



**PUBLIC CONSULTATION PAPER**

**NO. 1/2010**

**REVIEW OF SOPHISTICATED INVESTORS  
AND  
SALES PRACTICES FOR CAPITAL MARKET PRODUCTS**

The Securities Commission Malaysia (SC) invites your written comments on the issues set out in this consultative paper. Comments are due by **30 April 2010** and should be sent to:

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This Public Consultation Paper is dated 19 March 2010

## **EXECUTIVE SUMMARY**

### **1. Introduction**

- 1.1 In order to promote the development of the capital market a robust regulatory framework which will protect and enable investors to have access to a wide variety of capital market investment products and services is essential. Access to products and services must be complemented with adequate safeguards so as to ensure that investors' interests are not compromised.
- 1.2 With this in mind, the SC consistently reviews the capital market's regulatory framework to ensure that it remains robust and that it is able to support the development of the Malaysian capital market without compromising investor protection.
- 1.3 Through the Investor Affairs and Complaints Department, SC has received numerous complaints on inferior sales practices of retail capital market product sales personnel especially by unit trust agents. Examples of complaints relating to sales practices are verbally guaranteeing large returns, non-disclosure of risks of the fund to clients and inducement to invest large amount of monies with improper and conflicting advice to clients.
- 1.4 Due to the number of cases lodged with the SC over the years, the SC regards that it is timely that a review of the current regime on the sales of capital market products is undertaken together with the classification of "sophisticated investors". Hence, this consultation paper which consists of two parts is published with a view to enhance investor protection, which can in turn increase confidence in the Malaysian capital market.
- 1.5 Part 1 of this paper is intended to generate discussion and to obtain views from the public in respect of proposals to review the current criteria used to determine who is a sophisticated investor. Further, this paper also discusses proposals which seek to extend the existing categories of "sophisticated investors".

- 1.6 Part 2 of this paper is intended to generate discussion and to obtain views from the public in respect of proposals relating to sales practices. In view of the number of complaints filed with the SC on inferior sales and conduct practices in respect of capital market products, this paper will serve as a platform to seek views to review and strengthen the sales practices regime in the capital market. The SC's efforts in this area is timely as capital market regulators globally are also currently reviewing their respective sales practices regimes as a result of the financial debacle caused by the recent global financial crisis where investors have suffered heavy losses.
- 1.7 Taken together, the proposals set out in this consultation paper are intended to reinforce as well as strengthen the investor protection framework that is currently embedded within the capital market regulatory framework.
- 1.8 The responses to the consultation questions posed in this paper will assist the SC in formulating a robust regulatory framework that would support the continued growth of a vibrant capital market.

## **PART 1**

### **REVIEW OF CATEGORIES OF INVESTORS WHO ARE REFERRED TO AS "SOPHISTICATED INVESTORS"**

#### **1.1 Background**

- 1.1.1 Following complaints received from investors who had invested in complex capital market products such as Lehman's mini bonds and accumulators, the Securities and Futures Commission of Hong Kong (SFC) as well as the Monetary Authority of Singapore (MAS) have renewed their respective framework on sales practices with the view to enhance investor protection. In this regard, proposals to tighten the existing criteria as to who qualifies as a sophisticated investor have also been considered.
- 1.1.2 Although products such as Lehman's mini bonds and accumulators were not marketed to investors in Malaysia, the SC is of the view that it is timely to review the existing criteria

used to determine who qualifies as a sophisticated investor for the purposes of product offering. This is necessary as a greater diversity of capital market products may be offered to investors in Malaysia as a result of connectivity and integration of markets. Some of these products are complex investment products that should only be offered to sophisticated investors who have the financial means or knowledge to invest in such products.

## **2.1 Current framework**

2.1.1 The determination as to whether an investor is a “sophisticated investor” or a “retail investor” is important for several reasons. First, only sophisticated investors should have access to complex and risky capital market investment products such as structured products and units in wholesale funds<sup>1</sup>. This approach is consistent with the SC’s regulatory policy of not encouraging retail investors to have exposure to complex investment products, as retail investors may not have the necessary knowledge and risk tolerance to invest in such products.<sup>2</sup> Second, the disclosures that are to be made to retail investors are more extensive and prescriptive as opposed to the disclosures that are made to sophisticated investors. For example, when an offering of securities is made to retail investors, the offering must be accompanied with a registered prospectus.

2.1.2 The term “sophisticated investor” is not explicitly defined in the Capital Markets and Services Act 2007 (CMSA). However, Schedules 6 and 7 of the CMSA exempt the following investors and transactions from prospectus requirements:

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<sup>1</sup> For example, the Guidelines on the Offering of Structured Products provides that an issue, offer or invitation of unlisted structured products can only be made to investors listed in Schedules 2 and 3 of the SCA (now Schedules 6 and 7 of the Capital Markets and Services Act). The Guidelines on Wholesale Funds states that units in a wholesale fund can only be offered to qualified investors. Qualified investors include an individual whose total net personal assets exceed RM3 million or its equivalent in foreign currencies or a corporation with total net assets exceeding RM10 million or its equivalent in foreign currencies based on the last audited accounts.

<sup>2</sup> Moving forward the SC may consider whether retail investors should have exposure to some of these products particularly structured products and unlisted debt securities. Exposing retail investors to such products will however be complemented with an enhanced sales practices regime. Proposals to enhance the existing sales practices regime are further discussed in Part 2 of this paper.

- (a) A unit trust scheme or prescribed investment scheme;
- (b) A holder of a Capital Markets and Services Licence who carries on the business of dealing in securities;
- (c) A holder of a Capital Markets and Services Licence who carries on the business of fund management;
- (d) The aggregate consideration for the acquisition is not less than RM250,000 or its equivalent in foreign currencies for each transaction whether such amount is paid for in cash or otherwise;
- (e) An individual whose total net personal assets exceed RM3 million or its equivalent in foreign currencies;
- (f) A corporation with total net assets exceeding RM10 million or its equivalent in foreign currencies based on the last audited accounts;
- (g) A licensed offshore bank under the Offshore Banking Act 1990;
- (h) A licensed offshore insurer under the Offshore Insurance Act 1990;
- (i) A licensed institution under the Banking and Financial Institution Act 1989 or an Islamic Bank under the Islamic Banking Act 1983;
- (j) An insurance company registered under the Insurance Act 1996;
- (k) A statutory body established by an Act of Parliament or an enactment of any State; and
- (l) A pension fund approved by the Director General of Inland Revenue.

- 2.1.3 The above classification was adopted in year 2000 by the Securities Commission ("SC") when the prospectus requirements for the offer and invitation of securities were moved from the Companies Act 1965 to the Securities Commission Act 1993 via the Securities Commission (Amendment) Act 2000.
- 2.1.4 In drafting the excluded offers above, the SC has adopted and expanded the exempted offers list which existed under section 47B of the Companies Act 1965 and the Companies (Exempt Purchasers) Order 1997. Since year 2000, no review has been undertaken on the classification of "sophisticated investors".
- 2.1.5 Although the original intention behind Schedules 6 and 7 of the CMSA<sup>3</sup> was to clarify situations when an offer of securities would not need to be accompanied with a registered prospectus, over time, the use of the Schedules have expanded and are now used as a means to determine who are sophisticated investors for the purposes of offering complex investment products.

### **3. QUALIFYING CRITERIA AND CLASSIFICATION OF "SOPHISTICATED INVESTORS"**

#### **3.1 Qualifying criteria and classification of "sophisticated investors"**

3.1.1 Our research indicates that the qualifying criteria to determine whether a person is a "sophisticated investor" can be either one or more of the following:

- (a) the ***financial means test*** where consideration would be given to the net assets, portfolio of investments held by the investor or the income earned by the investor. In some jurisdictions, this test may take into account assets, portfolio of investments or income that is held or received jointly by the investor and his immediate family members. Where these criteria are imposed on an individual and that individual satisfies the criteria, that individual is usually referred to as a ***high net worth individual***. Where an entity satisfies this criteria, that entity is then referred to as a ***high net worth entity***, and

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<sup>3</sup> Schedules 6 and 7 of CMSA were in fact Schedules 2 and 3 of the Securities Commission Act 1993.

- (b) the ***requisite knowledge test*** where consideration is given to the knowledge that is presumed to be held or exhibited to be held by the investor. Some jurisdictions impose the knowledge test as an additional criterion that must be satisfied by an individual who has met the financial means test. The reason for imposing this additional knowledge requirement is that once it is satisfied, certain processes in respect of sales practices need not be observed when dealing with such investors<sup>4</sup>. In some cases, the investor concerned is deemed to have such knowledge where it involves entities which have been licensed or whose ordinary course of business includes making investments. These include licensed banks, corporations, unit trust funds, collective investment schemes and those who hold a licence to carry out a regulated activity. This category of sophisticated investors is commonly referred to as ***professional investors***.

## **3.2 High net worth individuals**

### **Current framework**

- 3.2.1 Within Schedules 6 and 7 of the CMSA, there exists a category of sophisticated investors who can be described as high net worth individuals. To qualify as a high net worth individual, the individual concerned must have a total net personal assets exceeding RM3 million or its equivalent in foreign currencies.<sup>5</sup>

### **Comparison with other jurisdictions**

- 3.2.2. The table below provides how other jurisdictions set their respective qualification for high net worth individuals.

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<sup>4</sup> This is further discussed below in paragraphs 3.7.2 onwards.

<sup>5</sup> Paragraph 10 of Schedules 6 and 7 of CMSA.

| Singapore   | Hong Kong   | Australia  | UK  | US   |
|---|---|--|---|--|
| <p>“Accredited investor” includes an individual:</p> <p>(a) whose net personal assets exceed in value SGD2 million (or such other amount as the Monetary Authority of Singapore (MAS) may prescribe); or</p> <p>(b) whose income in the preceding 12 months is not less than SGD300,000 (or such other amount as MAS may prescribe)</p> | <p>Portfolio of at least HKD\$8 million (either alone or with his spouse or children)</p> | <p>“Wholesale client” if the financial product is not provided for use in connection with a business and before the provision of the product, the client gives to the provider a copy of a certificate issued within the preceding 6 months by a qualified accountant stating that the client has -</p> <p>(a) net assets of at least AUD2.5 million; or</p> <p>(b) gross income of at least AUD250,000 per annum for each of the last 2 financial years</p> | <p>Net assets of at least £250,000 excluding primary residence, rights under contract of insurance or pension benefits on death or retirement</p> | <p>“Accredited investor” includes a natural person:</p> <p>(a) whose individual net worth, or joint net worth with his/her spouse exceeds USD1 million at the time of purchase; or</p> <p>(b) who had an individual income in excess of USD200,000 in each of the 2 most recent years or joint income with his/her spouse in excess of USD300,000 in each of those years and has a reasonable expectation of reaching the same</p> |



| Singapore | Hong Kong | Australia | UK | US                               |
|-----------|-----------|-----------|----|----------------------------------|
|           |           |           |    | income level in the current year |

### 3.3 Discussion and research on high net worth individuals

- 3.3.1 As can be seen in the above benchmarking exercise, the qualifying criteria of high net worth is evidenced both by net personal assets and net income.
- 3.3.2 In Malaysia, there is a general increase in net worth as evidenced by the steady increase in per capita income from year 2001 (RM16,116) to year 2007 (RM20,322)<sup>6</sup>.
- 3.3.3 Also, in year 2007, the US SEC had recognized that the wealth definitions in Regulation D (Regulation for Large Accredited Investors) enacted in 1982 have been superseded by inflation and had proposed that the definitions be indexed to inflation in the amendment proposals to Regulation D that year. If one were to index RM 3 million to inflation, the future value of RM3 million 10 years ago is now RM 4,614,516.91 (based on an average of 4.4% risk free interest rates i.e. 10 year government bond).
- 3.3.4 Our soft consultations indicate that many Malaysian investors treated as “sophisticated investors” have net worth far exceeding RM 3 million. This includes the value of all their assets and properties.
- 3.3.5 In comparison with other jurisdictions, the existing minimum net asset requirement in Malaysia is lower than in some jurisdictions: in Singapore, for example, the minimum net asset requirement is SGD2 million (around RM4.9 million) while it is AUD2.5 million in Australia (around RM7.8 million). However, the minimum net asset requirement in Malaysia is higher than that of the United Kingdom which is £250,000 (around RM1.4 million). In the UK however, the determination of net worth excludes the value of the investor’s primary residence and death and retirement benefit.

