Suruhanjaya Sekuriti
Securities Commission
Malaysia

The Reporter

2023 Issue

Executive Summary

CONTENTS

As part of the Securities Commission Malaysia's (SC) mandate to regulate and develop the Malaysian capital market, the SC has been on an ongoing mission to maintain a secure capital market for the protection of investors and also seeks to promote the overall well-being of the capital market which includes sustainability and competitiveness of the capital market ecosystem through its rule-making, supervisory and enforcement functions. Towards these objectives, *The Reporter* serves to provide insights on the SC's requirements and expectations *vis-à-vis* compliance and is part of the myriad of regulatory tools in SC setting out to be an open and transparent regulator.

On this note, the first article of this issue of *The Reporter* seeks to explain why the offence of intentionally causing wrongful loss under section 317A of the *Capital Markets and Services Act 2007* (CMSA) was introduced and the application of the said provision by the SC in its enforcement action in the case of Stone Master Corporation Bhd. The article further highlights the relevant corporate governance principles applicable and the importance of their implementation to support directors in discharging their roles and duties.

The second article serves to highlight the growth in sustainable and responsible investment (SRI) in the fund management industry in Malaysia as well as the initiatives that the SC has correspondingly put in place to combat the rise in greenwashing in the Malaysian SRI fund industry observed.

The third article of *The Reporter* delves into the background and key features of the SC's current regulatory framework for marketing representatives (MRs). The article highlights the various instances of poor conduct observed from both MRs and Capital Markets Services Licence (CMSL) holders, the SC's expectations of CMSL holders to curb such shortcomings, as well the SC's exercise of its supervisory functions in this regard.

In addition, the fourth article serves to give insight into the development of financial product governance regulations in Malaysia by the SC and other jurisdictions in the last decade and why product issuers and distributors need to implement an effective product governance framework within their businesses. The article also provides a summary of the SC's proposals on which the SC will be consulting several focus groups from the industry pursuant to its review of the relevant existing regulations in this area.

In an effort to encourage a more dynamic capital market, the SC also endeavours to provide robust and flexible regulatory frameworks to facilitate alternative methods of capital-raising and investment opportunities, in particular through the use of technology. In line with this, the final article of *The Reporter* seeks to provide some insights on the concept of crowdfunding, the regulatory considerations in the development of the equity crowdfunding (ECF) framework after 2015 and initiatives to promote them, as well as the latest updates and observations in this area.

Please share with us your comments, feedback or ideas for future editions via email to the Editorial Team at **reporter@seccom.com.my**

Stone Master - A Case of Causing Wrongful Loss to a Listed Corporation

This article discusses the case of Stone Master Corporation Bhd (Stone Master), which involved an elaborate scheme to defraud the listed corporation. The SC's actions are part of its continued efforts in strengthening the Corporate Governance (CG) regulatory framework in the capital market which, among others, started with the introduction of section 317A of the *Capital Markets and Services Act 2007* (CMSA) to address the issue of causing wrongful loss to listed corporations. The Stone Master case is one of the early cases in which the SC has taken action against a deputy managing director for causing wrongful loss to the listed corporation. This article also discusses the role of directors and how adopting and fortifying good practices are necessary in ensuring proper discharge of their legal duties.

Introduction of Offence of Causing Wrongful Loss

Financial irregularities involving listed corporations not only erodes trust and confidence among the corporation's stakeholders but also affects confidence in the capital market as a whole. The financial debacles of Transmile Group Bhd and Megan Media Holdings Bhd affected Malaysia's CG ranking in 2007.[1] Further, the World Bank's CG Report emphasised that director accountability in Malaysia required further improvement, particularly through effective enforcement.[2]

In 2010, the SC sought to strengthen its ability to uphold CG standards in relation to the financials of listed corporations through, among others, the introduction of section 317A which relates to causing wrongful loss to listed corporations. The aim of section 317A is to prevent the assets of a listed corporation from being misused by individuals entrusted with the role of managing the affairs of the listed corporation.

The new provision imposes a criminal penalty of imprisonment of not less than two years and a fine not exceeding RM10 million. The SC is empowered to initiate a criminal action or a civil enforcement action. Prior to this, the SC's ability to enforce CG standards against listed corporations was limited to taking administrative action under section 354 of the CMSA for breaches of CG provisions in Bursa Malaysia Securities Bhd's (Bursa Malaysia) listing requirements.

The Stone Master Case

Background

Incorporated in 1999, Stone Master and its group of companies were in the business of manufacturing and trading of marble, granite products, ceramic tiles, sanitary wares and contract works in the property development sector in Malaysia. Stone Master became the first company in the dimension stone industry to be listed on Bursa Malaysia in 2002.

[1] *ACGA-CLSA Corporate Governance Watch 2007:* https://www.acga-asia.org/cgwatch-detail.php?id=154

[2] World Bank, Malaysia: *Report on the Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment* (2005): https://openknowledge.worldbank.org/server/api/core/bitstreams/45c0b6ea-65ba-537a-a743-148a0440d942/content

Scheme to Defraud

Datin Chan Chui Mei (Chan), the deputy managing director of Stone Master, was involved in numerous self-dealing transactions. To camouflage these transactions, she created an elaborate scheme to defraud the listed corporation through artificial transactions which resulted in Stone Master acquiring huge debts with various third parties.

Stone Master had entered into 23 separate exclusive agency agreements (agency agreements) with 23 foreign companies based in China (China companies). These agreements were for the exclusive rights to market and promote construction products belonging to these China companies. Based on the terms of the agency agreements which were substantially identical, Stone Master was required to pay an initial agency fee amounting to RM3.05 billion. Upon the execution of the agency agreements, Stone Master was to pay a non-refundable deposit of RM11.59 million.

At the material time, Chan was a substantial shareholder of Stone Master, holding about 5.4% of its shares through her company Starfield Capital Sdn Bhd (Starfield Capital). Starfield provided financial assistance to Stone Master in the form of a loan amounting to RM18 million for the payment of the non-refundable deposit.

Setting up Fake Subsidiaries

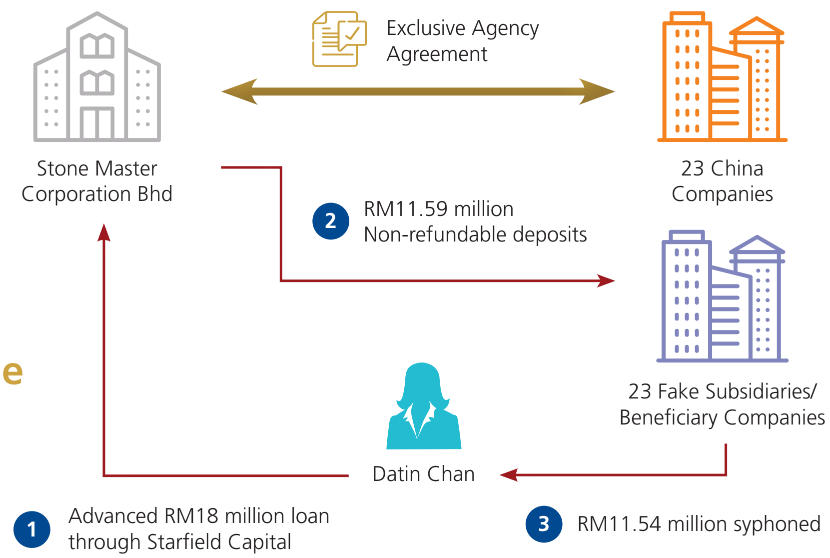
Chan was instrumental in setting up 23 private limited companies incorporated in Malaysia on 21 January 2016 which were purportedly subsidiaries and beneficiaries of the 23 China companies (fake subsidiaries). These companies were set up without the knowledge of the China companies and letters of authorisation were later sought from the China companies and backdated to 28 December 2015 before the fake companies were set up.

