

3 November 2011

Datuk Ranjit Ajit Singh (ranjit@seccom.com.my)
Securities Commission Malaysia
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Dear Datuk Ranjit,

Capital Markets and Services (Amendment) Act 2011

Thank you for agreeing to meet us on November 8. As mentioned, we would like to discuss the Capital Markets and Services (Amendment) Act 2011 (“**Amendment Act**” and together with the Capital Markets and Services Act 2007, the “**CMSA**”) which we understand has come into operation on October 3. We also note that the Licensing Handbook has been revised on October 3.

A number of the concerns that we had raised in our letter of September 23 have been addressed by the Capital Markets and Services (Amendment of Schedules 1, 2, 3 and 4) Order 2011. However, there remain certain key points that we hope to clarify during our meeting on November 8. To the extent that the Securities Commission (“**SC**”) considers it appropriate to do so, we believe that it would provide considerable guidance and comfort to market participants if the SC could publish FAQs on its website clarifying these points.

1. We note that Schedule 4 has been amended to exempt (among others) licensed financial institutions when dealing in derivatives in the money market or when dealing in over-the-counter derivatives (“**exempted dealing in derivatives**”) from having to obtain a Capital Markets Services Licence under Section 58(1) of the CMSA. However, they would still need to comply with certain requirements under the CMSA. Pursuant to Section 76(6) of the CMSA, these requirements are:
 - (a) Sections 91, 92, 93 and 97 of the CMSA and any regulation or guideline made pursuant thereto;
 - (b) The SC’s “*fit and proper*” requirements for employees that carry on exempted dealing in derivatives; and
 - (c) Maintaining a register of the names of such employees.

We note that section 3.03 of the Licensing Handbook makes Bank Negara Malaysia (“**BNM**”) responsible for ensuring compliance by licensed financial institutions with the above requirements. We seek clarification of the following points:

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- (i) Although BNM is responsible for ensuring compliance by licensed financial institutions, the requirements to be complied with will be set by the SC. Will the SC be prescribing any regulations or guidelines pursuant to Sections 91, 92, 93 and 97 of the CMSA or “*fit and proper*” requirements for employees that relate specifically to dealing in derivatives?
 - (ii) Are there any other requirements under the CMSA that licensed financial institutions need to comply with when carrying on exempted dealing in derivatives? For example, are they required to comply with the SC’s Guidelines on Investor Protection?
2. We note that Schedule 3 has been amended to exempt “*any person who deals in derivatives on the person’s own account or for his related corporation*”. Unlike registered persons under Schedule 4 who are still required to comply with certain requirements under the CMSA, specified persons under Schedule 3 are completely exempt from all requirements under the CMSA. As participants in the OTC derivatives market generally transact on a principal-to-principal basis, that is, for their “*own account*”, read literally, this would mean that all such participants (including a non-resident dealing with a resident) would be completely exempt from the CMSA. Please clarify whether this is the intent.
3. We note that Schedule 3 has also been amended to exempt “*any person who deals in derivatives where such person is a non-resident acting as principal or agent through the holder of a Capital Markets Services Licence who carries on the business of dealing in derivatives*”. Please confirm that the latter part of this clause (that is, holder of a Capital Markets Services Licence who carries on the business of dealing in derivatives) applies to both the case of the non-resident acting as principal and acting as agent. Secondly, please confirm that if a licensed financial institution that carries on the business of dealing in derivatives but is exempt from obtaining a Capital Markets Services Licence acts as intermediary for a non-resident, that non-resident would be entitled to the benefit of this exemption.
4. We note that Schedule 3 has been amended to provide as follows:

“A holder of a Capital Markets Services Licence who carries on the business of dealing in derivatives whose dealing in securities –

 - (a) *is the direct consequence of dealing in a derivative;*
 - (b) *is in connection with the delivery of a security within a class of securities which is the subject of a class of derivatives; or*
 - (c) *is in connection with the transfer of securities as collateral or security, or in realization of any collateral or security, for obligation under a derivative*”.

Please confirm that a licensed financial institution that carries on the business of dealing in derivatives but is exempt from obtaining a Capital Markets Services Licence is entitled to rely on this provision. Please also confirm that any dealing in securities by such institution that falls within (a), (b) and (c) above need not comply with any requirements pertaining to dealing in securities under the CMSA, in particular, Sections 91, 92, 93 and 97.