<sup>6</sup> Jabatan Statistik dan Perangkaan Malaysia.

- 3.3.6 In a research by UBS Research quoted in The Star newspaper on 27 June 2009 it is reported that the value of residential property in Malaysia is forecasted to increase 10% to 15% per annum in year 2010 to 2012.
- 3.3.7 A survey done by the Valuation and Property Services Department of the Ministry of Finance also shows that from 2005 to 2008 the number of property transactions for residential property worth more than RM1 million has been steadily increasing (Appendix 1). It can be inferred from these two research findings that a RM1 million or more residential property will be commonplace in the very near future especially in the urban areas of Malaysia.
- 3.3.8 Based on the empirical evidence, jurisdictional benchmarking and industry feedback as discussed above, we are of the view that it is now timely to review our existing qualification for high net worth individual.
- 3.3.9 In conducting this review SC is aware that any excessive increase in the minimum net asset threshold may have unintended consequences such as restricting access to certain capital market products. Further, any proposed amendments to Schedules 6 and 7 may also contribute to an increase in compliance costs, because persons who are excluded from these Schedules would require a registered prospectus to be issued to them when an offer of securities is made to them. It is for these reasons that the SC would like to seek public feedback on the following issues.

**The public's views and comments are sought with respect to:**

- 1. Should the net asset threshold for a high net worth individual be increased? If yes, what should the net asset threshold value be? What would the consequences be if the net asset threshold for a high net worth individual is increased?**
- 2. Should the net asset threshold take into account the net worth of both the investor and his/her spouse in combination?**
- 3. Should a portfolio of investments of a certain amount be included as one of the criteria to qualify as a high net worth individual? If yes, what should the value of the portfolio of investments be? Should this threshold include the portfolio of investments held by a spouse or children? Should this criterion stand alone or be read as an alternative or additional criterion to the net asset threshold for a high net worth individual?**
- 4. Should an annual income threshold be included as one of the criteria to qualify as a high net worth individual? Should this threshold include the income received by a spouse? What should the annual income threshold be? Should this criterion stand alone or be read as an alternative or additional criterion to the net asset threshold for a high net worth individual?**
- 5. Should the value of primary residence be excluded when computing the net asset threshold for a high net worth individual?**
- 6. Should the high net worth threshold take into account the investor's experience in investment holding? If so, what would be the appropriate criteria to apply in determining an investor's experience in investment holding?**
- 7. Should the additional criteria of requisite knowledge be applied to a high net worth individual?**

### 3.4 High net worth entity

3.4.1 Within Schedules 6 and 7 of the CMSA, there is a category of sophisticated investors who are high net worth entities. To qualify as a high net worth entity, the entity concerned must be a corporation with total net assets exceeding RM10 million or its equivalent in foreign currencies based on the last audited accounts<sup>7</sup>.

#### Comparison with other jurisdictions

3.4.2 The table below shows how other jurisdictions set their respective qualification for high net worth entity.

| Singapore  | Hong Kong  | Australia   | UK  | US  |
|--|--|---|---|---|
| Accredited investor includes–<br><br>(a) A corporation with net assets exceeding SGD10 million in value (or such other amount as MAS may prescribe); or<br><br>(b) Trustee as may be prescribed by MAS | (a) A corporation or partnership having a portfolio of at least HKD\$8 million;<br><br>(b) A corporation or partnership having total assets of at least HKD\$40 million; or<br><br>(c) A trust corporation having been entrusted with total assets of at least | Wholesale client includes a purchaser that controls at least AUD 10 million | Body corporate:<br>Called up share capital or net asset of not less than £500,000 (>20 members) or £5 million (<20 members)<br><br><b>MiFID</b> <sup>8</sup><br><br>(a) A body corporate whose shares are listed for trading on any European Economic Area (EEA) exchange or any IOSCO country official | Accredited investor includes–<br><br>(a) A charitable organisation, corporation or partnership with assets at least USD\$5 million<br><br>(b) A trust with total assets in excess of USD5 million, not formed for the specific purpose of acquiring the |

<sup>7</sup> Paragraph 11 Schedules 6 and 7 of CMSA.

<sup>8</sup> Markets in Financial Instruments Directive.

| Singapore | Hong Kong       | Australia | UK   | US   |
|-----------|-----------------|-----------|--|--|
|           | HKD\$40 million |           | <p>exchange which meet any of the two following criteria:</p> <p>Balance sheet total of EUR20m</p> <p>(i) Net turnover of EUR40m</p> <p>(ii) Own funds of EUR2m</p> <p>And is an entity required to be authorized or regulated to operate in the financial markets</p> <p>(b) An unincorporated association or partnership: Net assets &gt; £5m</p> <p><b>MiFID</b></p> <p>Partnership which meets any of the following criteria:</p> <p>1. Meets large undertaking financial criteria (2 of the following)-</p> <p>(a)Balance sheet total of EUR20m</p> | <p>securities offered, whose purchase is directed by a sophisticated person (a person who has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment)</p> |

| Singapore | Hong Kong | Australia | UK   | US |
|-----------|-----------|-----------|--|----|
|           |           |           | (b) Net turnover of EUR40m<br><br>(c) Own funds of EUR2m<br><br>And is a partnership required to be authorized or regulated to operate in the financial markets<br><br>(c) Trustee of a high value trust where aggregate value of trust's assets is at least £10 million |    |

**3.5 Discussion and research on high net worth entity**

3.5.1 If one were to index RM10 million to inflation based on an average of 4.4% risk free interest rates i.e. 10 year government bond, RM10 million invested 10 years ago is now RM15,381,723.02.

3.5.2 Although it may now be an appropriate time to re-evaluate the RM10 million net asset threshold for a high net worth entity, the SC is also aware that there are concerns as to how much it should be increased. The SC would like to seek public feedback on the following issues.

**The public's views and comments are sought with respect to:**

- 1. Should the net asset threshold for high net worth entity be increased? If yes, what should the net asset threshold value be? What would the consequences be if the net asset threshold for a high net worth entity is increased?**
  
- 2. Should a partnership with a requisite net asset threshold or portfolio of investments be included within the category of a high net worth entity? If yes, what should the net asset threshold and the value of the portfolio investment be?**
  
- 3. Should a trust corporation with a requisite net asset threshold or portfolio of investments be included within the category of a high net worth entity? If yes, what should the net asset threshold and value of the portfolio of investments be?**
  
- 4. If a portfolio of investments threshold is introduced, should this criterion stand alone or be read as an alternative criterion to the net asset threshold for a high net worth entity?**
  
- 5. Whether the use of the net asset threshold to determine whether an investor is a high net worth entity is still valid and reliable or should other criteria such as net turnover, total assets or balance sheet be considered as alternative criteria or in combination?**

### **3.6 Professional investors**

3.6.1 Professional investors, by virtue of their experience and knowledge would be in a better position to make informed decisions and protect their own interests.

3.6.2 Within Schedules 6 and 7 of the CMSA, professional investors would include–

- (a) A holder of a Capital Markets and Services Licence who carries on the business of dealing in securities;
- (b) A holder of a Capital Markets and Services Licence who carries on the business of fund management;
- (c) A licensed offshore bank under the Offshore Banking Act 1990;
- (d) A licensed offshore insurer under the Offshore Insurance Act 1990;
- (e) A licensed institution under the Banking and Financial Institution Act 1989 or an Islamic Bank under the Islamic Banking Act 1983; and
- (f) An insurance company registered under the Insurance Act 1996.

#### **Comparison with other jurisdictions**

3.6.3 The table below provides how other jurisdictions set their respective qualifications for professional investors.



| <b>Singapore</b>   | <b>Hong Kong</b>   | <b>Australia</b>  | <b>UK</b>  | <b>US</b>  |
|--|--|---|--|--|
| <p>Professional investors include –</p> <p>(a) Licensed bank, merchant bank, finance company, licensed insurance company; licensed trust company;</p> <p>(b) Government, statutory body, pension fund or CIS, CMSL for dealing in securities, fund management, providing custodial services, REIT management, trading in futures, dealing in bonds with accredited or expert investors; or</p> <p>(c) Person whose business involves acquisition and disposal or the holding of capital markets products whether as principal or agent</p> | <p>Professional investors include –</p> <p>(a) Licensed intermediaries, authorised financial institutions, insurance companies, recognized exchange companies; or</p> <p>(b) Corporation whose sole business is to hold investments which is wholly owned by a high net worth individual</p> | <p>Wholesale client includes –</p> <p>(a) Financial services licensee, person regulated by APRA;</p> <p>(b) Trustee of superannuation fund, approved deposit fund, public sector superannuation fund;</p> <p>(c) Listed entity or a related body corporate of a listed entity;</p> <p>(d) Exempt public authority; or</p> <p>(e) Person carrying on business of investment in financial products, interest in land and offer such investment for subscription</p> | <p>Per se professional client includes regulated investment firms, authorized financial institutions as well as large undertakings meeting 2 of the following size requirements on a company basis:</p> <p>(a) balance sheet total of EUR 20 million<br/> (b) net turnover of EUR 40 million<br/> (c) own funds of EUR 2 million</p> | <p>(a) Bank, insurance company, registered investment company, business development company or small business investment company;</p> <p>(b) Employee benefit plan if a bank, insurance company or registered investment adviser makes the investment decisions or if the plan has total assets in excess of USD\$5 million; or</p> <p>(c) Director, executive officer, or general partner of the company selling the securities</p> |

### **3.7 Discussion and research on professional investors**

- 3.7.1 Feedback received from soft consultations suggests that the existing categories of professional investor as set out in the above paragraph 3.6.2 should be expanded to include all CMSL holders and persons who hold a Capital Markets and Services Representative's Licence (CMSRL). This is because a holder of CMSRL should by virtue of his or her industry qualification have the necessary knowledge and investment experience.
- 3.7.2 It should be noted that in some jurisdictions, in addition to an individual having to satisfy the net asset threshold qualification, the individual concerned must also demonstrate that he or she has the relevant knowledge and investment experience to be categorized as a professional investor. For example, in Hong Kong for an individual to be treated as a professional investor, not only must the individual have a portfolio of not less than \$8 million or its equivalent in any foreign currency but the intermediary who is offering any products to the investor must also be satisfied that the individual investor has necessary knowledge and experience in dealing with those products.<sup>9</sup>
- 3.7.3 In some jurisdictions, the regulatory framework enables a retail client to elect that he or she should be treated as a professional investor. For example, in the United Kingdom, a qualified retail investor can elect to be treated as a professional investor.<sup>10</sup> In order for

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<sup>9</sup> Paragraph 15 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct). In determining whether the individual has the necessary knowledge or experience the intermediary must give attention to (a) the type of products in which the person has traded (b) the frequency and size of trades a Professional Investor would be expected to have traded (not less than 40 transactions per annum) (c) the person's dealing experience (a Professional Investor would be expected to have been active in the relevant market for at least 2 years); and (d) his awareness of the risks involved in trading in the relevant markets. Recently the HK SFC has also proposed to add another criterion which is the investor's specific knowledge and expertise in the relevant products. For this new item the licensed intermediary should take into account whether—  
(i) the person is currently working or has previously worked in the relevant financial sector for at least one year in a professional position that involves the relevant product; or (ii) the person has undergone training or studied courses which are related to the relevant product.

