

Reasons for Non Compliance of License Holders Towards Disclosure-Based Regulation in Malaysian Securities

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ABSTRACT

The objective of this paper is to report the findings of a study amongst licence holders of the capital markets in Malaysia in relation to the implementation of the Disclosure Based Regulation in Malaysia.

This survey was conducted among 107 principal and representative licensees registered with the Securities Commission of Malaysia. They consist of licensed dealers, investment advisers and fund managers. The majority of the respondents were capital markets and services representative licensees (CMSRL), while only 17 respondents were capital markets and services licensees. The survey indicates that non compliance occurs because of lack of ethical values and orientation of the players in the industry. In addition, non compliance was also reported to occur due to lack of understanding of law and regulations, inefficient company's surveillance, control and internal monitoring programmes, and weaknesses in the implementation and enforcement of law. Other reasons include greed (wanting to be rich quickly), selective application of the law, complicity between offenders and regulators, slow judicial process, and high legal cost for victims to pursue compensation. As the enforcement agency, Securities Commission should further enhance efforts to monitor and enforce the law of capital markets. On the other hand, the courts have to impose fines on criminals based on the extent of the losses investors have suffered by investors and on the effects of the crime on market stability. More importantly, ethics training should be carried out to license holders by the relevant bodies and agencies in the securities market. This paper provides useful information in relation to factors contributing to non compliance of participants of the capital markets. The enforcement body can implement measures on how to curb the unethical behaviour by carrying out ethics training and introducing new rules and regulations for the industry.

Keywords

Disclosure, Securities Law, Non-compliance

INTRODUCTION

The last two decades have marked the remarkable ascend of capital markets in the global economy. In 1990, the global equity market capitalization amounted to only USD10.4 trillion and was less than half the size of the world economy. But in 2007, the global equity market capitalisation had risen six-fold to USD64.6 trillion, about 1.17 times the nominal global GDP. Malaysia's capital market performed well in 2009 despite the lingering effects of the global

financial crisis and ensuing economic downturn. This is reflected from the Malaysia's biggest capital-raising exercise ever in the form of Maxis Bhd.'s RM11.2 billion initial public offering in 2009. Therefore, capital markets provide a useful means to mobilise capital and harness economic interests in an efficient manner to drive innovation and growth. Toward this end, Malaysia has implemented various measures to make the capital markets more attractive and competitive in the form of Disclosure Based Regulations (DBR) through the Malaysian Capital Markets Master Plan 2000 – 2010. Table 1 shows the stages of the implementation of this regulation in Malaysia.

Table 1: The Implementation Stages of Disclosure Based Regulation in Malaysia

6	Period	Focus
1	1996-99	The flexible/hybrid law based on merit together with the Implementation of disclosure, due-diligence and corporate governance.
2	2000	Part of DBR which focusing on the concept of disclosure, due diligence and corporate governance together with the promotion of accountability and self-regulations.
3	2001 and above	DBR in totality with highest standard in disclosure, due diligence, corporate governance and implementation of self-regulations.

Source: Securities Commission: The Malaysian Capital Markets Master Plan.

LITERATURE REVIEW

Disclosure Based Regulations

Malaysian Capital Market Master Plan was launched in 2001 to plan for 'blueprint' for 10 years with a view to enabling the vision of Malaysia's capital markets internationally competitive. Many recommendations have been implemented by establishing rules and a framework for markets to function properly. Malaysia, at present, has a framework of a comprehensive corporate governance and application of financial reporting standards comparable to other countries internationally, with clearing and settlement systems and legislation in line with the principles of the International Organization of Securities Commission (IOSCO).

Basically, the framework law for the capital market in Malaysia was developed to fulfill the following functions:

- (i) to facilitate the mobilization and efficient allocation of capital;
- (ii) to ensure confidence in the market;
- (iii) to ensure a fair market and providing protection to investors;
- (iv) to promote innovation with minimal compliance costs.

Malaysian capital market legal philosophy is: *"the legal regime should be able to adapt and respond to the reality and implications of the change in the financial field with time and appropriate ways to ensure the ongoing*

capital markets operate fairly and efficiently, and at the same time its role will assist economic development and growth, financial and business interests in the future.” (Security Commission, 2001)

Figure 1 below shows the legal framework of capital markets in Malaysia.

