IPPC Foundation Course

The **objectives** of this Course: to provide candidates with basic investment knowledge, prepare them to attend the 2-Day AICB IPPC Workshop, and to help ensure they **pass** the IPPC exam.

Outline of Course

- About the IPPC
- About the Exam
- What to Expect in the Exam
- *Basic Investment Knowledge* required for IPPC:
  1. Structured products and bonds
  2. Financial markets & instruments
  3. Laws and regulations
  4. Others (financial needs analysis & KYC)

About the IPPC

- Investor Protection Professional Certification (IPPC) is designed for employees of registered persons (*as defined in the Guidelines on Investor Protection*, jointly issued by Bank Negara Malaysia and the Securities Commission,
- Apply to those involved in the selling and marketing of structured products and unlisted debt securities,
- Certification is jointly awarded by Persatuan Pasaran Kewangan Malaysia (PPKM) and the Asian Institute of Chartered Bankers (AICB) (formerly IBBM),
- Aims:
  - to ensure the individuals in the identified roles continue to uphold the highest level of professionalism in preserving market integrity and promoting confidence in the capital market.

What to expect in IPPC Exam

- You need to pass Exam as part of Standard on Fit & Proper (Sec *8.2 of IPPC Guidelines*),
  - It is a 2 hours (120 minutes), 80 multichoice questions, with 4 options (A, B, C, D),
  - You need to get 70 of 100% to pass; i.e. 56 (or more) correct answers,
  - There is no penalty (or points deducted) for wrong answers – so, if you run out of time, just guess.
  - Do not leave <u>any</u> questions unanswered; and make sure you stay for the entire exam duration.

Know what's the IPPC Syllabus

- There are 4 major sections covered:
- Know what they are and their weightages:

Topic (Section) ^	Approx. no. of questions	Weightage (%)	Time to spend (mins)
1. Market structure	12	15	18
2. Laws & regulations*	24	30	36
3. Know Your Client	12	15	18
4. Structured Products & Bonds*	32	40	48
Total	80	100	120

* NOTE: Sec 4 on Products = 40% while Sec 3: Laws & Regulations = 30%

^ as per IPPC Syllabus

Know what's the IPPC Syllabus (cont..)

- Know that the sections do not carry equal weights, hence, you need to focus your study time accordingly,
- Note: Sec 4: Structured products, & Sec 2: Laws & regulations accounts for 40% and 30% of total, respectively.
- Sec 1 & Sec 3: are considered "low hanging fruits" – need to make sure you get them all correct to improve chances of passing,
- Prioritize: *a) Sec 4 (40%), b) Sec 2 (30%), then c) Sec 1 & Sec 3 (15% + 15%).*

40%

Basic Investment Knowledge

1. Structured Products & Bonds – Weightage: 40%

This section is divided into: 1) debt securities and 2) structured products. Candidates are expected to understand the basic characteristics of debt securities & structured products and risks associated with investing in them. And, also some knowledge of how derivatives (options) work.

What are Debt Securities?

- Debt are borrowings of the company,
- Issued to raise funds,

Types of Debt Securities

1) **Short term** = money market (or discount) securities; maturity < 1 year,
Examples: Treasury & BNM Bills, Banker's Acceptance & NIDs

2) **Long term** = bonds (or fixed income) securities; maturity > 1 year,
Examples: Corporate bonds and Government Bonds like MGS

Money Market and Bonds

Money Market

Short Term Securities

- Issued at *a discount* to par value, Example: Par value is RM1.0mil, issued to investor at RM984,000, 2 months maturity; yield is 9.9%.
- Interest payment (coupon),
- Potential capital gains (if sold before maturity);
- Repayment of principal (upon maturity).

Bonds

Long term financial contracts

- Issuer, pledges to repay a fixed amount of money with interest to Lender upon maturity;
- Lender (investor) gets cash flows which consist of: 1) periodic interest (Coupon) and 2) Par value (principal payable at maturity);

Time value of money (present value, future value)

- An important concept in investments;
- Candidates are expected to thoroughly understand the following concepts:
  - Discounting
  - Compounding
- Both of these are used extensively in design of structured products,
  - Especially, in principal protected products (use of zero coupon negotiable instruments of deposits (ZNIDs) which is a discount securities)

What is compound interest

- The value of a present amount, for example, RM100 in the future is found by applying *compound interest* over a period of time.
- Contrast this with *simple interest*, where interest is only paid on the principal amount alone.

Formulae: $\mathbf{FV = PV \times (1 + k)^n}$, where,

FV = future value,

PV = present value,

k = interest rate and ,

n = the number of period in years.

Simple vs. Compound Interest

- Example 1: A principal amount of RM100 is deposited in a bank account earning 8 percent per annum for two years.
- **Simple interest:** The total interest on RM100 at end of two years would be RM16 i.e. RM8 at the end of year one plus RM8 at end of year two. Hence, the future value of RM100 would be RM116 (RM100 plus RM8).

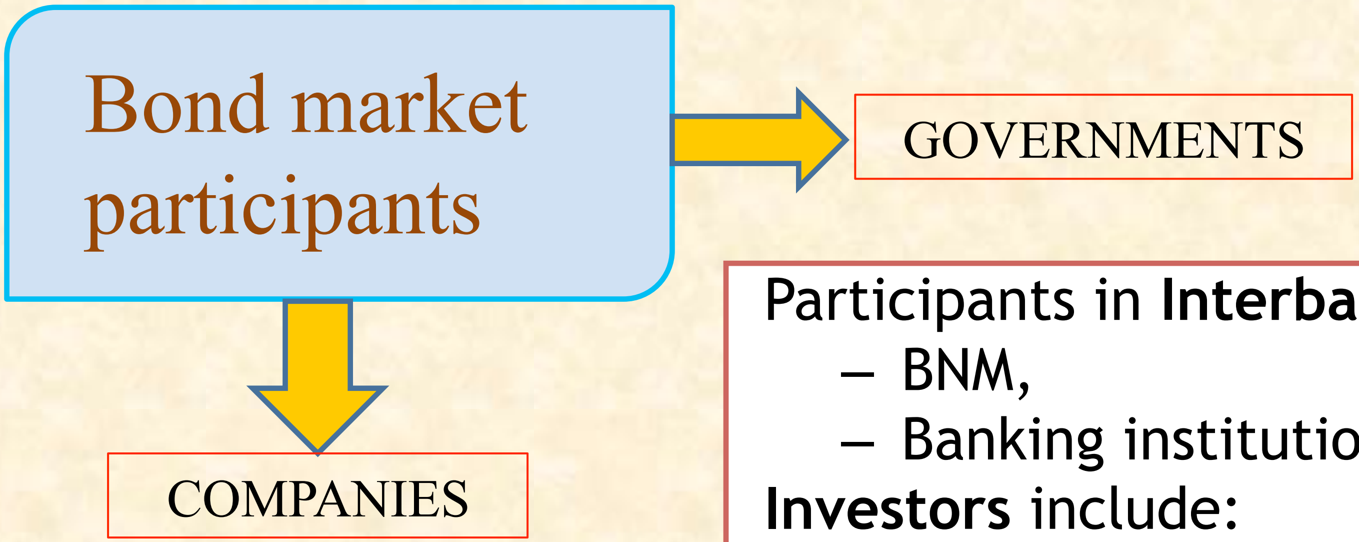
Compounding

- The total interest earned at end of year two would be RM16.64 i.e. RM8 at end of year one, plus RM8.64 in year two.
- The difference in the interest for year two is because the 8 percent interest is charged on both principal (RM100) *and* the interest earned in year one (RM8). Hence, the future value of RM100 would be RM116.64, if compound interest applied.
- FV = RM100 x $(1+0.08)^2$ = RM100 x 1.1664 = **RM116.64.**

Discounting

- Useful to determine the value today of a future amount of money (i.e. present value)
- Present value is the current dollar value of a future amount; or, the amount that would have to be invested today at a given interest rate over a specified period in order to equal the future amount.
- Process of finding present values is normally referred to as *discounting*, and is actually **the inverse** of compounding interest.