<sup>10</sup> To qualify for election purposes the individual investor must satisfy any two of the following conditions:

(a) the client (investor) has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters; (b) the size of the client's financial

an investment firm to treat the individual as a professional investor the firm must also issue a written warning to the client explaining the protections he or she may lose. A written declaration from the client acknowledging the above consequence is also required<sup>11</sup>.

3.7.4 Australia has also adopted a regulatory approach that enables a licensed intermediary to treat an individual as a wholesale client on the premise that the said individual has the relevant knowledge.<sup>12</sup>

3.7.5 It was asked of the soft consultation group whether the approach of having an individual sign a written declaration consenting that he or she be treated as professional investor would be appropriate if we were to extend the current remit of professional investors to include individuals who demonstrate that he or she is knowledgeable and have sufficient expertise and investment experience in the relevant products and markets. We received positive feedback on the proposal to obtain a written declaration from such investors. However, records of such written declaration would have to be filed and kept by intermediaries. On the other hand there is a risk that investors may sign the declaration without understanding the implications thereof.

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instrument portfolio, defined as including cash deposits and financial instruments, exceeds EUR 500,000;  
(c) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

<sup>11</sup> This approach is also adopted in the Hong Kong Code of Conduct. The Code states among other things that prior to treating persons as Professional Investors, the licensed or registered person should provide a written explanation to the person explaining the risks and consequences of being treated as a Professional Investor. Further, the licensed intermediary must also obtain a written and signed declaration from the person that the consequences of consenting to being treated as a Professional Investor and the right to withdraw from being treated as such have been explained to him and that he wishes to be treated as a Professional Investor.

<sup>12</sup> Section 761GA Corporations Act 2001 allows a licensed intermediary to treat an individual as a wholesale client if the licensee amongst other things is satisfied on reasonable grounds that the other [person](#) (the **client**) has previous experience in using [financial services](#) and investing in [financial products](#) that allows the client to assess the:

- (i) merits of the product or service;
- (ii) value of the product or service; and
- (iii) risks [associated](#) with [holding](#) the product.

Further the licensed intermediary must also give the client before, or at the time when, the product or advice is [provided](#) in a written statement of the licensee's reasons for being satisfied as to those matters and the client must acknowledge that he or she is treated as a wholesale client.

**The public's views and comment are sought with respect to:**

- 1. Should all CMSL holders, CMSRL holders and registered persons (as defined in the CMSA) who are involved in all types of regulated activities be treated as professional investors?**
- 2. Should there be any other criteria imposed on this group of investors before they are classified as professional investors?**
- 3. Should additional criteria such as knowledge, expertise and investment experience or net asset threshold qualification be applied to this group of investors?**
- 4. Should investors (other than those mentioned in question 1) be allowed to sign a declaration of knowledge, expertise and investment experience in order to create a separate category of professional investors?**
- 5. Should investment holding entities or corporations who act as the investment arm of their holding company be treated as a professional investor?**
- 6. Should the directors or executive officers of a CMSL holder or corporation mentioned in Question 4 be considered a professional investor?**

## **4. ADDITIONAL CONSIDERATIONS**

### **4.1 Minimum amount of investment (ticket size)**

- 4.1.1 Currently, Schedules 6 and 7 of the CMSA provides that a person who has made an aggregate investment of not less than RM250,000 or its equivalent in foreign currencies for each transaction, whether such amount is paid for in cash or otherwise, need not be given a prospectus and therefore put in the same position as a "sophisticated investor".
- 4.1.2 Based on jurisdiction benchmarking, Australia is the only country which uses investment value as an indication of "sophistication". In Australia, the collective amount invested in the same class of securities should add up to more than AUD\$500,000.
- 4.1.3 The SC has been made aware of cases where investors were considered as "sophisticated" based merely on ticket size of RM250,000 when in actual fact they did not fully understand the nature and risks of the product.
- 4.1.4 Feedback from soft consultations indicate that the RM250,000 threshold should be maintained to ensure a wider participation in complex investment products such as structured products and wholesale funds. If the threshold is to be abolished or increased, such products will not be able to reach many investors. Also, issuers may not even want to issue such products any longer as it may not be economically viable to do so.
- 4.1.5 Based on the SC's enquiries, it was found that most investors who bought into structured products were considered sophisticated based on "ticket size" (62%). It was also found that 93% of those who purchased structured products were made up of individual investors.

**The public's views and comments are sought with respect to:**

- 1. Should the investment value (ticket size) criteria be retained or discarded in determining whether an investor is a "sophisticated investor"?**
- 2. If the investment value criteria is to be retained, should it be increased?**
- 3. If the threshold is to be increased or discarded, what would the new threshold be so as not to stifle innovation and development in the capital market industry?**
- 4. If it is not increased, should it be used in addition to other criteria such as value of investment holding, frequency of trades or experience in business or financial matters?**

## **PART 2**

### **REVIEW OF SALES PRACTICES IN RESPECT OF CAPITAL MARKET PRODUCTS**

#### **5. INTRODUCTION**

##### **5.1 Objective**

5.1.1 Part 2 of the consultation paper discusses various proposals with the view of formulating a robust sales practices regime that would help to mitigate the occurrences of investors being misled into buying products that are not suited to their needs. The proposals discussed in this part of the consultation paper are a result of what the SC has gathered whilst conducting benchmarking studies and also feedback that the SC has received from soft consultations conducted.<sup>13</sup>

5.1.2 The SC is confident that the responses to the consultation questions posed in this paper will assist the SC in formulating a robust regulatory framework that will result in investors having trust and confidence in the capital market.

##### **5.2 Rationale for the proposals discussed**

5.2.1 The proposals discussed in this paper are in respect of regulatory measures that seek to better protect the interest of investors when investing in unlisted capital market products.<sup>14</sup> This paper does not focus on listed capital market products as the offering of these products are regulated by the Bursa Malaysia Rules in addition to the Capital Markets and Services Act 2007 (CMSA).

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<sup>13</sup> It should be noted that the SC has taken other initiatives to enhance investor protection. These include implementation of an alternative dispute resolution framework for the capital market and also placing greater emphasis on investor education.

<sup>14</sup> Examples of unlisted capital market products include unit trust funds, structured products, wholesale funds, asset-backed securities and private debt securities.

5.2.2 In discussing these regulatory measures, the SC took into account contributing factors which have caused investors in the region to be misled into investing in products which may not be suited to their needs. Some of these factors are:

- misleading marketing materials and advertisements;
- investors having no access to a concise and easily understood product summary which sets out key information about the product;
- conduct of product distributors including that of their agents in failing to disclose sufficient product information in product documentations to enable the investor to make an informed decision;
- conduct of product distributors including that of their agents in failing to diligently perform a product suitability assessment before making a recommendation to an investor;
- product distributors having incentive structures that may wrongly encourage sales personnel to conduct fire sales resulting in them pushing unsuitable products to investors;
- product issuers or distributors not having a culture that promotes fair treatment of customers (investors); and
- information not being provided to investors on an ongoing basis to enable them to better monitor their investments especially in respect of investments in structured products.

5.2.3 The SC is mindful that regulatory measures alone will not minimize the risk of investors being misled into investing in capital market products that are not suited to their needs



and that regulatory measures must also be accompanied with effective investor education programs.<sup>15</sup>

## **6. INVESTOR PROTECTION FRAMEWORK**

### **6.1 Current Regulatory Framework**

6.1.1 The CMSA together with a host of product related guidelines issued by the SC regulates the marketing of unlisted capital market products to investors in Malaysia.<sup>16</sup>

6.1.2 The CMSA regulates the marketing of such products, amongst others, by–

- (a) requiring that SC’s approval is sought before any offering of securities can be made to investors in Malaysia<sup>17</sup>;
- (b) requiring that the issuer register a Prospectus with the SC before any primary offering of securities can be made to retail clients<sup>18</sup>. The CMSA requires that the prospectus includes all necessary information that an investor would reasonably require to make a proper assessment of the securities being offered.<sup>19</sup> The issuer and its advisers are responsible for ensuring that the prospectus complies with the law. However, if a product is distributed to sophisticated investors, a

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<sup>15</sup> Various measures to enhance the effectiveness of SC’s investor education effort are also under way.

<sup>16</sup> These Guidelines include the Guidelines on Unit Trust Funds, Guidelines on Marketing and Distribution of Unit Trust Funds, Guidelines on Unit Trust Advertisements and Promotional Materials, Guidelines on Wholesale Funds, Guidelines on the Offering of Structured Products, Guidelines on the Offering of Asset-Backed Securities

<sup>17</sup> Section 212 of CMSA. Hence, under our current regulatory regime, primary offering of products such as “Lehman Minibonds”, units in foreign unit trust schemes, interest in foreign limited liability partnership would have required SC’s prior approval.

<sup>18</sup> For the purposes of this paper “retail clients” refers to persons who are not “sophisticated investors”. As discussed in Part 1 of this consultation paper sophisticated investors is a category of investors who are presumed to have relevant investment knowledge and risk tolerance.

<sup>19</sup> Section 236 of CMSA.

prospectus is not required and the issuer may issue an information memorandum instead.<sup>20</sup>

- (c) requiring that capital market products be marketed to investors in Malaysia by licensed or registered persons only<sup>21</sup>; and
- (d) imposing on licensed and registered persons various requirements that they must observe in respect of conduct of their business. For example, licensed and registered persons must have a reasonable basis when recommending investments in securities or futures contracts to investors, having considered the investment objectives, financial situation and the needs of the investor.<sup>22</sup>

6.1.3 Currently, the SC does not encourage unlisted capital market products such as structured products, units in wholesale funds or corporate debentures to be marketed to retail investors due to its complexity. Units in a unit trust fund which are unlisted can be marketed to the general public subject to fulfilling the requirements set out in the CMSA and in the Guidelines on Unit Trust Funds. The marketing of unit trust funds are subjected to a higher degree of regulation given the fact that unit trust funds are marketed to the general public which are mostly retail investors.

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<sup>20</sup> The CMSA currently does not mandate the issuance nor prescribe the contents of an information memorandum although some product related guidelines may do so as in the case of Guidelines on Wholesale Funds. Where an information memorandum is in fact issued it would be required to be lodged with the SC.

<sup>21</sup> Under the CMSA licensed institutions such as commercial banks and persons who are members of a body approved by the SC are referred to as registered persons: section 76 of CMSA. A registered person can carry out capital market activities without having to hold a Capital Markets and Services Licence.

<sup>22</sup> In the case of registered persons who are licensed institutions, this requirement is imposed on them by section 76 of CMSA. Further, they must also comply with requirements that are set out in the various product related guidelines. Persons who are members of a body approved by the SC refer to persons who are registered with the Federation of Investment Managers Malaysia (FiMM). Such persons by virtue of the rules of FiMM must comply with the relevant unit trust guidelines in particular the Guidelines on Marketing and Distribution of Unit Trust Funds which set out key obligations that must be observed by such persons when marketing units in a unit trust fund.

