

## Client Alert

5 May 2020

For further information, please contact:

**Mark Lim**  
Partner  
+603 2298 7960  
mark.lim@wongpartners.com

**Munir Abdul Aziz**  
Deputy Managing Partner  
+603 2298 7854  
munir.abdulaziz@wongpartners.com

**Stephanie Phua**  
Partner  
+603 2298 7895  
stephanie.phua@wongpartners.com

**Adrian Wong**  
Senior Associate  
+603 2298 7952  
adrian.wong@wongpartners.com

**Elaine Foo**  
Senior Associate  
+603 2298 7972  
elaine.foo@wongpartners.com

**Angel Ling**  
Associate  
+603 2298 7919  
angel.ling@wongpartners.com

**Rachel Ang**  
Associate  
+603 2298 7980  
rachel.ang@wongpartners.com

## Alternative Fundraising via Issuance Of Conventional Convertible Notes by Businesses to Venture Capital and Private Equity Firms

On 28 April 2020, in a move to provide alternative accessible funding to start-ups, micro, small and medium-sized enterprises and small and mid-cap companies which have been facing liquidity issues since the Malaysian Movement Control Order ("**MCO**") took effect (the MCO has been in effect since 18 March 2020 and has been recently extended to 12 May 2020), the Securities Commission Malaysia ("**SC**") has revised its *Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework* (issued on 9 March 2015 and revised on 28 April 2020) ("**LOLA Guidelines**") and the *Lodgement Kit: Unlisted Capital Market Products under the Lodge and Launch Framework* (issued on 9 March 2015 and revised on 28 April 2020) ("**Lodgement Kit**") to permit businesses to issue conventional convertible notes to venture capital firms ("**VC**") and private equity firms ("**PE**") registered with the SC<sup>1</sup> ("**CN Lodgement Regime**"). Currently only conventional convertible notes may be issued under the CN Lodgement Regime<sup>2</sup>.

The list of VC and PE firms registered with the SC can be found at <https://www.sc.com.my/api/documentms/download.ashx?id=89437f71-6ae1-4c47-8b53-8327195daa9e> and <https://www.sc.com.my/api/documentms/download.ashx?id=a0a47677-2527-4bc0-8bad-24f1f4715193><sup>3</sup> respectively.

Previously, any issuance of convertible notes (which fall under the definition of "debenture" under the Capital Markets and Services Act 2007 ("**CMSA**") to a VC or PE would require the prior approval or acknowledgment of the SC pursuant to Section 212(5) of the CMSA ("**SC Approval Regime**") unless such issuance and offering of convertible bonds is made to a VC and/or PE falling within the sophisticated investor class set out in Part I of Schedule 6 and/or Part I of Schedule 7 of the CMSA<sup>4</sup> for which SC's approval or acknowledgment would not be required provided the requirements under the LOLA Guidelines applicable to corporate bonds are fulfilled ("**Corporate Bonds Lodgement Regime**").

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<sup>1</sup> Pursuant to the Guidelines of Registration of Venture Capital and Private Equity Corporations and Management Corporation issued by the SC on 9 March 2015 and revised 16 April 2020

<sup>2</sup> Paragraph 6.06 of the FAQ on The Requirements of the LOLA Guidelines issued 9 March 2015 and revised 28 April 2020

<sup>3</sup> Note that the list on the SC website may not reflect the latest information.

<sup>4</sup> Issuances of bonds/sukuk to investors falling within any of the classes set out in Part I of Schedule 6 and/or Part I of Schedule 7 of the CMSA under the LOLA Guidelines regime merely require lodgment with the SC prior to issuance, rather than prior SC approval.



Under the CN Lodgement Regime, the issuance and offering of convertible bonds to VC and/or PE registered with the SC is exempted from compliance with the requirements under the LOLA Guidelines that are ordinarily applied to corporate bonds provided that the eligibility criteria as set out in the LOLA Guidelines are complied with.

The eligibility criteria for an issuance of conventional convertible notes pursuant to the CN Lodgement Regime are as follows<sup>5</sup>:

- (1) The issuance and offering must be solely to a person or persons registered with the SC under the *Guidelines on the Registration of Venture Capital and Private Equity Corporations and Management Corporation*;
- (2) Not transferable save and except to persons registered with the SC under the *Guidelines on the Registration of Venture Capital and Private Equity Corporations and Management Corporations*;
- (3) May only be convertible into shares of the issuer; and
- (4) Tenure must not exceed seven (7) years from the date of issuance.

