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CLC Quarterly

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Inaugural CLC Quarterly

We are very pleased to bring you the inaugural edition of the CLC Quarterly. The Firm's newsletter will focus on corporate and commercial legal issues that have an impact on your business.

Our articles aim to provide an overview of recent changes in the law and focuses on the practical implications on your business. In this and the coming issues, we will touch on an array of topics related to our practice areas, namely, banking & finance, projects & construction, energy infrastructure, disputes, debt & equity capital markets, and technology, multimedia & telecommunications.

We hope you find our articles timely and relevant, and we welcome any feedback or requests for articles on a specific point of law. Visit us online at www.christopherleeco.com for this and future editions of the CLC Quarterly and other information on the Firm.

The Editor

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This newsletter is circulated to clients of the firm for their information, and addresses legal issues in a general manner. The views expressed in this newsletter are not intended to constitute legal advice on any specific matter and should not be relied on as a substitute for detailed legal advice.

CHRISTOPHER LEE & CO Advocates & Solicitors

Can SPACs spark a new wave of consolidation?

Hibiscus Petroleum Bhd debuted on Bursa Malaysia on 25 July 2011 as the first Special Purpose Acquisition Company in the country.

Hibiscus Petroleum Bhd debuted on Bursa Malaysia on 25 July 2011 as the first Special Purpose Acquisition Company ("SPAC") in the country. SPACs were introduced jointly by the Securities Commission and Bursa Malaysia nearly two years ago in August 2009 to give investors a new platform for investment and to spur merger and acquisition activities.

A SPAC is a listed shell company with no operational track record and no income-generating business. The intention of a SPAC is to raise funds for the purpose of acquiring operating companies or businesses within 3 years of an IPO. 90% of the gross proceeds raised in the IPO must be placed in a trust account to safeguard the proceeds until the "qualifying acquisition".

A "qualifying acquisition" means the initial acquisition of business(es) which has a fair market value equal to at least 80% of the proceeds in the trust account and is in line with the business strategy disclosed in the listing prospectus. The qualifying acquisition must be approved by the SC and a majority in number of shareholders representing 75% of the total value of issued shares present and voting in person or by proxy at an extraordinary meeting convened to consider the acquisition.

There has been limited interest in SPACs since its introduction. The perceived risk of investing in a company with no business, no income and purely based on faith in the management team has resulted in limited interest from investors and consequently deterred entrepreneurs from using SPACs as an investment vehicle.

However, exactly what are the risks to investors? Arguably, there are fewer risks for investors as SPACs have some attractive downside protections:

Prior to completion of the qualifying acquisition, the maximum downside to an investor is limited as 90% of the gross proceeds raised in the IPO safeguarded in a trust account. If the SPAC fails to complete the qualifying acquisition within 3 years, either by failing to identify a suitable business to acquire or by failing to get the approval of the SC or shareholders, the SPAC will be liquidated and proceeds in the trust account will be returned to shareholders. Management may not participate in the liquidation distribution except for shares purchased after the IPO.

If a qualifying acquisition is identified and approved by the SC and a majority of the shareholders, dissenting shareholders are still entitled to a return of their proportionate share of the proceeds in the trust account. Any shareholder who is not convinced of the prospect of the proposed acquisition may still walk away at limited loss. Such protection is seldom afforded to minority shareholders who are often bound by majority decisions.

A SPAC is a clean shell with no history. There are no hidden risks or liabilities and SPACs have to comply with all disclosure rules applicable to a listed company. There can be very limited "surprises" which will impair the amounts invested by investors.

Interests of the investors and the management team are aligned. The management team must in aggregate own at least 10% in the SPAC on the date of listing. The management's shares cannot be sold prior to completion of the qualifying acquisition, and thereafter only at a maximum of 50% per year for two years. Management should be working towards enhancing shareholder value given the substantial management shareholding.

From the point of view of entrepreneurs, SPACs provide an effective way of creating

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acquisition currency. Listing of a clean shell company before an acquisition is much easier and faster than acquiring the business with a bridging loan and then listing the company to raise funds for repayment of the loan.

Funding is assured before the quest for targets begins which may strengthen the bargaining position of the SPAC during the negotiation process. However, the uncertainties associated with SC's and shareholders' approval may present a challenge in terms of timing for the acquisition of potential targets. A sale and purchase agreement which is conditional upon financing is more likely to complete faster than one which is subject to the acquirer obtaining SC's and shareholder approval.

A potential efficient use of SPACs is in consolidation. The "qualifying acquisition" may consist of more than one acquisition. SPACs can be used to combine two or more smaller players in the market into one listed company. However, each of the acquisitions must be inter-conditional and complete simultaneously. Alternatively, where one acquisition is sufficient to use 80% of the proceeds in the trust account, warrants may be issued at the IPO stage as a form of secondary financing for further acquisitions in the future. Malaysia is currently undergoing a consolidation phase with multiple mega mergers across the banking, oil & gas, construction and insurance sectors all aiming to create a scale of business which enables them to compete effectively and efficiently across ASEAN and internationally. SPACs could be used in such consolidations, though this remains to be seen.