## **7. STRENGTHENING THE REGULATORY INFRASTRUCTURE**

### **7.1 Know Your Client (KYC) in respect of making recommendations**

#### **Background**

- 7.1.1 One key measure in advancing investor protection in respect of sales practices is requiring product distributors including that of their representatives to diligently perform a product suitability assessment before recommending an unlisted capital market product to an investor.
- 7.1.2 In carrying out this product suitability assessment, the product distributor including its representatives must know his client's financial situation, investment experience and investment objectives before making a recommendation to him to invest in a capital market product. This is commonly referred to as the Know Your Client (KYC) process. Only with this information can a licensed person or registered person have a reasonable basis for making an investment recommendation to a client.
- 7.1.3 For supervision purposes, the product suitability assessment in respect of making recommendations is usually process driven in that it would involve some degree of documentation. The level of assessment that is conducted may also vary depending on whether the investor is a sophisticated or a retail investor. It is recognized that the degree of assessment will differ between an investor who seeks a recommendation through the telephone as opposed to the client meeting face to face with the representative.

#### **Current regulatory framework**

- 7.1.4 Section 92 CMSA encapsulates the requirement for licensed and registered persons to have a reasonable basis for making a recommendation to investors to invest in securities or futures contracts<sup>23</sup>. Further, it provides that in making this recommendation the licensed person must know his client in terms of his financial situation, investment

experience and investment objectives. This requirement is reinforced in some of SC's product related guidelines.<sup>24</sup>

## **Comparison with other jurisdictions**

### **Hong Kong**

- 7.1.5 In Hong Kong, the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (SFC Code) sets out the key requirement for intermediaries to ensure suitability in respect of making recommendations–

*"Having regard to information about the client of which the licensed or registered person is or should be aware through the exercise of due diligence, the intermediary should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for that client is reasonable in all circumstances."*

- 7.1.6 To clarify the responsibility of the intermediary when conducting the KYC process and suitability assessment, the SFC published a circular to all licensed corporations on their obligations. Information collected from a client during the KYC process should include the client's–

- (a) investment knowledge;
- (b) investment horizon;
- (c) risk tolerance (including risk of loss of capital); and
- (d) capacity to make regular contributions and meet extra collateral requirements where appropriate.

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<sup>24</sup> Paragraph 3.07 Guidelines on Marketing and Distribution of Unit Trust Funds. Paragraph 8.02 (a) Guidelines on the Offering of Structured Products. Paragraphs 8.01 and 14.02 Guidelines on Wholesale Funds. Paragraph 3.01(a) Guidelines on Compliance Function for Fund Managers.

- 7.1.7 If the intermediary encounters a situation where the client does not fully disclose his personal circumstances (e.g. financial situation), the intermediary can still make a personal assessment of the client's attitude towards risks, his expectations and so on. If such an assessment cannot be made, the Circular provides that the intermediary should explain to the client the limitations of the advice as a result of the lack of information and also the assumptions made by the intermediary.<sup>25</sup>
- 7.1.8 The Circular also explains that the suitability obligations expected of intermediaries are not just limited to the KYC process but also includes–
- (a) understanding the investment products they recommend to clients;
  - (b) providing reasonably suitable recommendations by matching the risk return profile of each investment product with the personal circumstances of each client; and
  - (c) providing all relevant information to clients and assist them in making informed investment decisions.
- 7.1.9 In assisting the client in making informed investment decisions, the Circular provides that the intermediaries use their professional judgment to assess whether the characteristics and risk exposure of the product are in the best interests of the client taking into account the client's investment objectives, investment horizon, risk tolerance and financial circumstances. Extra care should be exercised when advising elderly and/or retail clients and those who may not be able to make independent investment decisions especially on complex investment products.
- 7.1.10 In light of the complaints received in respect of the selling of Lehman Mini Bonds, SFC has proposed that the KYC process should now include an assessment of client's

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<sup>25</sup> Hong Kong Securities and Futures Commission: Circular to All Licensed Corporation dated May 2007 on Questions and Answers on Suitability Requirements, question 2.

knowledge of derivatives. To assess whether a client has derivative knowledge, the intermediary may have regard to the following–

- (a) client has undergone training or attended courses on derivative products;
- (b) client has prior trading experience in derivative products; and/or
- (c) client has current or previous work experience in relation to derivative products.

7.1.11 The SFC has also proposed that a client who does not have derivative knowledge can still be marketed such a product but the onus is on the intermediary to give him appropriate advice including assessment of suitability of the transaction.

## **Singapore**

7.1.12 The Monetary Authority of Singapore (MAS) in a notice that it has issued sets out clearly what is expected of financial advisers (FAs) when making a recommendation in respect of an investment product<sup>26</sup>. FAs are required to collect and document the following key information in relation to the customer–

- (a) financial objectives;
- (b) risk tolerance;
- (c) employment status;
- (d) financial situation, including assets, liabilities, cash flow and income; and
- (e) current investment portfolio.

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<sup>26</sup> This is set out in a document titled "Notice on Recommendations on Investment Products" FAA-N01.

7.1.13 The Notice also states that where a client does not want–

- (a) to provide any information requested by the financial adviser in accordance with the above paragraph; or
- (b) to accept the recommendation of the financial adviser and chooses to purchase another investment product which is not recommended by the financial adviser,

the financial adviser may proceed with the client's request, but it shall document the decision of the client and highlight to the client that it is the client's responsibility to ensure the suitability of the product selected.

7.1.14 MAS, in the light of complaints received following the Lehman Mini Bonds issue has proposed to require FAs to obtain the following additional key information–

- (a) information on the source and extent of the customer's regular income;
- (b) whether the amount to be invested is a substantial portion of the customer's assets; and
- (c) the regular financial commitments of the customer.

7.1.15 The collection of this information is necessary as it will enable FAs to check its client's ability to bear potential losses arising from the proposed investment. Further, MAS is also proposing to make it an obligation for the FA's company to put in place effective systems and internal controls to ensure that their representatives give a formal document recording the basis for a recommendation, and make reasonable enquiries to obtain key information from their customers.

## **European Union**

7.1.16 The Markets in Financial Instruments Directive (MiFID) is a European Union law that harmonized regulation for investment services across the 30 member states of the European Economic Area.

7.1.17 Article 19 of the MiFID provides among other things that:

- (a) When providing investment advice or portfolio management the investment firm shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him.
- (b) Member States shall ensure that investment firms, when providing investment services other than those referred to in the above paragraph, ask the client or potential client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client.
- (c) In case the investment firm considers, on the basis of the information received under the previous subparagraph, that the product or service is not appropriate to the client or potential client, the investment firm shall warn the client or potential client. This warning may be provided in a standardized format.
- (d) In cases where the client or potential client elects not to provide the information referred to under the first subparagraph, or where he provides insufficient information regarding his knowledge and experience, the investment firm shall warn the client or potential client that such a decision will not allow the firm to



determine whether the service or product envisaged is appropriate for him. This warning may be provided in a standardized format.

## **Proposal**

7.1.18 The KYC processes and suitability obligations gathered from the jurisdictional benchmarking above is applicable to all clients regardless of whether the client is a retail client or a sophisticated client.

7.1.19 The issue at hand now is whether the SC should have a “one size fits all” clarification of section 92 of the CMSA on KYC processes and suitability obligations for all types of products regardless of its target market. The reason for having a “one size fits all” approach is that there will not be any disparity in the KYC process and suitability obligations. Further, there will be parity of treatment for all investors thus accorded the same protection for the purposes of KYC and suitability.

7.1.20 However, feedback received from soft consultations conducted by the SC suggests that it may not be necessary for sales personnel to conduct the same rigorous KYC process and suitability assessments for certain products offered to sophisticated investors such as unlisted bonds that are sold to institutional investors. This is because such investors should be able to obtain independent advice before purchasing such investment products as they have the financial ability to do so. Moreover, for some institutional investors, purchasing investment products is part of their ordinary course of business.

7.1.21 To be in line with international best practices, the SC proposes to clarify section 92 of the CMSA by setting out the KYC processes and suitability obligations of sales personnel offering capital market products. The SC seeks views on whether such processes and obligations should be applicable to all types of investors.

7.1.22 The proposed clarification of KYC processes include understanding the client’s–

- (a) investment knowledge;

- (b) investment horizon;
- (c) risk tolerance (including risk of loss of capital);
- (d) capacity to make regular contributions and meet extra collateral requirements where appropriate;
- (e) financial status including his income, assets and liabilities and whether the amount to be invested is a substantial portion of the customer's assets; and
- (f) current investment portfolio.

7.1.23 As for the sales personnel's suitability obligations, he should be able to match the risk return profile with each client's personal circumstances gathered through the KYC process set out above. The sales personnel should take into account the transaction costs, effect of gearing and foreign currency risks and other risks of underlying investments of the investment product.

**The public's views and comments are sought with respect to the following questions–**

- 1. Should there be a standardized process that should be observed by licensed and registered persons in order to make informed and reasonable recommendation(s) to a client? If yes, what should the processes be?**
- 2. Should standardization of KYC processes be applied to private debt securities, asset backed securities, and negotiable instruments of deposit with tenure of more than 5 years, which are mostly subscribed by institutional investors?**
- 3. If the KYC process is required to be documented what would be the most efficient and cost effective way of doing so?**
- 4. Should the KYC process be excluded for professional investors (as discussed in paragraph 3.6 of Part 1 of this consultation paper)?**
- 5. Should the recommendation given pursuant to the KYC process be documented as well?**
- 6. Should the documented basis be done for each and every time the investors make an investment or increase his investment? Or should it be done only for first time investment in a particular product or fund?**
- 7. Should the product distributor have in place an internal control mechanism to ensure compliance with the KYC processes?**

## **7.2 Disclosure Document**

### **Background**

7.2.1 There is growing concern that prospectuses have been largely ineffective as a primary disclosure document in helping investors make informed investment decisions. Investors find prospectuses difficult to read and understand, as prospectuses tend to be drafted in a legalistic manner, and include financial and legal jargon.

7.2.2 To address this issue, some of the steps taken in other jurisdictions include:

- (a) having a simplified disclosure document to supplement the existing prospectus;
- (b) including in the formal prospectus a summary of the prospectus commonly referred to as the Product Highlight Sheet; and
- (c) a simplified prospectus written in simple language.

### **Current regulatory framework**

7.2.3 As discussed in paragraph 6.1.2(b), where an issuer makes a primary offer of capital market products to retail clients, the law mandates that the retail client must be provided with a registered prospectus. The content of the prospectus is prescribed both by the CMSA and the Prospectus Guidelines.

7.2.4 Chapter 5 of the Prospectus Guidelines mandates the inclusion of an Information Summary at the front of the prospectus, which summarizes key information about the offer or issue and the corporation or the group. Chapter 6 of the Prospectus Guidelines for Collective Investment Schemes also mandates that a prospectus be accompanied by an Information Summary.

7.2.5 We also note that recently, Bank Negara Malaysia has issued Guidelines on Product Transparency and Disclosure which introduces a requirement that a Product Disclosure

Sheet be provided by financial service providers to customers for loan products, negotiable instruments of deposit, and investments linked to derivatives<sup>27</sup>. This document is to be provided to the customer at pre-contractual stage.