5. Our members remain greatly concerned with Section 92A. Unlike the other capital market products, each OTC derivative is bespoke and customized on a trade-by-trade basis. It follows from this that each term sheet is unique and that term sheets are many in number. Thus, unlike say an offering document for a securities offer which is extensively reviewed both internally as well as by outside legal counsel and other external advisers, it is not practicable to perform anywhere near the same level of due diligence for an OTC derivative term sheet. In the circumstances, to make a false or misleading OTC derivative term sheet an offence punishable by fine and imprisonment for up to 10 years is manifestly excessive. Civil liability for a false and misleading OTC derivative term sheet is the appropriate redress.
6. Section 92 now refers to making recommendations in relation to derivatives as well. Parties to an OTC derivative transact on an arm's length basis and almost invariably provide mutual representations to this effect. While it is general market practice (as well as a requirement under BNM's Guidelines) for a licensed financial institution to provide a term sheet for a transaction that is not a plain vanilla OTC derivative, the provision of the term sheet does not detract from the arm's length basis on which the parties transact and the term sheet is clearly not meant to be a recommendation by the institution. Nevertheless, given the extension of Section 92 to derivatives, it would provide certainty to the market if the SC could state in FAQs that notwithstanding such extension, the provision of a term sheet does not in itself amount to making recommendations.
7. Section 7(2) of the CMSA prohibits a person from establishing, operating or maintaining, or assisting in establishing, operating or maintaining, or holding himself out as providing, operating or maintaining, a derivatives market that is not a derivatives market of a derivatives exchange, a derivatives market of an exchange holding company that is itself approved as a derivatives exchange, an exempt derivatives market or a registered electronic facility under subsection 34(1). Given the broad definition of "*derivatives market*" that includes a "*market ... at which derivatives are regularly traded*", any participant in the OTC derivatives market is potentially caught by the prohibition in Section 7(2). Please confirm that a participant in the OTC derivatives market will not contravene Section 7(2). Alternatively, please designate the OTC derivatives market as an exempt derivatives market pursuant to Section 7(3)(a) of the CMSA.
8. Given the mandatory requirement in the US for cleared OTC swaps to be executed on a swap execution facility and the anticipated analogous requirement in the EU for cleared OTC derivatives to be executed on an organized trading facility, it is likely that more and

more OTC derivatives will, going forward, be executed on a facility. Where there is a Malaysian party to an OTC derivative executed on such a facility, this will be potentially caught by the definition of “*derivatives market*” as a “*facility by means of which derivatives are regularly traded*”. Our members request either that confirmation be given that this will not contravene Section 7(2) of the CMSA or alternatively, that such facilities be designated as exempt derivatives markets pursuant to Section 7(3)(a).

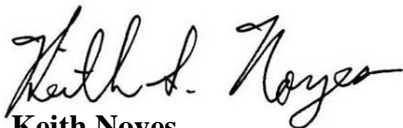
9. Section 105 prohibits a holder of a Capital Markets Services Licence carrying on the business of dealing in derivatives or fund management in relation to derivatives from trading standardized derivatives on a derivatives market outside Malaysia unless the derivatives market is a derivatives market of a Specified Exchange, or the standardized derivative is of an approved class of standardized derivatives. First, please clarify whether this prohibition also applies to a licensed financial institution that carries on the business of dealing in derivatives but is exempt from obtaining a Capital Markets Services Licence.

A “*Specified Exchange*” is defined as “*such derivatives market as may be provided in the rules of the derivatives exchange as a Specified Exchange*” and an “*approved class of standardized derivatives*” as “*such class of standardized derivatives of the derivatives market of a Specified Exchange as provided in the rules of the derivatives exchange as an approved class of standardized derivatives*”. We understand that Bursa Malaysia has a current approved list of Specified Exchanges and approved classes of [futures contracts] and assume that the intention is for this list to continue to apply. However, given that the definition of “*standardized derivatives*” requires such derivative to be traded on a “*derivatives exchange*” and for that trade to be cleared and settled by an “*approved clearing house*”, a standardized derivative by definition must be traded on a Malaysian derivatives exchange and cleared through a Malaysian clearing house. It is thus not possible for a standardized derivative to be traded in a derivatives market outside Malaysia in the first place. Nevertheless, please confirm that the Bursa Malaysia list will continue to apply.

We look forward to discussing the above points and your plans in regard to trade reporting and central clearing on November 8.

Yours faithfully,

For the International Swaps and Derivatives Association, Inc.



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