Hibiscus Petroleum aims to become a junior independent Malaysian oil & gas exploration and production company by acquiring companies and assets in upstream oil & gas activities. The public portion of its IPO was 3.8 times oversubscribed. However, the public portion represents only 3% of the offering owing to uncertainty over public reception to SPACs in Malaysia. The remainder of the shares was privately placed to selected investors. On debut, the share price of Hibiscus Petroleum fell 29% to 53 sen on its first day of trading. The disappointing debut can be attributed to a number of reasons including poor market sentiment due to worries over potential US and Greek debt default. The Hibiscus' share price remains at a discount to its 90% protected level.

A SPAC provides a hybrid investment vehicle between a private equity fund and a normal listed company. SPACs raise funds before investment targets are identified much the same way as private equity funds. The SC and its shareholders have the opportunity to examine and approve the proposed business and its future prospects much the same as in the case of a normal IPO. Depending on Hibiscus Petroleum's success, we may see SPACs providing greater depth to the Malaysian capital market which could spark a new wave of mergers and acquisitions and consolidations.

David Ong Chan Tong

SPAC provides a hybrid investment vehicle between private equity funds and normal IPOs. Depending on Hibiscus Petroleum's success, we may see SPACs providing greater depth to the Malaysian capital market and triggering a new wave of mergers and acquisitions and consolidations.

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Regulation of Derivatives

The Bill to amend CMSA is poised to bring about some far reaching changes, the most important of all being the regulation of derivatives.

The Bill

The Bill to amend the Capital Markets and Services Act 2007 ("CMSA") is poised to bring about some far reaching changes to, and to fill a lacuna in, the securities and financial services regulatory landscape, the most important of all being the regulation of derivatives. Thus far, the regulation of derivatives has been piecemeal, by virtue of regulations or circulars issued pursuant to the Exchange Control Act 1953 (to regulate, amongst others, interest rate swaps and foreign currency forwards), guidelines issued pursuant to the Securities Commission Act 1983 (eg. the Guidelines on the Offering of Structured Products) and the Futures Industry Act 1993 (relating to exchange traded futures contracts) which was subsequently, repealed and replaced by the CMSA.

Reasons for the amendments

Since the introduction of derivatives into the Malaysian market more than ten years ago, there have been lingering doubts as to whether or not derivative contracts might be considered gaming or wagering contracts by virtue of the speculative elements involved in such transactions. If such a characterisation were justified, derivative transactions would be rendered null and void by Section 26 of the Civil Law Act 1956 and no action may be brought or maintained in any court to recover money payable under such contracts.

As there was (and still is), no Malaysian case law exactly on point, English common law has been, and may be relied on as persuasive authority of the legal position in Malaysia. Amongst other restrictions and requirements gradually introduced over time by the regulators, the requirement that Malaysian parties have a genuine underlying commitment to hedge became the panacea to eliminate or minimise speculation, and indirectly, address the issues on gambling. The Central Bank through its Exchange Control notices, imposed restrictions on non-bank residents by granting permission to only enter into interest rate swaps and foreign currency forwards, to hedge interest rate and foreign currency exposure arising from genuine underlying obligations, to reinforce the need to have an underlying basis for entering into such transactions. Resident banks were permitted to enter into derivative transactions provided that inter alia they complied with certain prescribed risk management practices, and were not permitted to enter into commodity or credit derivatives without the prior approval of the Central Bank.

Over time, as derivative products evolved and became more sophisticated, they were no longer confined to being used as financial tools to hedge specific risks – instead, depending on their structure (eg. a deposit could be structured to pay interest linked to the fluctuations in the price of listed equities or debt securities), they could be classified as an investment, being in the nature of a hybrid security or a structured product, falling within the purview of the Securities Commission. Such structured products are classified as "securities" and permitted by the Securities Commission to be issued by sophisticated investors such as dealers and investment banks, on a non-tradable basis pursuant to the Guidelines on the Offering of Structured Products (April 2007).

It soon became apparent that there was a need to rationalise the various laws, regulations and circulars that applied to derivatives, and more importantly, to create a separate classification altogether for derivatives, instead of attempting to fit each derivative product on a case by case basis, either within the definition of "securities" for the purposes of the securities legislation or as a financial product for the financial services legislation to apply.

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Regulation of Derivatives

Derivatives and securities will be two separate and distinct capital market products, and mutually exclusive; provisions of the CMSA relating to securities, will not apply to derivatives.

The amendments

The Bill to amend the CMSA seeks to regulate derivatives under a single piece of legislation, amongst other changes. If it becomes law, it will introduce the concept of "capital market products" which will include securities, derivatives, units in a unit trust scheme and a private retirement scheme, it will create a separate class of products known as "derivatives" and it will introduce 2 separate and mutually exclusive types of derivatives, i.e. "standardised derivatives" and "over-the-counter derivatives".