Bond Market Participants



Participants in **Interbank market:**

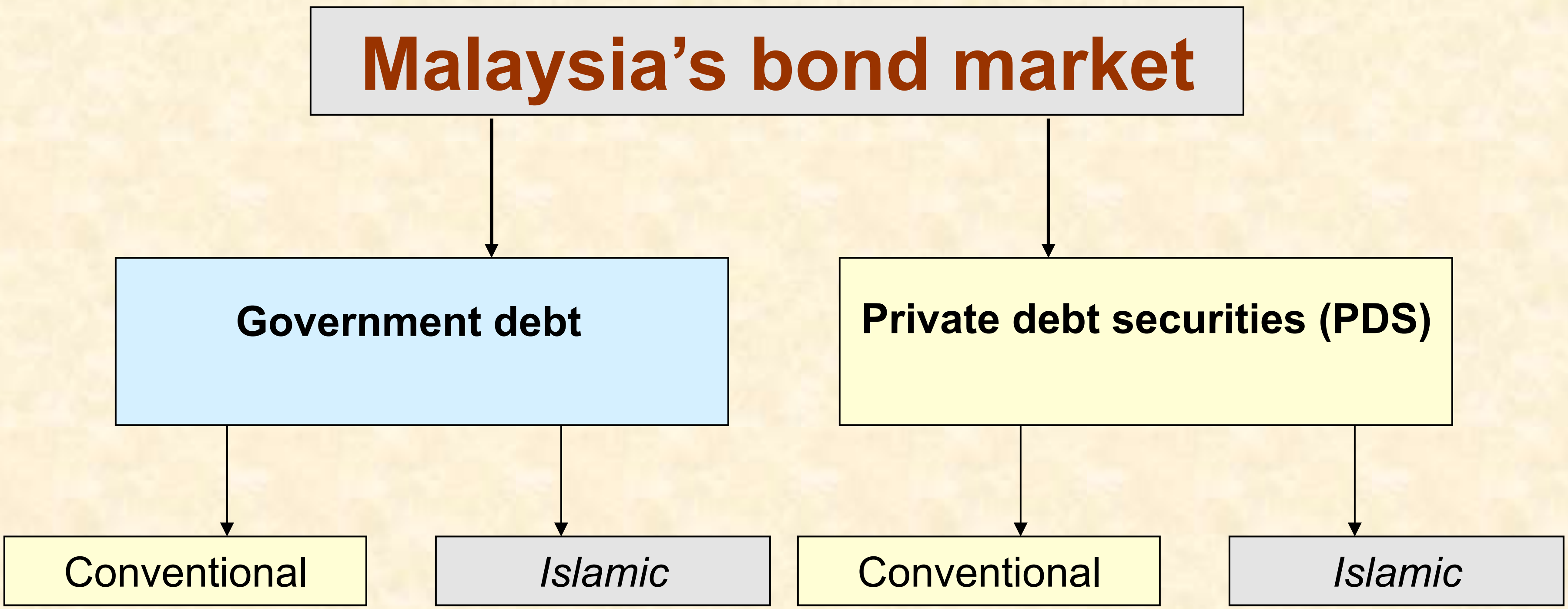
- BNM,
- Banking institutions.

Investors include:

- EPF,
- Unit trusts,
- Insurance companies,
- Asset management companies, and,
- Pension funds.

Bond Market

The main types of debt in Malaysia are:



Know the difference between the main types of debt securities

Types of Debt in Malaysia

1. **Straight bonds**
2. **Floating rate bonds**
3. **Zero coupon bonds**
4. Callable bonds
5. Commercial bonds
6. Irredeemable Convertible Unsecured Loan Stocks (ICULS)

*(*Make sure you are familiar with at least #1 – 3)*

1. Straight bonds

- Bonds are borrowings (loan) of government or company which promises to repay the principal at a future date and periodic fixed, coupon or interest payments,
- Represents the liability of government or company; the yield is affected by its credit ratings, that is its ability and willingness to repay the borrower.
- With straight bonds, investors and borrowers are routinely exposed to interest rates movement as the periodic interest payments are fixed,
  - When interest rates rise, a fixed coupon rate would expose the investors to a lower yield;,
  - Similarly for borrowers, when interest rates decline, a fixed coupon at a predetermined higher rate would be disadvantageous.

2. Floating rate bonds

- Floating rate bonds pays a coupon that is adjusted in a pre-determined way with changes to some reference rate, for e.g. resets every 6 months at KLIBOR + 25 bps*
- In other words, the coupon payment <u>varies with the KLIBOR rate,</u>
- In Malaysia, an example of the floating rate bond is: Cagamas floating rate bond.

*Note: 1bp (basis pt)= 0.1%

3. Zero coupon bonds

- *Example*: ZNIDs issued by Commercial Banks,
- Promises to pay stipulated principal amount at future maturity but with no interim coupons,
- Price of bond = PV of principal payment at maturity (using the required rate of return for bond)
- Plays an important role in principal protected structured investment (by providing principal protection).

Risk of investing in bonds

Risks of Investing in Bonds

1. **Default risk**
2. **Interest rate risk**
3. **Inflation risk**
4. Call risk
5. Reinvestment risk
6. Exchange rate risk
7. Liquidity risk
8. Volatility risk

Make sure you are familiar with at least:

Default risk, Interest rate risk, and Inflation risks

Interest Rate Risk

- What is interest rate risk?
  - Price of bond is **inverse** to change in interest rate,
  - When Interest rate rise, bond price falls & vice versa,
- If investor sell bond prior to maturity, an increase in interest rate will result in capital loss (i.e.. bond sold below purchase price),
- This is known as **interest rate risk,**
  - By far most major risk faced by investors,

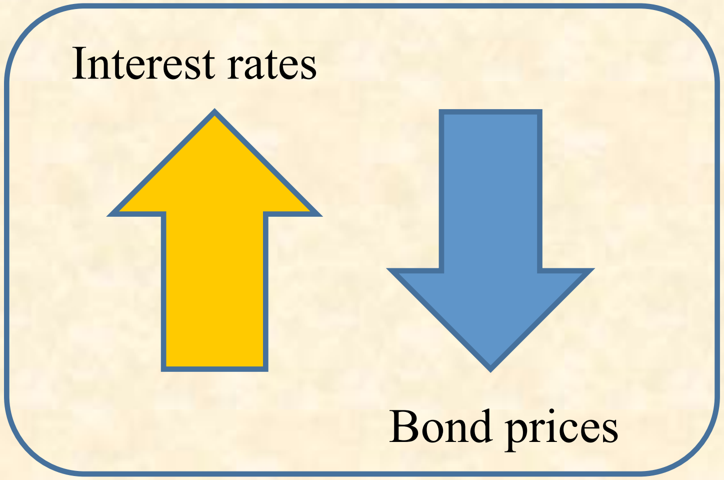
Default Risk

- What is default risk?
- Also known as **credit risk** or risk that issuer of bond may default or unable to make timely principal and interest payments,
- Investors are concerned with *changes in perceived default risk*
  - If perceived default risk increases, bond yields will go up, and bond price will likely fall, and vice versa

