Malaysian independence noted:

Recent share issues appeared to have encouraged the gambling instincts of certain sections of the public which apparently were prepared to buy shares, particularly industrial shares, at excessive prices unwarranted by their prospective yields. This state of affairs was aided and abetted by the failure of some of the broking firms to observe the rules of the Malayan Stock Exchange concerning delivery dates [38].

The stage, it seems, is set for tension between the government policies of economic redistribution and bringing stricter discipline to the financial market,
and the hitherto acceptable model of self-regulation and laissez-faire business activity.

4. The Role of the Securities Market

The Malaysian securities market is a significant market which has emerged and developed through private enterprise, first British and later Chinese, and is not the result of the government’s promotional efforts. This market has only recently come to occupy public attention because of concern that it is obstructing governmental policy. In 1983, the Kuala Lumpur Stock Exchange listed 269 companies with a total market capitalization of M$75,174,363,676 and showed a turnover for January to October of 1,066,024,000 stocks/shares with a market value of M$3,252,565,000. Its governing committee of five is comprised of a Malay chair and four Chinese members. The Exchange's broker-dealer membership includes 108 individuals of whom 23 are Malay [39]. These characteristics indicate that the exchange is still controlled by the Chinese community, although the number of Malay stockbrokers has increased in accordance with governmental policy.

Malaysian development planning hitherto has not focused on harnessing the stock exchange for development goals. Rather, the market has been used as an incident of capital activity. Thus, mobilization of domestic capital for development has relied on social security contributions by way of the Employee's Provident Fund, the post office savings banks, and similar agencies. Direct foreign investment, internal capital reserves, and international and domestic bank lending have supplied capital for industry [40]. Nevertheless, the securities market has played an important role in raising domestic capital, particularly in new issues [41].

5. The Legislative and Institutional Framework of the Securities Market

The securities markets of Malaysia and Singapore are closely related and the regulation of one market has important implications for the regulation of the other. An abbreviated history identifies and explains the ongoing relations of the two. Although there were antecedents, the beginnings of a Malayan stock exchange can be traced to the creation of a clearing house and the onset of continuous trading in 1960 [42]. The clearing house was a joint body serving both Singapore and Malay with trading rooms in Singapore and in Kuala Lumpur. With the formation of the Federation of Malaysia in 1963, which included Singapore, the clearing house was renamed the Stock Exchange of Malaysia. The name was changed to the Stock Exchange of Malaysia and Singapore (SEMS) when Singapore withdrew from the Federation in 1965 [43].
Significantly, the securities market of Malaysia and Singapore predated any governmental activity either to promote or to regulate it. The market was created in colonial times and its initial purpose was to deal in securities listed in London. The market operated to mobilize capital for tin mining, rubber plantations, agency companies, banking, and other services which facilitated the colonial pattern of trade between the United Kingdom and Malaya.

In 1969, the government commissioned a report on the Stock Exchange. The Ferris Report was the blueprint for securities legislation in both Singapore and Malaysia [44]. The legislation that it envisaged has been succinctly described in this way:

Both Bills contemplate the continuation of self-regulation in the industry. The SEMS will continue to exercise wide powers and duties in policing its own affairs under its own rules and by-laws. It will be responsible for running its day-to-day business and exert an important front line supervision of the industry. Superimposed over self-regulation is governmental regulation and it takes the form of ministerial approval for the establishment of a stock exchange and changes to stock exchange rules, licensing of various persons in the industry, disclosing of interests, helping of proper accounts and records, etc., as well as certain substantive prohibitory provisions against forms of malpractices and manipulation in share trading. The bills when enacted will thus establish a dual regulatory scheme or a two tier system - with the stock exchange committee playing an important front line duty of self-policing and the respective governmental bodies exercising overall supervisory administrative control [45].

The background to Singapore government intervention is explained thus:

Apart from stock exchange scandals, or the fear of them there were more immediate reasons for the introduction of controls in Singapore. The Government here was concerned at the ease with which any person, whatever his training or experience or previous history, could set up business as a dealer in securities or be employed as a representative and by a member of the Stock Exchange. The Stock Exchange itself, as a body, at that time, was not as effective as it might have been. These factors as well as the collapse of two quoted companies and the need to improve Singapore's image as a financial centre, made the introduction of certain forms of control inevitable [46].

In electing a model of self-regulation which includes some government supervision, a critical factor was the acute shortage of expertise and resources to effectively administer and control the market [47].

In 1973, at the initiative of the Malaysian government, the Exchange was split into two separate and independent exchanges: the Kuala Lumpur Stock Exchange and the Stock Exchange of Singapore. While the two exchanges are organized separately and are governed by distinct systems of securities regulation, several factors continue to dictate a close relationship not found among other stock exchanges. Most companies listed on one exchange are listed on
the other. The close, direct-line communication between the securities industry of the two countries allows for easy purchase and sale of securities through either or both exchanges. It is not uncommon for shares acquired on one exchange to be sold through the other exchange to avoid publicity or currency controls or to take advantage of the relative strength or weakness of the Singapore dollar and the Malaysian ringgit [48]. Thus, while the two governments may have differing economic policies and strategies, the mutual impact of such regulation makes a strong case for a common core of securities regulation:

As long as both markets lack depth, and are dependent on cross-listing, close cooperation and a common securities law regime are necessary. Differing government policies of both countries have an impact on the enforcement of securities regulation. The complexities this divergence generates is indicated by considering the difficulties of monitoring and regulating market manipulation activity which originates in one country and the impact of which is immediately felt in the other. The regulators of each market are dependent on the other to investigate and bring to task the violators in each case, but differing policy and administrative manpower may dictate otherwise [49].

Securities regulation in Malaysia may be summarized by reference to the legislative and the institutional systems prescribed by the Companies Act [50], the Securities Industry Act of 1983 [51], and the Kuala Lumpur Stock Exchange Listing Manual, Memorandum and Articles of Association, Rules Relating to Member Firms and Member Companies, and Rules for Trading by Member Firms and Member Companies. The Companies Act and the Securities Industry Act are administered by the Registrar of Companies. While Malaysia currently does not have a code on takeover and mergers [52], it has Guidelines for the Regulation of Acquisitions, Mergers and Takeovers, which are administered by the Foreign Investment Committee. The Foreign Investment Committee is organized within the Economic Planning Unit of the Prime Minister's Department. The Guidelines relate to acquisition of substantial fixed assets and acquisition of control or voting rights of Malaysian companies. The objective is to obtain prior approval of such acquisitions and approval is readily given to proposals that are consistent with the New Economic Policy, which seeks increased “Bumiputras” (indigenous Malay) participation.