## **Comparison with other jurisdictions**

### **Singapore**

- 7.2.6 A separate simplified disclosure document is being developed to supplement the prospectus. The Product Highlights Sheet will mainly highlight key information in a "Question & Answer" format while the prospectus remains as the main document containing all material information to assist an investor in making an informed investment decision. Also, the Product Highlights Sheet is to be handed to the investor together with the prospectus.

### **Hong Kong**

- 7.2.7 In Hong Kong, the Product Key Facts Statement is mandated as part of the offering document for all unlisted investment products but is not to be a substitute for the full information contained in an offer document. The key features and risks of the product are communicated to investors in a concise and effective manner where the use of diagrams and graphics are highly encouraged.

### **Proposal**

- 7.2.8 The SC considers that the issuance of a prospectus which is accompanied by a Product Highlight Sheet would be an effective measure to assist investors in understanding the product being offered. There will not be duplication in terms of the purpose of both the Product Highlight Sheet and the prospectus. The prospectus is to contain all material information that an investor would reasonably require to make an investment decision, and the purpose of a Product Highlights Sheet is to highlight key information to investors in a clear, concise and effective manner.

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<sup>27</sup> Paragraph 14 of the Guidelines.

- 7.2.9 It is proposed that the Product Highlights Sheet should contain information which is consistent with that found in the prospectus or information memorandum (or any supplementary or replacement prospectus, if applicable) before it is given to an investor.
- 7.2.10 Although the SC is aware that there may be concerns as to the liability attached to a Product Highlight Sheet, the SC considers it necessary to apply legal liability if the Product Highlight Sheet contains information which is false, deceptive or misleading. Legal liability will ensure that issuers of a Product Highlight Sheet ensure that it contains all material information in a truthful and non-misleading manner.
- 7.2.11 It is also proposed that issuers be held responsible for preparing the Product Highlight Sheet containing disclosure of key information in plain language as per the Plain Language Guide for Prospectuses contained in the Prospectus Guidelines.
- 7.2.12 Samples of a Product Highlight Sheet from Singapore and Hong Kong are attached in Appendix 2 and Appendix 3.
- 7.2.13 For particular products, the SC is aware that there may be specific features or additional information that should be disclosed to investors in the Product Highlights Sheet. Thus, apart from public consultation via this consultation paper, there will be engagement with industry to identify the specific features which should be disclosed for certain products.

**The public's views and comments are sought with respect to:**

- 1. Have you found the Information Summary mandated in the Prospectus Guidelines and the Prospectus Guidelines for Collective Investment Schemes to be effective?**
- 2. Is it necessary for issuers to prepare a Product Highlight Sheet in addition to the Information Summary where the offer requires a prospectus to be issued?**
- 3. If yes, what should the proposed form and content of the Product Highlight Sheet be?**
- 4. Should a Product Highlight Sheet replace the Information Summary?**
- 5. Please suggest additional information and specific features that should be disclosed in the Product Highlight Sheet for particular products.**

## **Disclosures for offer of securities which does not involve payment of consideration**

### **Background and current regulatory framework**

7.2.14 While the proposals in this Part relate to unlisted capital market products, the SC would like to take this opportunity to seek the public's feedback on disclosures for offer of securities which may be listed on an exchange.

7.2.15 The CMSA requires that a prospectus be provided to investors who receive issue, offers or invitations to subscribe securities. Specific exemptions to the prospectus requirements are found in Schedules 6 and 7. Some issues which do not involve any consideration are currently exempted e.g. items 29 and 31 of Schedule 7 exempt the issue of

dividends in specie and bonus issues respectively. However, these exemptions currently do not extend to corporate proposals which do not involve consideration.

7.2.16 In such cases, the issuer will have to submit a prospectus to the SC and be subjected to the prospectus requirements. The issuer however is entitled to apply for the waivers from certain prospectus requirements. This may have resulted in the issuer having to bear undue cost in corporate actions such as capital repayment or distribution of securities to its existing shareholders pursuant to an entitlement.

7.2.17 It is arguable that proposals that do not involve consideration should be treated differently as the investor's money is not at stake and would not require the disclosure documents to make any investing decision.

### **Comparison with other jurisdictions Singapore and Australia**

7.2.18 Both Singapore<sup>28</sup> and Australia<sup>29</sup> exempts issues or transfers of securities which does not involve any consideration from disclosure requirements.

#### **Proposal**

7.2.19 It is proposed that offers of securities which does not involve payment of consideration and which is not part of an initial listing exercise of securities on the stock exchange be exempted from the disclosure requirements in the CMSA. It must be noted, however, that this exemption would not be applicable where consideration is given in kind e.g. capital distribution in return for cancellation of shares. Another situation where this exemption would not apply is where consideration would occur at a later stage after the distribution of the securities.

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<sup>28</sup> Section 272 of the Singaporean Securities and Futures Act.

<sup>29</sup> Section 708 of the Australian Corporations Act 2001.



**The public's views and comments are sought with respect to:**

- 1. Whether the current disclosure requirements in relation to offers of securities which do not involve payment of consideration are necessary?**
- 2. If it is necessary, what should the disclosure document contain? Should it be in the form of a prospectus?**
- 3. Would an information memorandum be a sufficient disclosure document for such corporate proposals? If so, what information should it contain?**

**7.3 Advertising, Marketing and Promotional Materials**

- 7.3.1 Misleading advertisements and marketing materials can mislead investors into investing in products that are not suited to their needs.
- 7.3.2 Currently, the Guidelines on Unit Trust Advertisement and Promotional Materials and the Guidelines on Wholesale Funds states that information supplied in any marketing, advertising and promotional materials has to be accurate, not misleading or deceiving and shall be based on principles of good faith and fair dealing.
- 7.3.3 With the expansion in the area of promotional and marketing activities, it is important to ensure that information on any products is conveyed with integrity and investors are not deceived into making any investment decision.
- 7.3.4 Moving forward, the SC would like to propose that the principles set out in the Guidelines on Unit Trust Advertisements and Promotional Materials be extended to apply to all types of unlisted capital market products.

**The public's views and comments are sought with respect to:**

- 1. Whether the SC should extend the principles set out in the Guidelines on Unit Trust Advertisements and Promotional Materials to apply to the advertising and preparation of promotional materials in respect of all types of unlisted capital market products?**

## **7.4 Mitigating potential conflict of interest arising from monetary and non-monetary benefits**

### **Background**

- 7.4.1 There is a general concern that product distributors including their agents may have been given incentives to promote products to investors which will result in them receiving rewards (monetary as well as non-monetary) based on volume of sales rather than suitability of investors.
- 7.4.2 Concerns have been expressed that the level of commissions received from third parties may encourage financial institutions and capital market intermediaries to develop business strategies that inappropriately incentivize their sales staff to churn up volume of sales. Further, there is also concern that potential conflicts of interest can also arise for some distributors whose related companies are product issuers, as these distributors may be inclined to promote in-house products to clients.

### **Comparative Studies**

#### **Singapore**

- 7.4.3 In Singapore, products distributors are required to disclose the remuneration, including any commissions, fees and other benefits, that the company receives which is directly related to the making of a recommendation of an investment product or the sale of a collective investment scheme. This covers remuneration such as fees charged to customers, commissions from the product provider, trailer commissions or such other benefits accruing to the company. The purpose of requiring such disclosure of remuneration is to enable customers to be aware of the costs of the financial advisory services rendered, and for them to be able to make informed decisions.
- 7.4.4 MAS has noted that whilst disclosure is mandated at company level and that there is good reason to extend the disclosure requirement to representatives given the concern that representatives may be financially motivated to sell particular products that may not

be suitable for the customer, there is however practical implementation issues with requiring the disclosure of the representative's remuneration. This is because there is no standard way in which companies remunerate representatives for advising and selling investment products. Remuneration for representatives could involve complicated point systems and targets that are not easily explained to customers in a meaningful manner at the point of sale.

- 7.4.5 Given these implementation problems, MAS is looking at the possibility of requiring the board and senior management of product distributors to implement remuneration structures that seek to align representatives' interests with those of customers. MAS will formalise the expectation in the *Fair Dealing Guidelines* for the board and senior management to focus on ensuring that the remuneration structures are not only driven by sales volume but to ensure that they are better aligned with the interests of customers.

### **Hong Kong**

- 7.4.6 Currently SFC's Code of Conduct provides that licensed and registered persons must amongst other things:

- (a) act in the best interests of its clients;
- (b) try to avoid conflicts of interest, and when they cannot be avoided, should ensure that clients are fairly treated; and
- (c) not advise or deal in relation to a transaction for which it has an actual or potential conflict of interest unless it has disclosed that material interest or conflict to the client and it has taken all reasonable steps to ensure fair treatment of the client.

- 7.4.7 These provisions in the Code would help protect investors from the risk associated with potential conflict of interest as discussed in the above paragraph 7.4.1. However,

moving forward SFC is considering requiring explicit disclosure of monetary and non monetary benefits received by the intermediary or its associates with the view to mitigate risks to investors arising from its non disclosure. These disclosures are to be made in a "Sales Disclosure Document".

**The public's views and comments are sought with respect to:**

- 1. Should product distributors be required to disclose the remuneration that the company receives that is directly related to the making of a recommendation of an investment product?**
- 2. Should disclosure include remuneration such as fees charged to customers, commissions from the product provider, trailer commissions or such other benefits accruing to the company?**
- 3. Should disclosure be required at company level only or should it be extended to representatives?**
- 4. Should distributors be required to issue a Sales Disclosure Document?**

## **7.5 Mitigating potential conflict of interest arising from the use of gifts by distributors in promoting a specific investment product**

### **Current regulatory framework**

- 7.5.1 The Guidelines on Marketing and Distribution of Unit Trust Funds currently provides that persons authorized to sell unit trust funds should refrain from providing gifts to entice investors to invest in unit trust funds.<sup>30</sup>
- 7.5.2 Fund managers who sell units in a wholesale fund are also subject to Guidelines on Compliance Function for Fund Managers and these guidelines currently provide that the fund manager shall:
- (a) not offer or accept any gifts, rebates or benefits in connection with the affairs or business of a client, which is likely to significantly conflict with the duties owed to clients;
  - (b) establish, maintain and implement written policies and procedures, including monetary limits, pertaining to any acceptance or giving of gifts, rebates or any benefits by the firm or its employees; and
  - (c) maintain a register of gifts or benefits received and granted by the firm.
- 7.5.3 There is currently no provision pertaining to the offering of gifts in the Guidelines on the Offering of Structured Products, Guidelines on the Offering of Asset-Backed Securities and Guidelines for the Offering of Private Debt Securities.

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<sup>30</sup> Paragraph 5.03.

## **Comparative Studies**

### **Hong Kong**

7.5.4 The SFC is proposing to amend its Code of Conduct to include the following paragraph:

#### ***Use of gifts by distributors in promoting a specific investment product***

*"In promoting a specific investment product to a client, a licensed or registered person should not act in a way that would distract the client's attention from the features of the investment product by offering gifts that have a monetary value other than discount of fees and charges."*

7.5.5. The proposed amendment is a consequence of the Hong Kong Monetary Authority (HKMA) having noted that in the marketing of some Lehman retail investment products, "gifts" having monetary value such as supermarket gift coupons, audio-visual equipment and the likes were offered to investors. Hence, the HKMA pointed out that consideration should be given to restrict the use of gifts as a marketing tool to promote financial products to investors.