Inflation Risk

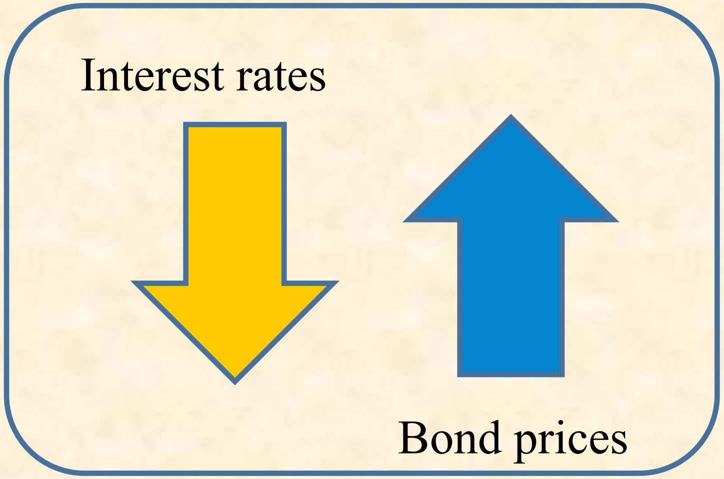
- Also known as **purchasing power risk,**
- Arise because of variation in value of cash flows from bonds due to loss of purchasing power,
- For all bonds (except floating-rate bonds), investors are exposed to inflation risk because interest rate promised by issuer is fixed for tenor of bond,
  - Floating rate bonds have lower level of inflation risk,
  - E.g. If coupon is 7% but inflation is 8%, then purchasing power of cash flow actually declined.

Bonds & interest rates



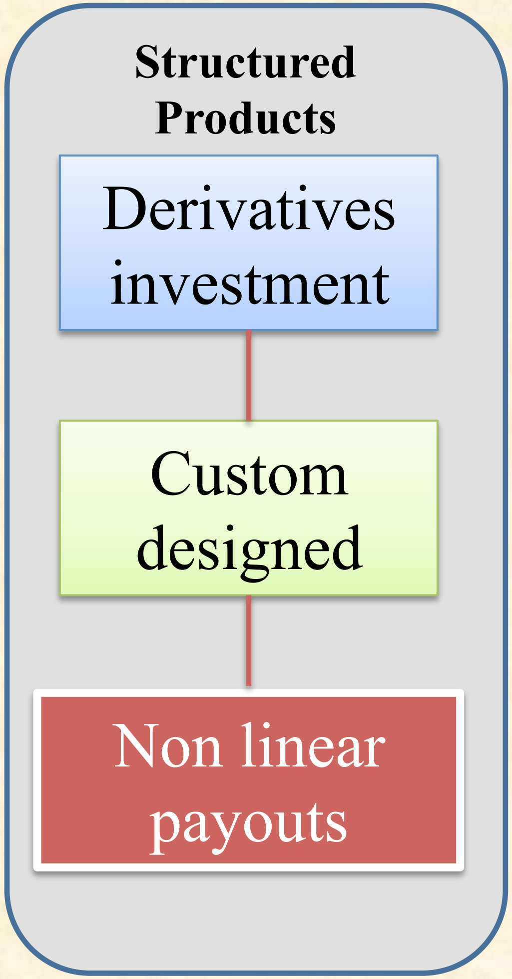
- Know that Interest rates and bond prices are **inversely** related,
- Interest rate and yield on bonds are the same (different terms used),

- What influences interest rates? – **term structure of interest rates** (as shown by yield curve).
- Interest rate is the price of loanable funds which is determined by supply and demand in the market



What’s structured products (SP)

- Are investments that use **derivatives** to create different risks and return profiles for investors,
- Are **custom-designed** investment products,
- What are Derivatives?: Financial instruments which derive their value from an underlying asset, for example, options, and futures
  - Example of Underlying assets : equities, indices, commodities, currency and others
- Structured products are able to deliver **non-linear** or variable payouts (i.e. if underlying go up/down by 10%, the SP can go up/down by more than 10%).

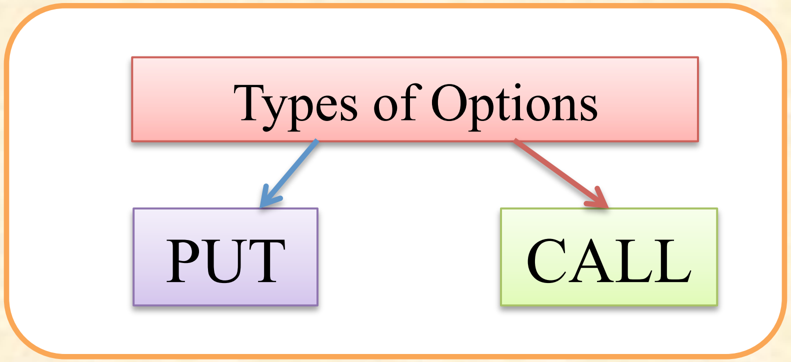


What's the <u>role</u> of structured products?

1. To enhance risk return of underlying asset e.g. stocks, index, commodities, others
2. For portfolio diversification, through a wide range of asset available
3. To optimize asset allocation for investors through different payouts.

Know what is an Option

- An option is a contract to buy or sell a specific underlying instrument or underlying interest.
- An option has a specific price, called the strike price, at which the contract may be exercised and a maturity/ expiration date. When an option expires, it no longer has value and no longer exists.
- As an option investor, one must choose to buy or sell and whether to choose a call or a put, based on the investment objective.



Know what is an Option (cont..)