A Capital Issues Committee was created in 1968, comprising the Governor of Bank Negara as chair and representatives from the government and private sector. Its stated function was:

to consider the draft prospectus or announcement of any company intending to make a new issue or to seek listing on the Exchange so as to ensure that the public is provided with all the relevant information about the company. The Committee has also the function of fixing an appropriate date for a proposed issue. It is the chief
The Securities Industry Act of 1973 [54] was repealed and replaced by the Securities Industry Act of 1983. However, the core of the regulatory system introduced by the 1973 legislation was retained in the 1983 Act. In outline, this core system has several key features. The Minister is empowered to approve the rules of a stock exchange, as well as the establishment of a new stock exchange [55]. The primary participants in a securities market must be licensed [56]. Licensing rules govern the granting and renewal of licenses for dealers, dealers' representatives, investment advisers, and investment representatives [57].

The primary participants in the securities market are required to maintain proper records of their dealings in securities and the Registrar may inspect these records and provide extracts to persons upon payment of a fee [58]. Dealers are required to keep audited accounts and other records which sufficiently explain the transactions and financial position of their business, and which facilitate preparation of accurate profit and loss accounts and balance sheets [59]. They are required to maintain trust accounts for clients' funds not immediately applied to the purchase of securities [60]. A fidelity fund has been created by the Stock Exchange to compensate any person who suffers a pecuniary loss as a result of defalcations by a dealer [61].

6. The Emerging Norms

6.1. The Capital Issues Committee [62]

In its origins, the Capital Issues Committee (CIC) appears to have been modeled upon the Capital Issues Committee in Britain. The British Committee was established under the Control of Borrowing Order of 1947 [63], which made it necessary to obtain Treasury consent to raise funds by the issue of securities. The purpose of this Committee was to mobilize investment for national interests in the post-war period. It was not designed for investor protection [64]. The Malaysian CIC, on the other hand, undertook investor protection functions with the objective of ensuring "a more orderly and sound development of the stock market" [65].

Until recently, there were doubts about the legal basis of the powers exercised by the Capital Issues Committee. A letter to the Kuala Lumpur Stock Exchange rather than legislation defined the role of the Committee [66]. The Securities Industries Act of 1973 did not authorize the creation of such a Committee, but merely empowered the Minister to "consult the opinion of a panel of experts now known as the Capital Issues Committee on matters
relating to the securities industry” [67] and to consult the Registrar for the proper and effective implementation of the Act [68]. Thus, the legitimacy of the CIC remained clouded.

The 1983 Act settles the issue. Under that Act, the Minister must establish a consultative body, known as the Capital Issues Committee, which will advise him on matters relating to the securities industry. The CIC may, on its own initiative, advise the Registrar on matters within its purview. In addition, the Registrar may consult the CIC on matters relating to the proper and effective implementation of the Act [69].

In addition to legitimizing the CIC, the 1983 Act gives statutory form and effect to the CIC’s role. The Capital Issues Committee has three basic functions:

1. to advise the Minister or the Registrar on matters relating to the securities industry or when the Registrar seeks its views as to the proper and effective implementation of the Act;
2. to deal with such other matters as may be assigned in writing to the Committee by the Minister relating to the securities industry; and
3. to exercise powers relating to proposals which must be submitted to the Committee by
   (i) all public limited companies incorporated in Malaysia unless the company falls within any exemption made by order of the Minister in Gazette, for any
      (a) new issues or offers for sale of securities to the public whether such issues or offers for sale are by way of public issues or by private placements;
      (b) right issues of securities;
      (c) bonus issues of securities otherwise than by way of the capitalization of unappropriated profits [70];
      (d) schemes of arrangements, schemes of reconstruction, takeover schemes, share option schemes and acquisition of assets by way of issue of securities; and
      (e) listing and quotation of securities on a stock exchange;
   (ii) all public limited companies incorporated outside Malaysia which entered to issue or offer for sale securities to the public or to list such securities on a stock exchange prior to the registration of the relevant prospectuses with the Registrar; and
   (iii) all public limited companies incorporated outside Malaysia which are already listed on a stock exchange, for the listing and quotation of any additional securities.

The Committee must examine these proposals with reference to: the viability of the company, the quality and capability of the management of the company, the suitability for listing of the company in a stock exchange where applicable, and the interest of the public. It may approve the proposals upon
such items and conditions as it deems fit. A decision of the CIC may be appealed to the Minister.

The role of the CIC as defined by statute does not differ substantially from that under the previous informal system. The significance of having statutory specification rather than informal guidelines is indicated by Wan Hamzah J., who considered the effects of the Guidelines for the Regulation of Acquisition of Assets, Mergers and Take-overs:

The guidelines were issued not pursuant to any power given by law, and in my opinion they have no force of law but are of advisory character merely. I do not think that noncompliance with the guidelines can be taken as an act opposed to public policy. The guidelines reflect the Government's political philosophy, but the Government's political policy is not public policy [71].

The 1983 Act does change the informal scheme in several important ways. There is now a statutory right of appeal to the Minister, whose decision is final. Also, the governing considerations of the CIC in approving proposals are now stipulated. The "finality clause" has the effect of precluding appeals to a court of law. It does not bar judicial review [72] on the usual broad grounds of jurisdiction and natural justice. The jurisdictional bases for judicial review include breaching the rules of natural justice, applying a wrong legal test, answering the wrong question, and failing to take relevant considerations into account or basing the decision on legally irrelevant considerations [73]. Interesting and difficult questions may be posed as to the definition of public interest and the extent to which the New Economic Policy can be equated with public interest, as opposed to political interests.

The statutory scheme expands the role of the Capital Issues Committee. The Minister must consult the CIC when invoking new powers to appoint government representatives to the Committee of the Stock Exchange [74] and to amend the rules of an approved stock exchange [75]. These two new ministerial powers make significant inroads into the self-regulation model so beloved by proponents of the free market [76].

Despite governmental representation on the Committee of the Stock Exchange, self-regulation remains a fundamental attribute of the market under a definition of self-regulation as day-to-day operation and continued autonomous administration of the market. The presence of governmental representation is designed to spur the Committee of the Stock Exchange to exercise its powers of supervision and surveillance. In the recent past, Committee members were not only lax in enforcement of stock exchange rules, but in some cases they allegedly violated such rules [77].