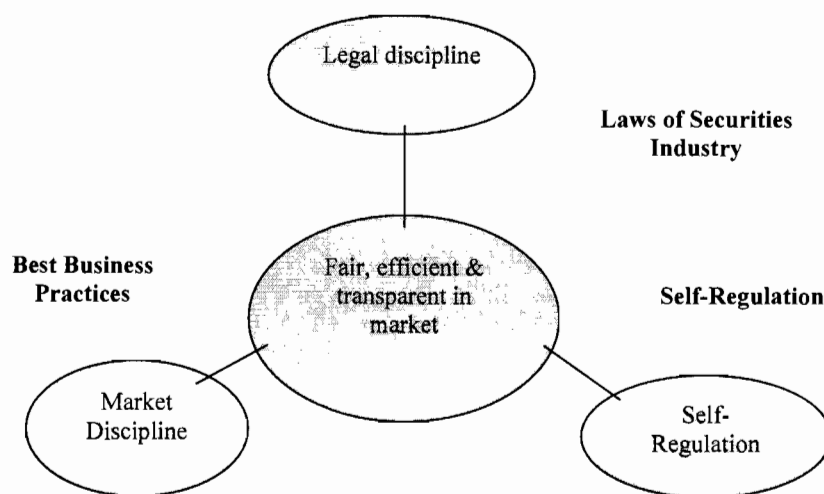


Figure 1: Mechanism of Capital Market Legal Framework

The legal framework of the securities market in Malaysia is based on the hybrid model. This means that the securities markets are regulated using a combination of (i) laws such as the Capital Markets and Services Act 2007 and the Companies Act 1965, and (ii) self-regulation implemented by Bursa Malaysia, and observed by listed companies.

In essence, the laws in Malaysia seek to regulate the actions of all parties involved in securities transactions. They include those who are granted a license under this law, labour security, advisers, promoters of investment schemes and other relevant parties. The Commission is authorized to be the enforcement body to monitor the participants in the industry from committing misconduct and transaction errors, such as internal information trading, market manipulation, fraud and others. Powers of the Commission are contained in the Securities Commission Act 1993.

At present, the framework of the securities laws in Malaysia is based on Disclosure Based Regulations (DBR). Characteristics of DBR can be classified as a system of law which requires companies to make a public announcement of material information. Further the information disclosed in the prospectus the company must be simple and adequate for public knowledge. This will enable and assist the public or potential investors make the right choice and good value for their investment and prospective investors know their investment risks. In addition, companies that issue securities and their advisers are responsible to meet certain standards when doing so and do it in a continuous manner. The aim is to inform investors to enable them to make judgments and decisions in their investments.

In 2011, the Securities Commission of Malaysia launched the second phase of the plan which concentrates more on the regulatory challenges, growth and governance. The regulatory challenges include (i) global regulation such as new international standards, (ii) changing landscape in managing risks to investors, and (iii) effective

regulation by facilitating new business models, streamlining processes and removing redundant rules, ensuring effective reach and oversight, and developing higher standards and capabilities of participants. To promote growth, the plan includes promoting capital formation, expanding intermediation efficiency and scope, deepening liquidity and risk intermediation, facilitating internationalization, building capacity, and strengthening information infrastructure. Lastly, to elevate governance, product regulation to manage risks, expanding accountabilities as intermediation scope widens, robust regulatory framework for a changing market landscape, effective oversight of risks, strengthening corporate governance, and broadening participation in governance, are some of the plans that are put forward. According to Eric Orts (1995), reflexive regulation encourages internal self-critical reflection within organizations and institutions process; that is, the development of mandatory procedures that by their nature force the firm to confront the substantive issues of concern to the regulator in a systematic way. Therefore, legal obligation is imposed upon companies to collect, process and disclose informations to insiders and outsiders. As a result, companies will be more responsible in regards to the internal structure and operation of its company.

RESEARCH QUESTION AND OBJECTIVE

Despite the changes in measures that are have been in place, questions remain as to how far the DBR is effective in ensuring compliance by license holders in Malaysia. In his research, Malloy (2005) showed that companies failed or did not comply with disclosure regulations because of the ambiguity in the law itself. Complexity of law interpretation regarding disclosure regulations sometimes creates conflicting definitions by companies (the body which has the obligation to implement the law) and the regulator. In addition, Malloy also found out that priority to profit making by business entities or individuals is also responsible for non compliance with regulations, as companies are willing to sacrifice a small amount of their profits for the sake of higher profits they could gain from engaging in unethical activities in the securities markets. A study by Asmah, Nurlı, dan Rohana (2002) revealed that several Malaysian listed companies still do not comply with the listing requirement of the Malaysian Bourse despite being repeatedly fined. They suggest that the fine imposed on the act may not be effective and sufficient deterrent against such misbehaviour. Ainum (1999) argues that non compliance is closely related to the monitoring and control mechanism in place in which the lack of efficient and effective regulation and supervision of the licence holders may encourage them to be non compliant.