Put/Call option

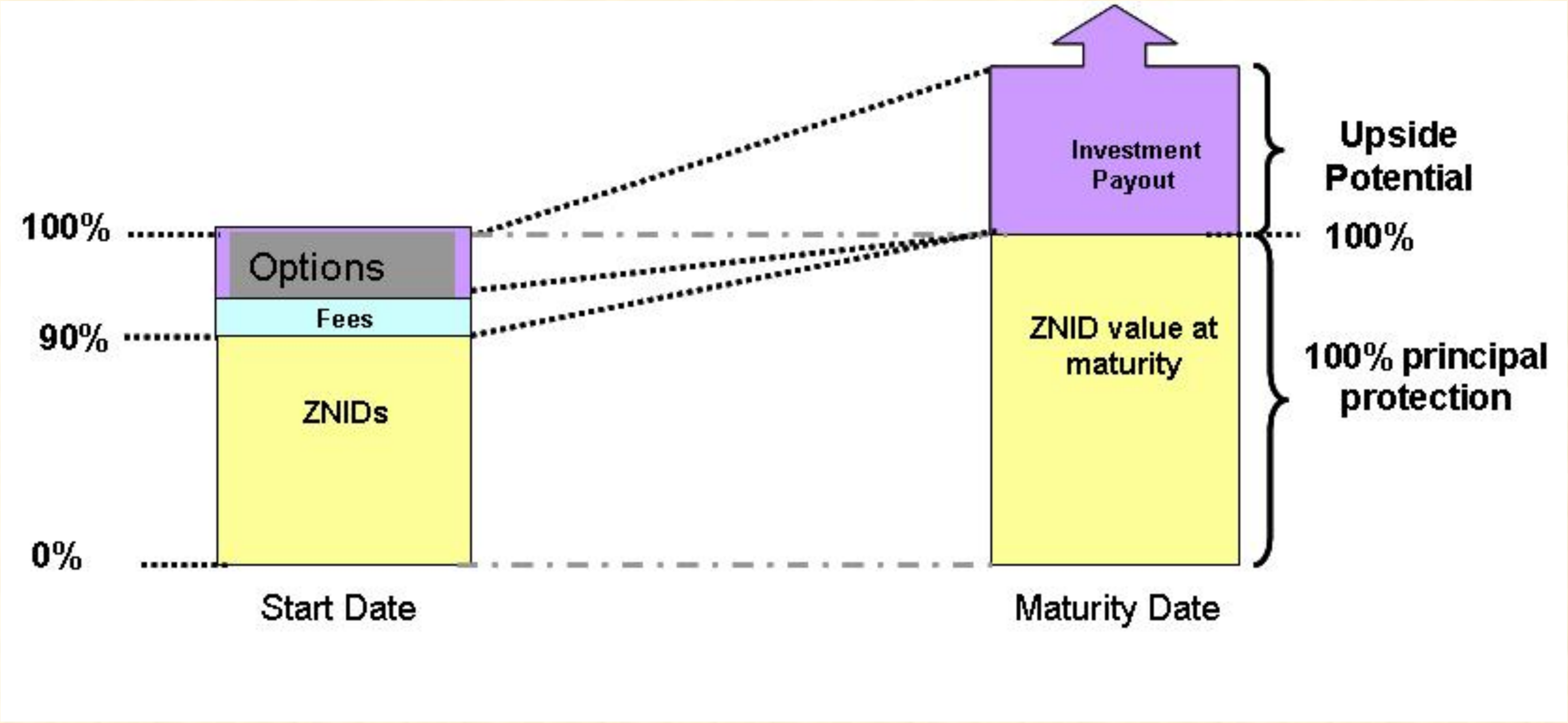
- When an investor buys a **call**, he/she has the right to buy the underlying instrument at the strike price on or before the expiration date.
- When an investor buys a **put**, he/she has the right to sell the underlying instrument on or before expiration.
- As the option holder, the investor has the right to sell the option to another buyer during its term or to let it expire worthless.

Principal protected products

- Is *one of most common* Structured Product concept,
- Generally consist of 1) Zero-coupon Negotiable Instrument of Deposits (ZNID) and 2) options,
- Zero-coupon Negotiable Instrument of Deposits (ZNID) provide principal protection for the structure: while the option provide potential Upside
- Only the principal amount (and not the return) is protected, <u>if held to maturity</u> (unless in callable or autocallable product)

Basic building block of principal protected product

Example: 100% principal protected product



Underlying assets

Structured products = Zero coupon bond + Derivative (options)

Options derive value from its Underlying Assets

1. Equities
2. Indices, including stocks
3. Commodities
4. Currencies
5. Interest rates – KLIBOR
6. Fixed income
7. Real estate
8. Hybrids

Risks of investing in structured products

RISKS

1. **Credit risk**
2. **Mismatch risk**
3. **Market risk**
4. **Liquidity risk**
5. Legal risk
6. Currency risk
7. Option risk
8. Tax risk
9. Callable risk

Know the Risks
Especially these ones

Structured Products Risks

- Credit Risk - the payment of principal and any returns from investment of structured products to investor depends on the **ability of the issuer** to make such payment
  - Hence, investors need to assess the credit risk of the issuer for example, bank or financial institution,
- Market Risk - The returns from structured products may vary depending on the outcome of one or more market factors.
  - This may include lower than expected returns, or no returns at all, if the underlying assets linked to the product does not perform,
  - There are various factors that can affect the performance of the option embedded in structured products which include:
    - Volatility,
    - Dividends (if any), and,
    - Interest rates.

Structured Products Risks (cont..)

- Liquidity Risk - structured products have options embedded, which may be relatively **illiquid**:
  - This illiquidity may result in lower pricing or value for product (i.e. below original value), if investor redeems early prior to maturity,
  - There may not be a ready secondary market for the structured product & issuer not obliged to make a market for it,
  - Hence, liquidity risk also known as *mark to market risk which m*ay result in a large gap between bid / ask (buying & selling prices).
- Mismatch Risk - Risk that the investments does not match investors' requirements;
  - For example, some investments may have a tenor of 50 years which are not suitable for those with shorter maturity requirement, for e.g. retirees or those age above 65,
  - Coupon payment frequency may not match intended income frequency of investors,

15%

Basic Investment Knowledge

2. Financial markets & instruments – weightage: 15%

This section covers the roles and functions of financial markets, its participants, and regulators. You are expected to know the structure of Malaysian financial system and its components.

Financial markets & instruments

- You are expected to know:
  - What are the components of Malaysia financial system,
  - What are the 5 major components of its financial markets?
  - What's a financial market (definition)
  - What's forex and money markets?
  - What's equity and debt markets?

Financial markets & instruments

- You are expected to understand the different categories of markets.
  - OTC versus exchange traded,
  - Offshore and onshore,
  - Primary vs. secondary markets.
- Who are the main regulators? BNM and SC
- Who are the main market participants?
- BNM – what's the role and function?
- SC – what's the role and functions?
- BNM – and its OPR and interest rates

Components of financial system (BNM)

Regulated by BNM:

1. Commercial banks
2. Islamic Banks
3. Investment banks
4. Takaful operators
5. Devt. Financial Institutions
6. Insurance co.
7. Reinsurance co.
8. Payment operators
9. Money changers

Regulated by LOFSA

1. Offshore banking
2. Offshore insurance / reinsurance
3. Offshore Fund Mgmt

6 DFIs under BNM: Agrobank, Bank Simpanan, EXIMBank, Bank Rakyat, and SME Bank & Bank Pembangunan

Non Banking financial Intermediaries

Registration / approval from BNM

- Money & forex brokers
- Leasing & factoring
- Credit companies

Regulated by SC

- Unit trusts
- Venture capital

Licensed by Kementerian Kesejahteraan Bandar, Perumahan & Kerajaan Tempatan

- Money Lenders

- Cagamas Berhad
- Credit Guarantee Corp
- Provident & Pension Funds
- Savings Institutions
- Housing Credit institutions
- Cooperatives
- Pilgrims fund board

Components of financial system (SC)