The Minister of Finance recently has exercised the new statutory power to amend rules of the stock exchange. Briefly, the amendments seek to allow the Minister to direct the Committee of the Stock Exchange to appoint as a member of the exchange any Malay whom the Minister considers suitable to
be a dealer in securities. Similar amendments would allow the Minister to approve as a dealer's representative any Malay the Minister considers suitable to deal in securities. Under the proposed amendments, the maximum number of seven Committee members would not apply to the Minister's appointees. Finally, the tenure of the chairman of the Committee would be extended to three years instead of the current one-year term. In line with this aspiration for professionalism, the Kuala Lumpur Stock Exchange has recently appointed an assistant general manager with previous working experience in the civil service and Registry of Companies [78].

6.2. The Effect and Enforcement of the Rules of the Stock Exchange

The Kuala Lumpur Stock Exchange has four separate constitutional documents with differing legal effects on members and on non-members. First, the Exchange is incorporated under the Companies Act and the legal obligations prescribed by its memorandum and articles of association are couched in standard company law terms [79]. The second set of documents comprises the Listing Manual, and its impact on listed companies is the result of a general undertaking by which the companies agree to abide by the rules of the exchange. The third set of documents is the Rules Relating to Member Firms and Member Companies. Every member firm or company signs an agreement to observe these rules, and breach of the agreement may subject the company to fine, suspension, or withdrawal of recognition [80]. The fourth set of documents is the Rules for Trading by Member Firms and Member Companies. The basis of the binding effect of the Exchange rules on members is not in doubt. A non-member dealing through a member of the Stock Exchange is legally bound as well; a non-member implicitly authorizes the member to make contracts according to the rules and undertakes to indemnify the member against any liability incurred under these rules. This rule does not apply when a court finds such rules to be either illegal or unreasonable and not known to the non-members [81].

Having summarized the usual effects of Stock Exchange rules on members and non-members, one should note that a common problem encountered in developing countries is that of translation of law on paper into active regulation and enforcement. Self-regulation requires private enforcement which, as discussed above, is inadequate in these countries. In Malaysia, the regulatory powers of the Registrar have been strengthened because of governmental impatience with the reluctance and inability of the Exchange to keep its house in order. Two new techniques have been designed to give effect to the rules and to ensure their enforcement: the first is judicial enforcement of the rules at the initiative of the Registrar and the second is considerable enhancement of the administrative and investigative powers of the Registrar. Section 11 of the 1983 Act permits the High Court to compel due compliance and observance of the
rules or listing requirements of a stock exchange. When any person is under an obligation to comply with, observe, enforce, or give effect to such rules or requirements and fails to do so, the Registrar or the exchange may now apply to the High Court for an order compelling compliance [82]. A company whose securities are listed on an exchange is deemed to be under an obligation to comply with the listing requirements [83].

The effect of such rules on members and others obliged to observe them is now enhanced by court orders. More significantly, this process is available to compel relevant agencies – the Committee of the Stock Exchange, for example – to enforce rules that it has failed to enforce in the past [84]. This change is a response to situations in which member companies operated branches in various states in breach of existing rules and the Committee was unwilling or unable to enforce the rules.

What is the effect of a court directive? Section 100 of the Act gives the Court extensive powers [85]. Where an offense has been (or is about to be) committed or where there has been a contravention of the conditions of a license or the rules (listing requirements) of the Stock Exchange, the Registrar may apply for an order. The Stock Exchange itself may apply for an order where the rules or listing requirements have been contravened. The High Court is then empowered to order one or more of the following:

1. in the case of persistent or continuing breaches, an order restraining a person from carrying on a business of dealing in securities, acting as an investment adviser, dealer's representative or investment representative or form holding himself out as so carrying on business or so acting;
2. restraining a person from acquiring, disposing of or otherwise dealing with any specified securities;
3. appointing a receiver [86] of the property [87] of a dealer or of property held by him for or on behalf of another person whether; in trust or otherwise;
4. declaring a contract relating to securities to be void or voidable;
5. to secure compliance with any order, under this section, to direct a person to do or refrain from doing a specified act; and
6. any ancillary order.

A person who fails to comply with a Court order commits an offense punishable under Section 100(5).

While Section 100 has wider application than Section 11, it encompasses Section 11 where the preconditions of Section 100 are present, that is, where the default also constitutes an offense or is a contravention of the conditions of a license or the rules or listing requirements of the Stock Exchange. It is not clear whether agencies which may be compelled under Section 11 to enforce the rules are amenable to the sanctions prescribed in Section 100. Their failure to enforce the rules does not ipso facto constitute an offense or a contravention of the rules or of the listing requirements of the exchange. Therefore, the powers prescribed in Section 100 would be inappropriate against the Commit-
tee of the Stock Exchange. It would be appropriate to compel the Committee or its members by the usual powers of contempt of court [88] or to cause members of the Committee to vacate office for non-compliance.

The administration of the Act is undertaken by the Registrar of Companies. The investigatory powers of the Registrar have been enhanced considerably in an attempt to remedy an inability to obtain information and to compel performance of duties by other bodies [89]. Section 10 of the new Act obliges the Stock Exchange to provide such assistance to the Registrar as reasonably required for the performance of functions and duties. The Exchange now is required to notify the Registrar of any disciplinary action against a member within seven days of that action, specifying the identity of the member, reason and nature of the action, and the sanction imposed [90]. Under subsection 10(3), the Registrar has a statutory right of full and free access to the trading floor of any stock market. Under subsection 10(4), any obstruction or hindrance of the Registrar’s right of floor access is a punishable offense [91]. Subsections 10(3) and 10(4) are intended to permit market surveillance during critical periods. However, it may become necessary for the Registrar to appoint a representative to monitor the floor on a more continuous basis. The presence of an informed officer may add another dimension to the surveillance role [92].

When a person has refused or failed to comply with an inspector's investigation by providing information concerning a questionable securities transaction, the Minister may issue any of several orders. The Minister may issue an order restraining such a person or brokerage house from disposing, acquiring or exercising any right attached to specified securities. The Minister may order the registered holder of securities to give notice of such an order to any person whom the holder knows is entitled to exercise a right to vote attached to those securities [93]. The Minister may order a third party not to pay any sum due in respect of such securities, except in the course of winding up. The Minister may also order a third party not to issue shares or register the transfer or transmission of securities to such non-complying recalcitrants [94].

Section 98 of the new Act empowers the Registrar to order a dealer to disclose the identity of all partners to a transaction and the nature of any instructions given in relation to an acquisition or disposal of securities [95]. The Registrar also may require any person who has acquired or disposed of securities to disclose whether that was done as trustee or on behalf of another person and the nature of any instructions given [96]. Additionally, a stock exchange may be ordered to disclose the names of members of the exchange who participated in an acquisition or disposal of securities [97].

