

# **GUIDELINES ON PRODUCT GOVERNANCE**

**SC-GL/3-2025**

1<sup>st</sup> Issued: 24 June 2025

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Effective Date upon 1 <sup>st</sup> Issuance:	2 January 2026
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## Chapter 1

### INTRODUCTION

- 1.01 The *Guidelines on Product Governance* (Guidelines) is issued by the Securities Commission Malaysia (SC) pursuant to section 377 of the *Capital Markets and Services Act 2007* (CMSA).
- 1.02 The product governance framework embodies controls, policies and procedures (CPPs) that are put in place across the lifecycle of unlisted capital market products. These CPPs, among others, ensure that unlisted capital market products are designed and distributed to the identified target market, and perform in the manner the investor has been led to expect. The firm's board of directors is responsible for putting in place an effective product governance framework while the firm's senior management is responsible for monitoring the continued effectiveness of the firm's product governance framework.
- 1.03 An effective product governance, which includes robust information sharing between product issuers and product distributors, is also essential for designing products that meet the likely needs and objectives of investors. Both product issuer and product distributor must maintain clear, open channels of communication and share relevant information regularly to ensure products are sold appropriately and continue to serve its intended purpose as well as to minimise any risk of investors' interests being compromised.

## Chapter 2

### APPLICABILITY

- 2.01 The Guidelines applies to a product issuer and a product distributor that issues or distributes unlisted capital market products, except the following:
- (a) Ordinary shares;
  - (b) Over-the-counter derivatives contracts that are customised specifically for an investor;
  - (c) Venture capital or private equity funds; and
  - (d) Products hosted or funds raised on the platform of a recognized market operator or initial exchange offering operator that is registered by the SC.
- 2.02 A product issuer and a product distributor must comply with the requirements in the Guidelines for a product that–
- (a) is issued and only made available to investors after the effective date of the Guidelines; or
  - (b) is existing but have undergone significant changes to the structure, feature and risk profile of the product, and made available to investors after the effective date of the Guidelines.
- 2.03 Notwithstanding paragraph 2.02(a), in relation to corporate bond or sukuk that is issued under a programme, the product issuer and product distributor of a corporate bond or sukuk is only required to comply with the requirements in the Guidelines based on programme for issuances with the same structure, features, and risk profile.
- 2.04 The product issuer's board of directors must identify a person from senior management to assess changes to the structure, feature and risk profile of an existing product for purpose of determining whether such change constitutes a significant change under paragraph 2.02(b). In making such determination, that person must evaluate the risk implications from the perspectives of both the product issuer and investors. The basis for such determination must be clearly documented and maintained.
- 2.05 The Guidelines must be read together with the relevant provisions in the securities laws and the relevant guidelines issued by the SC including the *Guidelines on Conduct for Capital Market Intermediaries* and *Guidelines on Advertising for Capital Market Products and Related Services*.

- 2.06 The Guidelines is in addition to and not in derogation of any other guidelines issued by the SC or any requirements as provided for under the securities laws.
- 2.07 Where a firm is subject to more than one product governance requirements, the stricter requirement shall prevail.
- 2.08 To assist with the interpretation and application of the requirements under the Guidelines, guidance has been provided, where appropriate. Any departure from the guidance provided will be taken into consideration in the SC's assessment on whether a breach of the Guidelines has occurred.
- 2.09 The SC may, upon application, grant an exemption from, or a variation to, the requirements of the Guidelines if the SC is satisfied that–
- (a) such variation is not contrary to the intended purpose of the relevant provisions in the Guidelines; or
  - (b) there are mitigating factors which justify such exemption or variation.

## Chapter 3

### DEFINITIONS

3.01 Unless otherwise defined, all words used in the Guidelines shall have the meanings assigned to them in the CMSA. In the Guidelines, unless the context otherwise requires:

adviser means a person licensed or registered to provide corporate finance advice and appointed by the issuer for the design or issuance of the unlisted capital market product;

firm means a product issuer and a product distributor;

product distributor means any person who markets and sells an unlisted capital market product, who may or may not be a product issuer;

product issuer means any person who issues an unlisted capital market product and includes an adviser.