The same two directors were appointed for each of the fake subsidiaries and were puppets of Chan as they did whatever they were told, including passing a resolution to make Chan the sole authorised signatory for the bank accounts of the 23 fake subsidiaries.

Monies Siphoned to Personal Account

Stone Master transferred RM11.59 million as payment for the non-refundable deposits to the 23 fake subsidiaries. Following this, almost 99% of the said amount (i.e. a total of RM11.54 million) was subsequently transferred into Chan's personal bank account. She used part of the monies for her personal use such as for credit card payments, housing loans and fixed deposits while some funds were also transferred to other bank accounts belonging to her as well as third parties.

Money Trail of the Scheme



The SC Commences Enforcement Action

Following an investigation, the SC moved quickly to initiate a civil action on 26 September 2016 against Chan for creating an elaborate scheme to defraud Stone Master with the intention of causing wrongful loss. The SC sought, among others, the following orders against Chan–

i. a declaration that Chan had contravened sections 179 and/or 317A and/or 370 of the CMSA;

ii. an order that Chan makes restitution to persons aggrieved by the contravention;

iii. an order that Chan pays the SC the sum of RM11.54 million, to be held in trust for Stone Master;

iv. an order that Chan be barred from being a director of a public-listed company for a period of five years;

v. payment of civil penalty of RM1 million to the SC for the contravention; and

vi. costs and interest.

In order to prevent the monies from being dissipated on the same date of the filing of the civil suit, the SC obtained an injunction to restrain Chan from dealing with the monies from Stone Master which had been channelled into her personal bank account up to the amount of RM11.54 million pending the outcome of the case.

Court Proceedings by the SC against Chan

On 17 December 2019, after a full trial, the High Court ruled that the SC had successfully proven its case against Chan and made the following orders–

i. a declaration that Chan had contravened sections 179, 317A and 370 of the CMSA;

ii. Chan to pay the SC RM11.54 million and this sum is to be held by the SC in trust for Stone Master;

iii. Chan to pay the SC civil penalty of RM1 million;

iv. Chan to be barred from being a director, or to be involved in the management, whether directly or indirectly, of any public company for a term of five years from the date of the judgment; and

v. Chan to pay costs of RM150,000 to the SC.

Findings of the Court

An excerpt of the High Court judge's grounds of judgment by Justice Mohamed Zaini bin Mazlan[3]:

"I am satisfied, that the plaintiff had on a balance of probabilities, proved the following against Datin Chan:

(a) That she was in a position of power and control of Stone Master, and that she was instrumental in-
(i) getting Stone Master to take up the loan of RM18 million from Starfield; and
(ii) proposing and getting Stone Master to enter into the agency agreements with the 23 China companies.

(b) Was instrumental in the formation of the 23 subsidiary companies.

(c) Appointed PW-9 and PW-10 as puppet directors for the 23 beneficiary companies, so that she could have full control over these companies.

(d) Became the sole signatory of the 23 subsidiary companies' bank accounts without the knowledge of Stone Master's board of directors.

(e) Concocted and fabricated the alleged letter of authorisation by the 23 beneficiary companies giving her the mandate to set up the 23 beneficiary companies.

(f) Kept Stone Master's board of directors in the dark of her activities with the 23 China companies and also the 23 beneficiary companies, and failing to disclose her conflict of interest and related party transactions."

Dissatisfied with the decision of the High Court, Chan appealed the decision to the Court of Appeal and thereafter for leave to appeal to the Federal Court. She was unsuccessful in both instances. Pending the hearing of Chan's appeal, the SC sought and succeeded to get a garnishee order from the High Court and pursuant to the said order, a sum of approximately RM6.7 million was recovered and held by the SC pending the final outcome of the case. On 7 September 2022, the Federal Court unanimously dismissed Chan's application for leave to appeal.

The decision of the Federal Court in September 2022 brings finality to the entire case after seven years. This included various challenges by Chan's legal team such as the challenging of the injunction order, application to strike out the SC's suit and various stay applications.

Following the decision of the Federal Court, the SC remitted a sum of RM5.439 million to the liquidators of Stone Master.

Strengthening Good CG Practices and Discharge of Directors' Duty of Care, Skill and Diligence

The case of Stone Master clearly highlights the crucial role directors play in running a company. With increasing public expectation on good CG conduct and practices, the law regarding the duty of directors to exercise care, skill and diligence continues to evolve.

[3] See *Securities Commission v Chan Chui Mei* [2019] 1 LNS 1955, at paragraph 128.

With this development, the effective adoption and implementation of the principles and best practices set out in the *Malaysian Code on Corporate Governance* (MCCG) is necessary to facilitate directors in ensuring the proper discharge of their legal duties, particularly the duty of care, skill and diligence. Equally important is the responsibility of directors in delegation and reliance on delegates of the company that are sitting as board members.

As business of management intensifies and becomes more and more complex, directors' ability to delegate and rely on their co-directors and management also becomes more crucial and necessary. Delegation is but one important function which directors regularly perform in the course of the day-to-day management of their companies[4] and is so recognised under the law[5].

The case of Stone Master demonstrates an example where individuals who have been delegated and entrusted to take on certain duties (and who appeared to be appropriate and qualified to do so) failed to perform those duties, honestly or otherwise.

Sections 213(2), 215 and 216 of the *Companies Act 2016* codifies the duty of care, skill and diligence as well as the ability of directors to reasonably rely on information and reasonable delegation. These provisions should be read together with court decisions which provide greater insights to the application of these requirements including the standard expected to be discharged by directors. Among others:

(i) Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them to properly discharge their duties as directors.[6]

(ii) While directors are entitled to delegate particular functions to those below them in the management chain, and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions.[7]

(iii) While directors are not in a position to check the information themselves or provide 'hands-on' supervision of management and employees, they are in a position to ensure that structure of reporting and supervision are put in place to ensure that–

  (a) the information upon which they rely is indeed accurate and reliable; and

  (b) management and employees are subject to supervisory checks and balances to ensure that they operate in accordance with the scope of authority delegated as well as within the laws and regulations.[8]

It is of utmost importance for the board to have in place proper systems and to ensure the procurement of reliable and efficient information as well as ensuring the effective supervision of management and employees. The failure to have in place proper systems and controls could result in claims of breach of the standard of care expected of directors.

[4] Ford HAJ, Austin RP and Ramsay IM, *Ford's Principles of Corporations Law* (9th Ed) at para 8.330.
[5] Section 216, *Companies Act 2016 (Act 777)*
[6] *Re Barings plc (No 5)*[1999] 1BCLC 433.
[7] Ibid.
[8] David Kershaw, *Company Law in Context – Text and Materials* (Oxford).