The Registrar may initiate investigations on his own initiative when there is reason to suspect a violation of the Act [98]. The Registrar now has the power to compound a person’s offenses [99] and to institute criminal proceedings [100].

The Minister may initiate an investigation when the national or public
interest so dictates. The Registrar is then directed to arrange for the investiga-
tion into the questionable securities transactions [101]. The powers of the
Registrar/Inspector are extensive and include the powers to require a person:
(a) to produce books under his control or custody; (b) to give the Registrar all
reasonable assistance in connection with an investigation; and (c) to appear
before the Registrar for examination under oath. While conducting an ex-
amination, the Registrar may make a written record of the proceedings which,
if authenticated, may serve as prima facie evidence of both the the questions
asked and the answers given [102]. According to Section 107, this evidentiary
record is to accompany the final report of an investigation [103].

The significance of the record as prima facie evidence in criminal or civil
proceedings is apparent when a court makes a determination that: the person
to be examined is dead or is unfit to give evidence as a witness; the person to
be examined is not in Malaysia and it is not reasonably practicable to secure
attendance; the person to be examined cannot be found despite reasonable
steps taken; considering the time lapse and other circumstances, the person
examined cannot reasonably be expected to recollect the matter; or in all the
circumstances, undue delay or expense would be caused by calling the person
as a witness.

The court establishes the weight of such evidence with due regard to all
circumstances from which an inference can be reasonably drawn as to the
accuracy of the evidence. Such circumstances, however, exclude the date of the
examination and the presence or absence of any incentive for concealment or
misrepresentation [104].

When contrasted with the Companies Act [105], the evidence-gathering
provisions of the Securities Industry Act appear quite novel. Generally, corpo-
rate investigations are administrative in nature, not judicial or quasi-judicial.
The report of the appointed inspector is an expression of the inspector's
findings and opinions and not a legal decision binding on all persons [106].
Criminal and civil proceedings may be initiated subsequent to corporate
investigations [107] but these are de novo proceedings [108]. Unlike the written
record of the examination conducted by the Registrar under the Securities
Industry Act, the report of the corporate inspector is not accorded independent
evidentiary weight.

6.3. Conduct of Securities Business

The new Act also encourages market discipline and professionalism through
changes in the substantive rules of trading. These changes are designed to
protect investors who do business with broker-dealers by augmenting basic
disclosure controls surrounding contract notes, brokers acting as principals,
dealers' interests in securities, dealers executing clients' orders, and transac-
tions through dealers' employees.
The new Act contains general provisions designed to regulate the conduct of the securities business. Some of these provisions amplify the underlying fiduciary relationship between dealers [109] and their clients and mandate specific types of disclosure. The first Malaysian innovation is the statutory requirement that dealers issue contract notes to their clients [110]. According to subsection 38(2), a contract note should include: the name and address of the dealer; if acting as a principal, a statement to that effect; details of the date, number, amount, price, commission, terms of delivery, and stamp duty and taxes payable; and details of any amount added or deducted from the settlement amount [111]. Significantly, a dealer is enjoined from including in a contract note the name of the person with or for whom he has entered into the transaction if it is known or could reasonably be expected to be known that the name is not the same by which that person is ordinarily known [112].

A dealer doing business with a non-dealer client is obliged to inform the client when he is acting as a principal and not as an agent. This common law fiduciary principle has been explained in this way:

The broker who is employed to buy shares cannot sell his own shares unless he makes a full and accurate disclosure of the fact to his principal and the principal, with a full knowledge, gives his assent to the changed position of the broker. The prohibition of the law is absolute. It will not allow an agent to place himself in a situation which, under ordinary circumstances, would tempt a man to do that which is not best for his principal. The Court will not enter into discussion as to the propriety of the price charged by the broker, nor is it material to enquire whether the principal has or has not suffered a loss. If the breach of duty by the broker be shown, the court will set aside the transaction [113].

The abuse has been long standing in Malaysia, as early case law reveals. In Fearon & Co. v. H.T. Stivin and G.E. Green [114], the practice of the broker, unknown to the client, was to quote stock purchase prices which included overhead expenses and the costs of cabling and rates of exchange, plus remuneration for the broker. As the Court wrote:

[T]he defendants not only never knew that the price to be paid as the purchase price was more than the market price but they also never knew they were sometimes buying plaintiff's own shares and when the time came that the shares were to be sold against them the communication on the telephone, a mere word "sold" from the plaintiff, would lead them to suppose that a genuine sale to an independent purchaser had gone through [115].

Section 40 of the new Act restates the prohibition against a broker's acting as a principal without informing the client and requires a statement of this disclosure in the contract note [116]. In addition, the broker is prohibited from charging the non-dealing customer any brokerage commission or fee in respect of the transaction [117]. The Act extends the broker-acting-as-principal doctrine
to situations where a dealer acts through or for persons associated with the dealer or a corporation in which the dealer and his partners or directors together hold a controlling interest [118]. A breach of the statutory disclosure requirement allows a purchaser or vendor who has not disposed of the securities to rescind the contract within fourteen days of receipt of the contract note [119]. The common law remedy of recision is also expressly preserved by subsection 40(8).

The nature of the securities industry in Malaysia and Singapore required statutory reaffirmation of the existing common law rule of recision. While the common law rule no doubt exists apart from legislation, its enforcement through an action is contingent upon detection of the irregularity by an aggrieved client – an unusual occurrence in active markets, even in the best of times. Incorporation of the rule into the new statute, linked with the addition of criminal sanctions, is more likely to generate industry-wide compliance.

When dealers, investment advisers or their representatives send circulars or written communications to clients in which they make recommendations, they must include a concise statement disclosing any relevant interest in the acquisition or disposal of those securities. The statement must be in type no less legible than that used in the remainder of the communication [120]. Furthermore, such documents must be signed by an appropriate party.

Brokers are now obliged to give priority to their client's orders and are subject to criminal sanctions for violating this duty. Section 92 of the new Act prohibits a dealer from entering into a purchase or sale of securities on a stock market if a client has an outstanding instruction to purchase or sell securities of the same class. This prohibition seeks to remedy what is locally referred to as being "jobbed by a dealer": a dealer fills an order at the end of the day at a price more favorable to the dealer than to the client. This may happen when the dealer fills an outstanding order after personally taking a security at a better price. The prohibition of Section 92 does not apply if the client's instructions impose specified conditions as to the price and the dealer has been unable to transact because of those conditions [121]. In sum, Section 92 applied when a dealer is given discretion, as for example when instructed to "deal at best".

