



Centre for Banking & Finance Law  
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## Working Paper

**An Examination of the Retail Investor Protection Framework in Malaysia**

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## **ABSTRACT:**

This paper seeks to examine the retail investor protection framework in Malaysia, in particular its characterisation, foundational basis and implications arising from the model currently in place. The first section of this paper provides an overview of the Malaysian capital market framework and the aspirations of Malaysia to grow its capital market, as documented in the Economic Transformation Programme and Capital Market Masterplan 2. The second section sets out the theoretical foundation of investor protection in brief and seeks to characterise retail investors, noting that this has been an area of much debate and discussion. It then studies the investor protection framework in Malaysia, focusing on retail investors. This paper puts forward a few modest proposals for consideration by policymakers in further strengthening the retail investor protection framework in Malaysia.

## **An Examination of the Retail Investor Protection Framework in Malaysia**

**Petrina Tan Tjin Yi<sup>1</sup>**

This paper seeks to examine the retail investor protection framework in Malaysia, in particular its characterisation, foundational basis and implications arising from the model currently in place. The first section of this paper provides an overview of the Malaysian capital market framework and the aspirations of Malaysia to grow its capital market, as documented in the Economic Transformation Programme and Capital Market Masterplan 2. The second section sets out the theoretical foundation of investor protection in brief and seeks to characterise retail investors, noting that this has been an area of much debate and discussion. It then studies the investor protection framework in Malaysia, focusing on retail investors. This paper puts forward a few modest proposals for consideration by policymakers in further strengthening the retail investor protection framework in Malaysia.

### **1.0 An Overview of the Malaysian Capital Market Framework**

The primary regulator of the Malaysian capital market is the Securities Commission (“SC”), a statutory body formed pursuant to the Securities Commission Act 1993<sup>2</sup> (“SCA”). Section 15 of the SCA sets out the wide range of regulatory functions of the SC, including but not limited to the supervision of exchanges, clearing houses and central depositories, approval of corporate bond issues and regulation of securities and derivatives contracts, take-over and mergers of companies and unit trust schemes. While the SC carries out the licensing and supervision of licensed persons and ensures the proper conduct of market institutions and licensed persons, it

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<sup>2</sup> Act 498

aims to move toward self-regulation by professional associations or market bodies in the securities and derivative industries<sup>3</sup>.

Underpinning all these functions is the SC's ultimate responsibility of taking all reasonable measures to ensure the confidence of investors in the securities and derivatives markets by ensuring adequate protection for such investors<sup>4</sup>. Apart from discharging its regulatory functions, the SC is also obliged by statute to encourage and promote the development of the securities and derivatives markets in Malaysia.

Further to the above, the Capital Markets and Services Act 2007<sup>5</sup> (“**CMSA**”) regulates and provides for matters relating to the activities, markets and intermediaries in the capital markets. The front-line regulation of the capital markets is carried out by Bursa Malaysia Berhad (“**Bursa Malaysia**”), a demutualised entity<sup>6</sup> which has been tasked with the duty of maintaining a fair and orderly market in the securities and derivatives that are traded through its facilities<sup>7</sup>. Alluding to its status as a demutualised entity, Bursa Malaysia Berhad and its subsidiaries<sup>8</sup> are required to act

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<sup>3</sup> Self-regulatory organisations are provided for in Part VIII of the Capital Markets and Services Act 2007. An example of a self-regulatory organisation in Malaysia is the Federation of Investment Managers (FIMM) which was gazetted as a self-regulatory organisation in January 2011. The FIMM describes itself as playing a dual role – an industry body and public interest body, while advocating the growth of the Unit Trusts and Private Retirement Schemes (PRS) in Malaysia on its website at <https://www.fimm.com.my/about-us/self-regulatory-organisation/>

<sup>4</sup> Section 15(1)(g) SCA

<sup>5</sup> Act 671

<sup>6</sup> Bursa Malaysia was converted from a company limited by guarantee to a public company limited by shares pursuant to the Demutualisation (Kuala Lumpur Stock Exchange) Act 2003.

