



Suruhanjaya Sekuriti
Securities Commission
Malaysia

ISSUER ELIGIBILITY GUIDELINES

– STRUCTURED WARRANTS

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Chapter 1

GENERAL

Purpose

- 1.01 The Malaysian structured warrants market has gradually seen the introduction of new types of products to meet investors' demand. Since the first listings of single-stock call warrants in Malaysia in 1995, new and increasingly more complex varieties of structured warrants have been introduced to the market, such as basket warrants, bull equity-linked structures, index warrants, warrants on exchange-traded funds and put warrants. The increasing sophistication of these equity derivatives products calls for higher standards of business and risk management practices of issuers and distributors of the products.
- 1.02 The *Issuer Eligibility Guidelines – Structured Warrants* is issued by the SC under section 377 of the CMSA for the purpose of regulating the suitability of structured warrants issuers, with the objectives of maintaining market confidence and enhancing investor protection. These guidelines incorporate and build on the requirements relating to issuers of structured warrants as contained in the now disappplied *Structured Warrants Guidelines*, and are intended to–
- (a) set out the eligibility requirements for issuers of structured warrants; and
 - (b) provide guidance as to the SC's overall expectations on issuer's risk management practices, sales and marketing practices and internal control systems and procedures to manage conflict of interest.

Definitions

- 1.03 In these guidelines–

Bursa Securities	means Bursa Malaysia Securities Bhd.
BNM	means Bank Negara Malaysia.
CMSA	means the <i>Capital Markets and Services Act 2007</i> .
corporation	has the meaning given in section 2 of the CMSA.

distributor	refers to a holder of the Capital Market Services Licence or an investment bank appointed by the issuer as the selling or placement agent for structured warrants.
eligible brokers	means the collective reference to investment banks, universal brokers, special scheme brokers and 1+1 brokers.
fully-collateralised call warrants	means call warrants where the underlying financial instrument is shares quoted on Bursa Securities, the issue of which is accompanied by a deposit of all shares, which is the subject of such warrants, with a custodian under section 121 of the CMSA for the entire term of the warrants in issue.
investment bank	means an entity that holds a Capital Markets Services Licence under section 58 of the CMSA for the regulated activity of dealing in securities and a merchant banking licence under section 5 of the <i>Banking and Financial Institutions Act 1989</i> , and duly established under the <i>Guidelines on Investment Banks</i> issued jointly by BNM and the SC.
licensed institution	has the meaning given in the <i>Banking and Financial Institutions Act 1989</i> .
listing requirements	means <i>Bursa Securities Main Market Listing Requirements</i> .
non-collateralised structured warrants	means structured warrants where the underlying financial instrument is not held in deposit by a custodian under section 121 of the CMSA for the entire term of the warrants in issue.
performance guarantee	in relation to an issuer, means an unconditional and irrevocable guarantee to perform any and all of the issuer's obligations under the terms and conditions of the structured warrants issue in the event the issuer fails to perform such obligations.

prospectus	has the meaning given to that term under the CMSA, and includes the terms “base prospectus” and “term sheet” for the purposes of structured warrants.
related corporation	has the meaning given in section 4 of the <i>Companies Act 1965</i> .
SC	means the Securities Commission Malaysia.
securities	has the meaning given in section 2 of the CMSA.
shares	means shares of a corporation quoted on Bursa Securities or a securities exchange outside Malaysia.
special scheme broker	means foreign stockbroking company established under the <i>Application for Establishment of Foreign Stockbroking Companies Under the Special Scheme</i> .
structured warrants	means individually or collectively, as the context may require, call warrants, put warrants, bull equity-linked structures or such other structures as may be specified in the listing requirements from time to time.
stockbroking company	refers to a holder of a Capital Market Services Licence which carries on the business of dealing in securities as defined in Part 2 of Schedule 2 of the CMSA and is registered as a participating organisation under the <i>Rules of Bursa Malaysia Securities Bhd</i> .
universal broker	means a stockbroking company that has merged with or acquired at least three other stockbroking companies, and has satisfied all the conditions and requirements stipulated by the SC under the <i>Guidelines for a Universal Broker</i> .
1+1 broker	means a stockbroking company that has complied with the <i>Policy Framework for Stockbroking Industry Consolidation</i> and has acquired, taken-over, amalgamated or merged with at least one other stockbroking company.

Chapter 2

ELIGIBLE ISSUERS OF STRUCTURED WARRANTS

2.01 Any person may issue fully-collateralised call warrants subject to—

- (a) a custodian under section 121 of the CMSA or a company registered as a trust company under the *Trust Companies Act 1949* being appointed to hold the underlying shares and act in the interests of the warrant holders; and
- (b) the person complying with these guidelines, the listing requirements, and all other applicable laws relating to the issue, sale or offer of structured warrants.