Section 92 is a desirable addition to securities regulation in Malaysia, where, as in Singapore, the practice of being "jobbed by a dealer" is common. However, the problem of identifying the prices and times of orders and executions remains. Regulations requiring time and date stamping of orders and the appropriate identification of execution would strengthen Section 92. Only then would it be possible to match orders and transactions to detect more readily if the prohibition has been violated. Additionally, by placing Section 92 within Part IX of this Act, Parliament has created a right to civil compensation after the conviction of an offender [122].

Dealers, investment advisers, and their employees may not as principals
jointly purchase or subscribe or agree to purchase or subscribe to any securities [123]. Credit may not be given by dealers or investment advisers to employees or persons associated with them for that purpose [124]. An employee of a member firm or company may only purchase or agree to purchase securities or rights or interests therein when the member firm or company acts as agent for the employee in the transaction [125].

These prohibitions address problems which arise when dealer companies relax credit controls for employee tradings [126]. Such informal credit to employees affects the liquidity and solvency of the dealer company itself. The object of Section 93 is to ensure that, in trading for themselves, employees are placed in a position no different than that of the clients of the dealer company. By placing Section 93 within part IX of this Act, Parliament has also created a right to civil compensation after the conviction of an offender [127].

With respect to an underwriting agreement that requires a person to take up all securities that have not been sold, such a person is barred, for 90 days after the close of the offer, from making an offer to sell other than in the ordinary course of trading on a stock market. A recommendation with regard to those securities may not be made unless the recommendation contains or is accompanied by a statement to the effect that the person has acquired or is obliged to acquire the securities under an underwriting agreement because they have not been fully subscribed or purchased [128]. Such circulars or communications are to be lodged with the Stock Exchange where the person is a member of the Exchange or else with the Registrar [129].

6.4. Securities Frauds

Finally, the new Act sets forth a new series of securities fraud provisions which proscribe short-selling, wash sales, matched orders, market rigging, insider trading, and use of false or misleading statements. The Australian Securities Industry Act 1980 served as a model for this part of the Act [130].

Short-selling is a device by which a speculator sells securities or commodities which he does not own, expecting that prices will fall to such an extent that he is able to cover himself or make delivery by buying at a lower price [131]. The practice is common to most securities and commodities markets. Often it is used as a device to manipulate the market. The proponents of short-selling argue that it is a useful and necessary device for maintaining an orderly market and that it functions to cushion the decline of prices. The practice, impact and abuses of short-selling have been longstanding issues in Malaysia and Singapore. The use of this device to manipulate the market has been described in the press in the following way:

The syndicates will recruit the help of delivery clerks, trading assistants and remisiers of most broking firms. Their intention is to find only one thing - which counters are "long" (lead buyers to hold the shares for investment) as on what
scrisps that are placed with brokers for sale in large numbers by institutions or larger shareholders.

The syndicates will then dive in for the kill, that is sell the shares downwards mercilessly. Then they will approach the brokers for a direct sale of the shares they have sold short the previous day. The brokers will only be too happy to sell. The shares are then distributed to the public who panic because of the falling values. The game is played on and on until there is no confidence at all in the shares [132].

Historically, the Kuala Lumpur Stock Exchange and the Stock Exchange of Singapore implemented common measures when short-selling was pinpointed as the reason for volatility in stock market prices. The exchanges usually ordered a stricter enforcement of existing rules on script delivery and prompt clearing of brokers' contracts. The Stock Exchange of Singapore attempted to diffuse criticism by announcing that it would investigate market trading and by ordering that all transactions be conducted on an immediate settlement basis of clearance within twenty-four hours. Brokers were prohibited from effecting sales when clients could not deliver share certificates within this time. All member companies were required to submit a list of contracts that were due and outstanding together with buying-in notices. The ineffectiveness of these measures was due in part to the absence of infrastructure capability.

The Malaysian Act now contains a prohibition against short-selling. Section 41 prohibits a person (or that person's agent) from selling securities unless there is a reasonable belief that a presently exercisable, unconditional right to vest the securities in the purchaser exists [133]. A "presently exercisable and unconditional right" covers a person who has such a right at any particular time or has the right vested in accordance with his instructions. It also encompasses a right to securities which are charged or pledged in favor of another person to secure the repayment of money [134]. Sales by a seller who has previously contracted to purchase securities and has a right to have such securities vested conditioned only upon payment of the consideration, receipt of a proper instrument of transfer, and documents of title to the securities, are excluded from the prohibition against short-selling [135].

A member of a stock exchange who holds a dealer's license and who specializes in "odd lot" transactions may, for these transactions only, sell short [136]. "Odd lots" are defined in relation to marketable parcels: they are small parcels of securities that otherwise would not be traded on the exchange because they do not amount to a marketable parcel within the meaning of the rules and listing requirements of that exchange [137].

A significant exemption is given to short sales when arrangements are made before the sale that will enable delivery of the securities to the purchaser within three business days after the sale. Persons who are associated with the issuing company are not exempted because such persons may cover themselves by causing the company to issue new shares to them. Two further conditions to this exemption are (1) that the sale is at a price not below that at which an
immediately preceding ordinary sale was effected, and (2) that it is above the price of an immediately preceding ordinary sale, unless the latter price was higher than the next preceding different price of an ordinary sale. The Stock Exchange is to be immediately informed that the sale has been made short [138]. Short-sellers are obliged to inform their brokers that the sale is a short sale [139]; and any document evidencing such sale is to include an endorsed statement that the sale was a short sale [140]. The Act makes short-selling a criminal offense. Civil remedies are not provided. The broker, however, has the usual remedies on non-delivery of securities: institution of buying-in procedures and indemnification by the short-selling client.

This new prohibition has several difficulties. First, the problem of ineffective enforcement is raised because most of the securities are listed on the Kuala Lumpur Stock Exchange and the Stock Exchange of Singapore, and some are additionally listed on the Hong Kong Stock Exchange and the London Stock Exchange. Although Malaysian clients and brokers may not sell short on the Kuala Lumpur Stock Exchange, problems arise if short-selling is conducted by Malaysian clients through the Singapore Stock Exchange where short-selling is not an offense. Similar problems arise when those who are not residents of Malaysia attempt to sell short through the Kuala Lumpur Stock Exchange. Second, arbitrage (which operates when prices for the same security are lower on one exchange than on the other) [141] between exchanges and short-selling on arbitrage similarly is prohibited. Arbitrage, however, is economically desirable because it serves to create a parity in prices of securities listed on several exchanges.