Capital market products

"Capital market products" is defined in the Bill, to mean any securities, derivatives, units in a unit trust scheme, a private retirement scheme and any other products as the Minister of Finance may prescribe as a capital market product; "derivatives" are defined to mean contracts which market value is, or delivery or payment obligations are, derived from underlying securities, commodities, assets, rates, indices or any of its combination, whether or not a standardised derivative or an over-the-counter derivative, but excludes:

"(a) securities;

(b) any derivative to which Bank Negara or the Government of Malaysia is a party;

(c) any over-the-counter derivatives whose market price, value, delivery or payment obligations are solely derived from, referenced to or based on, exchange rates; or

(d) any agreement, when entered into, is in a class of agreements prescribed not to be derivatives;".

Effectively, once the amendments take effect, derivatives and securities will be two separate and distinct capital market products, and mutually exclusive; provisions of the CMSA relating to securities, will not apply to derivatives, and conversely, unless the relevant provisions are stated to apply to "capital market products". Additionally, the Bill carves out of the jurisdiction of the Securities Commission, "over-the-counter derivatives" ("OTC derivatives") which reference exchange rates – these OTC derivatives are excluded from the definition of "derivatives" and accordingly, excluded from the purview of the CMSA. Such OTC derivatives thus, remain largely the responsibility of the Central Bank and the Controller of Foreign Exchange to regulate and monitor.

Regardless of the different types of instruments covered by the generic term "capital market products", the CMSA when amended, will impose obligations of full and frank disclosure on any person making representations in respect of any capital market products. The Securities Commission may specify the type of information, and the extent thereof, to be provided to a person intending to invest in any capital market product, and any person who issues or provides false or misleading information, makes any false or misleading statement with regard to such products or wilfully omits any material information, will commit an offence and be liable, on conviction, to a fine and/or imprisonment. This penalty will be without prejudice to any rights of action or remedy that the investor may have under any other law.

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Regulation of Derivatives

The Bill introduces a regulatory regime for OTC derivatives which are currently regulated from an exchange control perspective.

Standardised derivatives

The Bill provides that "standardised derivatives", which include futures contracts, are derivatives which are traded on an exchange and cleared and settled through a clearing house. Apart from creating a clear dichotomy between derivatives and securities within the CMSA, the Bill when (or if) it becomes law, will make dealing in derivatives a regulated activity. A person who deals in derivatives is a person who, as principal or agent, inter alia enters into or accepts orders for futures contracts (i.e. a type of standardised derivative), on behalf of other persons, and as such, is required to be either the holder of a CMSA licence or a registered person within the meaning of the CMSA.

Additionally, upon the Bill becoming law, it will amend and widen the scope of the provisions within Subdivision 3, Division 3 of Part III of the CMSA (which currently applies, solely, to futures contracts), to apply to standardised derivatives instead. Hence, the provisions relating to trading by the holder of a CMSA licence for its own account, trading limits, sequence of sending and carrying out of orders and trading outside Malaysia will apply accordingly, but with necessary amendments and modifications for standardised derivatives.

OTC derivatives

OTC derivatives are defined by the Bill, as any derivatives which are not standardised derivatives. The most common example of an OTC derivative would be the privately negotiated derivative contracts (usually documented by the International Swap Dealers' Association (ISDA) master agreement and confirmations) entered into between financial institutions, or by financial institutions with corporations, for hedging purposes. Currently, apart from regulation by the Central Bank of interest rate swaps and foreign currency forwards from an exchange control perspective, and of derivatives generally from a bank regulatory perspective, OTC derivatives are not otherwise regulated under any legislation.

The Bill therefore, introduces a regulatory regime for OTC derivatives. The proposed new Subdivision 4, Division 3 of Part III imposes a reporting obligation on holders of CMSA licences, registered persons (who consist primarily of financial institutions licensed under the Banking and Financial Institutions Act 1989) and other persons dealing in derivatives, to report to a trade repository, all information (including amendments thereto) relating to OTC derivatives they have entered into (Section 107J). Interestingly, for the purposes of Section 107J only, OTC derivatives which value, or payment or delivery obligations are derived from, relate to, or reference exchange rates, are deemed to be included within the term "derivatives" as used under that Section. Accordingly, financial institutions governed by the Central Bank which enter, for example, into foreign currency forward contracts with their customers for hedging purposes, are required to report the details of such OTC derivative transactions to the trade repository established under the CMSA.

Although Subdivision 4 provides for the establishment of the trade repository referred to above, curiously, the language of the relevant section does not appear to make it mandatory that a trade repository be established, or that such trade repository be established by the Securities Commission. Instead, Sections 107B and 107C state that the Securities Commission may approve a body corporate to be a trade repository, and that an application for the grant of approval as a trade repository shall be made to the Commission in such form and manner as specified by the Commission. As such, it appears that the trade repository until not be a creature of statute and could well be a commercial enterprise. Also, it is not clear from the provisions, if there is to be a single trade repository, or more than one.