### **Singapore**

7.5.6 In Singapore, in a document entitled "Information Paper on Good Practices For Licensed and Exempt Financial Advisers", paragraph 2.6.1 states:

*"Where gifts are offered to clients for conclusion of a sale, clients may be enticed to disregard a proper assessment of the investment and enter into a transaction that may not meet their needs. In view of this, it is good practice for FAs to have proper systems, processes and controls to ensure that the quality of fact find and needs analysis, as well as the basis for any recommendation are not compromised as a result of offering gifts."*

*Examples of good practices adopted by FAs include:*

- (i) having policies to ensure that gifts offered are of nominal value relative to the amount invested by clients; and*
- (ii) monitoring the conduct of representatives to ensure that gifts do not become the main focus of any transaction.”*

## **Proposal**

7.5.7 Moving forward, the SC proposes that the principles set out in the Guidelines on Compliance Function for Fund Managers in respect of gifts be extended to apply to the marketing of all products.

**The public’s views and comments are sought with respect to:**

- 1. Do you agree that the SC should extend the principles set out in the Guidelines on Compliance Function for Fund Managers in respect of gifts to the marketing of all products?**

## **7.6 Cooling-off period**

### **Current regulatory framework**

7.6.1 A cooling-off period provides individual investors with an opportunity to reconsider their investment decisions. It allows them to exit the investment without having to incur sales charges or commissions.

7.6.2 The Guidelines on Unit Trust Fund provides that management companies who manage a fund must provide individual investors who invest in the fund for the first time the right to exit out from their investment should they chose to do so. Further, this right is available to the individual within 6 business days when the management company first

receives the offer to invest in the fund. When the unit holder exercises his cooling-off right, the management company must refund to the unit holder a sum equal (the price of the unit on the day the units were purchased minus the charges imposed on the day the units were purchased).

- 7.6.3 The Guidelines on Structured Products<sup>31</sup> provides for a cooling-off period of 3 working days for individual investors only.

### **Comparative Studies**

#### **Hong Kong**

- 7.6.4 The Hong Kong Consultation Paper did not specify the number of days for cooling-off period. Currently, the SFC regulatory framework does not cater for cooling-off periods.

#### **Singapore**

- 7.6.5 Currently, cooling-off period of 7 days is mandated for unit trust products. Also, for structured notes, investors have the opportunity to cancel their investments anytime during the offer period. It is proposed in Singapore that a cooling-off period of 7 days is limited to unlisted debentures with tenures longer than 3 months. Investors are allowed to exit the investment without incurring sales charges or commissions.

#### **Proposal**

- 7.6.6 The SC proposes a cooling-off period of not fewer than six business days for all unlisted capital market products that are sold to retail investors only. This is in line with international best practices having surveyed the position in Singapore and Hong Kong.

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<sup>31</sup> Paragraph 8.01.



**The public's views and comments are sought with respect to:**

- 1. Should there be a standard cooling-off period of not fewer than 6 business days for all unlisted capital market products?**
- 2. Should the cooling off period apply just to retail investors only or should it be extended to all types of investors?**
- 3. Should the cooling-off period be made available for each product sold to investors?**
- 4. Is there a need to require the money for refunds to be kept in trust during the cooling-off period?**

## **7.7 Continuous Disclosure**

7.7.1 Investors should receive timely and meaningful ongoing disclosures regarding their investments, to better enable them to make informed decisions to protect their interests.<sup>32</sup>

7.7.2 The SC proposes to require issuers of unlisted investment products:

- (a) to make available semi-annual and annual reports to update investors on their investments and explain to investors the calculation of actual returns received. It is proposed that direct forecast or projections of future performance should not be part of the semi-annual and annual reports; and

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<sup>32</sup> Currently the principle of continuous disclosure of material information is embedded in the Guidelines on Unit Trust Funds and Guidelines on Wholesale Funds.

- (b) to report material changes which may affect the risks and returns of the unlisted investment product to investors as and when these changes occur.

**The public's views and comments are sought with respect to:**

- 1. Should the SC impose a continuous disclosure requirement for all types of unlisted capital market investment products?**
- 2. Should any capital market product be excluded from a continuous disclosure requirement? If yes, please state the product and reasons for its exclusion.**
- 3. Should the continuous disclosure requirement require product issuers to provide investors with information as set out in the above paragraph 7.7.2?**

## **7.8 Code Of Conduct**

7.8.1 The SC has issued the Guidelines on Market Conduct and Business Practices for Stock brokers and Licensed Representatives. The Guidelines set out 11 core principles of supervision applicable to stockbrokers and their representatives. The 11 core principles are set out in detail in Appendix 4.

7.8.2 Although the SC has not issued a specific code for product distributors, it must be noted that some of our product related guidelines do have provisions that set out conduct that is expected of product distributors. For example, the Guidelines on Marketing and Distribution of Unit Trust Funds which provides that persons authorized to sell unit trust products must act with honesty and integrity (Appendix 5)<sup>33</sup>.

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<sup>33</sup> Refer to paragraphs 3.02 to 3.11 of the Guidelines.

- 7.8.3 The Guidelines on the Offering of Structured Products also have some provisions dealing with conduct expected of a primary seller who sells structured products (Appendix 6).<sup>34</sup> The Guidelines on Wholesale Funds provides that the fund manager must observe high standards of integrity and fair dealing in managing the wholesale fund to the best interest of its investors (Appendix 7).<sup>35</sup>
- 7.8.4 Notwithstanding the requirements in respective product guidelines, the SC acknowledges that, currently, conduct requirements are not applied uniformly and are currently contained within the various guidelines.

### **Comparison with other jurisdictions**

#### **Hong Kong**

- 7.8.5 The SFC in May 2006 issued the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission. This Code amongst other things sets out general principles (GP) and provides detailed explanations for each GP. Many of these general principles equally apply to product distributors and as discussed above, several recommendations of the SFC in respect of protecting investors' interest against the mis-selling of products involves clarifying or incorporating new provisions into this Code.
- 7.8.6 The Code sets out the following general principles:

- ***GP1. Honesty and fairness***  
*In conducting its business activities, a licensed or registered person should act honestly, fairly, and in the best interests of its clients and the integrity of the market.*

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<sup>34</sup> Refer to paragraphs 8.01 and 8.02 of the Guidelines.

<sup>35</sup> Refer to paragraph 3.04 (b) of the Guidelines.

- **GP2. Diligence**  
*In conducting its business activities, a licensed or registered person should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.*
  
- **GP3. Capabilities**  
*A licensed or registered person should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities.*
  
- **GP4. Information about clients**  
*A licensed or registered person should seek from its clients, information about their financial situation, investment experience and investment objectives relevant to the services to be provided.*
  
- **GP5. Information for clients**  
*A licensed or registered person should make adequate disclosure of relevant material information in its dealings with its clients.*
  
- **GP6. Conflicts of interest**  
*A licensed or registered person should try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its clients are fairly treated.*
  
- **GP7. Compliance**  
*A licensed or registered person should comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market.*
  
- **GP8. Client assets**  
*A licensed or registered person should ensure that client assets are promptly and properly accounted for and adequately safeguarded.*

- **GP9. Responsibility of senior management**

*The senior management of a licensed or registered person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm. In determining where responsibility lies, and the degree of responsibility of a particular individual, regard shall be had to that individual's apparent or actual authority in relation to the particular business operations.*

## **Singapore**

7.8.7 MAS under the authority provided by the Financial Advisers Act (Cap 110) has issued "Guidelines on Standard of Conduct for Financial Advisers (FA)"<sup>36</sup>. Similar with the SFC Code, the Guidelines also sets out standards of conduct expected of financial advisers and their representatives. Conduct that is expected of the FA includes conducting its business with integrity, exercising reasonable care and judgment, avoiding situations that might impair its ability to make objective recommendation, disclosing all material facts relating to the key features of the product to the client and having a reasonable basis when making a recommendation.

## **Proposal**

7.8.8 Moving forward, the SC proposes that that the 11 core principles applicable to stockbrokers and their representatives under the current Guidelines on Market Conduct and Business Practices for Stock brokers and Licensed Representatives be extended to all licensed intermediaries and be housed in a proposed single Code of Conduct.

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<sup>36</sup> "Financial advisers" means any one carrying out any of the following activity:

1. Advising others, either directly or through publications or writings, and whether in electronic, print or other form, concerning any investment product, other than — (a) in the manner set out in paragraph 2; or (b) advising on corporate finance within the meaning of the Securities and Futures Act (Cap. 289).
2. Advising others by issuing or promulgating research analyses or research reports, whether in electronic, print or other form, concerning any investment product.
3. Marketing of any collective investment scheme.
4. Arranging of any contract of insurance in respect of life policies, other than a contract of reinsurance.

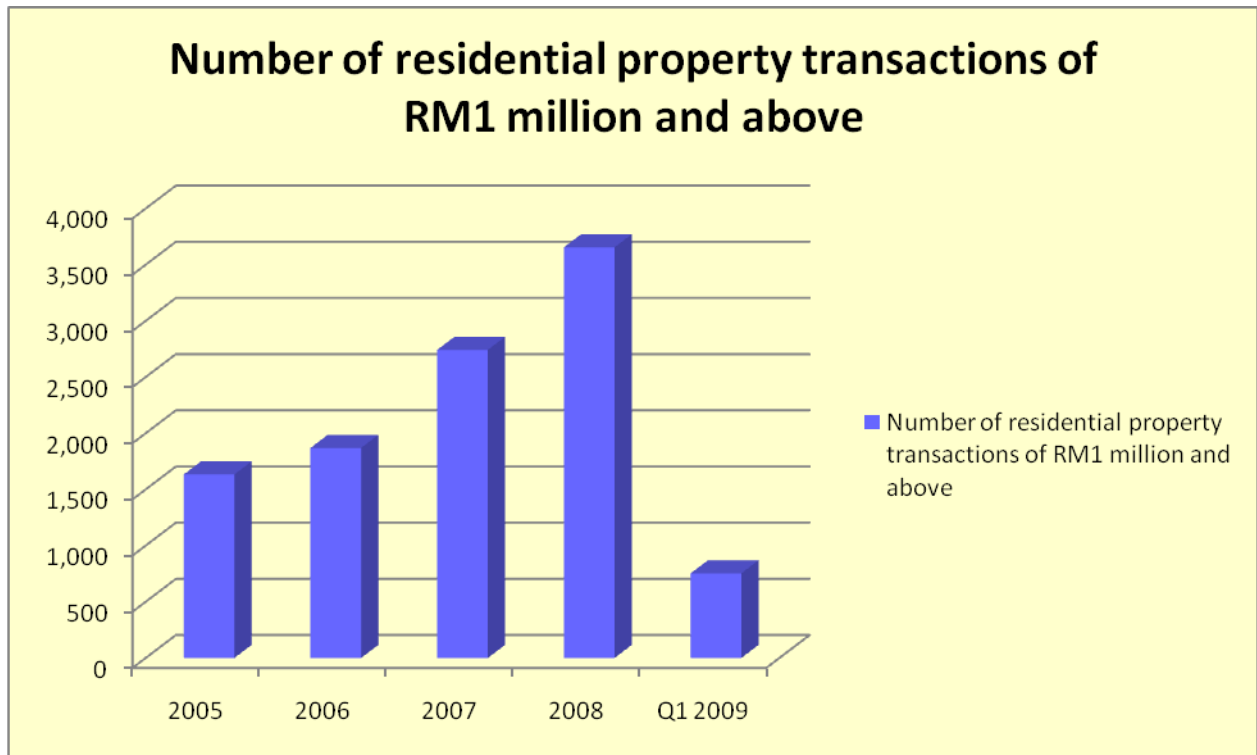
7.8.9 In addition to that, all conduct related proposals in this consultation paper are to be housed in the proposed Code of Conduct for all licensed intermediaries. The conduct related proposals are–

- (a) Know Your Client (KYC);
- (b) Advertising, Marketing and Promotional Materials;
- (c) Conflict of interest arising from monetary and non-monetary benefits; and
- (d) Conflict of interest arising from the use of gifts by product distributors;

7.8.10 The SC will consider other principles of conduct in addition to those specified above which are to be developed together with industry players.