2.02 An issue of non-collateralised structured warrants may only be undertaken by—

- (a) an eligible broker with a credit rating of at least investment grade or, where it does not possess the required credit rating, on whose behalf a performance guarantee has been issued by—
 - (i) its holding company having a credit rating of at least investment grade;
or
 - (ii) a financial institution with a credit rating of at least investment grade;
or
- (b) a licensed institution with a credit rating of at least investment grade.

For the purpose of this paragraph, the term “holding company” has the same meaning as given in section 5 of the *Companies Act 1965*.

Chapter 3

REQUIREMENTS ON ISSUERS

3.01 This section sets out the SC's overall expectations of the issuers in terms of risk management practices, sales and marketing practices and the management of conflict of interests.

Risk management practices

3.02 In undertaking structured warrants issuance activities, an issuer must practise the basic principles of prudence and ensure that it has–

- (a) adequate infrastructure for risk management;
- (b) adequate risk management processes that integrate sound measurement and valuation procedures, prudent risk limits, continuous risk monitoring and regular management reporting; and
- (c) comprehensive internal controls and audit procedures.

3.03 The board of directors and/or senior management of the issuer must ensure that they have effective oversight of the risk management practices of the issuer.

3.04 The board of directors and/or senior management of the issuer must ensure that prior to any issuance of structured warrants, the issuer must already have in place personnel with the necessary skills and knowledge to perform the risk management function. Any resignation of staff must not leave a gap in the capability of the issuer to manage risks. Therefore, the issuer must have in place a system which facilitates identification and training of replacement key personnel.

3.05 The board and/or senior management of the issuer should approve written policies and procedures which describe the overall framework for managing product risks. These policies should cover the following aspects:

- (a) Investment objectives/purpose of issuing structured warrants;
- (b) Definition of the parameters for the authorisation of new derivatives products or new variations of existing products. The authorisation process should be consistent and objective;

- (c) Identification, measurement and management of risks including the credit, market, liquidity, legal, operational, regulatory and extraordinary risks associated with the product¹;
- (d) Risk measurements and reporting methodologies that commensurate with the issuer's business strategies, size and complexity of its operations and risk profile of the product on an ongoing basis;
- (e) Clear delineation of lines of responsibility for managing product-related risks;
- (f) Provision of sufficient resources, which include competent staff and information technology systems and infrastructure to support the risk management and daily operations of the new/existing derivatives products;
- (g) Regular reviews of product's risk exposures to ensure all material risks are identified and monitored when market condition changes;
- (h) Reviews of stress scenarios, prepared by the business line responsible for risk monitoring, that measure the impact of market conditions that may cause volatility swings or reduced liquidity; and
- (i) Comprehensive and regular reports to the board and/or senior management that include the degree of compliance with policies and procedures for managing product risks, current assessment of product risks and any change in the direction of risks.

3.06 The board and/or senior management of the issuer should ensure comprehensive internal controls and audit function which include—

- (a) a review of the adequacy and effectiveness of the overall risk management system, including compliance with policies, procedures and risk limits; and
- (b) a check for adequacy of the various operational controls, including segregation of duties and staff's compliance with the established policies and procedures.

¹ The definitions for credit, market, liquidity, legal, operational, regulatory and extraordinary risks are given in Appendix 1.

- 3.07 The board and/or senior management of the issuer should also ensure that all policies and procedures are in place and are effective in monitoring the product risks on an ongoing basis.

Responsible sales and marketing practices

- 3.08 Issuers and distributors must have a set of policies and procedures on the product marketing and sales activities for structured warrants. Issuers and distributors must ensure that customers are fully informed through the appropriate disclosures on the key features and risks associated with the product.
- 3.09 Issuers and distributors must put in place a system for handling customer complaints. Distributors should provide regular reports to their senior management and also the issuer on the nature of customers' complaints, in order to identify areas for improvement, such as product features or disclosures or to rectify any misleading sales practices.
- 3.10 Issuers must have in place continuous educational programmes which could include seminars/workshops, media briefings, interviews etc to educate or create greater awareness on structured warrants among investors. At the very least, an issuer must carry out three seminars/workshops annually. The educational and/or marketing programmes must clearly explain the characteristics of structured warrants and their inherent risks.
- 3.11 Additionally, an issuer must maintain a dedicated webpage or website on structured warrants which contains–
- (a) educational documents/materials;
 - (b) the latest base prospectus;
 - (c) the term sheets; and
 - (d) an explanation of the issuer's role and obligation as a market maker (if applicable).