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Regulation of Derivatives

The Bill does not appear to regulate the substance of OTC derivative transactions or make it a requirement that prior approval be obtained.

Once established, the trade repository will be under the supervision of the Securities Commission and will require the prior approval of the Commission before it appoints any director or chief executive; such persons and any other officers, servants or agents of the trade repository will be under strict confidentiality obligations save in certain specified situations set out under Section 107G. The rules of the trade repository may also not be amended without the prior approval of the Securities Commission, and the latter may give directions to the trade repository on effective administration or to ensure compliance with conditions imposed on it or where it is in the interest of the public.

The Bill makes it an offence if a person fails to report its OTC transactions to the trade repository, or if it submits false or misleading information or omits material information from its report to the trade repository. However, it does not appear to regulate the substance of OTC derivative transactions, nor make it a requirement that the prior approval of the Securities Commission be obtained before a particular type of OTC derivative is entered into by a party, and in particular, the Bill does not appear to regulate persons other than a CMSA licence holder or registered person who enter into an OTC derivative transaction. Presumably, the new Section 378A which provides for coordination between the Securities Commission and the Central Bank in the regulation of OTC derivatives and money market instruments, will address this lacuna by promulgating regulations or guidelines to that effect, once the Bill is gazetted.

Derivatives not gaming or wagering contract

The Bill also puts to rest the decade old issue on whether or not derivatives are gaming or wagering contracts by expressly legislating, by virtue of a new Section 362A, that a derivative "shall not be taken to be a gaming or wagering contract". Although this Section will resolve the issue, it does not address the heart of the matter – if a derivative were entered into by a person, for the sole reason of benefitting from the fluctuations in the price of a security, or a basket of equities, or the fluctuations in an index, such a derivative transaction is much like playing a game of chance, but the new Section 362A will now enable such derivative transactions to slip under the radar of the gaming or wagering prohibition, and additionally, does not regulate the position with regard to derivatives entered into for speculative purposes.

Conclusion

The effort to regulate derivatives under a single piece of legislation is laudable and timely, and in all likelihood, stems from the regulators' acute awareness of the debilitating effect that a less than strict regulation of derivatives could have, ultimately, on the global financial markets. However, the relevant provisions of the Bill appear to be more an exercise in form than substance, and it remains to be seen if further regulation in the form of guidelines will be issued by the Securities Commission and the Central Bank to regulate the substantive aspects of derivative transactions, failing which it might ultimately, be a case of too little too late.

Fiona Sequerah
Partner

Regulation of derivatives is currently fragmented and piecemeal. The Bill will introduce "derivatives" as a separate class of product for the purpose of regulating derivatives under the one Act. However, the relevant provisions appear to be more an exercise in form than substance, and it remains to be seen if further rulings will be issued to regulate the substantive aspects.

CHRISTOPHER & LEE ONG
Advocates & Solicitors

Revised PDS, Sukuk and Trust Deed Guidelines

The revised Guidelines usher in a number of significant revisions aimed at bringing about a more disclosure-based regulatory approach

The revised Trust Deeds Guidelines ("TD Guidelines"), Private Debt Securities Guidelines ("PDS Guidelines") and the Islamic Securities Guidelines ("Sukuk Guidelines") will take effect on 12 August 2011. The revised Guidelines usher in a number of significant revisions which are aimed at bringing about a more disclosure-based regulatory approach, improving disclosure of information, providing added protection to debenture and sukuk holders and expediting time-to-market for issuance or offer of debentures and sukuk.

Some of the main changes made to the PDS Guidelines and the Sukuk Guidelines (the "Guidelines") are as follows:

a. introduction of "deemed approval" for applications that meet the requisite criteria; this process is aimed, primarily, at expediting the time-to-market issuance by issuers of AAA (domestic or regional) rated issuances or BBB- (international) rated insurances, for both Ringgit Malaysia ("RM") and foreign currency-denominated issuances;

b. introduction of "deemed approval" process for Negotiable Instruments of Deposit ("NID") and Islamic Negotiable Instruments of Deposit ("INID");

c. requirement to apply Shariah principles or concepts endorsed by the SC as set out in the Sukuk Guidelines or to obtain the Securities Commission's Shariah Advisory Council ("SAC") clearance for other Shariah principles; and

d. requirement for bond trustees/sukuk trustees to become actively engaged in the documentation process.

