GUIDANCE NOTE ON CONTROLS BY FUND MANAGEMENT COMPANIES IN MANAGING MATERIAL NON-PUBLIC INFORMATION

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CONTENTS

Page

PART I

INTRODUCTION AND OVERVIEW

Background and Purpose

1.1 The purpose of this *Guidance Note On Controls by Fund Management Companies In Managing Material Non-Public Information* is to assist Fund Management Companies (FMCs) in establishing and enhancing sound internal controls in managing material non-public information (MNPI) to prevent its misuse.

1.2 A person who misuses MNPI, whether as a principal or agent, may contravene the insider trading provisions in the *Capital Markets and Services Act 2007* (CMSA).

1.3 Insider trading is prohibited under section 188 of the CMSA and carries the penalty of imprisonment for a term not exceeding 10 years and fine not less than RM1 million upon conviction. What constitutes MNPI can be found in sections 183 to 187 of the CMSA.

1.4 The Securities Commission Malaysia (SC) conducted a thematic review to assess the practices and controls implemented by FMCs in managing MNPI including preventing wrongful usage of the same. Arising from this review and jurisdictional benchmarking conducted, this Guidance Note sets out best practices for the industry.

1.5 These best practices are not meant to be prescriptive and FMCs are expected to exercise its judgement in considering and adopting the best practices, taking into consideration the circumstances of the FMC including its size, scale and complexity of its organisation. Generally, FMCs are expected to enhance the practices and controls in place to uphold the principles of business conduct that promotes fair and orderly market as stipulated in the *Guidelines on Compliance Function for Fund Management Companies*.

1.6 This Guidance Note is applicable to FMCs licensed by the SC for fund management in relation to portfolio management pursuant to Paragraph 2.05 of the *Licensing Handbook*.

1.7 This Guidance Note should be read together with the relevant laws and regulations, and guidelines issued by the SC.

PART II

BEST PRACTICES

Governance

2.1 The board of directors is ultimately responsible in ensuring the adequacy, soundness and effectiveness of policies and procedures (P&Ps) for the prevention of misuse of MNPI.

2.2 The senior management should assume responsibility for the implementation of these P&Ps.

2.3 The compliance officer or designated officer should submit periodic reporting to the board of directors and/or senior management on MNPI matters such as incidents of non-compliance to the P&Ps and other concerns. In addition to periodic reporting, any misuse of MNPI must be reported immediately.

Policies and Procedures

2.4 FMCs should establish and implement effective P&Ps which would enable and facilitate the identification, control, monitoring and mitigation of risks as well as processes to escalate issues in relation to the misuse of MNPI. FMCs should also explore ways to promote better understanding of the P&Ps among its employees such as providing examples/illustrations of circumstances in which misuse of MNPI could typically arise.

2.5 The P&Ps should be accessible to all employees, and applicable to both the clients' investment and employees' personal account dealings.

2.6 FMCs should establish a whistleblowing channel to enable its employees to directly report misconduct relating to MNPI to an independent point of contact, the board of directors or senior management.

Controls

2.7 FMCs should assess MNPI-related risk as part of their risk assessment framework. In undertaking the assessment, FMCs should consider the circumstances of their business and operations including the types of clients that they have, products offered by the FMCs as well as the level of risks involved in respect of MNPI misuse. Such assessments would facilitate better identification and formulation of internal controls and mechanisms to adequately manage and mitigate MNPI-related risks.

2.8 The internal controls and mechanisms to manage and mitigate MNPI-related risk should be periodically reviewed to ensure their relevancy and effectiveness.

2.9 Some examples of potential MNPI-related risks as well as the best practices in managing the same are as follows:

(a) Consultations/Meetings/Engagements involving listed and to be listed issuers

FMCs should establish proper protocols to pre-empt or reduce the risk of procuring MNPI particularly in instances which involve listed and to be listed issuers. This may arise from FMCs undertaking company specific research.

(i) FMCs should consider assessing the risks of receiving MNPI prior to engaging with listed and to be listed issuers. For instance, FMCs might want to avoid any meetings during close period (i.e. period of time prior to publication of the company's financial results); and

(ii) If the meeting is unavoidable, FMCs should remind the relevant parties prior to the meeting that they should not disclose any MNPI.

(b) Handling and dissemination of information

(i) FMCs should consider establishing Chinese walls as well as clearance procedures to ensure proper handling and dissemination of MNPI. For example, FMCs should consider having functional separation by segregating dealing, research, and fund management. For small-scaled FMCs where functional separation is not feasible, FMCs should consider implementing controls as per paragraphs 2.9(b)(iii) and 2.10 to ensure any MNPI received are identified, contained and monitored to detect and mitigate abuse.

(ii) FMCs should consider physically restricting access to the designated functions in possession of MNPI.

(iii) FMCs should consider establishing and maintaining a "restricted list" (i.e. list of securities in which the FMC has in its possession MNPI) to prohibit the FMC's employees from trading or dealing in these securities for both clients (except for non-discretionary mandates) and personal accounts. Access to this list should be on "need to know" basis, for instance, where such information is required in order to carry out certain roles and responsibilities (e.g. pre-trade approvals and surveillance/compliance monitoring). Even then, disclosure should be limited to the securities that are restricted without revealing details of the MNPI.

(iv) FMCs should also maintain an "insider list" (i.e. list of employees who are in possession of MNPI) to facilitate more effective implementation of the P&Ps, including ensuring a more targeted monitoring of these employees in handling and dissemination of MNPI.

Monitoring and Surveillance

2.10 FMCs should conduct ongoing post-trade surveillance on risk-based approach to check and detect potential insider trading arising from the possession of MNPI. Such surveillance should cover both clients' investments and employees personal account dealings, and be conducted by an independent function such as Compliance.

2.11 FMCs should maintain timely and comprehensive records for the purpose of post-trade surveillance on any potential misuse of MNPI, including but not limited to the following:

(a) Rationale for investments/trading undertaken by the FMC for its clients;

(b) Register of company visits as well as reports/minutes/documents for each visit;

(c) Employee's pre-trade approval and post-trade notification; and

(d) Employee's annual disclosure of interest.

Personal Account Dealing

2.12 FMCs should have in place a policy pertaining to their employees' dealings in securities that are in line with the requirements as prescribed under the *Guidelines on Compliance Function for Fund Management Companies*. In addition to this, the P&Ps developed should facilitate the monitoring by FMCs towards better detection of MNPI misuse.

2.13 Additional measures such as imposing a minimum holding period for any securities acquired by employees might act as a deterrence to employees to trade on MNPI.

2.14 FMCs should consider obtaining authorisation from its employees (as well as their spouses) for the FMCs to access their CDS account balances to enable verification, if so deemed necessary.

Training on Material Non-public Information Risks

2.15 FMCs should provide adequate training to all its employees or at the very least relevant employees who are exposed to the risk of receiving MNPI, including but not limited to senior management, fund management and operation personnel and research analyst.

2.16 The training programmes should be undertaken on a regular basis and structured in accordance with the employee responsibilities and exposure to MNPI. The training programme should include the definition of MNPI, ways in which potential misuse could arise, consequences of breaching the P&Ps and the prohibition of insider trading under the CMSA.