7.8.11 The SC believes that having a single Code of Conduct that sets out general principles in respect of sales conduct will not only benefit investors but will also benefit the industry as it will provide certainty as to the conduct that is expected to be observed in respect of sale of products and services.

## Appendix 1



**Bar chart 1:** Number of residential property transactions of RM1 million and above taken from the Valuation and Property Services Department of the Ministry of Finance.

## Appendix 2

| <b>PRODUCT HIGHLIGHTS SHEET</b>   |
|---|
| <b>KEY PRODUCT FEATURES AND RISKS</b>   |
| <p><b>1. What are you investing in and who are you investing with?</b></p> <ul style="list-style-type: none"><li>• The objective of this question is for the issuer to describe the nature of the product and state the parties involved.</li></ul>   |
| <p><b>2. What are the key risks of this investment?</b></p> <ul style="list-style-type: none"><li>• The objective of this question is to allow investors to be aware of the key risks of the investment which they are exposed to.</li></ul>  |
| <p><b>3. What will you gain or lose in different situations, including the worst case?</b></p> <ul style="list-style-type: none"><li>• The objective of this question is to allow investors to be informed of what they could potentially gain or lose in different situations, including the worst case.</li></ul>   |
| <b>PRODUCT SUITABILITY</b>  |
| <p><b>4. Is the product suitable for investors who:</b></p> <ul style="list-style-type: none"><li>— <b>do not want to risk any part of their capital?</b></li><li>— <b>might need to sell their investments for short-term funding requirements?</b></li><li>— <b>do not have sufficient knowledge or experience investing in derivatives?</b></li></ul> <ul style="list-style-type: none"><li>• The objective of this question is to highlight to investors whether the product is suitable for investors whose investment objective is to preserve capital, investors who have liquidity needs, and investors who lack knowledge or experience in dealing with derivatives.</li></ul> |
| <b>MINIMUM INVESTMENT AMOUNT, FEES AND CHARGERS</b>   |
| <p><b>5. How much are you paying for this investment?</b></p> <ul style="list-style-type: none"><li>• The objective of this question is to inform investors of the minimum investment sum and the fees and charges of the distributors, fund managers and product providers, where applicable.</li></ul>  |



## LIQUIDITY

### 6. How often are valuations available?

- The objective of this question is to inform investors whether regular valuations are available and how to obtain them. If valuations are not readily available, the investors should be informed of the associated risks.

### 7. How can you exit from this investment and what are the risks and costs in doing so?

- The objective of this question is to inform investors of the mechanism by which investors can exit from their investment in the product and if the mechanism poses any risks or costs to investors, to highlight the risks and costs involved.

## STRUCTURAL SAFEGUARDS

### 8. Are the issuer, arranger and counterparties in Singapore and governed by Singapore law? If not, how does it affect you?

- The objective of this question is to highlight to investors whether the transaction parties involved in the product are entities in Singapore and subject to Singapore law. If not, the associated risks are to be highlighted to investors.

### 9. Is the investment secured by assets in Singapore? If not, how does it affect you?

- The objective of this question is to highlight to investors whether the assets securing the investment are located in Singapore. If not, the associated risks are to be highlighted to investors.

### 10. Is any aspect of the investment that has a material impact on you governed by foreign law? If so, how does it affect you?

- The objective of this question is to highlight to investors whether any aspect of the investment that has a material impact on investors is governed by foreign law. If so, the associated risks are to be highlighted to investors.

## OTHER RELEVANT INFORMATION

### 11. How do you contact us?

- The objective of this question is to establish the means by which investors may obtain information or raise complaints.

**12. What other important information should you know before you invest?**

- The objective of this question is to allow issuers to highlight any other material information which investors should know before investing in the product.

## Appendix 3

### PRODUCT KEY FACTS

[Product name and type

[Issuer's name and logo]

(e.g. XXX Callable Range Accrual ELIs)]

Issuer

[Date]

***This is an unlisted structured investment product.***

***This statement provides you with key information about this product.***

***This statement is a part of the offering document.***

***You should not invest in this product based on this statement alone.***

#### Quick facts

|                             |       |                              |                         |
|-----------------------------|-------|------------------------------|-------------------------|
| <b>Offer period:</b>        | [ • ] | <b>Issue date:</b>           | [ • ]                   |
| <b>Issue price:</b>         | [ • ] | <b>[Maturity /Expiry]</b>    | [ • ]                   |
| <b>Denomination:</b>        | [ • ] | <b>Date:</b>                 | [ • ]                   |
| <b>Minimum investment:</b>  | [ • ] | <b>Product type:</b>         | [ • ]                   |
| <b>Maximum loss[/gain]:</b> | [ • ] | <b>Principal protection:</b> | [Yes/No]                |
|                             |       | <b>Callable by Issuer:</b>   | [Yes/No][when earliest] |

#### What is this product and how does it work?

*[Briefly describe the nature of the product and how it works, in particular the situations under which investors will make gains/incur losses (with reference to the scenario analysis below)]*

What are the key risks? ***[Issuers may add other factors or revise the following as appropriate depending on the product]***

**Investment involves risks. Please refer to the [offering document] for details including the risk factors.**

- [Maximum loss – ***[product name]*** is not principal protected: you could lose all of your investment. *[Otherwise please explain the worst case scenario]*
- Unlisted structured product NOT protected deposit – Investment involves risks. This is an unlisted structured investment product which involves derivatives and is not

equivalent to nor should it be treated as a time deposit. The *[product name]* is not a protected deposit for the purposes of the Deposit Protection Scheme.

- [Limited upside – The maximum return is limited to [ • ]]
- [No liquid secondary market – *[product name]* has no liquid secondary market. If you try to sell your *[product name]*, you may not be able to find a buyer, or the sale price could be much lower than the amount you invested.]
- Counterparty risk – When you buy *[product name]*, you will be relying on [ultimate counterparty/issuer]'s creditworthiness. If [ultimate counterparty/issuer] becomes insolvent or defaults on its obligations under *[product name]* you can only claim as an unsecured creditor.
- Not the same as reference asset – Investing in *[product name]* is not the same as investing in the underlying assets. [Please elaborate as appropriate]

What are the key features?

*[Any assumption?]*

[Call feature]

*[[ describe how this works]* Potential early termination on any call date prior to expiry upon occurrence of [event]].

[Airbag feature]

*[ describe how this works]*

[Maximum potential return/coupon]

[ • ]%

*[Conditions for this to be achieved]*

[Payout scenarios]

[100]% of the principal amount

[Physical delivery of [worst performing asset in the basket]]

[Worst case scenario –any coupon?]

[Notwithstanding the parameters prescribed under this template, issuers are required to comply with the general principles applying to disclosure on the Product Key Facts Statement under the Code on Unlisted Structured Products]

Is there any guarantee or collateral?

*[Description of guarantee or collateral and disclosing the rights and exposures of investors]*

[You may not get back the amount of money you invest.]

|   |
|---|
| <p>Scenario analysis</p> <ul style="list-style-type: none"> <li>• Worst case scenario<br/>[ • ]</li> <li>• Middle-of-the road scenario<br/>[ • ]</li> <li>• Best case scenario<br/>[ • ]</li> </ul>   |
| <p>How can you buy the product?</p> <ul style="list-style-type: none"> <li>• [You can contact the appointed intermediaries to enquire about the product.]</li> <li>• [You will need to complete an [application/order] form provided by the intermediaries.]</li> <li>• [Your intermediary will also inform you the purchase consideration and any applicable charges.]</li> </ul>  |
| <p>Mode of settlement</p> <ul style="list-style-type: none"> <li>• [You will need to specify whether you elect for cash settlement or physical settlement at the time of application.]<br/>[You can change your election at any time no later than [ • ].]</li> <li>• [Please ask your intermediary for details.]</li> </ul>  |
| <p>Adjustments to the terms and conditions of the product [upon the occurrence of extraordinary events]</p> <ul style="list-style-type: none"> <li>• [Certain terms and conditions (including some of the key dates) of the product can be adjusted in certain circumstances.]</li> <li>• [Please refer to [ • ] for details.]</li> </ul>   |
| <p>What are the fees and charges?</p> <p><b><i>[Please elaborate as appropriate]</i></b></p>  |
| <p>Can you sell the product before expiry?</p> <ul style="list-style-type: none"> <li>• <b><i>[Product name]</i></b> is not listed on any stock exchange. There is no liquid secondary market.]</li> <li>• [The market agent [may/will] provide limited market making arrangements during [ • ]. Please refer to [ • ] for details]</li> <li>• [The sell-back value of your [<i>product name</i>] will be determined by [ • ] and may be substantially less than your initial investment.]</li> </ul> |
| <p>How can you find out the current market value of the product?</p>  |

|   |   |        |       |                  |      |       |  |        |       |  |          |       |
|---|---|--------|-------|------------------|------|-------|--|--------|-------|--|----------|-------|
| <ul style="list-style-type: none"> <li>• [You can request your intermediary to provide an indication of the daily market value of the product.]</li> <li>• [The market value of the product will also be reported in [ • ]]</li> </ul>  |   |        |       |                  |      |       |  |        |       |  |          |       |
| <p>Continuing disclosure obligations</p> <ul style="list-style-type: none"> <li>• <b><i>[State the types of reports/accounts that will be sent to investors and when will those reports/accounts be sent to them]</i></b></li> <li>• <b><i>[Depending on the actual circumstances of the case, state the continuing disclosure obligations as appropriate, bearing in mind the requirements under Chapter 7 of the Code on Unlisted Structured Products]</i></b></li> </ul>   |   |        |       |                  |      |       |  |        |       |  |          |       |
| <p>Additional information</p> <p><b><i>[Insert any other additional important information]</i></b></p>  |   |        |       |                  |      |       |  |        |       |  |          |       |
| <p>Product arranger's /intermediaries' information</p> <table> <tr> <td>[Name of product arranger/intermediaries]</td> <td>Phone:</td> <td>[ • ]</td> </tr> <tr> <td>[Address]: [ • ]</td> <td>Fax:</td> <td>[ • ]</td> </tr> <tr> <td></td> <td>Email:</td> <td>[ • ]</td> </tr> <tr> <td></td> <td>Website:</td> <td>[ • ]</td> </tr> </table> <p><i>[Note : As an alternative to providing the details of the intermediaries, details of where investors could obtain information on the intermediaries may be provided]</i></p> | [Name of product arranger/intermediaries] | Phone: | [ • ] | [Address]: [ • ] | Fax: | [ • ] |  | Email: | [ • ] |  | Website: | [ • ] |
| [Name of product arranger/intermediaries]   | Phone:                                    | [ • ]  |       |                  |      |       |  |        |       |  |          |       |
| [Address]: [ • ]  | Fax:                                      | [ • ]  |       |                  |      |       |  |        |       |  |          |       |
|   | Email:                                    | [ • ]  |       |                  |      |       |  |        |       |  |          |       |
|   | Website:                                  | [ • ]  |       |                  |      |       |  |        |       |  |          |       |
| <p>Important</p> <p>If you are in doubt, you should seek professional advice.</p> <p>The SFC takes no responsibility for the contents of this statement and makes no representation as to its accuracy or completeness.</p>   |   |        |       |                  |      |       |  |        |       |  |          |       |

### Guidance for preparing this statement

1. If you want to include a responsibility statement in this statement, please make sure that such statement is consistent with the responsibility statement in other parts of the offering document.
2. Where the issue of the offering document is described as having been authorized by the SFC, please include a SFC non-endorsement statement in this statement pursuant to the requirements of the Code on Unlisted Structured Products.