The PDS Guidelines and Sukuk Guidelines

These Guidelines were originally, issued by the Securities Commission ("SC") in the year 2004 pursuant to the Securities Commission Act 1993; following substantial amendments to the securities legislation and the Capital Markets and Services Act 2007 ("CMSA") coming into force, the original Guidelines were revised and have now been replaced by the PDS Guidelines and the Sukuk Guidelines. Any person proposing to raise funding by issuing bonds (i.e. a type of debenture) or sukuk (i.e. a type of Islamic security) is required to apply to the SC for approval under S. 212 of the CMSA (except for persons or transactions falling within the exempted categories under Schedule 5 of the CMSA), which application must comply with either the PDS Guidelines or the Sukuk Guidelines or both (if the issuance includes both conventional bonds and sukuk), the provisions of the CMSA and the TD Guidelines, and additionally, such application may also need to comply with the Equity Guidelines issued by the SC where the bonds or sukuk are convertible into, or exchangeable with equity or are issued with attached warrants.

Additionally, the changes to the Sukuk Guidelines are also aimed at providing greater clarity to ensure compliance with Shariah rulings and principles endorsed by the SAC. The changes to the Sukuk Guidelines come at a time when Malaysia has been designated as having the largest sukuk market in the world and would indicates an effort by the government to retain its global market position and to remain competitive in the face of increasing competition from markets in the Middle East.

For a start, the Guidelines introduce and allow special scheme brokers, i.e. foreign stockbroking companies, to act as principal advisers for proposals for the offering of bonds or sukuk of

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Revised PDS, Sukuk and Trust Deed Guidelines

Applications for issuances will be "deemed approved" by the SC once certain conditions have been fulfilled.

listed or unlisted foreign issuers to investors identified under Schedule 6 and Schedule 7 of the Capital Markets and Services Act 2007. On Issuers who are Multilateral Development Banks ("MDB") or Multilateral Financial Institutions ("MFI") are not required to appoint principal advisers and may submit the information and documents required by the Guidelines directly to the SC.

Deemed Approval Process

One of the main thrusts of the new Guidelines, i.e. to quicken time-to-market issuance, has seen the introduction of an improved application process by virtue of the expansion of the "deemed approval" process to a broader range of eligible issuers.

By way of background, the "deemed approval" process, where applications for issuances will be deemed approved by the SC once certain conditions have been fulfilled, was previously limited to foreign currency-denominated bonds and sukuk issued by certain qualified issuers, .e.g. MDBs, MFIs, multinationals, foreign governments and agencies of the Malaysian or other foreign governments. The process was restricted to these select few as they were typically issuers with strong financial and credit standing.

In an effort to encourage and expedite time-to-market issuances of highly-rated bonds or sukuk, the "deemed approval" process has been expanded to apply to issueances of RM-denominated bonds and sukuk but by highly-rated issuers from within and outside Malaysia.

A proposed RM-denominated issuance will now be deemed approved by the SC upon its obtaining a rating of AAA by a domestic or regional rating agency or BBB- by an international rating agency, upon submission of required documents and subject to compliance with the requirements in the Guidelines. The regional and international ratings will, however, only apply if the issuer had previously issued foreign currency-denominated bonds or sukuk for which a regional or international rating had been assigned and is still valid.

Similarly, the "deemed approval" application process will also apply to foreign currency-denominated bonds or sukuk which originate from Malaysia with at least a BBB- rating by an international rating agency provided that the requirements in the Guidelines are fulfilled.

Negotiable Instruments of Deposit & Islamic Negotiable Instruments of Deposit

The revised PDS Guidelines and Sukuk Guidelines also introduce the concept of "deemed approval" for NIDs and INIDs. To be eligible for this process, the NID or INID has to be issued by a bank and must be for a tenure of more than five years – NIDs and INIDs with tenures not exceeding five years are not recognised as debentures under the Securities Commission (Non-Application of the Definition of Debenture) Order 2001.

Floating rate NIDs and INIDs with tenures of longer than five years fall within the definition of "structured products" and any person proposing to issue floating rate NIDs and INIDs must comply with the Guidelines on the Offering of Structured Products issued by the Securities Commission, instead of the PDS Guidelines and the Sukuk Guidelines, as the case may be.

Any inherent risks in investing in NIDs and INIDsmust be disclosed to investors and the settlement procedures for early redemption or termination of an issue must be clearly stated.

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Revised PDS, Sukuk and Trust Deed Guidelines

To enhance investor protection, trustees are required to be actively involved in the documentation process, and more stringent standards have now been imposed on the contents of trust deeds.

Shariah Rulings

As under the previous Guidelines, the Sukuk Guidelines also require the issuer with the concurrence of the principal adviser, to appoint a Shariah adviser for any sukuk issuance, to advise on the structuring of the transaction, on the documentation and to ensure that the transaction is Shariah compliant. However, in addition to the appointment of the Shariah adviser, the Sukuk Guidelines now impose an additional obligation to apply and comply with certain Shariah rulings, principles and concepts endorsed by the SC. These rulings are extensively set out in the Sukuk Guidelines and range from rulings on asset pricings to rulings applicable to specific types of Sukuk.