The webpage or website must be updated from time to time to reflect any new developments or current market practice.

- 3.12 Where distributors are appointed for–
- (a) the sale and marketing of structured warrants in a placement exercise; or
 - (b) carrying out sales and marketing of structured warrants on behalf of an issuer who is not an eligible broker or a licensed institution,

the issuer must advise its distributors to–
 - (i) conduct separate due diligence or “know your client” assessment before offering the structured warrants to investors; and
 - (ii) ensure that the personnel involved in sales have sufficient knowledge of the investment products when advising the customers.

Managing conflict of interest

- 3.13 An issuer must put in place supervisory and internal control procedures and systems to ensure that–
- (a) any potential conflict of interest is addressed;
 - (b) there are adequate and effective Chinese walls between the various divisions of the issuer’s business; and
 - (c) non-public information is not shared with unauthorised persons.
- 3.14 Where the issuer reasonably believes that there is a potential conflict of interest, it must take all reasonable steps to resolve or adequately mitigate the conflict.
- 3.15 The issuer must make full disclosure to the SC of the nature of the conflict of interest and the steps taken to address such conflict.
- 3.16 The issuer must also disclose any conflict of interest to its clients.

Chapter 4

SUPERVISORY ACTION

- 4.01 An issuer may be subjected to a formal review by the SC (which may include an interview and/or a request for information from the issuer) at any point in time to ensure that it has complied with the requirements of these guidelines and is still eligible.
- 4.02 The SC may, at its discretion, request for additional information and documents other than those specified in these guidelines.
- 4.03 The board and/or senior management of the issuer must ensure that the required conditions and requirements set out in these guidelines are adhered to at all times. If the issuer no longer meets the eligibility criteria and the required standards and principles as set out in these guidelines, the SC must be informed in writing of such failure to meet within five business days.
- 4.04 In a situation where the requirements under these guidelines are breached, the SC will impose appropriate supervisory action, which may include—
- (a) directing the issuer to recall any structured warrant offered;
 - (b) publishing details of corrective actions taken against the issuer; and
 - (c) suspension or removal of the issuer as eligible issuer for structured warrants.
- 4.05 The suspension or cessation of an issuer as eligible issuer for any reason, does not affect any of its obligations that arose when it made an issue of structured warrants.

Chapter 5

SUBMISSION OF DECLARATION

- 5.01 Subject to the requirements of paragraphs 5.02 and 5.03, an issuer must submit to the SC a declaration of compliance to these guidelines at least one month prior to submitting for registration with the SC–
- (a) the prospectus for a single issue of structured warrants; or
 - (b) the base prospectus for multiple issues of structured warrants.
- 5.02 An issuer of fully collateralised structured warrants, who is not an eligible broker or a licensed institution, would only need to declare compliance to paragraphs 2.01 and 3.12 of these guidelines. The declaration form is specified in Schedule 1.
- 5.03 Eligible brokers and licensed institutions wishing to issue collateralised or non-collateralised structured warrants, whether in a single issue or multiple issues, would need to declare compliance to all the requirements specified in these guidelines. The declaration form is specified in Schedule 2.
- 5.04 In the case where the issuer is an investment bank or a licensed institution which is subjected to BNM's *Guidelines on Introduction of New Products*, the issuer must include in the declaration that it has fulfilled the requirements of the said guidelines of BNM.
- 5.05 Any concerns of the SC in relation to the suitability of the issuer will be communicated in writing to the issuer within 14 days from the submission of the declaration to the SC.
- 5.06 Should the issuer not receive any objection from the SC within 14 days from the date of submitting the declaration, the issuer may proceed to submit its prospectus or base prospectus for registration with the SC. Such submission of prospectus or base prospectus must, however, be made within a period of six months from the date of submission of the declaration.
- 5.07 The SC reserves the right to request issuers to submit a fresh declaration to the SC if the prospectus or base prospectus is not submitted within six months from the date of submission of the declaration.

5.08 Submission of declaration must be made in three hard copies and addressed to:

The Chairman
Securities Commission Malaysia
3 Persiaran Bukit Kiara
Bukit Kiara
50490 Kuala Lumpur

(Attention: Issues and Investments Division)

Schedule 1

DECLARATION BY AN ISSUER OF COLLATERALISED STRUCTURED WARRANTS WHO IS NOT AN ELIGIBLE BROKER OR A LICENSED INSTITUTION

The Chairman
Securities Commission Malaysia

Dear Sir,

ISSUER: ...(Name of Issuer)...