Administration of the short sales law presents considerable problems and it is difficult to see how evasion of its proscriptions can be entirely prevented. One might ask whether this is an instance of legislative overkill. Short-selling has an economic function – it generates a market and, consequently, a certain volume of trading, which accounts for brokers' fondness for the practice. Without the new law, the usual market-rigging provisions would apply to short sales used to manipulate the market, except that problems of proof would be difficult.

What then are alternative devices of control that might permit the desirable market-creating effects of short-selling but curb market manipulation? A common device is disclosure. Dealers and clients could be required to disclose short sales to opposite parties and to the Stock Exchange. The revealed information would be compiled and made available to the public at the end of each trading day or week. This device would fully inform the public about the occurrence and extent of short sales, enabling traders to avoid the consequences of being caught dangerously short. This device also would allow the Exchange and the Registrar to detect early signals of potential market manipulation, thereby permitting the effective use of protective measures. Another device is "designated securities" whereby an Exchange cautions market traders
that action with respect to a particular security is imminent. Such action may include the imposition of conditions on dealing, margin requirements, and immediate delivery conditions. The exchange may also restrict any dealer from doing business in particular securities or prohibit sales unless certificates are delivered at the time of the contract [142]. In extreme cases, suspension of the listing may be ordered [143].

Section 84 of the 1982 Act prohibits wash sales [144] and matched order transactions [145]. Under Section 84, a person may not create misleading appearances of extravagant prices or overactive trading in securities on a Malaysian stock market. Nor may a person maintain, inflate, depress or cause fluctuations in the market price of the securities by means of a purchase or sale of securities not involving a change in the beneficial ownership of those securities, or by any fictitious transactions or devices [146].

Section 85 of the 1982 Act outlaws market-rigging transactions [147]. It prohibits persons from effecting, taking part in, being concerned in, or carrying out two or more transactions in securities of a corporation that have or are likely to have the effect of raising, lowering, maintaining or stabilizing the price of such securities on a Malaysian stock market with intent to induce other persons to sell securities of this or related corporations. “Transactions” include making an offer to sell or purchase securities and an express or implied invitation to a person to offer to sell or purchase such securities [148].

Section 86 of the new Act adopts a prior prohibition against any person making a statement or disseminating information that is materially false or misleading and is likely to induce the sale or purchase of securities by other persons, or is likely to raise, lower, maintain or stabilize the market price of securities. The prohibition applies when the person making the statement or distributing the information does not care whether it is true or false or knows or reasonably ought to know that it is materially false or misleading.

6.5. Insider Trading

The Securities Industries Act of 1983 includes provisions on insider trading [149], adding to measures already prescribed in the Companies Act [150]. Section 89 of the new Act introduces a civil remedy substantially similar to that adopted in Singapore almost a decade ago [151]. That section extends the Singapore model in significant ways. “Insiders” include officers, agents, and employees of a corporation and officers of a Stock Exchange. The latter group is a new addition to the definition of “insiders”. The definition of “agents” is innovative as well, including accountants, stockbrokers, bankers, and solicitors who are or at any time in the preceding six months have been knowingly connected with a corporation and have obtained unpublished price-sensitive information by virtue of that connection, which they would not disclose except in the course of proper performance of functions attaching to their positions.
“Officers” include directors, secretaries, employees, receivers, managers, and liquidators in a voluntary winding up as well as persons who have held these positions for the preceding twelve months.

A new and highly desirable innovation is the extension of the insider prohibition to persons holding official positions. The provision covers the relevant ministers and high civil servants, the Registrar of Companies, the Registrar of Land Titles, the Tax Department, and officials of various statutory and non-statutory bodies including the Capital Issues Committee and the Foreign Investment Committee. Such persons are likely to be privy to corporate information that they may be tempted to exploit during their terms of office or after retirement. If such information is used while the officials are in office, the usual public service disciplinary procedures may be invoked. Section 90, however, is an invaluable control device if the information is used after retirement or resignation.

Such insiders are prohibited from dealing in securities and from making improper use of specific confidential information acquired by virtue of their position, which, if generally known, might be expected to affect materially the price of the securities on a Stock Exchange. Such insiders are also liable to a person for loss suffered by reason of payment or receipt of consideration that is greater or less than the consideration that would have been reasonable if the information had been generally known.

The insider trading prohibition extends to information concerning the possibility of a take-over offer or bid or the making of a substantial commercial transaction by a corporation. An action to recover must be commenced within two years of the completed transaction and is not contingent upon a prior criminal conviction. Damages are calculated as the price differential between what was paid for the securities and what the price would have been had the information been generally available.

The key ingredient of insider trading is “specific confidential information”. “specific” is defined as information that has an existence of its own and can be identified and expressed unequivocally. “Information” is knowledge of a particular event or situation such as advice, communication, intelligence, news, notification, and the like. “Confidential” information can hardly be interpreted to include only information actually labelled “confidential”. To apply such a limitation would negate the broad objective of Section 89. Rather, the term seems to encompass information that is disseminated to insiders to use for the company’s benefit; the information is not intended for general dissemination. One significant gap in this form of regulation is the omission of liability for “tippees”. Under Section 89, insiders are liable for gains by any others, including intended “tippees”; but liability of “tippees” themselves for gains resulting from inside information is not included in the section. This contrasts with the U.S. Rule 10b-5, which has been included in the Singapore Securities Industry Act.
The review of the emerging Malaysian model reveals two significant developments. First, from a self-regulatory perspective, the Malaysian government has introduced a significant number of interventionist and reserve powers into its securities market, some of which the government has begun to exercise in order to effect its economic policies. Second, the Malaysian model now includes a wide range of measures to ensure discipline of and enforce control over broker-dealers and to protect dealers. The weakness of self-discipline has justified the wider intervention. The question remains whether the government will have the capacity to enforce these powers and to induce the market behavior it desires.

The Indian experience, with a wider range of interventionist powers but a low capacity to exercise those powers, suggests that more than interventionist legislation is needed [160]. In the face of this reality, which is common to most Third World countries, securities regulation should be a cooperative exercise with the market itself undertaking the primary burden of responsibility and the government supervising the market through discretionary power to intervene directly when occasion demands. An alternative, fashioned after the U.S. model, is to regulate through an increased level of civil liability, supplemented by a small investigating staff [161]. This alternative, however, must acknowledge that the U.S. system depends on a contingency fee system that encourages private civil actions and on the litigiousness of the people of the United States.