In the event a proposed issuance of an RM-denominated sukuk is based on a Shariah ruling, principle or concept other than that provided for in the Sukuk Guidelines, the issuer must obtain the approval of the SAC prior to any submission to the SC.

Bond trustee/ sukuk trustee to play active role

The PDS Guidelines and the Sukuk Guidelines have enhanced the role of the bond trustee and sukuk trustee, requiring them to be appointed early on in a transaction, and to be actively involved in the documentation process.

In the past, as a matter of practice, trustees were often the last party to be appointed and usually, at a very late stage in the documentation process, when all negotiation had been concluded and the documents in almost final form.

As trustees are appointed to act on behalf of the holders of debentures or Sukuk and are required as part of their fiduciary duties to act in the best interest of the debenture or Sukuk holders, not involving the trustee in the deliberations and negotiation of the debenture or Sukuk documentation could impair or undermine the trustees' ability to act in the best interest of these investors. It appears that the Securities Commission in taking cognisance of this practice has now placed the onus on the principal advisor to involve the trustee in the documentation process on a timely basis.

As a result of this , trustees have begun playing an active role in the documentation process and it has been observed that they are also now legally represented which unfortunately has caused an increase in the transaction cost to the issuer.

Trust Deed Guidelines

The TD Guidelines aim to enhance the protection afforded to debenture or sukuk holders, by implementing more stringent standards on the contents of trust deeds.

The TD Guidelines require that relevant thresholds for tests of 'materiality' be clearly stated in the trust deed. Also, trust deeds must now include the basis of calculation and the profit sharing ratio of any interest or profit rate payable; and where a rebate may be given, the agreed rate or calculation method must be expressly provided. Where an issuer has an option to redeem the debentures or sukuk before the legal maturity date, the TD Guidelines require that the procedures for such early redemption be expressly included into the trust deed, including any procedures to obtain the prior approval of, or to notify the debenture or sukuk holders.

Trust deeds must now provide the detailed formula governing any limitation on the amount of borrowing by the issuer, and the detailed meanings or definition of each component in the formula in order to facilitate computation and verification of such limit. Hence, for example, where an issuer is required to comply with certain financial ratios, which may have the effect

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RM30,000 from the proceeds of bonds or sukuk issued will be set aside to deal with occurrence of events of default or enforcement events.

of limiting its level of borrowing, the relevant provisions must include detailed formula, specific definitions and clarify with respect to the mode of computation of such ratios. Additionally, the issuer is required to furnish a report, at least annually, to the trustee stating the compliance or non-compliance with such limits.

To enhance the protection of holders of debentures or Sukuk, issuers are now required to allocate a sum of RM30,000 from the proceeds of debentures or Sukuk issued, and to deposit it into an account which will be operated by the trustee. The trust deed should therefore, set out the terms of operation of such account, which is to be known as the "Trustee's Reimbursement Account for Debenture holders' Actions" or in relation to sukuk, the "Trustee's Reimbursement Account for Sukukholders' Actions". The trustee may only utilise the moneys standing to the credit of this account to deal with the occurrence of events of default or enforcement events provided for in the trust deed, and such amount is required to be maintained throughout the duration of the issuance. This new provision will alleviate the perennial problem faced by the trustee when an issuer defaults, as to whom the trustee may look to, to be indemnified for the costs of such enforcement proceedings, particularly when time is of the essence.

Conclusion

It is hoped that the significant changes brought about by the various Guidelines will achieve its aim in implementing an improved framework and in streamlining the approval process of any proposed issue, offer or invitation of PDS and sukuk. In light of the revisions, it appears that the changes will not only be welcomed by investors and holders of PDS or sukuk, but also issuers as well, as the new Guidelines provide much needed clarity and expedites the overall process of an issue. Having said that, it still remains to be seen if the process will prove to be more efficient or if the various requirements will only serve as added red tape to hinder and slow down the whole process when the opposite is intended.

Chor Jack
Associate

CHRISTOPHER & LEE ONG
Advocates & Solicitors

The new Guidelines aim to quicken time-to-market for highly rated issuances, provide better investor information through increased disclosure requirements, and enhance investor protection through more stringent standards. It remains to be seen whether these increased requirements will bolster the depth of the Malaysian debt capital market or simply constitute additional bureaucratic measures.

Corporate finance advisory without CMSL

The Singapore High Court has opened the scope for boutique corporate finance advisors to provide corporate finance advice without licence.

A recent case in Singapore, *Rockeby Biomed Ltd v Alpha Advisory Pte Ltd* [2011] SGHC 155, has opened the scope for boutique corporate finance advisors to carry on corporate finance advisory work in Singapore without a capital markets services licence. The Singapore High Court held that the corporate finance advice "must relate directly to an actual offer to the public" before it may fall foul of the exemptions granted under the Securities and Futures (Licensing and Conduct of Business) Regulations ("Regulations") which are commonly relied upon by boutique corporate advisors.