For the avoidance of doubt, a product issuer includes persons who are eligible to issue structured products as specified under the *Guidelines on Unlisted Capital Market Products under the Lodge and Launch Framework*;

unlisted capital market product or product means a capital market product, whether issued in or outside Malaysia that is not listed and traded on the stock exchange, or traded on the derivatives exchange in Malaysia.

For the purpose of the Guidelines, 'unlisted capital market product' includes corporate bonds or sukuk under the Exempt Regime of Bursa Malaysia Securities Bhd. Under the 'Exempt Regime', corporate bonds or sukuk are listed on the Main Market of Bursa Malaysia Securities Bhd but are not quoted and traded on the Main Market.

## **Chapter 4**

### **PRODUCT GOVERNANCE**

#### **General**

- 4.01 Product governance requires a firm to consider and give due regard to the interests of investors, at all stages of the product lifecycle, namely the design, distribution, and after-sale stages.
- 4.02 Product governance seeks to align the firm's interest with that of the investors' interests. Product governance through its CPPs ensures that the products are designed and distributed to the identified target market and perform in the manner that the investors have been led to expect. Product governance CPPs must therefore identify, manage and mitigate risks that result from the misalignment of the firm's interest with that of investors' interests.
- 4.03 At the heart of effective product governance is the need for the firm to have the right culture. The firm's board of directors through its leadership can ensure that the firm has the right culture in giving due regard to investors' interests.
- 4.04 The Guidelines sets out the obligations which must be performed by the firm in order to achieve the outcomes that are outlined in the Guidelines.



## Chapter 5

### DESIGN OF PRODUCT

- 5.01 At the product design stage, a product issuer's product governance CPPs must ensure that—
- (a) the product is designed to meet the likely needs and objectives of an identified target market;
  - (b) the distribution strategy of the product is compatible with the identified target market;
  - (c) reasonable steps are taken so that the product is only made available to the identified target market; and
  - (d) prior approval is obtained from the board of directors or senior management before the launch of the product.

#### Target market

- 5.02 Central to the product governance framework is identification of the target market. A product issuer must identify the target market for each product and take reasonable steps to ensure that such product will only be made available to the identified target market. This measure seeks to reduce the risk of product mis-selling even before the point of sale of such product.

#### **Guidance to paragraph 5.02**

The product issuer should consider the following factors when identifying the target market of a product:

- (a) The type of investors to whom the product is targeted;
- (b) The knowledge and experience of the target investors. The product issuer should consider the knowledge that the target investors should have in order to understand the product. The product issuer should also consider how much experience the target investors should have before investing in the product;
- (c) The financial situation of the target investors. The product issuer should consider the percentage of losses the target investors should be able and willing to afford and if there are any additional payments that is over and above the amount invested;

- (d) The risk-return profile of the product. The product issuer should consider the risk tolerance and compatibility of the risk and reward profile of the product with the target investors; and
- (e) The likely investment objectives and needs of the target investors. The product issuer should consider the likely investment objectives and needs of the target investors that the product is compatible with. Examples of specific investment objectives includes capital growth, capital preservation, regular income or payment.

5.03 The product issuer must identify the target market for each product at a sufficiently granular level to avoid the inclusion of any investor for whose needs and objectives are not compatible.

**Guidance to paragraph 5.03**

The level of granularity of the target market should make it possible for a firm to assess which investors fall within the target market.

A product issuer should determine the granularity of the target market in a proportionate manner, based on the complexity as well as risk and level of risk of the product. For products that may be regarded as not complex which may be distributed via an execution-only transaction basis, the target market may be identified with less detail. On the other hand, for more complex products that should be distributed on an advised basis, the target market should be identified with more detail.

**Pre-launch testing**

5.04 Before a product is launched, the product issuer must test if the product meets the needs and objectives of the identified target market.