The model now emerging in Malaysia is the result of Malaysia's own set of circumstances. However, several elements of the Malaysian experience have wider relevance, particularly to Third World countries. On the one hand, this experience suggests that the self-regulatory model is not very useful for many developing countries because it depends on private-sector professionalism. On the other hand, the U.S. model of government regulation also depends upon private-sector professionalism and is institutionally expensive at the same time.

The Malaysian system suggests an alternative model premised on government intervention and initiative to compel the market to acquire and maintain some degree of professionalism. This model requires that the government develop its own administrative and regulatory capability, as well as inspire the private sector of the capital market to raise its standards of professionalism.

The value of the Malaysian model for other developing countries is two-fold. For countries that already have securities markets, it suggests a range of structural measures that may be useful in correcting market imperfections without the high administrative costs required by prominent Western models. These measures provide the leverage with which governments may induce the private securities market to correct abuses and upgrade professional skills. For countries that do not have viable securities markets and are creating them, the Malaysian model points out the problems of reliance on the private sector, as well as reliance on governmental regulatory capacity. In either case, the Malaysian experience recommends slow, painstaking development of institutional capacity.
Notes


[2] In this article, "model" and "paradigm" are used interchangeably to denote theoretical constructs rather than actual regulatory systems themselves.


[14] Contingency suits are not permitted by the legal professions as they amount to maintenance and champerty (an illegal agreement to pay the expenses of a suit for a share in the proceeds). See G. Graham-Green, Cordery's Law Relating to Solicitors 204 (7th ed. 1981).


[17] An empirical study of the economic impact of disclosure on capital markets reveals that "in the short run full disclosure may prevent unwarranted price rises and in the longer run ensure a closer coincidence between initial price and intrinsic value." Friend, The Economic Impact of Securities Regulation, Duke U. Conf. on Sec. Reg. 119, 126 (R. Mundheim ed. 1965), cited in Roth, supra note 16 at 1292.

[18] Whatever else African countries may lack in the way of modern armies, a literate population, an adequate infrastructure, large capital resources, and an experienced cadre of leaders at all levels, there is one thing they all have, which can be as rapidly and cheaply manufactured as paper money and which has the same tempting property of seeming to be available to solve all problems: that is the legislative power.


[21] Loss, supra note 12, at 763.

[22] The Singapore Stock Exchange Committee is the saddest example of the weakness of functional group leadership. They have shown a singular lack of discipline, responsibility or strength. They have used the authority the Government has
allowed them to exercise, to protect their own sectional interest at the expense of the public investor. The result is that the government may have to intervene.

Address by Prime Minister Lee Kuan Yew, Singapore Advocates & Solicitors Society Annual Dinner, 1970 Malayan L. J. xxxvi. xxxvii.

[23] See Business Times (Singapore), supra note 1.
[40] Chitrasmi & Tham Siew Yean, Money, Banking and Monetary Policy, The Political Economy of Malaysia, supra note 30, at 298–99.
[43] It was unique to have a common stock exchange functioning with two trading rooms in independent countries.
[47] Id.
[48] In P.P. v. Choudhury, 1981 Malayan L. J. 76, one of the devices used to attempt to avoid detection of an insider trading transaction was for a director of a Singapore company to arrange a sale of his shares through a stockbroker in Penang, Malaysia.
[57] Licensing of key participants continues to be a device to secure investor protection. "[T]he main object ... is to secure that persons who carry on the business of dealing in securities shall be honest and of good repute, and in this way to protect the public from being defrauded." Lymburn v. Mayland, 1932 A.C. 318, 324 (P.C.).
[60] *Id.* §§ 44–47.
[61] *Id.* §§ 60–83.
[62] The proposed Panel on Takeovers and Mergers is to be a separate body, but it might comprise the same membership.
[64] This hypothesis is suggested by Theng, *supra* note 42, at 733.
[66] *See supra* note 53.
[68] *Id.* § 4.
[70] The Capital Issues Committee (CIC) had originally intended to exempt bonus issues as they did not involve raising new funds in the market. However, it was faced with a growing trend of revaluation of assets to create surpluses by use of accounting standards that were not acceptable. Thus, only bonus issues out of capitalized profits are excluded from the requirement of CIC approval. *See* Letter to Kuala Lumpur Stock Exchange, June 19, 1976, *reprinted in* Theng, *supra* note 42.
[75] *Id.* § 9(4).
[76] The historical model of self-regulation is that of the London Stock Exchange, described in Weinberger v. Inglis, 1919 A.C. 606, 618–19, as being:

> In reality a building vested in certain proprietors and used for the purpose of carrying on a market for stocks and shares. It is not regulated in any way by charter or statute. ... The prestige and authority of the institution depend entirely upon the reputation it has established for honest and efficient business methods. Any group of people who so desire could start another Stock Exchange tomorrow. It is not a public market – it is a private market and access to it is only obtained through membership.

Published by Penn Law: Legal Scholarship Repository, 2014
[77] The Malaysian Registrar of Companies had publicly accused the committee of “dragging its feet in taking action against members indulging in malpractices even though it had been given the documentary evidence.” Business Times (Singapore). supra note 1, at 1.


[80] Kuala Lumpur Stock Exchange Rules For Trading by Member Firms and Member Companies, Rules 2(2) and 8(1).


[82] Malaysian Securities Industry Act of 1983, § 11(1) (person against whom such order is sought has right of hearing).

[83] Id. § 11(2).

[84] This problem was publicly described by the Registrar in Business Times (Singapore). supra note 1, at 1.

[85] Under the previous legislation, such powers were only exercisable in relation to contravention of the Act or any conditions of a license. See Malaysian Securities Industry Act of 1973, Act No. 112, § 91.

[86] Under Malaysian Securities Industry Act of 1973, Act No. 42, § 100(3), the powers of the receiver include the power to require delivery of the property and all information concerning it; to acquire and take possession of any property; to deal with such property in any manner in which the dealer might lawfully deal with it; and to exercise any other power given by the court.

[87] Malaysian Securities Industry Act of 1983, § 100(4) defines property to include “monies, securities and documents of title to securities or other property entrusted to or recovered on behalf of any other person by the dealer or another person in the course of or in connection with a business of dealing in securities carried on by the dealer.”

[88] Id. § 100(6) expressly preserves this power.