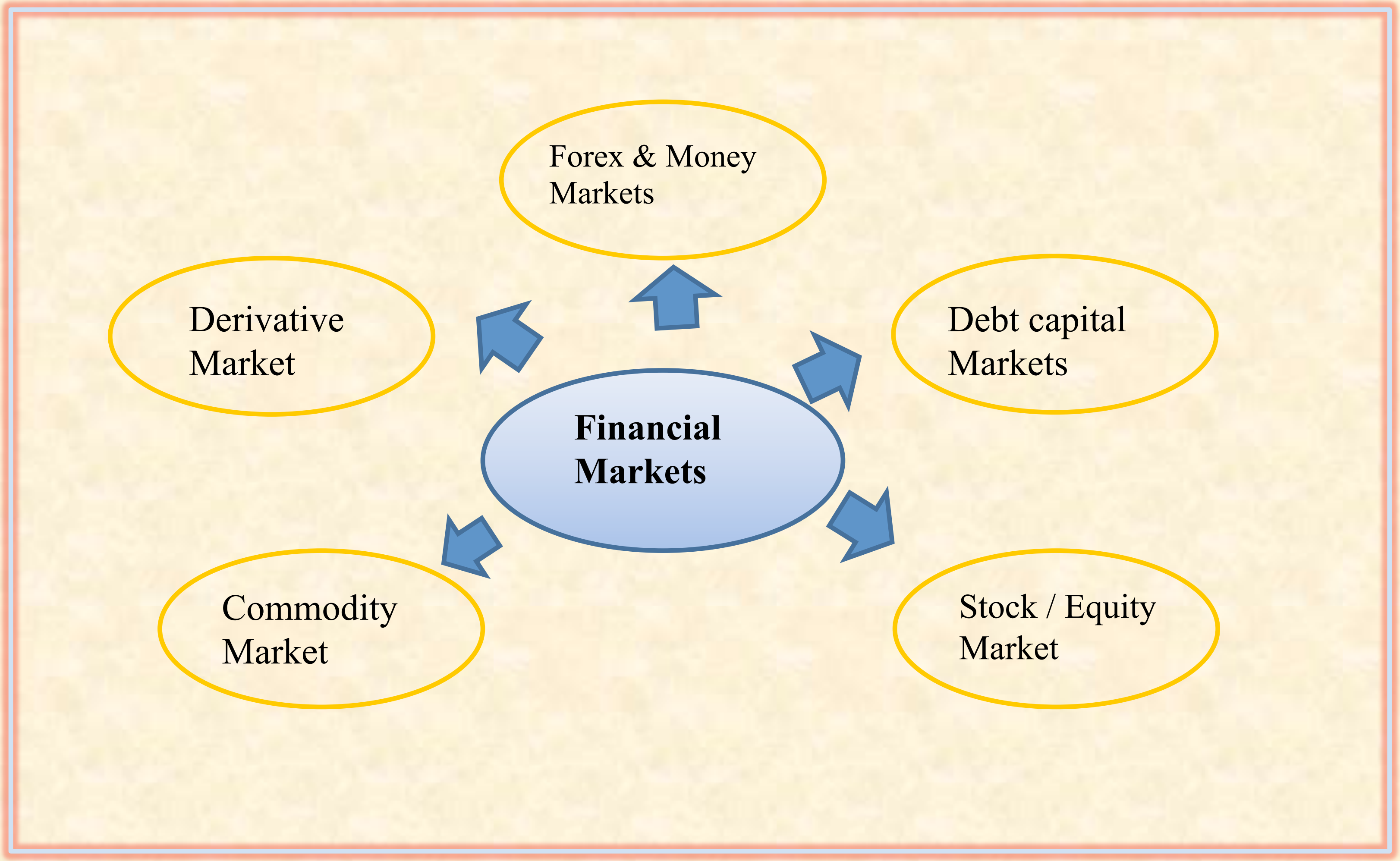
<u>Regulated by Securities Commission (SC)</u>

1. **CAPITAL MARKETS**
   a) Debt
   b) Equity
2. **DERIVATIVES**
   a) Commodity Futures
   b) MGS Futures
   c) FBCM KLCI Futures
   d) KLIBOR Futures

<u>Notes</u>

- Investment banks are jointly regulated by SC and BNM
- Investment banks are created via merger of (merchant bank + stock broking co), or (2 discount houses + stock broking co), or (universal broker + discount house)

Major component of financial markets



What's financial market?

- A platform or forum which people and entities can trade financial securities (such as bonds, stocks, commodities, options, and others)
- It facilitates:
  - The raising of capital (in capital market),
  - The transfer of liquidity,
  - International trade,
  - Price discovery

Financial markets

Financial Markets

Forex market Facilitates the trading of **foreign currencies**, also known as forex market,

Money market - Facilitates transfer **of liquidity** by providing **short-term debt financing and investment**.

Equity - An entity or a platform where company stocks (shares) are listed and traded. Also known as the stock market.

Debt - A financial market where participants can issue new debt instruments (primary market) and buy and sell debt instruments (secondary market). Also known as the bond or fixed income market.

Different categories – financial markets

Exchange Traded Market -where traders/investors transact deals in an organized exchange where the central clearing house of the exchange becomes sellers to the buyers and buyers to the sellers.

Different Categories of Markets (1)

The Over-the-Counter (OTC) market - where traders/investors transact deals by contacting counterparty, either through brokers or directly through phone or any telecommunication means.

Offshore vs Onshore markets

Onshore market:
Located in home country,
Handles trading & transactions
within the home country

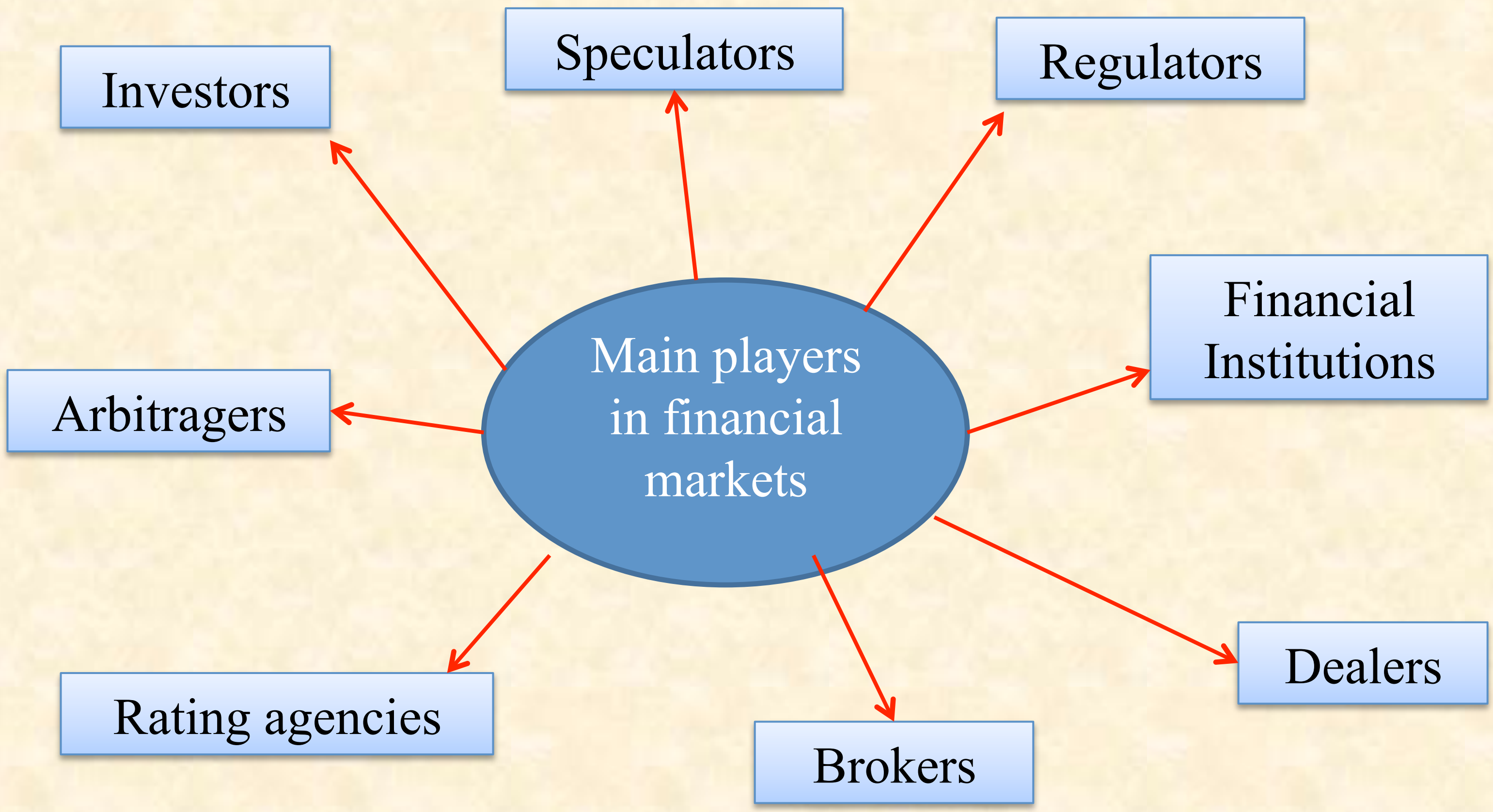
Different
Categories of
Markets (2)