MCCG Principles

The MCCG issued by the SC sets out principles, practices and guidance on good CG to help boards manage the business affairs of their companies. The MCCG provides a framework of control mechanisms that support the company in achieving its goals while avoiding conflicts. The pillars of CG such as accountability, transparency and sustainability are important to the governance of companies and stewardship of investors' capital.

While this may not guarantee that companies will not be faced with board misconduct as in the case of Stone Master, companies whose boards embrace these principles and practices are more likely to ensure that they act in the best interest of their companies in the discharge of their legal duties.

The principles and guidance below are pertinent for board effectiveness, risk management, and controls, providing a good start for companies and their board of directors.

Board Effectiveness (MCCG Principle A – Board Leadership & Effectiveness)

Practice 1.1

The board should set the company's strategic aims, ensure that the necessary resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and other stakeholders are understood and met.

Guidance (G1.1)

All directors should objectively discharge their duties and responsibilities at all times as fiduciaries in the interests of the company. All directors must act with integrity, lead by example, keep abreast of his responsibilities as a director and of the conduct, business activities and development of the company.

To enable the board to discharge its responsibilities in meeting the goals and objectives of the company, the board should, among others:

- Together with senior management, promote good corporate governance culture within the company which reinforces ethical, prudent and professional behaviour.

Effective Risk Management and Internal Controls (MCCG Principle B – Effective Audit & Risk Management)

Practice 10.1

The board should establish an effective risk management and internal controls framework.

Guidance 10.1

The board should determine the company's level of risk tolerance and actively identify, assess and monitor key business risks to safeguard shareholders' investments and company assets. Internal controls are important for risk management and the board should be committed to articulating, implementing and reviewing the company's internal control framework.

- Review, challenge and decide on the management's proposals for the company, and monitor its implementation by management.

- Supervise and assess management performance to determine whether the business is being properly managed.

- Ensure there is a sound framework for internal controls and risk management.

- Ensure that there is an appropriate risk management framework to identify, analyse, evaluate, manage and monitor significant financial and non-financial risks.

Practice 3.1
The board establishes a Code of Conduct and Ethics for the company, and together with management implements its policies and procedures, which include managing conflicts of interest, preventing the abuse of power, corruption, insider trading and money laundering.

Conclusion

The case of Stone Master reinforces the importance of the board in ensuring and fortifying good CG practices. While the SC would do its part in pursuing errant directors and officers, it is imperative that boards and management of corporations do their part, including ensuring proper and effective governance structures and processes are in place towards addressing risk and transformation.

Sustainable and Responsible Investment Fund Management Industry in Malaysia

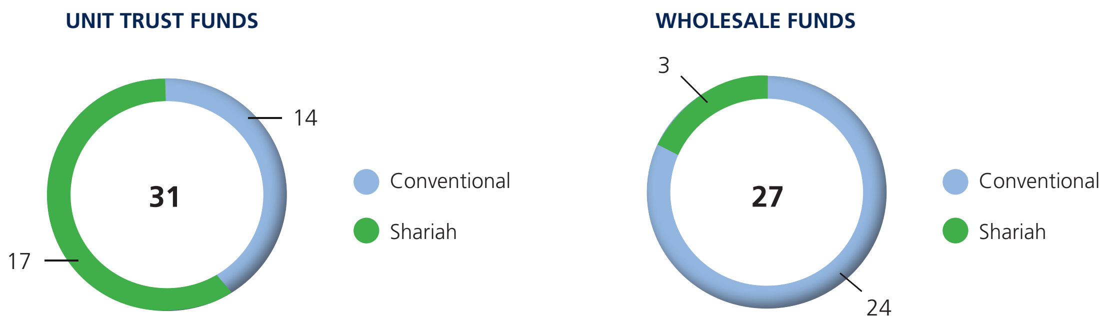
Introduction

The concept of environmental, social and governance (ESG) has grown by leaps and bounds since it was first introduced by the United Nations Global Compact in 2004[1]. In line with this, as many seek to get onboard the bandwagon of sustainable and responsible investment (SRI), concerns have been raised on the practices of greenwashing due to exaggerated claims about the environmental or social impact of the investments. Greenwashing is increasingly becoming a concern for regulators as funds marketed as being ESG or SRI-friendly may not be true-to-label, and hence may pose misrepresentation and mis-selling risk to investors. This article highlights measures that the SC has put in place to mitigate the risks of greenwashing in the SRI fund management in Malaysia.

Growth of Sustainable Investments

In recent years, sustainable investments have witnessed significant growth driven by investors' increasing awareness of environmental concerns, a desire to create positive impact, the need to manage risks associated with ESG factors, as well as regulatory and policy changes. Globally, assets under management (AUM) surged from US$30.7 trillion in 2018 to US$35.3 trillion in 2020[2] and this amount is likely to grow further where ESG AUM is expected to exceed US$53 trillion by 2025[3]. This represents a remarkable increase from the US$22.8 trillion in AUM at the beginning of 2016[4]. Sustainable fund inflows also showed greater resilience within the last quarter of 2022, with US$37 billion of fund inflows, relative to the broader market which experienced US$200 billion of net withdrawals over the same period[5].

SRI Funds in Malaysia



The list of designated SRI funds in Malaysia can be accessed at **www.sc.com.my**

[1] See United Nations Global Compact 2004 Report, *"Who Cares Wins"*: https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf
[2] How sustainable investing will become the norm, World Economic Forum, 2022.
[3] ESG assets may hit US$53 trillion by 2025, a third of global AUM, Bloomberg Intelligence, 2021.
[4] *2016 Global Sustainable Investment Review*, Global Sustainable Investment Alliance, 2017.
[5] Global Sustainable Fund Flows: Q4 2022 in Review, Morningstar, 2023.

Similar growth trends have been observed in Malaysia, where the growth of qualified SRI funds has grown multi-fold since the *Guidelines on SRI Funds* was introduced in 2017. As at 2022, the SRI fund industry in Malaysia has grown to RM7.05 billion in Net Asset Value (NAV) with a total of 58 SRI funds. These figures indicate a strong interest from both investors and fund managers in integrating ESG factors into their investment strategies.

Addressing Greenwashing Risks

While the rise of sustainable investments presents exciting opportunities, it also brings forth the challenge of greenwashing, where misleading or unsubstantiated claims are made about the ESG attributes of investment products.[6] A survey conducted among investors in the United Kingdom revealed that the biggest concern among 44% of the respondents is investments not being what they claim.[7] This highlights the need for greater transparency and clarity in the sustainable investment landscape. Globally, the absence of standardised definitions for sustainable products, combined with the challenge of obtaining the required data to support investment selection of sustainable products further amplifies the concerns surrounding greenwashing, prompting regulators, investors, and asset management firms to closely monitor the potential risks associated with it.

These risks related to greenwashing are currently addressed through the regulatory framework which prohibits the provisions of false or misleading disclosures to the SC and the stock exchange under section 369 of the CMSA. Where it relates to the sales of products such as SRI funds, the *Guidelines on Sales Practices of Unlisted Capital Market Products* provides that product issuers and distributors are to treat investors fairly, honestly and responsibly, and includes providing accurate and reliable information on the products. The *Guidelines on SRI Funds* provide guidance on the disclosure and reporting requirements for SRI funds.