<sup>7</sup> Section 11(2) CMSA.

<sup>8</sup> Bursa Malaysia is the holding company of:

- Bursa Securities, which is responsible for regulating stock exchanges in Malaysia, companies whose securities are listed on and participants of the Main Market and the ACE Market. As a result of a revamp of the Malaysian Stock Exchange, on 3 August 2009 the Main and Second Boards unified to become the Main Market while the ACE Market replaced the Malaysian Exchange of Securities Dealing and Automated Quotation (“**MESDAQ**”) Market;
- Bursa Derivatives, a futures and options exchange covering financial, equity and commodity-related instruments;
- Bursa Malaysia Securities Clearing Sdn Bhd, which provides, operates and maintains a clearing house for the securities exchange;
- Bursa Malaysia Derivatives Clearing Sdn Bhd, which provides, operates and maintains a clearing house for the futures and options exchange;
- Bursa Malaysia Depository Sdn Bhd, which provides, operates and maintains the central depository;
- Bursa Malaysia Depository Nominees Sdn Bhd, which acts as a nominee for the central depository and receives securities on deposit for safe custody or management;

in the public interest, having particular regard to the need for protection of investors in the discharge of its duties and its statutory duties shall prevail over its corporate interests. This approach is found throughout the provisions of Part II of the CMSA which pertain to the establishment of securities and derivatives markets and the various markets institutions.

The SC and Bursa Malaysia work closely with industry via industry associations such as the Malaysian Investment Banking Association (MIBA) and the Malaysian Institute of Chartered Professional Accountants (MICPA) as well as other stakeholders such as the Minority Shareholder Watchdog Group (MSWG) which established as a government initiative in the year 2000 as part of a broader capital market framework to protect the interests of minority shareholders through shareholder activism.

## **2.0 The Malaysian Economic Transformation Plan and Malaysian Capital Market Masterplan 2**

The strategic direction of the growth of the Malaysian economy is set out in the Malaysian Economic Transformation Plan (“ETP”) which was prepared and launched in 2010 by the Performance Management & Delivery Unit (PEMANDU)<sup>9</sup>, a unit in the Prime Minister’s Department. The ETP focuses on 12 National Key Economic Areas (“NKEAs”), one of which is the Financial Services sector. PEMANDU has identified the challenges which the Financial Services sector faces, which include limitations in the types of investors, products, and currencies available in the capital market and the need to improve personal financial literacy and the local industry to operate in a competitive environment regionally<sup>10</sup>.

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- Bursa Malaysia Bonds Sdn Bhd, which provides, operates and maintains registered electronic facility for the secondary bond market;
  - Bursa Malaysia Information Sdn Bhd, which provides and disseminates prices and other information relating to securities quoted on exchanges within the Bursa Malaysia group; and Labuan International Financial Exchange (“LFX”), a self-regulatory international financial exchange based in Labuan, Malaysia’s international business and financial centre. The LFX, established in 2000 to complement various Labuan financial services, provides a funding mechanism for international companies operating in the Asia-Pacific region and caters for the listing of multi-currency financial instruments.

<sup>9</sup> Please see <http://www.pemandu.gov.my/about.aspx> for more details on the formation, background and establishment of Pemandu.

<sup>10</sup> Please see [http://etp.pemandu.gov.my/Financial\\_Services-@-Financial\\_Services.aspx](http://etp.pemandu.gov.my/Financial_Services-@-Financial_Services.aspx)

Following from the above and as part of the SC's aspirations in helping Malaysia achieve developed nation status, the Malaysian Capital Market Masterplan 2 ("CMP2") was released in 2011 in the wake of the global financial crisis of 2009-2010. The CMP2 is a key document setting out the broad strategic direction of the Malaysian capital market over the course of the next decade.