Offshore market – similar
function as Onshore market but
located in another country

Capital markets

- The capital market can be divided into the following:
- *1) Primary market:*
  - Is where newly issued securities are bought and sold.
  - Is where transactions done between issuers and investors.
  - Methods of issuing securities - initial public offering (IPO), rights issue (for existing companies), preferential issue and tender or private placement.
- *2) Secondary market:*
  - It is where previously issued financial instruments such as stock, bonds, options, and futures are bought and sold (traded),
  - A market which allows investors to buy and sell existing securities

Who are the market participants?



(*refer to Workshop slides / notes & make sure you understand their roles)

Bank Negara Malaysia (BNM)

- BNM – what's the role and function?
  - Established on 26 January 1959 under the Central Bank of Malaysia Act 1958 (CBA1958).
  - The CBA1958 has since been repealed by the Central Bank of Malaysia Act 2009 which became effective on 25 November 2009.
  - A statutory body wholly-owned by the Government of Malaysia.
  - Reports to the Minister of Finance, Malaysia and keeps the Minister informed of matters pertaining to monetary and financial sector policies.
- Principal objectives of BNM as stated in the Central Bank of Malaysia Act 2009: 1) monetary stability 2) Financial stability and 3) efficient payment systems

BNM & Interest rates

- BNM is responsible for setting and maintaining Policy rate (Overnight Policy Rate or OPR) and maintains an operating target
  - Monetary operating framework - overnight policy rate guided within a corridor.
  - Overnight rate as the policy rate and also the operating target
  - Operating band of 50 basis points to minimize extreme volatility.
  - Standing facility available at the ceiling and floor rate.
  - Overnight rate was chosen as the policy rate for the following reasons:
    - High controllability
    - Minimal expectation content
  - Interest Rates (other tenors) are determined by the market.

Securities Commission (SC)

- What's the role and function?
  - Established on 1 March 1993 under the Securities Commission Act-1993,
  - Is a self-funding statutory body with investigative and enforcement powers.
  - Reports to the Minister of Finance and its accounts are tabled in Parliament annually.
  - SC is ultimately responsible to protect the investor.
  - Apart from discharging its regulatory functions, the SC is also obliged by statute to encourage and promote the development of the securities and futures markets in Malaysia.

30%

Basic Investment Knowledge

3. Laws & Regulations- weightage: 30%

This section relates to laws and regulations, which concern structured products, and investor protection. There are many laws which are covered and candidates are expected to have sufficiently high understanding of these, and the know penalties for non- compliance of such laws.

Laws and Regulations

- You need to **read & understand** the material to be presented in the slides/notes (AICB Workshop),
- Forms 30% of total marks (from 100%) – you need to get at least, 24/80 questions correct,
- How to allocate your time and focus? See Table below.

Laws & Guidelines	% of Time allocation for study
1. Guidelines on IPPC	10%
2. FSA/IFSA/ CMSA	30%
3. SC Guidelines on Offering of Structured Products	15%
4. Guidelines on Introduction of New products	5%
5. Guidelines on Sales of Unlisted Capital Market Products	10%
6. Guidelines on Product Transparency and Disclosures	10%
7. AMLA /CFT/ PIDM	10%
8. Sukuk /PDS / ECM / Secondary FCY Debentures	10%
Total	100%

Laws and Regulations – Key focus areas

Focus on 3 key areas (initially)

1. Guidelines on IPPC

2. FSA / IFSA / CMSA

3. SC: Guidelines on Offering of Structured Products

Guidelines on IPPC

- Know the Learning Objectives (esp. on "fit & proper"):
  - To explain the requirements that must be complied with under the Guidelines for Investor Protection
  - To identify the **standard of "fit and proper"** as set out in the guidelines, (*most important part to understand in this Guideline)*
  - To recognize the examination requirements as set out in the guidelines
  - To interpret the implications of non-compliance to both investor and Bank.

What is IPPC

BNM/SC: Guidelines for Investor Protection (or IPPC):

- Jointly issued by Bank Negara Malaysia (BNM) and Securities Commission (SC) pursuant to relevant sections in:
  - Financial Services Act 2013 (FSA)
  - Islamic Financial Services Act 2013 (IFSA)
  - Section 377 of Capital Market Services Act 2007 (CMSA) read with Section 76 of CMSA and Amendment Act of 2012
- These guidelines are applicable to the following financial institutions which carry out permitted capital market activities under:
  - Financial Services Act 2013 (FSA)
  - Islamic Financial Services Act 2013 (IFSA)

Know what is “fit and proper”

- Section 8, standard on “Fit and Proper”
  - Section 8.1: Employees of a registered person carrying out permitted capital market activities on behalf of a registered person are not required to hold a capital markets services representative’s license.
  - However, they must be "fit and proper" as set out in these Guidelines.
- Section 8.2: The standard on "fit and proper" is met through compliance with:
  - Minimum "fit and proper “ criteria;
  - Examination requirements; and,
  - Continuing Professional Education (CPE) requirements

“Fit and proper” criteria

- What is the **minimum "fit and proper**" criteria?:
  - Not an undercharged bankrupt;
  - Not a judgment debtor;
  - Not convicted of an offence involving fraud /dishonesty/ violence;
  - Not convicted of an offence in respect of banking, securities and insurance laws;
  - Not engaged in any deceitful or oppressive business practices; and
  - Not been engaged in business practices or conducted him in such a way where his competence and soundness of judgment is doubtful.
- If any employee who carries on the permitted capital market activities is not “fit and proper”, a registered person shall:
  - Immediately notify BNM; and,
  - Stop such employees from continuing to carry on permitted capital market activities on its behalf.