The Need for Reliable and Comparable Information

In order to drive sustainable investments, it is important to have high quality, consistent and comparable sustainability disclosures. In recognition of this requirement, the International Sustainability Standards Board (ISSB) spearheads the development of a global baseline of sustainability reporting standards, an effort which has received wide support, which the SC echoes.

To support the implementation of the International Financial Reporting Standards (IFRS) Sustainability Disclosure Standards (ISSB Standards) Sustainability Disclosure Standards (ISSB Standards), the SC has established a national level Advisory Committee on Sustainability Reporting (ACSR) which members include Bank Negara Malaysia (BNM), Bursa Malaysia, the Companies Commission of Malaysia (SSM), the Audit Oversight Board (AOB) and the Financial Reporting Foundation. Ultimately, the ACSR's efforts will help ensure smooth implementation of ISSB standards in Malaysia, which is important to reduce disclosure fragmentation, and promote more credible, transparent and comparable sustainability disclosures for companies. These are critical for asset managers in undertaking sustainability assessment of investment and in constructing their sustainable investment portfolio.

6 Avoiding the Greenwash Peril, KPMG, 2023.
7 Greenwashing tops investors' concerns around ESG products, Quilter, 2021.

Driving Growth and Transparency of SRI Funds

The *Guidelines on SRI Funds* which was initially released in 2017 was intended to facilitate and encourage greater growth of SRI funds in Malaysia. The *Guidelines on SRI Funds enables* funds to be designated as SRI funds, thereby widening the range of SRI products available in the market and attracting more investors to the SRI segment. It applies to fund products within the SC's oversight such as unit trust funds, real estate investment trust funds (REITs), exchange-traded funds, and venture capital and private equity funds. The *Guidelines on SRI Funds* introduces additional disclosure and reporting requirements that aim to encourage greater transparency in investment policies and strategies of SRI funds.

To ensure that investors have access to sufficient and transparent information, the SC recently revised the *Guidelines on SRI Funds* in February 2023 to provide enhanced sustainability reporting and disclosure requirements for qualified SRI funds, and to qualify SRI Funds under the *ASEAN Sustainable and Responsible Funds Standards* (ASEAN SRFS). The revision also aims to promote the growth of SRI funds in Malaysia, while safeguarding investors' interests by requiring adequate disclosures are made to mitigate greenwashing risks.

The ASEAN SFRS which was released by the ASEAN Capital Markets Forum (ACMF) in 2021 aims to provide the minimum disclosures and reporting requirements that can be consistently applied to collective investment schemes (CIS) that seek to qualify under the ASEAN SRFS, considering the rise of CIS[8] with ESG investment focus and the need for a comparable, uniform, and transparent disclosure of information to mitigate the risk of greenwashing.

Mitigating Financial Risks Through Responsible Investing

To enhance SRI intermediation capabilities of fund managers, the SC issued a *Guidance Note on Managing ESG Risks for Fund Management Companies* (Guidance Note) in June 2022. Given that ESG risks are increasingly recognised as sources of financial risk which, if materialised, could cause actual or potential negative impact on the value of investments and/or returns, there is an increased expectation for fund management companies (FMCs) to manage ESG risks in their investment portfolios.

The purpose of the Guidance Note is to assist FMCs in establishing a responsible investment framework by providing clarity and setting out the SC's expectations regarding the development and implementation of robust policies and procedures for effective analysis and management of material ESG risks within the FMC's investment portfolios. By providing comprehensive guidance on addressing ESG considerations, the SC empowers FMCs to mitigate potential risks associated with sustainability issues, ensuring long-term resilience and responsible stewardship of investment funds. Moreover, the Guidance Note aims to facilitate meaningful disclosures to investors while driving positive impact and change.

Guiding Principles for the Classification of Sustainable Investment Activities

To provide further guidance in the classification of what constitutes as a sustainable asset and investment, the SC issued the *Principles-Based Sustainable and Responsible Investment Taxonomy for the Malaysian Capital Market* (SRI Taxonomy) in December 2022. The SRI Taxonomy provides universal guiding principles for the classification of economic activities that are in support of environmental, social, and sustainability objectives.

The SRI Taxonomy comprises these ESG components:

The environmental component includes 4 environmental objectives:

while the social component contains 3 social objectives:

The sustainability component refers to activities that are aligned with the objectives of both the environmental and social components of the SRI Taxonomy.

The SRI Taxonomy can be referred to by fund managers in constructing an SRI Taxonomy-aligned portfolio. It provides guidance for FMCs in the assessment of investments that align with the environmental, social, and sustainability components of the SRI Taxonomy. FMCs can also utilise the SRI Taxonomy's guiding principles to assess the classification of different economic activities, allowing them to make investment choices that align with their clients' specific ESG preferences and objectives.

[8] CIS are trust-based schemes where many different investors pool their money with similar investment objectives into a CIS portfolio, and the pooled money is then managed and invested in a range of assets by professional investment managers. Each investor owns a portion of (or units in) the fund. The common types of CIS are unit trust funds, wholesale funds, exchange traded funds, private retirement schemes (PRS) and REITs. Source: https://www.atcm.com.my/cis.

Empowering Retail Investors

Investor education and awareness are important initiatives that can lead to more informed investors who are self-reliant and able to make investment decisions that are right for them. The SC continues to carry out its flagship investor education and awareness programme, InvestSmart, which was launched in 2014 throughout the nation, reaching a wide spectrum of the public, educating them on a range of investment-related topics which include sustainability. Awareness on SRI products and greenwashing risks are incorporated into the InvestSmart programme. Through this initiative, the SC is equipping retail investors with the necessary education and awareness to navigate the world of sustainable investments.

Conclusion

While the SC has put in place measures to mitigate greenwashing risks, the industry should play its role to ensure that funds are true-to-label, disclosures made are comprehensive and transparent, and continuously monitor the investments' compliance with the ESG criteria. On the other hand, investors must be vigilant and ensure they understand the risks and returns of the funds prior to investing. Although it is growing, the SRI fund management industry is still quite nascent compared to the overall fund management industry in Malaysia. Thus, it is important to ensure greenwashing risks are mitigated to protect and maintain the reputation and credibility of the SRI fund management industry in Malaysia.

Demystifying the Marketing Representatives Framework

Background to the MR Framework

The SC had on, 8 October 2012, established the regulation of introducing and referral marketing activities through the issuance of the *Guidelines for Registered Person (Registered Representative)* (Registered Person GL) which introduced, among others, new classes of registered persons, namely Introducing Representative (IR) and Marketing Representative (MR). An IR is a person who refers or introduces prospective clients to Capital Markets Services Licence (CMSL) holders i.e. known as the principals who carry on the regulated activity of dealing in securities with whom he is registered whereas an MR is an employee of a fund management company who undertakes the marketing of fund management services and provides client support services and is registered with the SC. The measure was intended to strengthen the role of dealers, facilitate the provision of specialised services and broaden their client base and ultimately grow the stockbroking industry while ensuring investors' interests are adequately safeguarded.

