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## The Kuala Lumpur Stock Exchange (Malaysia)

*The Securities Commission (Malaysia)*

### 19.1 Introduction

There are currently two stock exchanges and one futures exchange in Malaysia, which are the Kuala Lumpur Stock Exchange (KLSE), the Malaysian Exchange of Securities Dealing and Automated Quotation Bhd (MESDAQ) and the Malaysia Derivatives Exchange (MDEX). The KLSE and MESDAQ have recently commenced efforts to merge to form a single Malaysian exchange for the capital market. MESDAQ was incorporated in May 1997 as a company limited by guarantee, and its main objective is to provide a market for high-growth and high-technology companies to raise capital, and to promote the development of technology-intensive industries. MDEX is already a wholly owned subsidiary of the KLSE.

### 19.2 Ownership Structure of the KLSE

KLSE is a public company limited by guarantee incorporated in 1976 under the *Companies Act 1965*. It has no shareholders and no share capital, only members, with membership comprising of two classes—voting and nonvoting, as defined in Article 1 of the KLSE's *Articles of Association*.

Voting members are made up of companies that carry on the business of dealing in securities, which are stockbroking companies. Nonvoting members may either be dealing members or nondealing members. Dealing members refer to executive directors of the member companies, who hold a dealer's representative license, while nondealing members include individual and corporate shareholders, and nonexecutive directors of the member companies.

As at 30 June 2001, KLSE had 369 members, comprised of 56 voting members and 313 nonvoting members. Of the nonvoting members, 116 are dealing members while 197 are nondealing members. The nondealing members are comprised of 124 nonexecutive directors, 11 individual shareholders and 62 corporate shareholders.

A nine-member committee headed by an executive chairman oversees the affairs of KLSE. Four out of the nine members, including the executive chairman are appointed by the Minister of Finance, while the remaining five are elected from the voting members.

### 19.3 Listing Data

As at 30 June 2001, 809 companies were listed on the KLSE. Of these, 512 companies were listed on the main board and 297 were listed on the second board.<sup>1</sup> In total, these companies had a market capitalization of RM403.5 billion (main board—RM387.2 billion, second board—RM16.3 billion).

### 19.4 Corporate Governance

The KLSE's *Articles of Association* provide that the composition of its board of directors shall not be fewer than six and not more than nine persons. Under section 8(3) of the *Securities Industry Act 1983* and article 9.2(a) of the *Articles*, the Minister of Finance may appoint no more than four persons to be on the board to represent the interest of the public. Under section 8(4) of the same *Act*, one of the four appointed board members shall be the executive chairman of the board. The length of service of the appointed board members is determined by the Minister of Finance.

The *Articles* also state that for board members not appointed by the Minister of Finance (elected board members), a candidate shall be nominated by no fewer than two member companies. Election for the board members shall be carried out at the annual general meeting. A member company has a vote for each position available but may only vote once for each candidate.

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<sup>1</sup> The Second Board of KLSE, which complements the Main Board, was established in November 1988 to enable smaller companies with strong growth potential to seek a listing on the Exchange.

The board shall appoint two independent persons to conduct the ballot. All voting papers and proxies shall be examined and counted in the presence of KLSE's President, the two independent persons and all member companies at the annual general meeting. The decision of the independent persons shall be final and conclusive. However, if the independent persons are unable to agree, the decision of KLSE's President shall be final and conclusive. If two or more candidates receive an equal number of votes, the chairman of the board shall have the casting vote.

At every annual general meeting, a third of the elected board members shall retire. The longest serving elected board members shall retire first unless there is an agreement among them. Retiring elected board members are eligible for re-election but shall not hold office more than six years.

Under article 15.1(1) of the *Articles*, the board shall appoint a president upon such terms and conditions as the board thinks fit. The responsibility of the president shall be to manage the day-to-day affairs of KLSE. In addition, the board may delegate its power to sub-committees under article 11.2(1) of the *Articles*.

