



**Suruhanjaya Sekuriti**  
Securities Commission  
Malaysia

# **GUIDELINES ON REGULATION OF MARKETS**

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## **1.0 PURPOSE OF THESE GUIDELINES**

- 1.01 The *Guidelines on Regulation of Markets* (Guidelines) are issued by the Securities Commission (SC) pursuant to section 377 of the *Capital Markets and Services Act* (CMSA).
- 1.02 These Guidelines aim to provide industry with a better understanding of how the SC will administer the law relating to markets as is provided for under Part II of the CMSA and achieve its regulatory objectives.
- 1.03 In this respect these Guidelines will, among other things, seek to clarify–
- (a) the factors that will be taken into consideration by the SC in regulating a cross-border market provider;
  - (b) the factors that will be taken into consideration by the SC in determining the appropriate level of regulation that would be imposed on a domestic or on a cross border market provider; and
  - (c) the type of electronic facilities that would be captured by the stock market and futures market definition as provided for under the CMSA.
- 1.04 These Guidelines will also explain when an operator of an electronic facility may register its electronic facility as a “registered electronic facility” for the purposes of section 34 of the CMSA.

## **2.0 REGULATORY OBJECTIVES OF REGULATION OF MARKET**

- 2.01 These Guidelines outline the SC’s regulatory approach to regulation of markets as provided for under Part 2 of the CMSA. The SC believes that a pragmatic and flexible regulatory approach should be adopted in the regulation of markets while not compromising the SC’s statutory duty to protect investors.
- 2.02 The approach stated above is necessary to ensure that–
- (a) there is no more regulation than necessary;
  - (b) regulation shall facilitate the development of markets; and
  - (c) the market operated by the market operator is fair, orderly, transparent and efficient.
- 2.03 In administering the relevant provisions of the law, the SC will consider, among other things, the systemic importance of a market that is to be operated by a prospective market operator. Hence, the degree of regulation imposed on a

market will be dependent upon various factors demonstrating the level of systemic risk that the market poses to the general public.

### **3.0 WHEN ARE YOU CONSIDERED TO BE PROVIDING, OPERATING OR MAINTAINING A STOCK MARKET OR FUTURES MARKET IN MALAYSIA**

3.01 A person shall be considered to be operating, providing or maintaining a stock market or a futures market in Malaysia for the purposes of Part 2 of the CMSA if–

- (a) the person physically locates its trading floor in Malaysia or a significant part of the person’s market infrastructure is located in Malaysia; or
- (b) the person’s market facilities are located outside Malaysia (an overseas market) and the person actively targets Malaysian investors.

3.02 The following factors indicate that an overseas stock market or futures market is targeted at Malaysian investors–

- (a) when one or more participants in Malaysia have direct secure access to the market trading platform through a market screen;
- (b) when the operator, or a person acting with the endorsement of the operator, promotes the market in Malaysia, for example by–
  - (i) advertising the market in Malaysian publications; or
  - (ii) sending direct mail or e-mail publicity about the market to Malaysian addresses;
- (c) when the prices on the market are denominated in Malaysian ringgit; or
- (d) when the market is regularly used by Malaysian investors.

3.03 The following factors indicate that an overseas stock market or futures market is not targeted at Malaysian investors when–

- (a) a Malaysian participant accesses the market, they are presented with information that clearly and prominently states that the market is targeted at residents of some other jurisdiction;
- (b) a Malaysian participant accesses the market, they are presented with information that clearly and prominently lists the jurisdictions (other than Malaysia) in which the market is authorised to operate; or
- (c) the operator takes precautions designed to prevent use of the market by Malaysian investors. Such precautions include the screening of invitations, offers and acceptances from Malaysian addresses. Precautions that

merely require market users to identify whether they are Malaysians are insufficient.

- 3.04 Note that the above factors are indicative only. They are neither exhaustive nor determinative. Determining whether an overseas market is targeted at Malaysian investors will require an assessment of all the facts and circumstances.
- 3.05 In determining whether an overseas market operates in Malaysia, we have taken into account–
- (a) the globalisation of markets and the use of communications networks, such as the Internet, that operate cross-border. We accept that it is neither feasible nor appropriate for us to attempt to regulate all markets on which Malaysians may directly participate; and
  - (b) the need to protect Malaysian investors and the integrity of Malaysian markets.