The opening section of the CMP2 explains the macro-level and regulatory challenges for the Malaysian capital market to expand its role in invigorating national economic growth while addressing concerns about the efficacy of the market. The CMP2 takes a two-pronged approach, focusing on **growth strategies** to expand the role of the capital market and **governance strategies** for investor protection and stability.

In terms of **growth strategies**, the SC is focusing its efforts on promoting retail participation in the bond markets by developing a framework to facilitate the offering of corporate bonds to retail investors, covering the eligible issuer base, mode of offering, format of offering documents, price, transparency, investor protection and education activities. In addition, distribution channels will also be widened to enable greater retail investment<sup>11</sup>. The SC is also looking to attract more short-term international and domestic traders, including retail investors, to bring about better balance to a market environment that is currently dominated by long-term investors and to address the changing trading patterns of retail investors which now favour electronic access in view of its lowered costs in recent years.<sup>12</sup>

With regard to **governance strategies**, the SC highlighted the move towards disclosure-based regulation with greater emphasis on the accountability of issuers and professionals for the disclosure of information. Among others, the SC intends to enhance product regulation to manage risks, expand accountabilities in tandem with the widening intermediation scope and create a robust regulatory framework with effective oversight of risks and stronger corporate governance.

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<sup>11</sup> Securities Commission, Malaysia *The Malaysian Capital Market Masterplan 2*, pg 27

<sup>12</sup> *Op cit*, pg 42

*A Focus on Retail Investor Engagement*

Since the inception of the ETP and CMP2, the SC and its stakeholders have embarked on various initiatives to increase retail investor engagement in the capital markets.

In 2011, the bond and sukuk markets were opened to retail participation i.e. issuers would now be able to issue bonds through the stock exchange or over-the-counter (OTC) via appointed banks. Previously, access for retail investors to bonds and sukuk was mostly available through bond and sukuk unit trust funds and exchange traded funds<sup>13</sup>.

As a means of increasing financial literacy and investor education, Bursa Malaysia set up the Bursa Marketplace, a virtual marketplace providing investor education, real time pricing information and market insights targeted at the younger generation. In 2014, the SC and industry collaborated on a comprehensive investment literacy outreach campaign 'InvestSmart' under the SC's Investor Empowerment initiative, to enable more confident and informed retail participation in the capital market. Even more recently, Bursa Malaysia launched Bursa Celeb.Tradr, a portal designed to attract retail investors, especially millennials, to invest in the equities market<sup>14</sup>.

Such initiatives are timely in view of a study in 2012 which shows that 80.1% of Generation Y respondents believe that investing in the stock market is risky and 62.8% of Generation Y respondents do not prefer to invest in Bursa Malaysia<sup>15</sup>. The results of the analysis show that the top 3 factors Generation Y respondents consider before investing are the security of investments (68.7% ) followed by the interest rate (61.2%), and risk (53.5%). Recommendations by remisiers and stockbroking firms are factors least considered by the Generation Y respondents in this study, with the percentage for both standing at a mere 7%.

Indeed, as recently as January 2015, retail participation in Malaysian shares was described as weak and lacking vibrancy among its Asian peers. In an article by The Edge Malaysia, statistics cited that institutional investors accounted for 74% of stock trades while retail investors carried

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<sup>13</sup>Please see <http://www.sc.com.my/retail-bonds-and-sukuk-market-in-malaysia/> and <http://www.sc.com.my/comparison-between-bonds-and-sukuk-traded-on-the-exchange-and-otc/> for further details on the applicable framework.

<sup>14</sup> Please see <http://www.bursamarketplace.com/index.php>. Also please see <http://www.nst.com.my/node/79994>

<sup>15</sup>Sangeetha Amirtha Ganesan *Consumption, Spending And Investment Behaviour Of Malaysia Generation Y*, Master of Business Administration thesis, Universiti Tunku Abdul Rahman Faculty of Accountancy and Management [May 2012]



out the remaining 26% of local share trades<sup>16</sup> consistent with the findings in the study referred to above. Using velocity as a determinant of vibrancy, Bursa Malaysia's vibrancy stood at 26.8% as compared to 51.5% for the Hong Kong Stock Exchange and 38.9 for the Singapore Stock Exchange<sup>17</sup>. In view that vibrancy is an important factor in attracting more investments in the stock exchange, these figures merit closer attention by stakeholders of the capital markets.