5.05 As such, a scenario analysis must be conducted by the product issuer on the product prior to the launch of the product, to assess the following:

- (a) The product is likely to be consistent with the likely needs and objectives of the identified target market; and
- (b) The benefit of the product to target investors under different market conditions to determine its likely benefit or value to such investors.

### **Guidance to paragraph 5.05**

When conducting the scenario analysis, the product issuer should consider how the product is expected to perform under average market conditions as well as under negative market conditions, by taking into account, among others, the impact of fees and costs. This may require the assessment on how the product features are likely to operate in practice and how these may affect investor outcomes.

For example, the expected investment return from the product should be considered. If fees and costs effectively deplete the return that investors are expected to receive, the product issuer should take this into account when critically assessing if the product is likely to be consistent with the likely needs and objectives of the identified target market.

- 5.06 If the results from the scenario analysis show that the product is not likely to be consistent with the likely needs and objectives of the target market, the product issuer is required to either adjust the design of the product or modify the target market to ensure better investor outcomes.

### **Distribution strategy**

- 5.07 Apart from identifying target market, the product issuer must take reasonable steps that will, or are reasonably likely to, result in distribution of the product being consistent with the identified target market. In complying with this requirement, the product issuer must, among others, set an appropriate distribution strategy for the product.
- 5.08 In setting the distribution strategy of the product, the product issuer must consider all circumstances relating to the product's distribution including—
- (a) the distribution channels and methods;
  - (b) the marketing and promotional materials; and
  - (c) selection of product distributors.

### **Guidance to paragraph 5.08**

#### *Distribution channels and methods*

A product issuer should consider the characteristics and the identified target market of the product in determining an appropriate distribution channel and method. For example, it may not be appropriate to distribute a product that is regarded as more complex on a non-advised basis via an execution-only transaction.

#### *Marketing and promotional materials*

The product issuer should also evaluate the promotional materials and marketing campaigns to ensure they are strategically aligned for direct distribution to the product's identified target market. For example, mass market advertising or online advertisement is generally not appropriate for a product with a narrow target market.

#### *Selection of product distributors*

The product issuer should select product distributors whose clients are consistent with the target market for the product. The product issuer should assess the capacity of the product distributor to comply with the distribution strategy and meet its own obligations as a product distributor. Such assessment would include consideration of relevant factors such as the product distributor's resources, internal controls, past conduct, experience with the target market and competence to distribute the product to the target market.

- 5.09 The product issuer must also adequately supervise and monitor the distribution of its product, having regard to the identified target market for the product and the potential harm on an investor outside of the identified target market acquiring the product. If the product issuer has any reason to believe that the distribution of the product is or is likely to be inconsistent with the identified target market, steps must be taken to align the distribution efforts towards the identified target market of the product.

### **Product approval**

- 5.10 The product issuer's board of directors or senior management must approve all new products as well as any existing products that have undergone significant changes before they are made available to the identified target market. Prior to giving its approval, due consideration must be given to the following:

- (a) The objective of introducing the product as well as the identified target market of the product;

- (b) The key features of the product and the method of distribution;
- (c) The assessment of the potential risks associated with the product, and how these risks will be managed and disclosed to investors;
- (d) The appropriateness of the product for its identified target market including whether any fees or charges imposed is fair, and whether the product's distribution strategy is consistent with the product's identified target market;
- (e) The skills, expertise and resources required to manage any risk associated with the product throughout the product's lifecycle. This may also require controls to be put in place to identify and manage any risk;
- (f) The disclosures relating to the product including any promotional material; and
- (g) Whether the product fully complies with all applicable legal and regulatory requirements or restrictions, including a description of any unresolved legal or regulatory issues.

### **Information disclosure to product distributors**

- 5.11 The product issuer must make available all relevant product information to its product distributors, including the following:
- (a) The product's identified target market; and
  - (b) The distribution strategy of the product.
- 5.12 The information provided to the product distributors in paragraph 5.11 must enable the product distributors to understand and recommend or sell the product appropriately.