#### **4.0 HOW WILL THE SC REGULATE A FACILITY OPERATOR WHO PROVIDES, OPERATES OR MAINTAINS A STOCK MARKET OR A FUTURES MARKET**

- 4.01 A facility operator who provides, operates or maintains a stock market or a futures market shall be subject to an appropriate level of regulation of market as is provided for under Part 2 of the CMSA. The level of regulation imposed on a type of market that is operated, provided or maintained by a facility operator shall correspond with the risk posed by that market.
- 4.02 A systemically important market shall be regulated as an approved market and shall be subject to a higher level of regulation. This is necessary to achieve the regulatory objectives of regulating markets, particularly the need to reduce systemic risk. On the other hand, a market that does not pose any or very little systemic risk shall be regulated as an exempt market or as a registered electronic facility and therefore be subject to a lower level of regulation.
- 4.03 The SC, in deciding the appropriate level of regulation shall consider the following factors:

**(a) The size and structure, or proposed size and structure, of the market**

Consideration will be given to the size of the market, including the volume and value of transactions that will be conducted on the market, the number of investors trading on the market and the number of participants.

The structure of the market refers to how the market is organised. This includes, among others, a member-broker structure and direct

participation structure. A market that is organised in a more complex manner, and in a manner which magnifies its reach or influence, e.g. via a member-broker structure rather than a direct participation structure, could be considered to pose a greater risk;

**(b) The nature of the services provided, or to be provided, by the market**

This relates to the range of services provided by the market operator, such as the provision of quotes, matching of orders and provision of data services;

**(c) The nature of the securities or futures contracts traded, or to be traded, on the market**

This relates to the number of classes of securities or futures contracts traded on the market (for example, equities, warrants, options and single stock futures);

**(d) The nature of the investors or participants, or proposed investors or participants, who may use or have an interest in the market**

Consideration will be given to the level of sophistication of the investors or participants, the systemic importance of the participants and the impact of any failure of the market on the investors or participants and the broader financial sector. A market that is widely used by retail investors is more likely to be considered systemically-important;

**(e) Whether the facility operator is presently regulated by the SC**

The SC wishes to avoid unnecessary regulatory duplication. The SC will therefore assess if its regulatory objectives can be achieved by some other form of regulation.

For example, the SC may exempt the stock market or futures market that is operated by a facility operator who is also a holder of a Capital Market Services Licence, who is authorised to carry on the business of dealing in securities or trading in futures contracts. The exemption granted shall be subject to such terms and conditions as the SC thinks is reasonable and appropriate;

**(f) In the case of an operator who provides access to an overseas market, whether the operator, in the country or territory in which the head office or principal place of business is situated, is subject to requirements and supervision comparable to which market operators are subject to under the CMSA**

The SC will examine the regulatory regime imposed by the overseas regulator on the overseas market and consider if it achieves similar objectives to that of regulation of market in Malaysia. When a market operator is already adequately supervised by its home regulator and the supervision is comparable to the SC's supervision had the market operator been situated in Malaysia, the overseas market operator is more likely to be subject to a lower level of regulation. This is to minimise duplication of regulatory efforts and compliance costs;

**(g) The interest of the public**

The SC may consider if it is in the interests of the public to approve the corporation operating the market as an approved exchange. Such interests may arise if such approval may further the development of the financial sector or reduce systemic risk in the financial system of Malaysia; and

**(h) Any other circumstances that SC may deem relevant**

The SC retains the flexibility to consider other circumstances, as it may deem relevant.

**5.0 EXCLUDED FACILITIES AND PERSONS**

5.01 The definition of stock market and futures market in the CMSA is wide. Subsection 2(1) of the CMSA provides the meaning of stock market as follows:

"A market or other place at which, or a facility by means of which—

- (a) offers to sell, purchases or exchanges of securities are regularly made or accepted;
- (b) offers or invitations that are intended, or may reasonably be expected, to result, whether directly or indirectly, in the making or acceptance of offers to sell, purchase or exchange securities, are made regularly; or
- (c) information concerning the prices at which or the consideration for which, particular persons, or particular classes of persons, propose, or may reasonably be expected to sell, purchase or exchange securities is regularly provided."