A summary of the differences between the previous regimes and the CN Lodgement Regime are set out as follows:

Requirement	SC Approval Regime	Corporate Bonds Lodgement Regime	CN Lodgement Regime
Appointment of a Principal Adviser	Yes	Yes	No <sup>6</sup>
Appointment of a Lodgement Party	No	Yes <sup>7</sup>	No <sup>8</sup>
Appointment of a trustee	Yes, unless exempted under the CMSA	Yes, unless exempted under the CMSA	Yes, unless exempted under the CMSA

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<sup>5</sup> Chapter 2, Part 5 of Section B of the LOLA Guidelines

<sup>6</sup> Chapter 3, Part 5 of Section B of the LOLA Guidelines

<sup>7</sup> Paragraphs 3.04, 3.05, 3.06 and 3.08, Section A, Part 1 and Section B, Part 3 of the LOLA Guidelines

<sup>8</sup> Chapter 3, Part 5 of Section B of the LOLA Guidelines



Execution of a trust deed	Yes, unless exempted under the CMSA	Yes, unless exempted under the CMSA	Yes, unless exempted under the CMSA
Party responsible for submitting application for approval to or lodgement with SC	PA <sup>9</sup>	Lodgement Party	Issuer <sup>10</sup>
Due diligence exercise	Typically investors are not involved directly in the due diligence exercise which will be carried out by the principal advisor / lead arranger and their appointed counsel prior to lodgement	Typically investors are not involved directly in the due diligence exercise which will be carried out by the principal advisor / lead arranger and their appointed counsel prior to lodgement	The investors may have to conduct their own due diligence prior to lodgement
Conditions Precedent or Conditions Subsequent to the lodgement/issuance of the convertible notes	In practice, yes	In practice, yes	Depends on the investors
Principal Terms and Conditions / Lodgement Form	Yes	Lodgement Form <sup>11</sup>	Lodgement Form <sup>12</sup>  The format of the Lodgement Form may be downloaded from

<sup>9</sup> Paragraph 2.02(a), Chapter 2 of the Principal Adviser Guidelines issued by the SC on 8 May 2009 and revised on 3 August 2009.

<sup>10</sup> Chapter 3, Chapter 5, Section B of the LOLA Guidelines.

<sup>11</sup> Part 3, Section 1 of the Lodgement Kit

<sup>12</sup> Part 3, Section 1 of the Lodgement Kit



			this link: <a href="https://www.sc.com.my/api/documents/download.ashx?id=ebef0035-b094-472b-a22e-8cd7ca539eeb">https://www.sc.com.my/api/documents/download.ashx?id=ebef0035-b094-472b-a22e-8cd7ca539eeb</a>
Lodgement fee payable to SC	Yes	Yes	No
Revision fee payable to SC	Yes	Yes	No
Method of lodgement of information with the SC	Via email	Via SC's online submission system	Via email

[www.wongpartners.com](http://www.wongpartners.com)

Wong & Partners  
Level 21  
The Gardens South Tower  
Mid Valley City  
Lingkaran Syed Putra  
59200 Kuala Lumpur



### VC and PE as investors

The CN Lodgement Regime provides a quick and cost effective means for VC and/or PE investors registered with the SC to provide debt financing to Malaysian private companies in need of working capital. In the past, because of the extensive approval applications and/or lodgement procedures under the LOLA Guidelines, VC and/or PE investors seeking to provide early stage debt financing have traditionally been limited to investing in debt-like equity in the form of Ringgit-denominated redeemable preference shares.

Under the new Malaysian foreign exchange rules that came into force on 30 April 2020, there is now no longer any limit to the amount of Ringgit borrowing that can be raised by Malaysian companies through the issuance of tradeable convertible notes or redeemable preference shares. The formulation of these new rules enables SC registered foreign venture capital and private equity firms to invest in Malaysian companies via ringgit denominated convertible notes without limit.

The new expedited CN Lodgement Regime provides further flexibility to the types of instruments available to VC and/or PE investors and is a welcomed development for the industry.