As the CMP2 highlights, retail investor participation is critical to the success of the Malaysian capital market, especially in terms of liquidity of the market, and in particular with regard to smaller cap Main Market companies and listed corporations on the ACE Market. Institutional investors are often confined to making investments in large cap corporations by virtue of their investing mandate. It is noted that most small cap stocks have thin floats so the purchase of a significant number of shares in a small cap company could have a significant impact on the price of the shares, thus reducing the attractiveness of the investment<sup>18</sup>. In this regard, retail participation is critical in ensuring the success of such smaller cap Main Market listed issuers and ACE Market listed corporations in seeking financing via the stock exchange.

In this connection, while much has been done to further retail investor engagement in the capital markets via financial literacy and outreach programmes, it would appropriate to consider the regulatory framework underlying retail investor protection to ensure an adequate and appropriate level of protection for retail investors in tandem with the aspired increase in retail participation in the capital market.

### **3.0 The Current Investor Protection Framework in Malaysia**

At present, the investor protection framework in Malaysia as set out in the CMSA recognises the distinction between retail investors, sophisticated investors and institutional investors. This is reflected in section 229 of the CMSA which provides for excluded offers or

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<sup>16</sup>: 'Bursa retail participation weak, lacks vibrancy'. *The Edge Markets*, 31 Jan 2015

<sup>17</sup> *Ibid*

<sup>18</sup> Requiem for retail investor, page 1117. Also see Paul A Gompers & Andrew Metrick, Institutional Investors and Equity Prices 17-18 (National Bureau of Economic Research, Working Paper No. 6723, 1998), available at <http://www.nber.org/papers/w6723>

excluded invitations<sup>19</sup> for accredited investors, high net worth entity and high net worth individuals.

This framework was established pursuant to the SC's public consultation paper on the review of sophisticated investors and sales practices for capital market issued in 2010. The SC recognised that a greater diversity of capital market products may be offered to Malaysia as a result of connectivity and integration of markets, some of which are complex investment products that should only be offered to sophisticated investors who have the financial means or knowledge to invest in such products<sup>20</sup>. In doing so, the SC proposed certain qualifying criteria and classification of 'sophisticated investors' which culminated in the introduction of 'sophisticated investors' as fully set out Part 1 of Schedules 6 and 7 of the CMSA. The term 'sophisticated investors' encompasses accredited investors, high net worth entities and high net worth individuals. In this aspect, the wealth of the entities reflect a higher standard of knowledge and experience.

Since its introduction, the SC has built on this foundation in the public consultation paper issued in 2014 seeking feedback on the proposed regulatory framework for equity crowdfunding<sup>21</sup>. Section 5 of the consultation paper sets out the proposed threshold of investment amount in relation to sophisticated investors and retail investors. Sophisticated investors are defined as comprising accredited investors, high-net worth entities and high-net worth individuals, as provided under Part 1 of Schedules 6 and 7 of the CMSA which indicates that underlying principles have remained the same.

As regards the Main Market and ACE Market Listing Requirements, the concept of investor protection is embedded throughout via mechanisms such as mandatory provisions to be inserted in the articles of association of the listed issuer, continuing listing obligations and continuing disclosure i.e. the timely and accurate disclosure of all material information by a listed issuer to the public. There is no discernible distinction between retail and institutional investors or

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<sup>19</sup> Excluded offers and invitations are defined in section 229(1) of the CMSA as an offer for subscription or purchase of, or an invitation to subscribe for or purchase securities specified in Schedule 6 or the offer or invitation is made to a class of persons prescribed by order published in the Gazette.