5.02 However the following facilities may not be construed as a "stock market" given the nature of the facility, the types of services it provides and its systemic risks to the investors:

**(a) Exclusion of non-multilateral facility**

The definition of "stock market" and "futures market" as provided for in section 2(1) of the CMSA, implies the bringing together of many buyers and many sellers on a centralised basis. Therefore, a non-multilateral facility or a "one-to-many" facility may not be considered a "stock market" or "futures market" for the purposes of the CMSA. A "one-to-many" facility shall not be considered as a market even if the facility exhibits features of a bulletin board, provided that the operator of the facility is either–

- (i) a holder of a Capital Markets Services Licence granted under the CMSA; or
- (ii) the operator is a registered person who is specified under Part 1 of Schedule 4 of the CMSA,

and that the users who use this facility do not trade with other users but only with the facility operator, whereby the facility operator retains the right of refusal to either accept, reject or counter an order received from its user;

**(b) Exclusion of pure order routing facility**

The inclusion of the word "facility" within the "stock market" and "futures market" definition would capture any facility, including a facility that is merely a communication infrastructure or that which only acts as a conduit or a channel of communication to an approved stock market or futures market.

It is not the regulatory intent of the CMSA to regulate facilities by which offers to sell and buy securities or futures contracts are communicated to an approved stock market or futures market. Hence, an operator of such a facility shall not be regulated by the CMSA.

An operator of such a facility may however be required to hold a Capital Markets Services Licence, as the operator may be carrying on the regulated activity of dealing in securities or trading in futures contracts which requires a licence under Part 3 of the CMSA;

**(c) Exclusion of market making facility**

As discussed above, the definition of "stock market" and "futures market" as provided for in section 2(1) of the CMSA implies the bringing together of many buyers and many sellers on a centralised basis. Therefore, a facility that enables one person to make or accept offers or invitations to sell, purchase or exchange securities or futures contracts to many, shall not be regulated by the CMSA.



An operator of such a facility may, however, be required to hold a Capital Markets Services Licence, as the facility operator may be carrying on the regulated activity of dealing in securities or trading in futures contracts which requires a licence under Part 3 of the CMSA;

**(d) Exclusion of financial portals**

It is not the regulatory intent of the CMSA to regulate operators of financial portals that aggregate content and provide links to financial sites of service and information provider. However, such operators may be required to hold a Capital Markets Services Licence, as the operator may be carrying on the regulated activity of investment advice which requires a licence under Part 3 of the CMSA; and

**(e) Exclusion of technology vendors**

It is not the regulatory intent of the CMSA to regulate technology vendors who develop software applications for participating organisations of an approved stock exchange or for affiliates of an approved futures exchange.

**6.0 FACILITIES CAPTURED WITHIN THE MEANING OF STOCK MARKET OR FUTURES MARKET**

6.01 Set out below are the facilities that shall be regarded as falling within the meaning of "stock market" or "futures market" and therefore the provision, operation or maintenance of such facilities shall be regulated by the CMSA:

**(a) Facility that performs the function of centralised price discovery**

Central to the finding of whether a facility should be regulated as a stock market or futures market is the determination of whether the facility is providing a centralised basis for the making of offers, invitations and acceptance of securities or futures contracts. Offers, invitations and acceptance of securities or futures contracts conducted in a centralised manner enable price discovery of the securities or futures contracts and are, therefore, indicative that a market exists. A facility that pools together bids and offers of various market participants for the comparison and competition of bids and offers or which provides for the interaction of bids and offers in a centralised manner shall, therefore, be treated as a stock market or a futures market for the purposes of the CMSA and therefore shall be regulated by the CMSA;

**(b) Facility that performs the function of a bulletin board**

A facility that does not provide for actual trade execution or matching of offers and acceptance on the facility can still be regarded as operating a

stock market or futures market for the purposes of the CMSA, provided its participants have a reasonable expectation that they may execute a trade in securities or in futures contracts through or outside the electronic facility based on the information obtained or posted on the facility. Such a facility could be a bulletin board. A bulletin board is a platform on a website of an operator where the participants can post indicative prices, volumes and counters of the securities they wish to transact in. Information posted on the bulletin board provide the ability to ascertain the identity of interested counterparties and shall lead to a reasonable expectation that trades can be effected.