Financial Services Act 2013

- **Financial Services Act 2013 (FSA)**
  - Came into force on 30 June 2013.
  - Consolidates and replaces:
    - Banking and Financial Institutions Act 1989 (BAFIA)
    - Exchange Control Act 1953
    - Insurance Act 1996, and
    - Payment Systems Act 2003
  - Purpose of Act – to provide for the regulation and supervision of financial institutions; payments systems, and other relevant entities and the oversight of money and foreign exchange market, to promote financial stability and for related consequential or incidental matters.
  - Provide laws for;
    - Licensing and regulation of Institutions.
    - Deposit-taking.
    - **Banking secrecy.**
    - Powers of BNM to issue guidelines, investigation and prosecution of offenders.

Islamic Financial Services Act 2013

- **Islamic Financial Services Act 2013** (IBFA) replaces Islamic Banking Act 1983 (IBA),
  - Came into force 30 June 2013
  - Purpose of Act - to provide for the regulation and supervision of Islamic financial institutions; payments systems, and other relevant entities and the oversight of Islamic money and foreign exchange market, to promote financial stability and compliance with Shariah, and for related consequential or incidental matters.

Summary for IFSA / FSA

	FSA	IFSA
Secrecy (aim to preserve customer confidentiality)	**Sec 133** – penalties for non compliance, max RM10mil, or jail max 5 years or both	**Sec 145** - penalties for non compliance, max RM10mil, or jail max 5 years or both
Permitted disclosures	**Sec 134**	**Sec 146 (1)**
Penalties for non-compliance (Permitted Disclosures)	**Sec 134 (4)** - penalties for non compliance, max RM10mil, or jail max 5 years or both	**Sec 146 (4)** - penalties for non compliance, max RM10mil, or jail max 5 years or both

FSA / IFSA

- Secrecy:
  - no person **who is or has been a director officer, or agent of the Islamic financial institution** who by reason of this capacity or office has by any means access to any document or information relating to the affairs or account of any given customer of that Islamic financial institution shall give or disclose or reveal any information whatsoever to another person.
- Permitted disclosures
  - Section 146 (1): States that circumstances in which customer documents or information may be disclosed as set out in Schedule 11 among others:
    - Customer gives permission in writing to do so, or
    - Disclosure of information is approved by BNM in writing or
    - Customer is declared bankrupt,
    - For purpose of criminal or civil proceedings,
    - In compliance with Court order,
    - Disclosure of information by PIDM.

Capital Markets Services Act (CMSA) 2007

- CMSA 2007 Consolidates:
  - Securities Industry Act 1983;
  - Futures Industry Act 1993; AND
  - Part IV (on fund raising), Securities Commission Act 1993.
  - Supported by:
    - Capital Markets and Services Regulations 2007;
    - The SC Licensing Handbook; and,
    - Guidelines on Regulation of Markets.

Outlines what is "reasonable basis" and Recommendations made by sales people

“Reasonable basis“

- Section 92 (Recommendations by licensed person) – *understand what is concept of reasonable basis*
  - Section 92(1) states that a licensed person must have a **reasonable basis** for making recommendations.
  - E.g. Not to simply recommend an investment product that does not meet the client’s needs, just to meet sales targets.
  - Section 92(2) - explains what reasonable basis is:
    - Information on the investment objectives, financial situation and particular needs of the person is accurate and complete;
    - Has given consideration to, and conducted investigation of, the Subject Matter of the recommendation; and,
    - The *recommendation* ***is based*** *on such consideration and investigation.*

What are consequences, if without reasonable basis?

- *Understand that if without reasonable basis → liable for losses or damage caused by an investment based on his/her recommendation.*
  - If licensed person makes **a recommendation without reasonable basis** he commits an **offence [Section 92(3)]** and he shall **be liable to pay damages to the investor who suffered loss or damage caused by an investment based on such recommendation [Section 92(4)].**
- *Understand that Licensed person is **not liable** if:*
  - A reasonable person in the circumstances would have done or omitted to do that act in reliance on the recommendation - Section 92(5).
  - Recommendation was appropriate - Section 92(6).

Recommendation by sales person

- Section 92A (2) (Recommendations by licensed person)
  - Any person who **issues/provides false/misleading information; or**
  - Makes **any false/misleading statement**; or
  - **Willfully omits to state any matter/thing** without which the statement/ information is misleading in a **material aspect**, to an investor in capital market product, commits an offence.
  - Penalty for non-compliance:
    - Fine of up to RM3million, or
    - Imprisonment of up to 10 years; or Both

CMSA – Fraud

- **Section 178 (Fraudulently inducing persons to deal in securities)**
  - Under Section 178(1), a person shall not fraudulently (making misleading / false / deceptive statements / promise / forecast or recklessly making / publishing or recording / storing such information) induce persons to deal in securities:
  - Examples: -Promising returns on an investment product that definitely will be better than fixed deposit interest when it is not certain to be so.
  - Assuring the investor that the principal sum invested is guaranteed when it is not.
  - Penalty for non-compliance:
    - Fine not less than RM1 million, **AND**
    - Imprisonment for a term up to 10 years.

Guidelines on Offering of Structured Products

- Any person who issues, offers for subscription or purchase, or makes an invitation to subscribe for or purchase, or makes available <u>structured products requires the approval of the SC and shall comply</u> with these Guidelines.
- These Guidelines stipulate the criteria which must be met when issuing, offering, making an invitation for, or making available unlisted structured products to investors listed in *Schedules 2 and 3* of the SCA.

Know the definitions

- A "qualified bank" means:
  - A commercial bank, an Islamic bank; or an investment bank licensed as a dealer and as a merchant bank, and established under the Guidelines on Investment Banks jointly issued by BNM and the SC.
- A "Qualified dealer" means a dealer licensed under the Securities Industry Act 1983, and:
  - Which is a universal broker as defined in the SC's Guidelines on Permitted Activities for Stock broking Companies;
  - Which is a 1+1 broker as defined in the SC's Guidelines on Permitted Activities for Stock broking Companies; or which is a special scheme broker as defined in the SC's Guidelines on Permitted Activities for Stock broking Companies.
- "Structured product" means any investment product that falls within the definition of "securities" under the SCA arid which derives its value by reference to the price or value of an underlying reference;
- "Underlying reference" means any security, index, currency, commodity or other assets or reference, or combination of such assets or reference.

What are the Requirement for Disclosure?

- **Primary seller*** to make available a risk disclosure statement of structured products to investors when offering, making an invitation for, or making available structured products.
- **Who is a* Primary seller?: the party that offers, makes an invitation for, or makes available the structured product to investors at the primary market, and that may be the Eligible Issuer itself and in the case of tradable structured product, may also include its adviser and subscriber.

What needs to be included in the Disclosure Statement under the Guidelines

- Components of a **risk disclosure statement** are:
  - Clear explanation highlighting all material risk factors of investing in the structured product;
  - Recent price trends of the underlying reference;
  - Scenarios showing range of potential gains/losses resulting from changes in value of the underlying reference;
  - Information on the liquidity provider/other liquidity facilities;
  - A rating for the structured product and definition of such rating;
  - Other material information on the structured products to enable/ assist investors to make an informed decision; and
  - Where issuer is a SPV* or making available structured products of SPV, material information regarding such SPV and arrangements made for performance of SPV obligations.