[89] Under the preceding legislation, the Registrar's powers related to licensing of dealers, investment advisers, and their representatives. Malaysian Securities Industry Act of 1973, §§ 9-24. Access to registers of securities is covered. Id., §§ 25-31. Under that statute, The Registrar had power to inspect the books and records of licensees and others provided that such documents are related to the business and are required to be kept under the Act. Id. § 90. Additionally, the Registrar could apply to the High Court for restraining orders where there had been a contravention of the Act or of conditions of a license. Id. § 91. On show of reasonable cause (that a person has committed an offense in connection with trading or dealing in securities and that evidence thereof is to be found in any books or papers under the control of a dealer) the Court might order that access be given to the Registrar. Id. § 92.

[90] Press reports suggested that the failure of the Committee of the Kuala Lumpur Stock Exchange to take action against its members, including Committee members, for breaches of its own rules resulted in the Registrar's refusal to review some members' dealing licenses. Business Times (Singapore). Dec. 10, 1982, at 1.


[92] Id. at §§ 10(3), (4).

[93] According to Section 95, the Registrar may, in writing, give a direction to the following persons: a stock exchange, a member of its committee, a dealer, an investment adviser, or representatives or nominees of the above, or a person who is or has been an officer or employee or agent, advocate or solicitor or auditor for the above or anyone acting for the above individuals. The direction is to require production to a person authorized by the Registrar of books relating to any of the following: the business or affairs of a stock exchange, any dealing in securities, any advice concerning securities, or issue or publication of a report or analysis concerning securities, the character or financial position of any business carried on by such persons, or an audit or any
report of an auditor concerning a dealing in securities or any accounts or records of a dealer or investment advisor. Section 95(3) extends this expression to include dealings by a person as a trustee.

[94] Securities Industry Act of 1982. § 119. Judicial recourse to either vary or revoke such an order is available at the instance of an aggrieved person. Id. § 119(4).

[95] Id. § 98(1).
[96] Id. § 98(2).
[97] Id. § 98(3).
[98] Id. § 99.
[99] Id. § 124.
[100] Id. § 126.
[101] Id. § 102.
[102] Id. § 106. The record is to be furnished to the person examined on request. Id. § 106(2). Any advocate or solicitor acting for someone who is conducting or contemplating civil or criminal proceedings in respect of the matters investigated may be given a copy. Such advocate or solicitor shall not publish or communicate such record or book for any other purposes. Id. § 106(4). (5).

[103] Id. § 107.
[104] Id. § 110.
[107] Additionally, such a report may be a ground for winding up, if the inspector is of the view that the company cannot pay its debts or that it is in the interest of the public that it should be wound up. Malaysian Companies Act. § 218(8).

[108] Corporate investigations may be ordered as to the likelihood of fraud, misfeasance, or misconduct by persons involved in the formation or management of a company, or as to whether it is in the public interest to do so, or as to the ownership, acquisition, or disposition of shares. Id. §§ 193–210. On completion of an investigation, the inspector is to report to the Minister, through the Registrar, his opinion and the facts on which it is based. Id. § 114.


[110] Id. § 38. In Singapore, these are required under Rule 19(2) of the Securities Industry Regulations of 1974. § 144. Thus, in both Malaysia and Singapore, the practice of issuing contract notes is longstanding.

[111] Id. § 38(2).
[112] Id. § 38(3). The legal effect of a contract note is unaffected except that failure to issue one is now an offense. Under the common law, the note is neither the contract nor the evidence of the contract made between the parties for the purchase of the shares in question and only amounts to evidence that the party has performed the transaction described therein. Tomkins v. Savony. [1829] 9 B & C 704, 109 All E.R. 262.
[114] [1927] 6 F.M.S.L.R. 104.
[115] Id. at 106.

[117] Securities Industry Act of 1982, § 49(4). Exempted from this prohibition are odd lot dealers and non-dealers in unit trusts and like interests. Id. §§ 40(5). (6).

[118] Id. § 40(2).

[120] Id. § 39. This section is an elaboration of Securities Industry Act of 1973. § 33. This requirement should be considered in light of the Securities Industry Act of 1982. §§ 29–35, which requires such persons to maintain a register of their interests. Interests are defined to include any direct or indirect financial benefit that will accrue upon or will arise out of the disposal of the
securities and any person who has entered into an underwriting agreement is deemed to have an interest in the acquisition or disposal of those securities. Id. § 39(3). Excluded are those who are partners or directors of dealers otherwise than by reason of dealing in securities, or unless they act together or in accordance with an arrangement to send the communication or to make the recommendation. Id.

Where securities are subscribed or purchased with a view to a further public offering and such offering is made, the seller/underwriter may not make an oral or written recommendation, unless informing each person to whom the recommendation is made that the shares were acquired for the purpose. Id. § 39(4). Section 39(10) extends the expression “offer” to include statements expressed in terms not usually interpreted as an offer, but which expressly or implicitly invite the recipient to offer to acquire securities.

[121] Id. § 92(3).
[122] Id. § 125.
[123] These provisions are the result of Senate Select Committee on Securities and Exchange, Australian Securities Markets and Their Regulation (1974).

[125] Id. § 93(2).
[126] Id. § 93(3).
[127] Id. § 125.
[128] Id. § 39(5).

[129] Malaysian Securities Industry Act of 1982 § 39(7); see also id. § 39(8). These circulars must be signed by the person or partner issuing them or, if issued by a corporation, by the director, senior executive, or secretary of the issuing corporation. Id. § 39(11). When a partner signs the circular, it is deemed to have been sent by each of the partners; when signed by a corporate director, executive officer or secretary, the circular is deemed to have been sent by the corporation.

[131] When there is short-selling, a broker is entitled to close an account or require further security. Zacks v. Gentles & Co., [1939] 1 D.L.R. 545. 548 (Can.); see also Kuala Lumpur Stock Exchange Rules for Trading by Member Firms and Member Companies, Rule 8.

[134] Id. § 41(4).
[135] Id.
[136] Selling is broadly defined to include a purported sale, an offer for sale, a holding out of entitlement to sell, and instructions to a dealer to sell. Id. § 41(8).

[137] Id. § 41(5).
[138] Id. § 41(5)(c).
[139] Id. § 41(6).
[140] Id. § 41(2).


[143] Id. Rule 2(3).

Malaysian Companies Act, Act No. 125, §§ 132(4), 134–135 (1973). The Act regulates insider trading through direct and indirect means. It does so indirectly through the requirement that one maintain registers of substantial shareholdings. It does so directly through prohibiting insider trading by corporate officials.


Malaysian Securities Industry Act of 1983, § 89(4). For a detailed analysis of the Singapore equivalent of § 89, see *supra* note 149.


Id. § 89(1).

Id. § 89(5).

Id. § 89(3).


Rosen. *supra* note 27.