<sup>20</sup> Securities Commission Malaysia, Public Consultation Paper No. 1/2010, '*Review of Sophisticated Investors and Sales Practices for Capital Market Products*'

<sup>21</sup> Securities Commission Malaysia, Public Consultation Paper No. 2/2014, '*Proposed Regulatory Framework For Equity Crowdfunding*'

shareholders in this framework as the mechanisms outlined earlier would apply equally to both retail and institutional investors.

The next section will consider the theoretical foundations of investor protection and will highlight areas for further strengthening and refining in the context of the existing retail investor protection framework.

#### **4.0 The theoretical foundations of investor protection**

At its very heart, investor protection is premised on private contractual law and autonomy and *caveat emptor* (buyer beware). Autonomy is generally regarded as the fundamental right of individuals to shape their own future through voluntary action, and is associated with freedom of contract and the concept of *casum sentit dominus* (the loss lies where it falls)<sup>22</sup>.

Investors are protected via the disclosure of material information to enable investors to make informed investment decisions. The principle underlying disclosure was piquantly described by the Nestor of US Securities, Professor Louis Loss as ‘*Every investor has the right to make a fool of himself*’<sup>23</sup>. Disclosure requirements form a thread that runs throughout financial law<sup>24</sup> and can be understood from a variety of perspectives.

From an economics perspective, the disclosure of material investment information is meant to lead to more information impounded into stock market prices (**informational efficiency**), more trust in the markets (**institutional efficiency**), more liquidity and better capital allocation

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<sup>22</sup> Ogus, Anthony Ogus & Willem H van Boom (eds) 2011, *Juxtaposing Autonomy and Paternalism in Private Law* Hart Publishing, United Kingdom

<sup>23</sup> L. Loss, ‘The Protection of Investors: I The Role of Government’, 80 South African LawJournal (1963) p. 53, at p. 60 = ‘Der Schutz der Kapitalanleger’, 129 Zeitschrift für das gesamte Handels- und Wirtschaftsrecht (ZHR) (1967) p. 197, at p. 208. This expression goes back to the 1935 report of the Canadian Royal Commission on Price Spreads (p. 38). See also T.H. Hazen, ‘Rational Investments, Speculation, or Gambling? Derivative Securities and Financial Futures and Their Effect on the Underlying Capital Markets’, 86 Northwestern University Law Review (1992) p. 987: ‘there is no need to protect a fool from his or her investment folly so long as no fraud or manipulation is involved. As cited in Klöhn, Lars *Preventing Excessive Retail Investor Trading under MiFID: A Behavioural Law & Economics Perspective* Volume 10 / Issue 03 / [European Business Organization Law Review](#) [28 September 2009]

<sup>24</sup> Benjamin, Joanna, *Narratives Of Financial Law* Oxford Journal of Legal Studies (2010) 30 787. She quotes *Derry v Peek* ‘[F]or the general public is so at the mercy of company promoters, sometimes dishonest, sometimes over sanguine, that it requires all the protection that the law can give it’. *Derry v Peek* (1889) LR 14 App Cas 337 (HL) 345 (Lord Watson).

(**allocation efficiency**)<sup>25</sup>. In other words, disclosure is designed to solve the informational asymmetries that exist between companies and investors. The logic is that by arming investors with information, mandatory disclosure promotes informed investor decision making, capital market integrity, and capital market efficiency<sup>26</sup> On a fundamental level, disclosure regulation is not concerned with fairness or justice and tends to run counter to equality and democracy – its ambition is not to protect risk-takers from risks they cannot bear, but merely from risks to which they have not informedly consented<sup>27</sup>.

At the same time, there is present in securities regulation elements of ‘libertarian paternalism’, an approach that preserves freedom of choice but that authorises both private and public institutions to steer people in directions that will promote their welfare<sup>28</sup>. In this connection, libertarian paternalism may also be described as weak paternalism in which there are information rules or default rules to assist the investor to make decisions that maximise his or her welfare<sup>29</sup> while avoiding the chilling effect which overly prescriptive rules and regulations have on innovation.