Following a review of the referral and introducer framework, the SC introduced a revised framework, namely the MR framework, to govern referral, introducing and MRs across all regulated activities, not just stockbroking and fund management activities. The revised MR framework serves to promote consistency and clarity on the role and parameters of an introducer in performing referral, introducing and marketing activities in the capital market. The revised framework was implemented on 23 June 2017 through the issuance of the *Guidelines on Marketing Representatives* (MR Guidelines) which superseded the Registered Person GL. The framework on IR and MR are respectively subsumed by the MR Guidelines. Persons registered with the SC as an IR or MR under the Registered Person GL are deemed to be registered with the respective principals as an MR under the MR Guidelines. The objective of the revised MR framework is to ensure that the activities by MRs are conducted in a responsible and ethical manner to protect and benefit both investors and the overall market ecosystem.

Key Features of the MR Framework

WHO is an MR?

A person who is appointed by a CMSL holder (known as a principal) to–

- introduce or refer prospective clients to the principal;
- market the services of the principal; and
- provide client support services.

WHAT does SC expect of a principal?

- Register with the SC, any MR that it appoints
- Establish robust procedures to monitor and supervise the conduct of its MRs to ensure that MRs operate within the confines of their permitted activities and continuously comply with the MR Guidelines
- Ensure that its MRs undergo regular training to increase their knowledge and technical know-how and keep abreast with current developments in the industry
- Maintain a register of its MRs and submit an updated list of its MRs to the SC on a monthly basis

WHAT is an MR permitted to do?

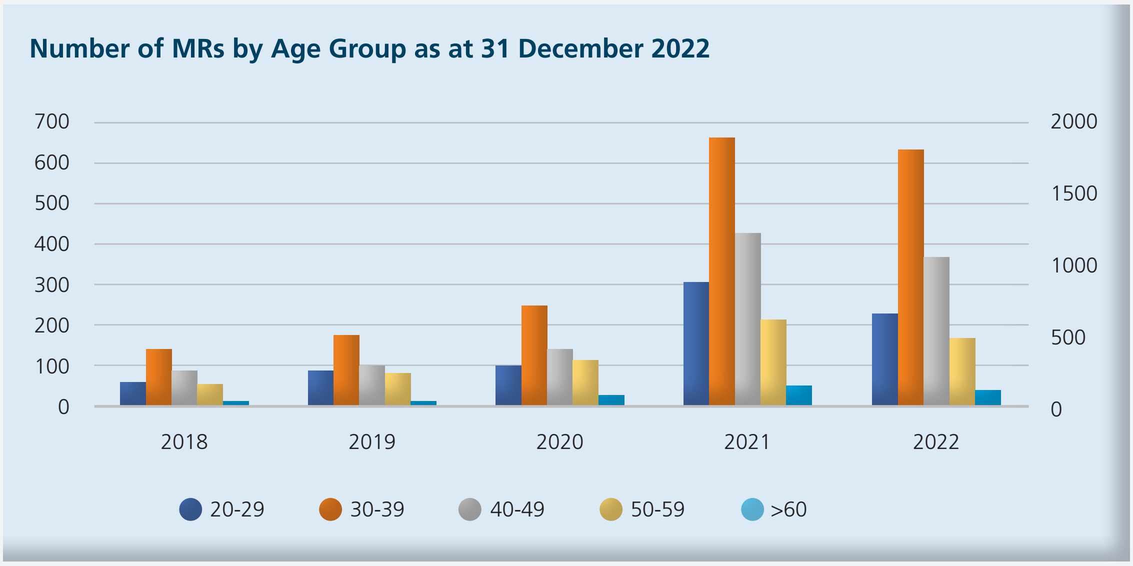
- Arrange for the customer to meet with or speak to the principal
- Forward the customer's particulars to the principal
- Provide the customer with factual information relating to products and services offered by the principal, including conducting presentations
- Provide client support services such as forwarding information on the performance of funds to clients

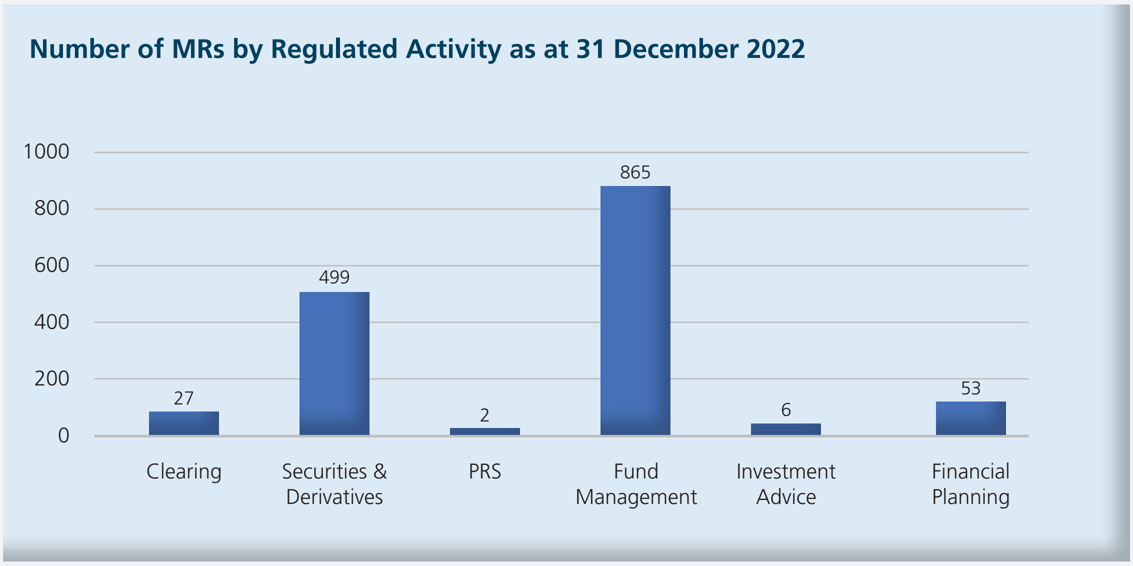
WHAT does SC expect of an MR?

- Inform a client of any remuneration scheme and its amount in relation to its marketing activity, if the client requests for this
- Ensure that he does not hold himself as a licensed person and conducts his activities efficiently, honestly and fairly
- Continuously complies with the fit and proper criteria under the MR Guidelines
- An MR is NOT ALLOWED to take clients' orders, execute trades, or give specific recommendations / transactional advice

Growth in the Number of MRs

Since the establishment of the MR framework in 2017, the industry saw an increasing trend in the number of registered MRs. The two regulated activities with the highest number of MRs are fund management and dealing in securities and derivatives.





Issues and Challenges Involving MRs and Principals

Based on the SC's ongoing supervision on sales and marketing activities by CMSL holders, the SC observed several transgressions on regulations surrounding the conduct of MRs and principals. The following is a snapshot of some of the key concerns observed.