Bulletin boards that are a part of a non-multilateral facility or a "one-to-many" facility as discussed under sub-paragraph 5.2(a) of these Guidelines shall however be regarded as falling outside the meaning of "stock market" or "futures market" and therefore would be subject to regulation of markets; and

**(c) Facility that automates traditional over-the-counter trades**

A facility which enables its participants to post firm prices for the order size that they wish to transact and automatically executes and clears a firm-price order if it matches an existing firm-price order, shall be regarded as operating a stock market or futures market for the purposes of the CMSA, although such facility does not settle trades. Notwithstanding the fact that the facility is a non-multilateral facility or a "one-to-many" facility, this facility shall, therefore, be regulated by the CMSA, as its participants have a reasonable expectation that orders posted on the facility will lead to the conclusion of a transaction.

- 6.01 Further, reference can be made to **Appendix 1** of these Guidelines for guidance as to the SC's regulatory approach in respect of regulating the various kinds of facilities.

**7.0 CLASSIFICATION OF STOCK MARKET OR FUTURES MARKET**

- 7.01 The stock market or futures market operated, provided or maintained by a facility operator can be classified into three types of markets that are subject to different level of regulation.

- 7.02 The three types of markets are—

- (a) approved market;
- (b) exempt market; and
- (c) registered electronic facility.

- 7.03 Whether a stock market or futures market shall be regulated as a registered electronic facility, exempt market or an approved market is dependent on the list of factors set out in the above paragraph 8 of these Guidelines.

## **8.0 APPROVED MARKET**

- 8.01 An approved market refers to a stock market of an approved stock exchange or a futures market of an approved futures exchange. These exchanges are to be approved by the Minister of Finance (Minister) pursuant to section 8 of the CMSA.
- 8.02 A market that is systemically important therefore will be regulated as an approved exchange.
- 8.03 This type of market is subjected to stringent requirements, such as the requirements on approval of its proposed rules or proposed amendments to its existing rules. The imposition of stringent requirements on an approved market is necessary to ensure that the regulatory objectives in regulating markets are achieved.
- 8.04 Whether a market operator will be regulated as an approved market is dependent on the list of factors set out in the above paragraph 4 of these Guidelines. It is, therefore, envisaged that an approved market will have to be of a certain size such that any disruption in its operations will have an adverse impact on a significant number of public investors. Therefore, a higher level of regulation is needed to ensure the integrity and efficiency of this market.

## **9.0 EXEMPT MARKET**

- 9.01 The SC can advise the Minister to declare a particular stock market or futures market, to be an exempt stock market or an exempt futures market for the purposes of the CMSA. A market may be exempted for example when the market operator is already subjected to other form of regulation and, therefore, subjecting the market operator to regulation of market may result in duplication of regulation.
- 9.02 The CMSA empowers the Minister to impose terms and conditions as he deems reasonable when declaring a stock market or futures market to be an exempt market. The Minister, in imposing terms and conditions will give regard to a number of factors, such as the type of securities or futures contracts that are traded on the exempt market, the level of sophistication of investors in the exempt market, the level of penetration of the exempt market amongst investors in general and the level of systemic risk posed by the exempt market.
- 9.03 The Electronic Broking System which is operated by a licensed money broker as defined under the *Banking and Financial Institutions Act 1989*, has been declared

as an exempt stock market under the *Securities Industry (Declaration of Exempt Stock Market) Order 2005*. However, in view of its features, it is felt that the system will be more appropriately regulated as a registered electronic facility. The CMSA has, therefore, declared these systems to be registered electronic facility for the purposes of Section 34 of the CMSA.

## **10.0 REGISTERED ELECTRONIC FACILITY**

- 10.01 The CMSA provisions on registered electronic facilities (REFs) as provided for under Subdivision 4 of Part 2 of the CMSA, are designed to regulate market operators who make use of an electronic facility to provide, operate or maintain a stock market or futures market that is not systemically important. Therefore, such market operators shall be subject to minimum regulatory requirements which among other things, will include the market operator having to register its electronic facility with the SC, pursuant to section 34 of the CMSA.
- 10.02 An operator of an electronic facility, who falls within paragraphs 6(a), (b) or (c), as discussed above, may be registered as an REF subject to the consideration of the list of factors set out in the above paragraph 4 of these Guidelines. The decision as to whether a market operated, provided or maintained by an operator of an electronic facility should be regulated as an approved market or an REF or an exempt market shall be based on an analysis of the factors set out in the above paragraph 4 in their entirety and is not solely dependent on any one factor.
- 10.03 An operator of an REF shall be subjected to minimal obligations. In registering the electronic facility pursuant to section 34 of the CMSA, the SC may impose terms and conditions on the operator of the electronic facility. The terms and conditions imposed on an operator of REF, shall commensurate with the risk profile, nature and scope of the proposed market operations that are to be carried out by an operator of an REF.