## **19.5 Business of the Exchange**

KLSE operates as a group of companies, which collectively service the securities industry. The following are the KLSE's subsidiary and affiliate companies and their respective functions:

- KLSE-Bernama Real-Time Information Services (KULBER), which compiles and disseminates real-time share price and other relevant financial and economic information to information vendors and other subscribers;
- Labuan International Financial Exchange (LFX), an offshore financial exchange based in Labuan that is wholly owned by KLSE;
- Malaysian Central Depository (MCD), which operates the Central Depository System (CDS), the KLSE's electronic settlement system which eliminated the movement of physical scrip;
- MDEX, which offers equity derivatives, financial derivatives and commodity derivatives;

- Malaysian Share Registration Services (MSRS), which undertakes the function of a share registrar;
- Research Institute of Investment Analysts Malaysia (RIIAM), which carries out the responsibility of upgrading the investment research standard in Malaysia and enhancing the level of knowledge of the investing public through courses, seminars and workshops; and
- The Securities Clearing Automated Network Services Sdn Bhd (SCANS), which is the central clearing house of KLSE.

## 19.6 Trading Rights

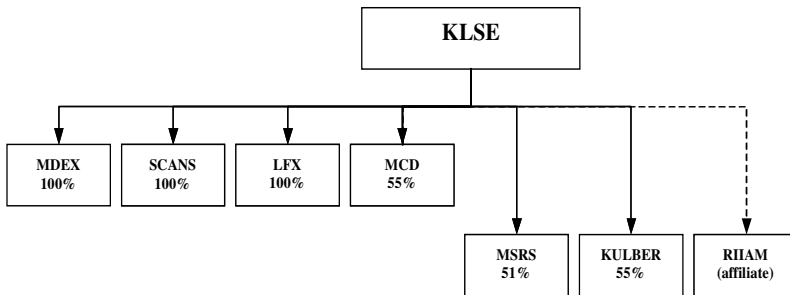
Trading on the KLSE—an order-driven market—was fully computerised in 1992 with the full implementation of the System on Computerised Order Routing and Execution (SCORE) automated trading system, whereby a central computer engine is responsible for matching all orders. SCORE eliminated the need for a trading floor at the Exchange's premises (Figure 19.1).

The business of trading in securities is carried out by the KLSE members/stockbroking companies. Before a person can trade in the shares of KLSE listed companies, he/she will first need to open a trading account with one of the stockbroking companies, and a person can only buy or sell shares through a licensed dealer or remisier.

According to the *Securities Industry Act 1983 (SIA)*, no person shall carry out the business of dealing in securities unless he/she holds a dealer's license. The dealer's license is issued by the Securities Commission to the stockbroking company and is not transferable. The SIA also allows a dealer's representative license to be issued to individual stockbrokers (directors of a stockbroking company), corporate nominees representing corporate members of the KLSE, employees of stockbroking companies and remisiers, who are not employees of a stockbroking company but are engaged by the company to carry on the business of dealing in securities on its behalf.

Stockbroking companies are equipped with the KLSE's enhanced broker front-end system, WinSCORE, whereby each dealer operates from an integrated terminal providing real-time market information dissemination as well as order and trade routing and confirmation.

**Figure 19.1. Kuala Lumpur Stock Exchange Corporate Structure**



- KLSE : Kuala Lumpur Stock Exchange
- MDEX : Malaysian Derivatives Exchange
- SCANS : Securities Clearing Automated Network Services Sdn Bhd
- LFX : Labuan International Financial Exchange Sdn Bhd
- KULBER : KLSE-Bernamea Real Time Information Services
- MSRS : Malaysian Share Registration Services Sdn Bhd
- RIIAM : Research Institute of Investment Analysts Malaysia (a company limited by guarantee)

## 19.7 Risk Management and Supervisory Issues

The KLSE is a self-regulatory organization which governs the conduct of its members and member stockbroking companies in securities dealings. KLSE regulates its members through its *Memorandum and Articles of Association (M&A)* and *Rules of KLSE*. The *Memorandum* sets out the objectives of a Company and the *Articles* govern the internal affairs of KLSE as well as regulate the KLSE’s relationship with its members.

KLSE has monitoring and risk management systems, which incorporate internal procedures and principles to enable it to deal with default risk, settlement risk and major market disruptions. In this regard, KLSE has formulated specific rules for the purpose of managing risks, which were developed in consultation with the Securities Commission.