Inadequate screening of MRs' background on past misconduct or unethical practices by principals resulting in repeat misconduct and poor practices, compromising clients' interests

Comprehensive screening process should also be able to detect any past misconduct, not just whether academic qualifications have been met

Inadequate training by principals to enable MRs to provide accurate, relevant and up-to-date information on products/services to potential clients

Focus should be on identifying the need for training programmes and their content, rather than treating the SC's training requirements as a box-ticking compliance exercise

Use of inaccurate, false and misleading marketing materials, including in social media postings and organised talks to potential clients

Remuneration structures that do not consider the MR's poor conduct and customer outcomes

Use of multi-level sales agency structures by MRs

MRs holding themselves out as licensed persons and carrying out regulated activities beyond their permitted activities

Principals engaging and incentivising individuals including social media influencers who are not registered as MRs to market their services

Use of false and misleading marketing materials - The materials used in these instances were neither reviewed nor vetted by the principals, and contained elements of aggressive product pushing which did not provide the requisite clear, fair and balanced information on the product or service marketed. Examples of those inaccurate, false and misleading information include:

a) Providing misleading information on investment returns by advertising the returns of a single client, implying that potential investors can expect to earn similar returns.

b) Advertising returns for a good year when the returns in most other years were, in fact, poor.

c) Using phrases such as 'guaranteed return', 'capital preserved', 'minimal risks', 'shielded from market risk', etc. in representing associated risks of the product, when this may not be the case.

d) Not disclosing all fees and charges that are to be borne by the investor, e.g. sales charges, performance fees, administrative charges, etc.

In this respect, the SC expects that a principal, as part of its supervisory policies and controls as well as in line with its obligation, ensures MRs' continuous compliance with the relevant requirements of the MR Guidelines. Principals should therefore have, among others, training programmes as well as monitor their MRs including their social media postings and ensure all marketing material used by MRs have been duly vetted for misleading/inaccurate statements.

Poor remuneration structures - The remuneration structure of an MR is determined by the principal, and is typically structured as follows:

(a) A one-off fee to the MR at the time of securing the client. This is customarily called sales charges and is charged to the client upfront or in some instances, borne by the principal.

(b) An on-going trailer fee as long as the client remains with the principal.

The remuneration structures are therefore solely driven by the quantum of business referred to by the MR. Consideration of poor conduct/outcomes to the client is not factored into the remuneration structure. As a result, there is no incentive/motivation for MRs to give serious attention to compliance with regulations and internal policies set by the principal. Principals are therefore urged to design an MR's remuneration structure to also take into account certain qualitative criteria such as positive customer feedback through client call-backs and compliance considerations.

Use of multi-level sales agency structures - Agency structures comprising multi-level sales tiers would inevitably make it more challenging for principals to monitor and supervise all of the MRs within the agency structure and ensure their continuous compliance of the relevant requirements, increasing the risk of poor practices towards investors. The risk in this scenario becomes critical as the network expands with multiple levels involving more MRs acting on behalf of the principals.

Person A
(Registered MR)
- Level 1

Person B
(Registered MR acting as Person A's agent)
- Level 2

Person C
(Not registered as MR, but acting as Person B's agent)
– Level 3

Moreover, there is also increased risk that some marketing staff from the lower tiers may not be registered as MRs with the principal. These individuals may alternatively channel their referrals through their up-liners who are registered MRs. In this instance, the principal would be left to assume that the client was referred by the registered MR. To mitigate this, it is imperative for the principals to undertake adequate due diligence on and require proper training for prospective MRs at the outset to ensure proper conduct. Additionally, towards facilitating effective supervision, it is strongly recommended that principals limit the number of tiers in respect of any agency structures adopted.

MR holding himself out as licensed person - As illustrated above, the role of an MR is essentially to introduce, refer and market the products or services offered by the principal and support the principal in limited circumstances. However, a review of a number of social media postings involving products or services of CMSL holders revealed instances where the content of such postings appeared to cross into the ambit of regulated activities, which is prohibited for MRs. Such content included providing specific views, opinions and recommendations on a product as well as expectations on future performance for the same. Principals should be mindful that the MRs' conduct, in these instances, may not only prompt the SC to take action for the lack of a proper compliance and oversight framework to address these issues by MRs, but such conduct by MRs would also result in reputational risk to the principals and potentially harm investors.

This problem is further exarcebated due to competing interests between compliance and business as MRs are relied upon by some of the principals as their main source of client acquisition. While the number of potential clients brought in by the recruited MRs have corresponded to the increase in MRs recruited for this reason, the principals were unable to facilitate prudent onboarding processes for clients due to the lack of back-office resources. Consequently, reliance was placed on the MRs to conduct the know-your-client procedures, with little or no communication or interaction with the principal, which is in contravention of the law. Due to such dependence by the principals, this also raises concerns on whether the principals would be motivated to de-register or take appropriate action against its MRs in the event of misconduct by the MR, for fear of losing clients.

Engaging unregistered individuals - The SC has observed increasing instances of individuals, including social media influencers marketing capital market products or services of certain CMSL holders and essentially take on the role of MRs, but without registration. In several of these cases, such individuals have also crossed over into giving recommendations and advice on products and services, which is an activity that is only permitted to be conducted solely by the principal. Again, such misconduct may not only lead to SC taking action against such principals for non-compliance with the MR Guidelines and breach of the licensing conditions as well as disrepute to the principals, investors would also be at risk of being fed false or misleading information or advice on products and services.

Actions Taken by the SC

The SC has recently taken enforcement action against a number of principals for failure to establish adequate controls to supervise their MRs. In particular, the SC had, in October 2022, imposed a penalty on a licensed asset management company (the said company). The said company in this instance did not have any proper policies for registration and monitoring of its MRs. In addition, it had allowed an agency and an individual (who was the founder of the agency) to act as its agent to market and promote its services in contravention of the MR requirements as the actions undertaken were that of an MR.

Conclusion

In light of recent findings and concerns, the SC will be closely monitoring the marketing activities in the capital market including by the CMSLs. Where there are undesirable practices which could lead to breaches or has led to breaches including arising from use of social media influencers and celebrities, the SC may take appropriate action such as enforcement against the CMSLs as well as the relevant parties. In addition, the existing framework will be reviewed for possible enhancements towards ensuring that these activities are undertaken and conducted responsibly.

The Way Forward for Financial Product Governance

Introduction

As a result of social and economic developments, there has been greater interest to invest in financial products. However, following the increase in investments, including investments being made through online platforms, the mis-selling of financial products continues to be a growing concern. To address this concern, regulators and policy makers are placing greater importance on the need for product issuers and product distributors to have in place a framework to ensure that investors' interests are given due regard throughout the product lifecycle and that investors are treated fairly.

What is Financial Product Governance?

The sales practice framework focuses on conduct requirements at the point-of-sale. In contrast, product governance requires product issuers[1] and product distributors[2] (together, a firm) to have in place controls, policies and procedures (CPP) to ensure good investor outcomes throughout the product continuum. This includes ensuring that financial products made available to investors are designed to meet the investors' needs and are targeted accordingly.

As such, a robust product governance framework imposes obligations on the product issuer and product distributor respectively at relevant stages of the product lifecycle; from the design stage, to the marketing and sale stage and finally, the post-sale stage.

Why Product Governance?

As mentioned above, there is now a shift in approach in dealing with the mis-selling of financial products. Today, greater emphasis is placed on the need to align the firm's interests with the investor's interests throughout the product lifecycle. This is opposed to merely focusing on conduct at the point-of-sale and the provision of mandatory information to investors.