### **Terms and Conditions**

- 10.04 The SC may impose conditions that include—
- (a) restrictions on the types of investors or participants who may have access to an REF;
  - (b) the products that can be traded on or through an REF;
  - (c) the requirement for an operator of an REF to notify the SC of any changes to its business;
  - (d) the requirement for an operator of an REF to submit periodic reports to the SC; and

- (e) the provision of right of access and assistance to be given to the SC to inspect an REF, its operator and participants.

### **Revocation of Registration**

10.05 The SC can revoke the registration status that has been accorded to an REF pursuant to section 36 of the CMSA.

10.06 This will occur where—

- (a) an REF operator has contravened any of the requirements imposed on it; and
- (b) revocation is in the interest of the investing public or is necessary for the maintenance of an orderly and fair market.

### **Change of Status**

10.07 In recognition of the possibility that the market operated or provided for by an REF operator has the possibility to grow overtime to become systematically-important or of systemic-wide importance, the SC may, if necessary, advise the REF operator to make an application to the Minister to be regulated as an approved market.

**APPENDIX 1**

**EXAMPLES OF ELECTRONIC FACILITIES**

<b>No.</b>	<b>Classification</b>	<b>Description of Facility</b>	<b>SC Regulatory Approach To That Facility</b>
1.	Order routing facility	Order routing facility enables clients to input orders for securities and futures contracts through the facility where such orders shall be channeled to the relevant exchanges, without any alteration of the information contained. All orders entered into a routing system are sent to another facility for the matching and trading of such orders.	As the pure order routing facility merely serves as a conduit without any matching of the orders of one client with another, the operator providing the facility shall not be subject to regulation of market as provided for under Part 2 of the CMSA. However, the operator of this type of facility may be required to hold a Capital Markets Services Licence.
2.	Bulletin board	A bulletin board is a platform on a website of an operator where the participants can post indicative prices, volumes, and counters of the securities they wish to transact in. No trading and matching are being done here as all subsequent negotiation, trading, clearing and settlement activities by the transacting participants will take place off the website of the operator.	As the information posted on the website and the ability to ascertain the identity of interested counterparties lead to a reasonable expectation that trades can be affected through this type of facility the operator of this type of facility shall be subject to regulation of market as provided for under Part 2 of the CMSA. Even though the execution of trade is done outside the facility, it is caught under the definition of "stock market" and "futures market" as provided for under section 2(1) of the CMSA.

3.	Market making facility	A market making facility is a system developed to disseminate the market maker's own quotations to the public, or to allow its customers to direct orders for execution solely against that market maker's inventory. Such systems automate the order routing and execution mechanism of a single market maker and guarantee that the market maker will execute orders submitted to it at its own posted quotation for security.	As a market making facility merely provides a more efficient means of communicating the trading interest of separate customers to one licensed intermediary, the operator of such facility shall not be subject to regulation of market as provided for under Part 2 of the CMSA as the market making facility is not a multilateral market but is instead based on a "one-to-many" facility.
4.	Centralised price discovery facility	It is an electronic facility that pulls together multiple market makers. Each single market maker posts quotes and the market maker is able to determine which users are permitted to view its quotes or interact with the market maker. By bringing together the quotes of multiple market makers, the facility facilitates the offer and invitations to sell, purchase or exchange fixed income products on a centralised basis.	As the facilitating of bids and offers of the various market makers constitute a price discovery function, the operator providing this facility shall be subject to regulation of the market as provided for under Part 2 of the CMSA.
5.	Electronic trading facilities	It is an electronic facility which provides access via a secured website or through proprietary terminals. Participants may post firm prices for the order size that they wish to transact. The facility automatically executes and clears a firm-price order if it matches an existing firm-price order. The facility does not settle trades. If no match is immediate available, the facility displays the firm order to all clients.	As there would be a reasonable expectation that orders posted on the facility will lead to the conclusion of a transaction, the operator providing this facility shall be subject to regulation of market as provided for under Part 2 of the CMSA.

**Note: The examples provided above are without prejudice to the SC's actual decision to be made in any actual case.**