ABDULLAH CHAN

ADVOCATES & SOLICITORS

The Financial Services Act 2012 - Interest in Shares (Part 1)

(Part 3 of 4)

By Gopal Sundaram
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This series of articles are written to introduce and explain significant features of the Financial Services Act 2012 which was recently passed by Dewan Rakyat and Dewan Negara of the Malaysian Parliament. The Royal Assent to the Bill has not been announced yet. Neither has the new Act been gazetted. The Bill provides that the Act will come into force on a day determined by the Minister of Finance.

The concept of "interest in shares" was introduced into banking legislation in Malaysia in the 1980s in conjunction with the issue of shareholder dominance in financial institutions. Unlike trading and other commercial corporations, banking and financial institutions are largely funded in their business activities by public moneys, largely consisting of deposits, investment accounts or premiums. Hence the business and operations of these custodians of public money should be professionally managed. The thinking at that time was that while shareholders activism should be encouraged as a check and balance on the management of financial institutions, a single shareholder or a group of shareholders should not become so dominant as to interfere with the professional management of these institutions.

When rigorous adherence to this school of thought produced financial institutions with lacklustre leadership, it became increasingly clearer that it was important to harness the strength of shareholders interests, especially, those which have significant stakes in the financial institutions, to give direction to, and propel innovation and robust growth in, the institutions. The principle that shareholders who have significant stakes in financial institutions should be "fit and proper persons" gained prominence and helped to mitigate the negative aspects of shareholder dominance and interference in the management of financial institutions.

Significant or substantial stakes in financial institutions was measured using the concept of "interest in shares". A 5% stake was considered significant or substantial and would need the approval of the Minister of Finance before it could be procured. Beyond a holding of 5%, the criteria of "fit and proper persons" assumed greater importance to determine whether the Minister's approval for the acquisition should be given.

Originally, "interest in shares" was simply understood to mean that if Corporation A owned 20% of Corporation B and Corporation B owned 100% of Corporation C, then the interest in shares of Corporation A in Corporation C is 20% x 100% i.e. 20/100 x 100% which equals 20%. The label given to this form of deriving interest in shares was "effective interest in shares" as opposed to a "direct interest in shares". In the example above, Corporation A has a direct interest of 20% in the shares of Corporation B and Corporation B has 100% direct interest in Corporation C.

When the Banking and Financial Institutions Act 1989 came into force, the interest in shares provisions in the Companies Act 1965 were imported into that legislation. The effect was that the regulatory net was thrown wider than before. Under the BAFIA, in the above example, since Corporation A owns more than 15% of Corporation B, Corporation A is deemed to have an interest in all of Corporation B's shares in Corporation C i.e. a 100% deemed interest in the shares of Corporation C. If, in addition, Corporation X, Corporation Y and Corporation Z respectively owned 20% of Corporation B, it would result in Corporations A, X, Y and Z all having a deemed interest of 100% in Corporation C, a resultant legal consequence which though useful for regulatory purposes,

did not make much practical sense. The deemed interest in shares principle would operate provided that the first level corporation holds not less 15% in the second level corporation. The chain of interest in shares breaks wherever the holding in any subsequent level corporation is less than 15%.

It would appear that we have come a full circle with the Financial Institutions Act 2012. The Act reintroduces the concept of effective interest in shares which will henceforth be used to measure shareholdings in banking and financial institutions.

Article Written By:

GOPAL SUNDARAM
LL. B. (Hons.)(Mal)

E: gopal@abdullahchan.my
T: +603 2381 2070 ext 13

Gopal began his highly distinguished career in Bank Negara Malaysia (BNM) in 1982, pursuant to graduating from University of Malaya on a Bank Negara scholarship. He was appointed as Assistant Governor in 2006. As Assistant Governor he was responsible for the Legal Department, Finance Department and the IT Services (Computer) Department as well the Money Museum and the Art Gallery. During his tenure, he was a member of various committees chaired by the Governor, inter alia, the Management Committee, the Monetary Policy Committee, the Financial Stability Committee, the Budget Committee, the Risk Management/ Committee and in attendance at the Malaysia International Islamic Financial Centre Executive Committee (MIFC), a multi-agency committee appointed by the Prime Minister.

Upon his retirement in 2011, he was appointed as Project Advisor to BNM to advise and supervise the drafting of an omnibus legislation for banking, insurance, payments systems and exchange control as well as an omnibus Islamic legislation for Islamic banking, takaful, payment systems and exchange control proposed to be tabled in Parliament later this year.

Gopal is the only member of the International Monetary Law Committee of the International Law Association (MOCOMILA) from Malaysia. He is also in the Executive Committee of the Malaysian Chapter of ASIL (Asian Society for International Law). Gopal sits on the Board of Directors of Kuwait Finance House (Malaysia) Berhad, the Board of Management of Methodist College Kuala Lumpur, the Council of Education, Methodist Church in Malaysia and the Judicial Council, Methodist Church in Malaysia.

He is a leading adviser on the new Financial Services Act (FSA) and Islamic Financial Services Act (IFSA).
