MINORITY SHAREHOLDERS WATCH GROUP
Badan Pengawas Pemegang Saham Minoriti Berhad (524989-M)

The Observer

(Following the announcement made by Prime Minister, YAB Tan Sri Muhyiddin Mohd Yassin on 25 March 2020, in relation to the extension of Movement Control Order to 14 April 2020 in order to contain the COVID-19 outbreak, public listed companies have postponed their general meetings to a later date. Hence, there will be no Weekly Watch featured on newsletter).

At this trying time, let us all continue to stay home, stay safe and stay healthy! Be patient, as better days are on their way!

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Desperate Times Need Desperate Measures

There is a triple whammy affecting global capital markets; the trade wars, the oil prices and the COVID-19 pandemic.

Recently, Bursa Malaysia and Securities Commission made certain decisions regarding short selling, margin financing rules and continuous trading. The rule changes and decisions are due to the desperate times that the investors, brokers and the Exchange are facing. After all, desperate times need desperate measures.

Short-selling

In a pronounced continuous downspin in the market, it is wise to stop short selling temporarily, (despite there being an uptick rule). Our market saw wild continuous downward pressure recently; at times our FBMKLCI index was down over 90 points during the day.

Short selling creates both actual and psychological downward pressure on the market in such a scenario. The actual downward pressure arises from the huge short-selling sell orders that tend to drive the price downwards.

This is exacerbated by the psychological (or even real) fear on other investors who jump onto the bandwagon to also dump their shares. Thus, there is a downward spiral on the share prices and the indices.

Short selling was abandoned to help mitigate the downward spiral in share prices.

Margin Accounts

The downward spiral in the share prices results in the forced-selling of margin accounts kicking-in and this adds further fuel to the downward pressure on share prices.

Margin accounts may provide useful leverage in a bull market but can become a nightmare in a bear market. Investors who utilize margin accounts must maintain a certain level of collateral against their margin loans.

Under the Rules of the Exchange, once the collateral drops to a certain percentage of the loan (150% of the loan), the margin-loan provider will call the margin account holder to maintain the collateral level at above 150%.

However, if the collateral value drops to a lower prescribed level (130% of the loan), the loan provider, which often is the stockbroker, can under the rules of the Exchange force-sell the collateral shares; this in turn creates further downward pressure in an already downward-trending market; further fuelling other instances of margin force-selling – a painfully vicious cycle.

It must be understood that the stockbroker is required under the rules of the Exchange to force-sell the collateral shares when they reach below 130%; otherwise, the stockbroker will end up holding receivables (margin loans given out) which are below the collateral value and this will in turn, create a systemic risk amongst the stock brokers.

Margin Accounts – Abandoning the Rules

The above rules, which seek to centralise risk management at the Exchange level, were abandoned on 26 March as additional relief measures to alleviate the impact of COVID-19 on capital market players.

The Exchange decided to give more flexibility and discretion to brokers by removing the requirement to automatically liquidate their client's margin account if the equity in the margin account falls below 130% of the outstanding balance. Brokers will also not be required to make additional margin calls or impose haircuts on any collateral and securities purchased and carried in margin accounts due to an unusually volatile market.

What the Exchange is saying is that we are suspending the abovementioned rules on the premise that the brokers know their customers best and thus leaving it to the brokers to manage the margin risks. The question then is that should not this approach also apply in good times i.e. that the broker knows their customers best.

This relaxation of rules may also seem somewhat paradoxical in that in good times, the Exchange wants to manage margin risks, but in bad times, when

arguably the Exchange should be managing the risks, the brokers are asked to manage their own margin risks.

Another change in the Rules is that the Exchange will allow brokers to accept other collaterals, such as bonds, collective investment schemes, unit trusts, gold and immovable properties for purposes of maintaining their clients' margin account if such collaterals are valued as per the broker's credit policy.

This is a relaxation as the Exchange previously prescribes the kinds of collateral that are acceptable and the haircuts, if any, for the various types of collateral. Now, it is up to the broker, both as to the type of acceptable collateral and the haircuts that need to be given.

Another risk is systemic risk to the capital market; as some brokers may be 'gung-ho' and end up with substantial margin loans with inadequate collateral. These brokers may end up posing a systemic risk as they may become bankrupt.

Desperate times need desperate measures; and once we are beyond the COVID-19 pandemic, we need to evaluate our approach to rule making and implementation; we seem to making centralised rules to be abided by in good times and abandoning these centralized rules in bad times; when arguably it should be the other way around.

Continuous Trading

There was a call to suspend the stock exchange (as was done in the Philippines). But this would be akin to imposing 'capital controls' on the investors in the stock market as they will not be able to liquidate (cash-out) by selling their shares.

Reportedly, the Philippine Stock Exchange (PSE) Index plunged as much as 24% on 19 March after it resumed trading due to an unprecedented two-day closure over fears of Covid-19. PSE Index ended the day with a 13% decline. Analysts have suggested the sell-down was due to the loss of confidence in the PSE resulting in a rush to safer assets.

It is the role of an exchange to provide continuous trading to enable investors to manage their risks (which can change in seconds) in today's globalized world, and to capitalize on opportunities.

Suspending the exchange is akin to changing the goalposts in the middle of the game. If an exchange suspends the market, the investors will not be able to sell their shares and get the cash (by T+2).

The provision of continuous trading is the responsibility of a responsible stock exchange.

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