In light of the previous research and to answer the question of the effectiveness of DBR in Malaysia, the present research sought the perspectives of the licence holders of the capital markets in Malaysia on the implementation of the DBR in Malaysia since 2000.

RESEARCH METHODOLOGY

This survey was conducted among principal and representative licensees registered with the Securities Commission of Malaysia. They consist of licensed dealers, investment advisers and fund managers. According to the official list issued by the Commission until December 31, 2007, there were 37 licensed dealers (company), 96 investment advisers (80 companies and 16 individuals), 41 investment advisors (financial planner) (27 companies and 14 individuals), and 80 fund managers (i.e. companies). With regard to company licensee dealers, questionnaires were mailed to the Company Secretary and Compliance Officer, while the questionnaires were mailed to the Company Secretary for other licensees of the company status (e.g. investment advisor). With regard to individual licensed holders, questionnaires were handed to them.

The respondents were asked to indicate their level of agreement or disagreement on a five-point Likert scale ranging from '1' "Strongly disagree" to '5' "Strongly agree", on a number of items purported to contribute to non-compliance behavior of participants in the securities market. The items were assembled based on previous research, particularly Malloy (2003) and relevant Malaysian statutes, regulations and rules.

Out of 254 questionnaires sent out, 107 were returned. A total of 17 respondents are the Capital Markets and Services licensees while the remaining 90 respondents are the Capital Markets and Services Representative licensees (CMSRL).

RESEARCH FINDINGS AND DISCUSSION

Table 2 below shows factors for non compliance with disclosure based regulations.

Table 2: Quantitative Factors of Non Compliance with Disclosure Based Regulations

No.	Item	Strongly Disagree	Disagree	Not sure	Agree	Strongly Agree	Min
1.	Lack of understanding of the law and regulations	1.0	4.9	10.7	57.3	26.2	4.029
2.	Ambiguity of the law and regulations.	1.9	7.8	6.8	52.4	31.1	4.029
3.	More profits gained compared to punishment provided by the law and regulations.	-	4.9	11.7	45.6	37.9	4.165
4.	Company's surveillance, control and internal monitoring programmes are not efficient.	-	2.9	18.4	56.3	22.3	3.980
5.	Punishment and penalty are not sufficient.	-	7.8	15.5	51.5	25.2	3.941
6.	The license holder is not trustworthy and no integrity.	-	1.0	10.7	44.7	43.7	4.310
7.	Companies did not implement best practice in the management of the company.	-	2.9	9.7	56.3	31.1	4.155

Table 2 shows that the good majority of the respondents indicated that the factors listed above are potential causes for non compliance with the DBR. Specifically, the respondents believed that the main reason for non compliance is attributed to the ethics of the individual, as indicated by the highest mean value of 4.30. License holders who are not trustworthy and have no integrity are perceived to be willing to engage in non compliance. The respondents also thought that license holders who believe that the profits reaped and gained could outweigh the

punishment meted out when caught in non-compliance behaviour, are more likely to engage in non compliance (mean = 4.165). In addition, companies that do not implement best practice in their management are also perceived to engage in non compliance (mean = 4.155).

Next, based on the mean values, ambiguity in the law and regulations (mean = 4.029), and lack of understanding of them (mean = 4.029) are also reported to be the important factors that contribute to non compliance with disclosure based regulations of the players or participants in the securities and capital market in Malaysia.

These two sets of findings indicate that the ethical values and orientation seem to play a more important role in contributing to non compliance with the disclosure based regulations, as perceived by the respondents, than the laws. In other words, the internal control in the form of ethical values and orientations seem to be more important than the external control in the form of laws and regulations to regulate behaviour of participants in the industry.

The researcher also sought to get qualitative opinions on non compliance from the respondents. Toward this end, open ended questions were asked, and 15 out of 107 respondents gave their personal views regarding reasons why non compliance happens. Table 3 below illustrates their personal opinion regarding this issue.