Conduct requirements at the point-of-sale do not not take into account poor practices at other stages of the product lifecycle which may be detrimental to investors. Furthermore, the provision of mandatory information to investors alone is not adequate in addressing the risk of product mis-selling. Reasons for this include investors' attention being diverted by product promotion instead of being directed to the product information and difficulty in understanding information on more complex products.

[1] A person who designs or makes available financial products.
[2] A person who markets and sells financial products.

Given these concerns, the regulation of conduct at the point-of-sale and the provision of mandatory information are supplemented with having in place CPPs to ensure that financial products made available to investors are designed to meet their needs and are targeted accordingly. Taken together, this is referred to as a product governance framework.

Jurisdictions such as Singapore, the European Union, the United Kingdom and Australia have introduced and implemented standards and rules for regulating product governance.

Singapore

Law / regulation

Guidelines on Fair Dealing – Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes to Customers issued on 3 April 2009 (revised on 20 February 2013).

Reason

To improve standards of fair dealing with investors by setting out fair dealing outcomes to be achieved by firms, with particular focus on the role of the board and senior management.

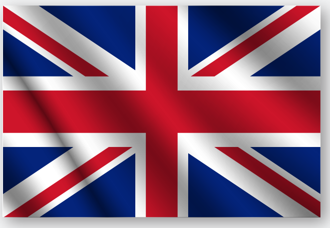
European Union

Law / regulation

Directive 2014/65/EU on Markets in Financial Instruments (MiFID II) issued on 5 May 2014 and *Guidelines on MIFID II* product governance requirements issued on 5 February 2018.

Reason

To address the risk of mis-selling of products and other detrimental practices towards investors by enhancing the role of the board and organisational arrangements in relation to the launch of new products, and strengthen internal control functions.



United Kingdom

Law / regulation

Product Intervention and Product Governance Sourcebook issued on 3 January 2018.

Reason

To improve firms' product oversight and governance processes by operationalising the MiFID II requirements.

Australia

Law / regulation

Part 7.8A, Chapter 7 of the *Corporations Act 2001* and *Regulatory Guide 274 – Product design and distribution obligations* issued on 5 October 2021.

Reason

To address the risk of mis-selling and other problems related to the poor standards of disclosure information and advice by introducing design and distribution obligations specific to issuers and distributors.

Salient Features of a Product Governance Framework

Although adapted to each jurisdiction's regulatory approach, the product governance framework set up in the various jurisdictions have similar salient features. These salient features are set out below.

Product Governance Framework

Design stage

Product issuer obligations

- Design the product to meet the needs and objectives of the identified target market
- Undertake internal approval process to identify and manage any risks associated with the product
- Conduct product review to verify any information being disclosed to investors

Post-sale stage

Product distributor's obligations

- Conduct review of its distribution strategy and give feedback to the product issuer on whether the product remains fit for the identified target market

Product issuer's obligations

- Conduct regular reviews on the product post-launch to ensure that it is performing as investors were led to expect
- Take any remedial measures to address concerns raised in any of the reviews

Distribution stage

Product distributor's obligations

- Ensure the distribution strategy is consistent with the target market
- Put in place product governance arrangements to:
  - ensure that employees understand the product to be distributed
  - enable investors to make an informed decision through accurate disclosure of product information
  - ensure products recommended to investors are suitable to the investors' needs and circumstances
  - minimise product mis-selling through appropriate incentive structures

Financial Product Governance by the SC

The SC has been taking gradual steps to curtail the mis-selling of investment products and enhance investor protection.[3] In 2012, the SC issued the *Guidelines on Sales Practices of Unlisted Capital Market Products* (SPG) to strengthen the sales practices regime for certain unlisted capital market products.

The SC's key expectations under the SPG are, among others, that–

(a) a firm's board implement policies and procedures which give due regard to the interests of investors in the development, marketing and sale of products so as to ensure that fair treatment of investors is embedded within the firm's culture;

(b) investors are provided with a product highlights sheet which gives clear, concise and effective disclosures to facilitate product comparison and responsible decision-making; and

(c) product distributors have in place policies and processes, including conducting a suitability assessment, to ensure that the product recommended to an investor is suitable to the investor's objectives and needs.

The SC is currently reviewing the SPG in tandem with its review of the CMSA to ensure that the SPG remains fit for purpose. In this regard, the SC has taken note of regulatory developments in other jurisdictions with regard to product governance as set out above. As part of its review exercise, the SC is also engaging various focus groups from the industry to seek feedback on its proposals which includes requiring–

(a) a product issuer to identify an intended target market for the product it is designing and ensure that the product designed is fit for the intended target market;

(b) a product issuer's board or senior management to conduct the necessary due diligence prior to offering a product (e.g. ensuring the appropriateness of the product for its intended target market, assessing potential risks associated with the product and ensuring that the product fully complies with regulatory requirements);

(c) product distributors which distribute products through online or digital platforms to comply with certain general principles to address the unique risks associated with online distribution (e.g. ensuring that the online distribution platform is compliant with regulatory requirements and ensuring the continuous reliability and security of such platforms);

(d) firms to consider their treatment of vulnerable investors to ensure that vulnerable investors are treated fairly and not disadvantaged; and

(e) firms to ensure that investors' claims and complaints are handled fairly, effectively and efficiently.

[3] Bank Negara Malaysia has issued policy documents on the governance of banking and insurance products.

With increasing expectations in this area as well as heightened risks posed by today's evolving product landscape, firms must be able to update themselves in their evaluation and design of their product governance framework to be able to compete as well as meet regulatory expectations. In doing so, firms must strike the appropriate balance between increasing commercial wins and meeting market demands while enhancing product risk management through an effective product governance model, processes and technology.

Product governance goes beyond satisfying regulatory expectations. Effective product governance is key towards firms elevating competitiveness and building business sustainability by driving better commercial outcomes while satisfying market demands. Responsible product governance encourages responsible innovation, which ultimately serves to build greater confidence in the market.

Conclusion

In view of the shift over the last decade to impose greater responsibility on firms to affect a culture which prioritises the interests of investors across the product lifecycle, it is crucial that firms take effort to have in place a robust product governance framework to deliver the outcomes sought to be achieved by these regulatory developments. In this respect, the SC hopes to work together with firms to raise standards in respect of practices relating to the design and distribution of financial products and overall treatment of investors.

On this note, it should be emphasised that investors must still be vigilant and take responsibility to ensure that they understand the risks associated with an investment before making an investment decision. Among others, investors should ensure that they obtain accurate product information from the product distributor to assist them in making an informed decision. Investors should also be honest and forthcoming with disclosing their own information to enable firms to provide them with advice or recommendations which meet their needs and objectives.

Developments of equity crowdfunding in Malaysia

Introduction

The adoption of technology in the world of finance or Fintech has opened up access to capital markets, bringing about innovation and new products.[1] This article traces regulatory developments since the introduction of equity crowdfunding (ECF) in 2015.[2]

What is Crowdfunding?

Crowdfunding is an umbrella term. The term 'crowdfunding' itself borrows from and expands on the concept of 'crowdsourcing' which involves the solicitation of contributions in the form of services, ideas or content from a large group of people, generally done over the internet.