In managing default risk and protecting investors, a Compensation Fund has been established under Section 61 of the SIA. If a person has suffered monetary loss due to defalcation or fraudulent misuse by a director, officer, employee or representative of a member company, or the insolvency of a member company, that person may make a claim from the Compensation Fund. The SIA also requires member companies upon

being licensed to make contributions to the Compensation Fund in every financial year.

In addition to the Compensation Fund, a standby facility has been established by both the Securities Commission and KLSE to minimize systemic risks arising from the failure of any stockbroking company in meeting its obligation to the clearing house. Clearing members who face tight liquidity problems may apply for this facility either up to a maximum of RM10 million per day or the net settlement amount for that particular day, whichever is lower. The maximum amount that a clearing member may borrow in aggregate is RM20 million within one settlement cycle.

As an aspect of its management of systemic risk, KLSE continuously and diligently monitors the risk exposures of its members. With the implementation of the new risk-based Capital Adequacy Requirements (CAR), members of the stock exchange are also able to compute and monitor their own risk exposures to ensure that their liquid capital is sufficient to absorb those risks.

With regard to managing market disruptions, KLSE has incorporated in its rules the requirement to establish procedures to deal with crisis and emergencies, which include the requirement to inform the Securities Commission of any crisis or emergency. The stock exchange is also required to enhance its disaster recovery and emergency procedures from time to time and to conduct regular maintenance and checks on the overall integrity of their systems.

In addition, the move to shorten the settlement cycle is one of many reforms introduced by the Securities Commission to reduce settlement risk. With the implementation of the shorter settlement cycle by KLSE, the settlement date has been changed to three days after trade date (T+3). This means that a seller will need to deliver the sold securities on the third business day after trade date. Similarly, the buyer will have an obligation to pay for the securities on the third business day after trade date.

The securities clearing house, SCANS, also has arrangements in place to manage risk arising from default of clearing members. Failure on the part of the clearing members to meet their obligation reflects the credit risk to be assumed by SCANS, which, if not properly contained, could affect the market and the liquidity in the market. In managing default risk, SCANS is empowered by its rules to decide on what steps it may take in the event of a default by a clearing member.

Other than the aforementioned external risks, KLSE is also exposed to internal risks, which is its own internal operational procedures. Within KLSE, the Group Internal Audit Department (GIAD) has been set up to assess the various functions and control systems of the KLSE group, and

appraise their effectiveness with regard to compliance with laws, regulations and procedures, and advise management of their status and conditions.

## 19.8 Statutory Regulatory Role

The role of the securities market regulator, which is the Securities Commission, is outlined in laws governing the Malaysian capital market that is, the *Securities Commission Act 1993 (SCA)*, and *SIA* and *Futures Industry Act 1993 (FIA)*.

The *SCA* sets out the functions of the Securities Commission while the *SIA* and *FIA* focus on the equity and futures market respectively.

The *SCA* grants the Securities Commission the role of the sole regulatory authority to regulate the Malaysian capital market and empowers the Securities Commission to supervise and monitor the activities of exchanges. By virtue of the *SIA* and *FIA*, the Securities Commission is also empowered to approve the Business Rules of exchanges and amendments thereof.

The Securities Commission has no shareholding in and Memorandum of Understanding with the exchanges and there is no regulation that grants any power to the Securities Commission to regulate the solvency of the exchanges.

## 19.9 Stock Exchange Seeking to Demutualize

In February 2001, the Securities Commission released a *Capital Market Masterplan (CMP)*, to provide the capital market with a blueprint for growth and development for the next decade. As part of the development process for exchanges, the *CMP* recommended that given the increased dynamism and competitive pressures of the global marketplace, a single Malaysian exchange be established through consolidation of all existing exchanges, and that the single Malaysian exchange should demutualize and list on the stock market by 2003.

As such, KLSE has embarked upon a concerted implementation programme for the consolidation, demutualization and listing of KLSE to be effected within the timeframe stipulated in the *CMP*, details of which are still being discussed and considered by the relevant parties.