"The exemptions [in the Regulations] are aimed at insuring that when securities are to be sold to the investing public, for the protection of that public, the persons advising the issuer or seller of the securities are qualified to do so…The Regulations, however, do not stop firms like the Advisor from giving advice to clients to put such clients into a position in which they can subsequently consider whether to implement an actual public offering and to hire suitably qualified professionals to advise them…"

This article compares the corporate finance advisory licensing regime under the Singaporean Securities and Futures Act ("SFA") and the Malaysian Capital Markets & Services Act ("CMSA"), and considers whether there is similar scope for boutique advisory firms to operate without capital markets services licence ("CMSL") in Malaysia.

Licensing regime for Corporate Finance Advisory

The SFA and CMSA both provide that no person shall carry on a business in any regulated activity without a CMSL. Advising on corporate finance, as defined below, is considered a regulated activity.

SFA	CMSA
''advising on corporate finance'' means giving advice — a. *to any person (whether as principal or agent, or as trustee of a trust) concerning compliance with or in respect of laws or regulatory requirements (including the listing rules of a securities exchange) relating to the raising of funds by any entity, trustee of a trust on behalf of the trust or responsible person of a collective investment scheme on behalf of the collective investment scheme;* b. *to a person making an offer —* *(i) to subscribe for or purchase securities; or* *(ii) to sell or otherwise dispose of securities,* *concerning that offer;* c. *concerning the arrangement, reconstruction or take-over of a corporation or any of its assets or liabilities; or* d. *concerning the take-over of a business trust or any of its assets or liabilities held by the trustee-manager on behalf of the business trust;*	*"advising on corporate finance" means giving advice concerning –* a. *compliance with or in respect of Part VI, any regulation made under section 378 and any guidelines issued under section 377 relating to any matter provided under Part VI, or relating to the raising of funds by any corporation;* b. *compliance with the listing requirements of the stock exchange in relation to the raising of funds or related party transactions;* c. *arrangement or restructuring of a listed corporation.* *Note: Part VI of the CMSA deals with proposals in relation to securities, and takeovers and mergers, prospects requirements, and requirements for issue of debentures, Islamic securities, units trusts and prescribed investment schemes.*

Corporate finance advisory without CMSL

Boutique corporate advisors rely on certain exemptions in the Singapore Regulations which do not exist in the Malaysian CMSA.

Specific exemptions from holding a CMSL are given to "Specified Person" as listed in the Third Schedule of the SFA and Schedule 3 of the CMSA. Examples of Specified Persons include solicitors and accountants in practice whose carrying on of the regulated activity is solely incidental to the practice of law or accounting. In Singapore, further exemptions are granted under the Second Schedule of the Regulations. No similar regulations exist in Malaysia. However, the list of Specified Persons under Schedule 3 of the CMSA is more extensive and largely provides the same exemptions available under the SFA and the Regulations.

However, in respect of giving advice on corporate finance, there is no Malaysian equivalent to the Singapore Regulations which grant certain exemptions as follows:

> *7. (1) (b) a person resident in Singapore who carries on business in giving advice on corporate finance to accredited investors provided that such advice is not specifically given for the making of any offer of securities to the public by the accredited investor… and such advice is not circulated to the shareholders (other than shareholders who are accredited investors) or is otherwise made known to the public.*
>
> *7. (1) (c) a person who advises another person concerning any arrangement, reconstruction or take-over of any corporation or any of the corporation's assets or liabilities, provided that such advice is not specifically given for the making of any offer of securities to the public by the second-mentioned person… and such advice is not circulated to the shareholders (other than shareholders who are accredited investors) or is otherwise made known to the public.*
>
> *7. (1) (d) a person who carries on business in giving advice to another person concerning compliance with or in respect of any laws or regulatory requirements relating to the raising of funds not involving any securities.*

The Rockeby Biomed case as mentioned above concerns Clause 7(1)(b) and (c) above, specifically the interpretation of "*not specifically given for the making of any offer of securities to the public*".

***Rockeby Biomed* case**

The plaintiff (the "Client") is a company incorporated in Australia. The defendant (the "Advisor") is a Singapore company that carries on the business of giving corporate finance advice. The Client and the Advisor entered into a Consultancy Agreement pursuant to which the Advisor was to provide advice on securing a Singapore listing for the Client through either a reverse takeover in Singapore or an initial public offering ("IPO"). Through the course of the engagement, the Advisor determined that the Client needed to acquire another company to provide the Client with the necessary profitability to meet the Singapore listing criteria and therefore the advice given considered in some detail how this could be achieved. The Client did not pay the contractual sum under the Consultancy Agreement claiming the Advisor lacked the legal capacity to enter into such agreement by not holding a CMSL and the agreement was void for illegality as the Advisor was providing advice on the listing exercise which does not meet the criterion for "*not specifically given for making of any offer of securities to the public*".