** SPV = special purpose vehicle*

Fair dealing and suitability requirements

- A primary seller shall adopt fair dealing best practices when dealing, marketing and selling structured products to investors.
  - Different standards of fair dealing in relation to institutional investors and investor individuals should be noted and addressed.
  - Investor individual, who invests in structured products during an offer period, is given the option to obtain a full refund of principal investment sum within 3 working days of such investment or the remaining offer period, whichever is earlier.
- *What are the* Minimum key measures?
  - 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.

Minimum key measures

- A primary seller is expected to observe the following:
  1. Know your client: Determine whether structured products are suitable for the targeted client. Assess client's financial position, investment experience and
  2. Duty of care: Ensure that financial risks and potential losses are fully explained to clients before decision is made. Projections of returns on investment are to be based on historical performance and reasonable expectations of future performance.
  3. Sales Personnel: Has financial background and adequate knowledge and understanding of structured products.

Minimum key measures (cont)

4. Provide Risk Disclosure Statement: Provide clients with pertinent information regarding the investment risks.

- Risk disclosure statement provided separately from the application form or other document constituting a contract, and
- Furnished to the potential investor together with other promotional and sales documents, before any binding contract is entered into by the investor.

5. Confirmation of Disclosure by Client: Invite client to read the risk disclosure statement, ask questions and take independent advice.

- Client to sign a confirmation that the relevant disclosure has been made by the primary seller.

6. Individual Investors: Ensure that a higher standard of diligence is exercised when dealing with 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

Other Laws and Regulations covered

Be familiar with the other Laws & Guidelines listed in Syllabus, before attending the 2 Day Workshop

15%

Basic Investment Knowledge

4. Others (Financial Needs Analysis & KYC)

- weightage: 15%

This section covers the KYC principles; you need to understand its importance. It also covers risk profiling as part of the investment sales process and fair dealing with clients.

Know-Your Client (KYC)

Know the importance and principles of *Know-Your-Client (KYC)*

What is KYC?

1. Standard Form in investment Industry

2. Integral part of sales process

3. Advisors to know detailed information of client:
  - -Risk tolerance,
  - -Investment knowledge,
  - -Financial position

KYC (cont..)

- KYC process also crucial for Banks as part of anti-money laundering and related activities – protects from breaches and risks.
- Know the *purpose and objectives* of KYC:
  - To continuously have an understanding of the client's financial needs, requirements, and objectives.
  - Is a necessary part of determining risk profile and product suitability.
  - Aimed towards helping clients make informed investment decisions to optimize returns for their portfolio.

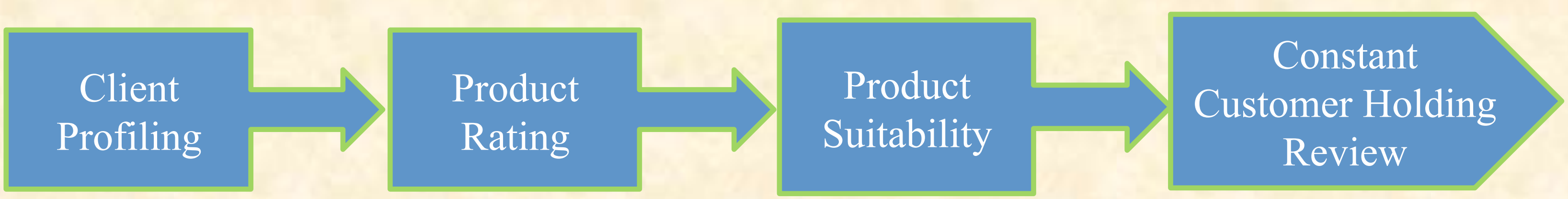
KYC as part of investment process

- Regulatory requirement: SC Guidelines for Offering of Structured Products
  - To determine whether SP is suitable for targeted client, need to take reasonable steps to assess client's:
    - Financial position,
    - Investment experience,
    - Investment objectives.
  - When is KYC not required?
    - "For execution only" client
    - Client refused to be interview to establish risk profile

Client Suitability & Risk Profiling

- *Understand what is involved in Risk Profiling & Client Suitability*
  - Investment solutions to be proposed only after determining client's specific risk appetite and returns expectations.
  - By using risk profiling tools (questionnaire, & interviews):
    - Ensuring adequate due diligence is done, and,
    - Setting risk profiling ranking.

Know the steps involved - Profiling and Review:



Risk Profiling

- Know what is **risk profiling**:
  - A **methodology** for investor risk profiling and investment product risk rating.
  - Utilized to determine customer's risk appetite and risk tolerance.
  - An analysis of the willingness vs. the ability of the investor to take risks.
  - Describes the level of risk considered acceptable by the investor (who may be an individual or in the case of a corporation, the authorized persons of the organization) and understanding of risk tolerance level to determine a suitable financial strategy.

Fair dealing

- Know what is **fair dealing**:
  - Banks shall adopt fair dealing best practices when dealing, marketing and selling to investors.
  - There are different standards of fair dealing and duty of care - in relation to institutional investors and investor individuals.
  - Such best practices ensure quality of sales process - maintains good client experience, FI’s reputation.
  - Be aware of regulatory and legal requirements on fair dealing towards better investor protection and transparency.

Regulations – fair dealing

- *Know what are the Regulatory requirements (as per Section 2) – fair dealing and misrepresentation*
  - BNM: Guidelines on Introduction of New Products
  - BNM: Guidelines on Product Transparency and Disclosures
  - CMSA 2007
  - SC: Guidance Notes on secondary trading of FCY denominated debentures and FCY denominated Islamic securities.
  - SC: Guidelines on the Offering of Structured Products

Fair dealing requirements

SC: Guidelines on the Offering of Structured Products

- 8.01: States that: a primary seller shall adopt fair dealing best practices when dealing, marketing and selling structured products to investors.
- The different standards of fair dealing in relation to institutional investors and investor individuals should be noted and addressed.
- Give 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 3 working days of such investment or the remaining offer period, whichever is earlier.

Fair dealing requirements (cont)

- *Know **minimum key measures** to ensure **adequate investor protection** for any issue, offer, invitation for, or the making available of structured products:*
  - KYC : whether suitable for target client?
  - Duty of care owed - ensure financial risks and potential losses from product fully explained before investment decision. Projections of returns on investment are to be based on historical performance, if available, and reasonable expectations of future performance.
  - On sales personnel - ensure that actual and potential Clients - attended to by specifically identified personnel with financial background and possess adequate knowledge and understanding of structured products, particularly when dealing with investor individuals.
  - Risk disclosure statement- provide clients with pertinent information on risks in investing in structured products
  - Confirmation of disclosure by Client - should invite 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.
  - Ensure Individuals (higher standards of due dilligence) than for institutional clients.

Final notes & disclaimers

- ✓ Candidate should understand all the basic concepts shared in the Foundation Course. This should preceed attending the AICB 2 days course.
- ✓ It serves to provide an overview of knowledge required for a candidate to undertake the AICB 2-day course and subsequently, sit the IPPC examination;
- ✓ It will help you to be better prepared and to ask the right questions during the course, and clarify your understanding.
- ✓ It is provided as a guide only and is not intended to replace the 2 Day course.
- ✓ The author does not make any representations, warranties or guarantees, on the accuracy and effectiveness of the materials presented here. All errors remain the author's.
- ✓ Candidates are advised that they use the material solely at their own discretion.
- ✓ All the best with the IPPC.

Chris' Email: cgan88@gmail.com