We, ...(Name of issuer)..., are applying to be an eligible issuer under the *Issuer Eligibility Guidelines – Structured Warrants* (guidelines) issued by the Securities Commission Malaysia (SC).

1. We hereby confirm that we meet all the requirements in paragraphs 2.01 and 3.12 of the guidelines.
2. We undertake to inform the SC immediately if we are no longer able to comply with the requirements set out in the guidelines.
3. We undertake to provide the SC with all information as and when required in relation to qualifying as an eligible issuer of structured warrants.
4. We agree to be subjected to a review by the SC in relation to being an eligible issuer of structured warrants.
5. We declare that the information supplied herein is true and not misleading.

Yours faithfully,

Signature
(Signed on behalf of the Board)
Name of director:
Designation:
NRIC No*:
Date:

...(Signature)...

(Signed on behalf of the Board)

Name of director:

Designation:

NRIC No*:

Date:

* *National registration identity card number (or passport number if foreign national).*

Schedule 2

DECLARATION BY AN ELIGIBLE BROKER OR A LICENSED INSTITUTION AS AN ISSUER OF COLLATERALISED OR NON-COLLATERALISED STRUCTURED WARRANTS

The Chairman
Securities Commission Malaysia

Dear Sir,

ISSUER: ...(Name of Issuer)...

We, ...(Name of issuer)..., are applying to be an eligible issuer under the *Issuer Eligibility Guidelines – Structured Warrants* (guidelines) issued by the Securities Commission Malaysia (SC).

1. We hereby confirm that we meet all the requirements and are in adherence to the principles as stated in–
 - (a) the guidelines; and
 - (b) the *Guidelines on Introduction of New Products* issued by Bank Negara Malaysia (applicable to an issuer which is an investment bank or a licensed institution).
2. We undertake to inform the SC immediately if we are no longer able to comply with the requirements set out in the guidelines.
3. We undertake to provide the SC with all information as and when required in relation to qualifying as an eligible issuer of structured warrants.
4. We agree to be subjected to a review by the SC in relation to being an eligible issuer of structured warrants.
5. We declare that the information supplied herein is true and not misleading.

Yours faithfully,

Signature
(Signed on behalf of the Board)
Name of director:
Designation:
NRIC No*:
Date:

...(Signature)...
(Signed on behalf of the Board)
Name of director:
Designation:
NRIC No*:
Date:

* *National registration identity card number (or passport number if foreign national).*

Appendix 1

TYPES OF DERIVATIVES RISK

1. Credit risk

Credit risk is due to the counterparty's failure to perform an obligation to the intermediary. Credit risk in derivative products comes in two forms:

- (a) **Pre-settlement risk**, which is the risk of loss due to a counterparty defaulting on a contract during the life of a transaction. The level of exposure varies throughout the life of the contract and the extent of losses will only be known at the time of default.
- (b) **Settlement risk**, which arises when the counterparty fails to perform its obligation after an intermediary has performed its obligation under a contract on the settlement date.

2. Market risk

Market risk is the risk of loss due to adverse changes in the market value (the level or volatility of market prices). Market risk exposure occurs when there are changes in market factors, such as underlying interest rates, exchange rates, equity prices and commodity prices or in the volatility of these factors.

3. Liquidity risk

Intermediaries involved in derivatives activity face two types of liquidity risk, namely market liquidity risk and funding liquidity risk.

- (a) **Market liquidity risk** is the risk that an intermediary may not be able to exit or offset positions quickly, in sufficient quantities, and at a reasonable price. This inability may be due to inadequate market depth or market disruption.
- (b) **Funding liquidity risk** is the inability of the intermediary to meet funding requirements because of cash flow mismatches. Cash flow mismatches may occur during exercise of options and the implementation of dynamic hedging strategies.

4. Legal risk

Legal risk arises from contracts which are not legally enforceable. The causes of legal risk include non-recognition of a derivative contract under the laws of a particular country, the counterparty does not have the power or authority to enter into a particular type of derivatives transaction, incorrect documentation and allegations of misrepresentation .

5. Operational risk

Operational risk is the risk of loss occurring as a result of inadequate systems and control. It is due to deficiencies in information systems, human error, or inadequate procedures and controls. Due to the complexity of certain products and their continual evolution, certain derivatives activities may cause an increase in operational risk.

6. Regulatory risk

Regulatory risk is the risk arising from the nature of or changes to the legal, taxation and other relevant regulatory frameworks.

7. Extraordinary risk

Extraordinary risk is due to the occurrence of an unexpected event such as natural disaster, collapse of the exchange trading system or recession.