Table 3: Qualitative Factors of Non-compliance (N = 15) with Disclosure Based Regulations

Respondent	Opinions
1	The lack of successful cases being brought by the SC and these cases are not published as a major issue in the newspapers. Therefore, people are not aware of non-compliance penalties and what actions can be taken.
3.	<ol style="list-style-type: none"> 1. The securities market in Malaysia is less transparent and there is lack of governance. 2. The public should understand more about the securities market in Malaysia. Lack of understanding of the industry in Malaysia enables the few to dominate this market. These are the participants who act arbitrarily and contribute to non compliance with the legal system of disclosure in the securities industry in Malaysia.
11	<ol style="list-style-type: none"> 1. Director / officer responsible for the company is only interested in maintaining his/her own reputation even though he/she is ware that the company is having problems. 2. Company compliance officers do not advise the board of directors or management effectively or do not have the skill or integrity to do so.
13	<ol style="list-style-type: none"> 1. Lack of public disclosure of the legislation. 2. Intervention of outsiders in the management of the securities market in Malaysia. 3. Development of industries in the Malaysia market.
14	Internal factors and fearless of the punishment that may be carried out.
23	<ol style="list-style-type: none"> 1. Selective application of the law. 2. Complicity between offenders and people with regulators.

	3. Slow judicial process. 4. High legal cost for victims to pursue compensation.
50	Lose in the enforcement.
48	Lack of law or law enforcement is not strict.
71	Do not apply integrity as required by the PIN & Target 2008 & Integrity.
75	There is no communication with each other.
96	Indifferent attitude for those involved.
99	Not concerned about the law and want to get rich quickly.
101	Self regulation being practiced in Malaysia is actually appropriate, but there are some people who refuse to comply.
104	Mastery of the laws is loose. The law exists but there is no enforcement control.
106	No exposure to the law or regulation in the securities industry in Malaysia.

Table 3 further supports the quantitative findings shown in Table 2 earlier in that the respondents affirmed the similar factors identified in influencing non compliance.

From Table 2 above, majority of respondents agreed that non-compliance of disclosure law and regulations is because of the weaknesses of implementation and enforcement of law. Other reasons are unethical personal behaviour such as not being trustworthy, wanting to be rich in a short time, selective application of the law, complicity between offenders and regulators, slow judicial process, high legal cost for victims to pursue compensation and others.

The findings of this study provide further empirical support for previous works (e.g. Ainum, 1999; Asmah, Nurli, & Rohana, 2002; Malloy, 2005), in that non compliance is attributed to issues related to the laws and regulations themselves. In particular, lack of enforcement, ambiguity in the law, and ineffective punishment as a form of deterrent were cited by the respondents are being responsible in causing non compliance. However, unlike the findings of the previous studies, the findings of the present research seem to extend the findings of previous studies further by suggesting the more important role of ethical values and orientation of the individual players in influencing non compliance. Whilst ethical orientation has been consistently found as an important factor in shaping individual behaviour and action (e.g. Greenfield, Achilles, & Counts, 2007; Keller, 1997), more studies need to be carried out to ascertain and validate further the findings revealed by the present study.

Based on the findings of the study, a number of recommendations can be offered.

1. As ethical values and orientation is important in ensuring compliance, ethics training could be carried out amongst the industry players and participants. The Securities Commission, as the main enforcement body in this industry, can play an active role in developing and promoting ethical perspective in the securities market.

2. Weaknesses and loopholes in the existing laws and regulations need to be addressed effectively. The Securities Commission should further enhance efforts to monitor and enforce the law of capital markets, as cases of unlicensed business operations are quite common in this industry, indicating the lack of surveillance and monitoring by the SC network. As perpetrators will adopt a more novel approach to committing a crime, for example, by using fake websites or falsifying financial statements the SC investigating officers should also be trained in new strategies to combat industry securities criminals.
3. The Bursa Malaysia should also beef up its enforcement so that self regulation by listed companies is effectively practised. Those who fail to meet the Bursa Malaysia and PPBM SSP requirements need to be de-listed as repeated fines seem to be insufficient. And once a company is de-listed, it is recommended that admission into the listing be made only after a period of three years when the company is able to provide evidence of good record and good behaviour. In essence, for self regulation to work, listed companies must show proof of good governance system and compliance with it.
4. The punishment meted out against the industry perpetrators should also be harsher to reflect the consequences of the action on the overall performance of the industry, the stability of the market, and the investors' confidence in the market. Light sentence and small fine may encourage future criminal behaviours as the high return obtained from such criminal act could offset the small fine imposed.
5. Training and providing necessary information to potential investors are important so that they are aware of what can and what cannot be done in the securities market in Malaysia, and how they can protect themselves from being victimised by the perpetrators that are looming at large.

In conclusion, the present study has contributed to the existing knowledge on non compliance with disclosure based regulation amongst participants in the Malaysian securities market. Whilst the present study has offered preliminary insight into the factors thought to cause non compliance, more studies need to be conducted to validate it. For example, future studies could embark on investigating the legal structure and its effectiveness in addressing non compliance.

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