The modern crowdfunding model is based on three types of actors –

1. the project initiator who proposes the idea or project to be funded;
2. individuals or groups who support the idea; and
3. a moderating organisation (the 'platform') that brings the parties together to launch the idea.

Crowdfunding as a phenomenon predates the introduction of its established term. One of the earliest examples of crowdfunding is the funding of the Statue of Liberty. In 1885, when government sources failed to provide funding to build a monumental base for the Statue of Liberty, a newspaper-led campaign attracted small donations from 160,000 donors.

[1] See article on Opportunities and Challenges: Financial innovation and the Fintech landscape in Malaysian Capital Market (*The Reporter*, June 2018)
https://www.sc.com.my/api/documentms/download.ashx?id=85390647-8f49-4f51-b0d7-6c742e7ab886
and article on Digitalisation in the Malaysian Capital Market (*The Reporter*, June 2020)
https://www.sc.com.my/api/documentms/download.ashx?id=f5d48f26-3c0e-4005-af8f-6bcca0e1c55d

[2] See article on equity crowdfunding – A new and innovative mechanism for market-based financing (*The Reporter*, March 2016)
https://www.sc.com.my/api/documentms/download.ashx?id=3a6dd78f-8fe3-4bf4-aea3-62d227e4542d

The general models of crowdfunding can be seen below

CROWDFUNDING MODELS

Donation

Reward

Debt

Equity

Donation based crowdfunding

Mainly for raising funds for charitable purposes, usually used by non-profit organisations

Rewards based or seed crowdfunding

Investors are rewarded with certain products which corresponds to the "tier" of investments provided (e.g. Kickstarter)

Debt and Equity crowdfunding

More relevant commercially, it is for businesses seeking to raise funds where investors could potentially gain monetary benefits from investing (i.e. getting shares, investment notes, digital assets, etc.)

Developments of ECF Regulatory Requirements

Since being the first ASEAN country to introduce ECF in 2015, the SC has further developed regulatory requirements in relation to ECF. Some of the key developments that have taken place include–

1. introduction of ECF regulatory framework (2015);
2. increasing the fundraising limit on ECF platforms from RM5 million to RM10 million through its lifetime (2020);
3. introduction of additional requirements to be complied with by an ECF operator who wishes to operate on the secondary market (2020);
4. introducing requirements to have in place policies and procedures on anti-corruption, pursuant to the enactment of the corporate liability provisions under section 17A of the *Malaysian Anti-Corruption Commission Act 2009* (2020);
5. increasing the fundraising limit on ECF platforms from RM10 million to RM20 million through its lifetime (2021);
6. expanding the list of permitted issuers to include unlisted public companies (UPC)(2021);
7. introducing prospectus requirements for UPCs seeking to raise funds on an ECF platform (2021); and
8. expanding obligations of ECF operators to assess and register prospectuses prepared by UPCs (2021);

Data Post-regulatory Developments

The SC has seen encouraging developments since the liberalisation of the ECF framework.

Since its inception in December 2015, participants in the ECF framework raised RM560.4 million in funds for 305 issuers via 330 campaigns as at end-December 2022 (end-December 2021: RM420.9 million). In 2022, some RM140.38 million was raised by 65 issuers through 67 successful campaigns (2021: RM220.72 million and 104 issuers). Although the pace had decelerated, larger campaigns were the order of the day, with 89% raising more than RM900,000 each.

The biggest sum raised by a single campaign stood at RM17 million. About 49% of ECF issuers were technology-focused entities, with business expansion cited as the main purpose for fundraising. As at end-December 2022, the investor demographics revealed that some 37% were aged below 35 years while an overall 48% were retail investors.

Factors That Were Taken Into Account in Developing the ECF Framework

Having balanced regulation is one of the main factors that have contributed to a successful ECF Framework. Other factors include:

01 Providing adequate investor protection

To ensure adequate disclosures to enable investors to make an informed decision

02 Encouraging platform operators

To ensure operators carry on its business in a manner where issuers and investors can engage with each other efficiently

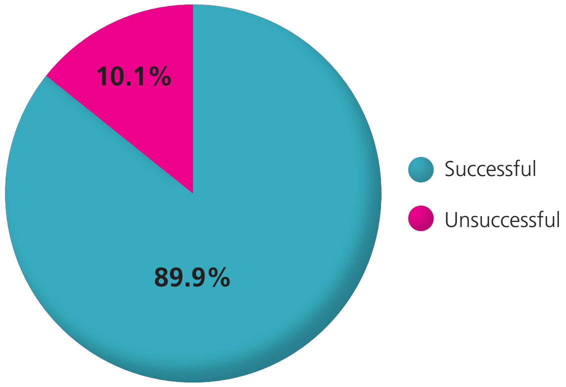
03 Promoting innovation and inclusion

To facilitate SMEs with innovative business proposals

Aside from having a successful framework, other incentives were also introduced to increase the attractiveness of ECF. Other than regulation, the SC introduced other efforts such as MyCIF and certain tax incentives to encourage more investors to participate in crowdfunding.

In April 2022, *Income Tax (Exemption) (No.4) Order* was gazetted to provide income tax exemption equivalent to 50% of the amount of investment in ECF, up to a maximum of RM50,000 for each year of assessment.

Issuer's Success Rate in Raising Funds Through ECF



Data as at 31 December 2022

These incentives, coupled with balanced regulation makes for a successful crowdfunding environment. Since inception, 89.9% of issuers have successfully fundraised through ECF.

Message to Investors

Investors need to be aware of the following before investing in ECF:

a. To understand the risks of their investment

- There may be an issue with re-selling shares in the secondary market. An investor may not be able to recuperate their investment in time.
- There is risk that an investor may lose all his investments if the funding for the project fails.
- There is a risk of fraud which no amount of legislation can eliminate.

b. To know the company you are investing in

- Investors must try and obtain as much information as possible about the company they are investing in.
- Although platform operators are required to conduct due diligence on prospective companies, you should always read the disclosure documents (or specifically, the prospectus in the case of UPCs) of the company before investing and conduct your own due diligence (e.g. check whether the operator is registered with the SC).
- Investors must also be aware of the types of investments the company plans to make and what the company plans to invest in.

c. To know your rights as an investor

- Investors are entitled to obtain all relevant information in relation to the company or the project such as key characteristics of the company, purpose of the fundraising, business plan of the company and its financial information.
- The company is also required to disclose the amount of fees and charges investors must pay as part of the investment.

Message to Intermediaries

- As a platform operator, intermediaries must be aware of the obligations set out in the *Guidelines on Recognized Markets.*
- Intermediaries must also ensure they conduct proper due diligence on the issuers. The disclosure documents must match the intended offerings of the issuers.
- Intermediaries must also ensure that business proposals that seek to obtain fundraising on ECF platforms are legitimate and would bring some benefit to the market and to the investors.

For Complaints or Disputes

- ECF operators must have processes in place for complaints handling or dispute resolution.
- Such information must also be made accessible to all investors.
- Alternatively, an investor may lodge their complaint by contacting the Consumer and Investor Office (CIO) of the SC.

FOR MORE INFORMATION

www.sc.com.my

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