### **Proper record maintenance**

- 5.13 The product issuer must ensure that complete and accurate records are maintained in respect of decisions made in relation to the identified target market, and any scenario analysis conducted, including reasons behind the decisions and its underlying data. The records maintained by the product issuer must also include the approval referred to under paragraph 5.10 and information which has been shared with the product distributor.

## Chapter 6

### DISTRIBUTION OF PRODUCT

- 6.01 The product distributor's governance framework must comprise CPPs that are designed with the view to ensure that—
- (a) the product distributor understands the product that is intended to be distributed to investors; and
  - (b) the product is only distributed to investors in the target market identified by the product issuer.
- 6.02 For avoidance of doubt, in the case where the product issuer is also the product distributor, the product issuer's CPPs must also include what has been specified for the purposes of a product distributor's governance framework.

### Obtaining information from product issuer

- 6.03 The product distributor is required to take all reasonable steps to gain the necessary knowledge and understanding of the product it intends to distribute to investors. These steps include requiring the product issuer to provide additional information or training, if necessary.

### Target market and distribution strategy

- 6.04 Upon receiving the identified target market from the product issuer, the product distributor must assess the appropriateness of the identified target market and form an independent conclusion as to the appropriateness of its client segments being targeted.

#### **Guidance to paragraph 6.04**

In assessing the appropriateness of the identified target market, the product distributor may consider, among other matters,—

- (a) whether its target clients are able to understand the product, given its characteristics and level of complexity; and
- (b) whether the product's objectives, characteristics (including risk and return) and associated cost and fees are likely to be appropriate for the target clients.

- 6.05 The product distributor must ensure that the product is not distributed to a non-intended target market. In doing so, the product distributor must assess and determine whether its intended distribution strategy will, in fact, result in the product being distributed only to the identified target market.
- 6.06 The product distributor must ensure that complete and accurate records are maintained in respect of decisions made in relation to its product promotion and distribution and any reviews conducted, including reasons behind the decisions and its underlying data. The records maintained by the product distributor must also extend to any information which has been obtained from and shared with the product issuer.

#### **Distribution of product issued by foreign product issuer**

- 6.07 In the case of a product designed by a foreign product issuer which is subject to applicable product governance requirements, the product distributor must obtain all relevant product information as set out in paragraph 5.11 from the foreign product issuer, in order to comply with the requirements provided in this chapter.
- 6.08 In the case of a product designed by a foreign product issuer which is not subject to any applicable product governance requirements, the product distributor must take reasonable steps to comply with the requirements provided under paragraph 6.09.
- 6.09 The product distributor must put in place effective arrangements to ensure that it obtains adequate and reliable information from the foreign product issuer about the product to ensure that the product will be distributed to an appropriate target market.

## **Chapter 7**

### **POST-SALE OF PRODUCT**

- 7.01 The requirements in this chapter do not apply to a product issuer who is an adviser.
- 7.02 The product issuer's CPPs must include a review on the products issued, as and when necessary. The product review is to assess whether the product is in fact performing in the manner that the investor has been led to expect. The review must focus on whether—
- (a) the product remains consistent with the needs and objectives of the identified target market;
  - (b) the distribution strategy remains appropriate; and
  - (c) information on product performance, if any, that has been disclosed to investors remain accurate.
- 7.03 The product issuer must also take remedial measures to address any issues raised from the product review. The remedial measures taken by the product issuer must give due regard to investors' interests. The remedial measures may include ceasing further issuance of the product, contacting investors to inform them of the defect discovered and how the product issuer will remedy the defect.
- 7.04 Where remedial measures have been taken, the product issuer must notify the SC of these measures as soon as practicable.
- 7.05 The product distributor must also review the appropriateness of the identified target market of the product it distributes as well as the product's distribution strategy, as and when necessary. Feedback must be provided to the product issuer so that appropriate changes can be made to the product design and distribution strategy.