The learned judge held that:

- The SFA aims at protecting the investing public whilst at the same time allowing for diversity

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Corporate finance advisory without CMSL

Advice to put a company in a position that it may qualify to subsequently make an offer to the public does not constitute advice specifically given for the making of any offer of securities to the public.

of service providers in the capital markets services sector by ensuring that there were areas within which boutique firms could operate and reach clients who would find it expensive to engage the services of investment banks.

- The phrase "*specifically given for the making of any offer of securities to the public*" implies a degree of exclusivity in that it implies that the **advice must be precisely concerned with or directed to** an offer of securities to the public which is imminent or ongoing.
- If the purpose of the advice is to put a particular company in such a position that it may qualify to subsequently make an offer of securities to the public, then such advice would not be considered to have been specifically given for the making of any offer of securities to the public even though that might have been the ultimate purpose for which the advice was taken.
- The Regulations envisage that the provision of corporate finance including advice on acquisition of corporations were among the services to be provided by such boutique firms. Such advice must of course include methodology of financing. This could take many forms but an offer to the public need not necessarily be involved.
- From an examination of the facts, it was clear that the Client had, as one of its ultimate purposes, a listing on a stock exchange in Singapore. Much of the advice given was directed at considering how the Client could be placed into a position such that it would go on to apply for a listing. It was clear that nothing the Advisor did pertained immediately to the issue of securities to the public.
- Further, the Consultancy Agreement expressly provided that if in the future there was to be an IPO or a reverse takeover, other professional advisors would be appointed to deal with these matters. The Court noted that this indicated that the Advisor was aware of the limitations on its ability to advise and wanted to make clear to the Client that another person who was qualified under the SFA would be appointed if the advisory services required related to a public offering.

The Malaysian position

The Singapore exemptions contained in the Regulations relied upon by the Advisor do not exist in Malaysia. There has been no reported judgment to date on section 58 of the CMSA which requires persons carrying on a business in advising on corporate finance to hold a CMSL.

However, it is interesting to note that the Malaysian definition of "advising on corporate finance", extracted above, is narrower than its Singaporean counterpart:

a. *advice concerning compliance with or in respect of Part VI and any regulations and guidelines relating to matters provided under Part VI*

The scope of corporate finance advisory requiring a CMSL is limited to **<u>compliance</u>** with matters provided under Part VI of the CMSA. Part VI deals with proposals such as an invitation to subscribe for securities in Malaysia, takeovers, mergers and compulsory acquisitions, prospectus requirements, and requirements for the issue of debentures, Islamic securities, unit trusts and prescribed investment schemes.

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Corporate finance advisory without CMSL

Scope of advice on corporate finance which requires the advisor to hold a CMSL is more narrowly defined under the CMSA.

An analogy may perhaps be drawn from *Rockeby Biomed* in that until the corporate finance advice is "**precisely concerned with or directed to"** such offering of securities, takeovers and mergers etc. when submissions, registrations or approvals from the Securities Commission are required, section 58 of the CMSA, requiring a CMSL, will not apply.

b. *advice concerning compliance with listing requirements in relation to raising of funds or related party transactions*

Again, the application of section 58 requiring a CMSL for advice on listing requirements is confined to compliance. In the *Rockeby Biomed* case, advice to the Client concerning takeovers of another corporation in order to meet the Singapore stock exchange's profitability requirement was held as advice to put the Client in a position that it may qualify to subsequently make an offer to the public and was not specifically given for the making of any offer of securities to the public even through that was the ultimate purpose for which the advice was taken.

However, it is important to bear in mind that one of the aims of securities laws is protection of the investing public. Where advice is given to public companies or companies which are about to be listed, the Malaysian courts may be more strict in interpreting the degree to which an advice is given, specifically where it concerns compliance with the listing requirements. Much will depend on facts of the case and the relationship between the advisor and its client. Caution should be exercised and CMSL holders should be appointed at the point where listing of the corporation is imminent.

c. *advice concerning arrangement or restructuring of a listed corporation*

This third category of advice on corporate finance on arrangement and restructuring is not limited to compliance; however, it is limited to listed corporations. The Singapore equivalent does not have the same limitation to listed corporations, but it provides for an exemption in *7. (1) (c)* where such advice is not specifically given for the making of any offer of securities to the public.

Schemes of arrangement and restructuring of listed corporations have direct impact on the value of the public's investments. As a policy for the protection of public investors, the Malaysian courts and the Securities Commission may require such advice to come from licence holders in order to ensure the interest of the investing public are protected.

Conclusion

The jury is still out, in Malaysia, on the issue of whether a boutique corporate advisor can carry on a business in advising on corporate finance without holding a CMSL. Boutique advisors need to recognise limits on their abilities to advise, ensure such limits are communicated to their clients and specifically provide in the engagement letter for other qualified professionals to be appointed when matters progress to a stage beyond the limits of the advisor's ability to advise. For corporations which are already listed, advice concerning scheme of arrangements or restructuring is best provided by licence holders in order to ensure the interest of the public investors are protected.

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