3. Disclosures shall be visually reader-friendly and written in plain language so that investors can easily read and understand them. Use of technical jargon or complex sentences shall be avoided.
4. Use of visual aids, graphs and charts is generally encouraged to illustrate the product structure and features.

*Note : For example flowcharts may be used to assist investors' understanding of the product structure.*

5. Depending on the actual circumstances of the case, the contents in this statement may differ. Nevertheless, the headings set out in the template above are generally expected to be observed unless there are good reasons to do otherwise. Words inside the square brackets in the template are drafting notes. They should be construed as examples rather than suggestions, and are not meant to be exclusive or prescriptive. Issuers are responsible for what is and what is not to be included in this statement.

## Appendix 4

### Guidelines on Market Conduct and Business Practices for Stockbrokers and Licensed Representatives

#### PART II

#### 3.0 CORE PRINCIPLES OF SUPERVISION

- (a) The SC is actively promoting a culture of compliance, professionalism, ethical standards and responsible conduct among stockbrokers and their representatives and employees. Towards this end, the SC has adopted principles-based regulation in supervision and set out below are 11 core principles which apply to stockbrokers:

| <b>Core Principles</b>              |  |
|-------------------------------------|--|
| <b>1. Integrity</b>                 | <b>A licensed person must conduct its business with integrity.</b><br>(Example: Act in a fair and consistent manner, and treat all clients fairly, equitably and equally.)   |
| <b>2. Skill, care and diligence</b> | <b>A licensed person must conduct its business with due skill, care, and diligence.</b><br>(Example: Ensure employees are suitably qualified for the positions in which they are employed, and there are sufficient resources to manage business activities and accommodate temporary absence of key personnel.) |



| <b>Core Principles</b>            |   |
|-----------------------------------|---|
| <b>3. Supervision and control</b> | <p><b>A licensed person must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management and supervisory system.</b></p> <p>(Example: Ensure key duties and functions are properly segregated. Establish a system of follow-up and review for delegated authority and responsibility. Ensure proper assessment and management of risks, and provision of timely and adequate information to senior management.)</p> |
| <b>4. Financial requirements</b>  | <p><b>A licensed person must maintain adequate financial requirements.</b></p> <p>(Example: Level of risk assumed by the stockbroking company must commensurate with its level of capital.)</p>   |
| <b>5. Market conduct</b>          | <p><b>A licensed person must conduct its business activities in a manner which contributes to the maintenance of a fair and orderly market.</b></p> <p>(Example: Implement policies and procedures to detect and prevent fraud, market rigging, and other improper activities.)</p>   |

| <b>Core Principles</b>                   |  |
|--|--|
| <b>6. Priority to client's interests</b> | <p><b>A licensed person must give priority to the client's interest.</b></p> <p>(Example: Refrain from dealing for own account ahead of clients' orders.)</p>  |
| <b>7. Communication with clients</b>     | <p><b>A licensed person must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair, and not misleading.</b></p> <p>(Example: Must not deliberately mislead or attempt to mislead a client.)</p>  |
| <b>8. Conflict of interests</b>          | <p><b>A licensed person must manage conflict of interests fairly, both between itself and its clients, and between a client and another client.</b></p> <p>(Example: Ensure proper Chinese Wall policies and procedures are put in place to prevent the company or its employees from taking advantage of confidential price sensitive information.)</p> |
| <b>9. Safeguarding clients' assets</b>   | <p><b>A licensed person must arrange adequate protection for clients' assets.</b></p> <p>(Example: Ensure clients' monies and properties are credited into a trust account, and conduct reconciliation of trust account balance as per company's records with bank statements.)</p>  |

| <b>Core Principles</b>             |  |
|------------------------------------|--|
| <b>10. Compliance culture</b>      | <p><b>A licensed person must inculcate good compliance culture.</b></p> <p>(Example: Board of directors must establish clear compliance policies and procedures that extend to all operations of the company.)</p>   |
| <b>11. Dealing with regulators</b> | <p><b>A licensed person must deal with its regulators in an open and co-operative way.</b></p> <p>(Example: To promptly report information that is of material significance to the SC, and supply the SC with documents and information when requested and within the time limits of request.)</p> |

## **Appendix 5**

### **Guidelines on Marketing and Distribution of Unit Trust Funds**

3.02 An authorised person should, at all times–

- (a) act with honesty, dignity and integrity. An authorised person who is an individual, must conduct and encourage others to deal in units of unit trust funds in a professional and ethical manner that will reflect credit on themselves, fellow registered persons and the industry;
- (b) deal in a fair and equitable manner, and avoid aggressive and offensive sale practices;
- (c) deal in good faith and with best of intentions; and
- (d) treat investors with respect and disclose fully all information pertinent for investors to make informed investment decisions.

3.03 An authorised person should not misrepresent or recklessly represent–

- (a) (for individuals) his qualifications or that of the principal he represents;
- (b) the products and/or its characteristics offered by the principal; and
- (c) the past performances of the fund he is marketing.

3.04 Conduct which is dishonest includes any omission of a material fact. A material fact is defined as one which causes investors to perceive the fund to be different from what is actually represented to them.

3.05 An authorised person who is an individual should, on introduction to a prospective investor, disclose that he is authorised to deal in unit trust funds and produce his

authorization card to identify himself. Only cards issued by a body approved by the SC or a recognized self-regulatory organization are recognized for dealing in units of unit trust funds.

3.06 As prescribed under section 232 of the CMSA, an authorised person should not–

- (a) deal in units of unit trust funds unless the prospectus of the fund has been registered with the SC; and
- (b) issue, circulate or distribute any application forms unless the form is accompanied by a copy of the prospectus.

3.07 An authorised person should conduct all dealings with every care, skill and diligence. In this regard, an authorised person should–

- (a) ensure as far as possible that the unit trust fund is suitable for the needs of the prospective investor and is not beyond the investor's resources;
- (b) take all reasonable steps to give information in a comprehensible, full and fair manner to assist the prospective investor make a balanced and informed decision;
- (c) provide information only on those matters in which he is competent to deal with and seek or recommend other specialist advice to the prospective investor where appropriate;
- (d) when conveying information to a prospective investor, bear in mind the overall context in which the statements are made. Different investors may require different levels of detail and explanation. Efforts should be made to improve the amount and clarity of information given. Brief or overly technical explanations tend to create confusion and misunderstanding;

- (e) in making comparisons with other funds, make clear the different characteristics of each fund; and
- (f) not omit a material fact, nor make exaggerated, unwarranted, misleading statements or claims, or forecasts of future events.

3.08 An authorised person should adequately explain to a prospective investor the nature and characteristics of the fund that is being marketed. Towards this end, an authorised person should–

- (a) make clear all essential attributes of the fund, including–
  - (i) the investment objectives of the fund;
  - (ii) the investment strategy to achieve the stated objectives;
  - (iii) the risks of investing in that fund and unit trusts generally;
  - (iv) the distribution policy of the fund;
  - (v) the fees, charges and expenses involved; and
  - (vi) the tax implications (if any);
- (b) ensure as far as possible that the prospective investor understands what he is committing himself to; and
- (c) draw attention to any unique feature and/or restriction applicable to the fund, such as–
  - (i) (if loan financing is to be used) the risks of purchasing units via loan facilities; and

- (ii) the long-term nature of the fund and the risks of early withdrawal from the fund.

3.09 An authorised person should endeavour to provide prompt, efficient and continuous service to investors. In particular, he should be ready to answer any query about the funds.

3.10 An authorised person should take every precaution to protect and preserve the confidentiality of investors' information and must not in any way use such information for his personal or another person's gain.

3.11 An authorised person should—

- (a) maintain knowledge of, and comply with, all applicable laws and rules governing the unit trust industry. Where required, he must deal with the regulatory authorities in an open and co-operative manner, and disclose such information as is reasonable and appropriate; and
- (b) act with proficiency and strive to maintain and improve his competency and that of fellow registered persons.

## **Appendix 6**

### **Guidelines on the Offering of Structured Products**

#### **8.0 SUITABILITY AND FAIR DEALING REQUIREMENTS**

- 8.01 A primary seller shall adopt fair dealing best practices when dealing, marketing and selling structured products to investors. In particular, the different standards of fair dealing in relation to institutional investors and investor individuals should be noted and addressed. This includes giving an investor individual who invests in structured products during an offer period, the option to obtain a full refund of his principal investment sum within three working days of such investment or the remaining offer period, whichever is earlier.
- 8.02 A primary seller should endeavor to make an investor understand the risks in relation to investing in structured products before marketing and selling structured products to that investor. The following are minimum key measures that a primary seller is expected to observe to ensure adequate investor protection with regard to any issue, offer, invitation for, or the making available of structured products:
- (a) **KNOW YOUR CLIENT:** To determine whether structured products are suitable for the targeted client, a primary seller should take all reasonable steps beforehand to assess the client's financial position, investment experience and investment objectives.
  - (b) **DUTY OF CARE:** A primary seller should ensure that the financial risks and potential losses that may arise from investing in structured products are fully explained to clients before the client makes his investment decision. Projections of returns on investment are to be based on historical performance, if available, and reasonable expectations of future performance.
  - (c) **SALES PERSONNEL:** A primary seller should ensure that actual and potential clients are only attended to by specifically identified personnel who have a financial background and possess adequate knowledge and understanding of structured products, particularly when dealing with investor individuals.



- (d) **PROVIDE RISK DISCLOSURE STATEMENT:** A primary seller should provide clients with pertinent information regarding the risks in investing in structured products. In this regard, the risk disclosure statement is to be provided separately from the application form or other document constituting a contract between an Eligible Issuer and the investor, and is to be furnished to the potential investor together with other promotional and sales documents, before any binding contract is entered into by the investor.
  
- (e) **CONFIRMATION OF DISCLOSURE BY CLIENT:** A primary seller should invite the client to read the risk disclosure statement, ask questions and take independent advice if the client so wishes. Thereafter, the client should be requested to sign a confirmation that the relevant disclosure has been made by the primary seller.
  
- (f) **INVESTOR INDIVIDUALS:** A primary seller should ensure that a higher standard of diligence is exercised when dealing with investor individuals. Among other things, investor individuals should be provided with the contact information of the relevant person(s) (and not merely an automated answering service) who may be contacted for queries, requests and complaints.

## **Appendix 7**

### **Guidelines on Wholesale Funds**

3.04 The fund manager must have in place appropriate systems, procedures and controls, which commensurate with the size of the wholesale fund being managed and the wholesale fund's risk profile, including–

- (a) organizing its internal affairs in a responsible manner, ensuring it has appropriate internal controls and risk management systems, procedures and controls designed to mitigate and manage such risk;
- (b) observing high standards of integrity and fair dealing in managing the wholesale fund to the best interest of its investors; and
- (c) ensuring that the fund manager's representatives have the requisite level of knowledge and experience for the tasks that they undertake, are competent for the work they undertake and are appropriately supervised.