## **5.0 Defining and Characterising Retail Investors**

Having set out the underlying rationale for investor protection in securities regulation, this paper now seeks to define and characterise retail investors, in contrast to institutional investors. The characterisation of retail investors is important because they are not homogenous<sup>30</sup> and display

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<sup>25</sup>Klohn, Lars *op cit*

<sup>26</sup> Paredes A. Tryo, 2003 *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, **81** Washington University Law Quarterly 417, 418

<sup>27</sup> Benjamin, Joanna *op cit* ‘

<sup>28</sup> Libertarian Paternalism : *The American Economic Review*, Vol 93, No. 2, Papers and Proceedings of the One Hundred Fifteenth Annual Meeting of the American Economic Association, Washington .DC., January 3-5, 2003, (May, 20023), pg 179

<sup>29</sup> Ogus & van Boom *op cit*

<sup>30</sup> Moloney, Niamh 2010, *How to Protect Investors – Lessons from the EC and the UK*, Cambridge University Press, United Kingdom

different levels of sophistication, competence and risk appetite<sup>31</sup>. These differences prompt a closer look to ensure that the balance between overly protective regulatory behaviour which may result in moral hazard and the stymieing of market development and regulation which is too lax and places too much trust in investors, removing an essential layer of protection which regulation, supervision and enforcement should afford.

It is noted that the term ‘retail investor’ is often used synonymously with ‘mom and pop investors’ or ‘unsophisticated investors’. Hence, persons who do not fall within the definition of institutional or professional investor (individuals or entities that meet certain net wealth or asset levels) are treated as a retail investor<sup>32</sup>. In other words, the definition of retail investors are then the group of investors which remain after the parameters for institutional or professional investors have been drawn.

#### *Retail investors or Consumers?*

Arising from the discussion above and the often interchangeable use of the terms ‘retail investors’ and ‘consumers’<sup>33</sup>, this articles posits 2 issues for consideration:-

- Are retail investors the same as consumers?
- Should the degree of protection for investors be the same as that afforded to consumers?

The CMP2 begins with the statement that financial products create value by offering benefits for the buyer which would be similar to consumer products. However, financial products differ from consumer products in that investors, in effect, supply capital through purchasing equity ownership, debt or investment contracts that promise a combination of returns and risks. As the ability of a financial product to deliver on its promises is dependent on uncertain events in the

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<sup>31</sup> Moloney Niamh, *op cit*

<sup>32</sup> Based on the definitions section in the IOSCO questionnaire on the development and regulation of institutional investors in emerging markets

<sup>33</sup> Please see [http://www.ifs.org/docs/IFSF6\\_Dr%20Nik%20Ramlah%20Mahmood\\_FINAL.pdf](http://www.ifs.org/docs/IFSF6_Dr%20Nik%20Ramlah%20Mahmood_FINAL.pdf) for an example of the interchangeable usage of investor and consumers in a Malaysian context.

future, the main tool for the protection of investors must mainly rest on the quality and reliability of information disclosures.

There is a sound basis for the statements made in the CMP2 as it follows that consumer protection goes to process and not outcome i.e. the focus is on protection from unfair odds, rather than unfair harms<sup>34</sup>. The core regulatory concepts informing retail investor protection i.e. best execution and suitability focus on the point of sale and not on possible future losses that may materialise many years in the future<sup>35</sup>. In ensuring that process is safeguarded, consumers would need to be protected from other parties and from themselves.

However, the focus on the role of investor as a supplier of capital obscures the fact that investors are increasingly expected to assume financial security in retirement by investing in the capital markets, as the experience in the United States of America (“US”)<sup>36</sup> and European Union (“EU”)<sup>37</sup> experience highlight. Although this is beyond the current scope of the paper, the issues surrounding the retirement savings crisis in Malaysia<sup>38</sup> and the introduction of a private retirement scheme framework suggest that the Malaysian public may well tread the same path as their US and EU counterparts in the coming years i.e. in order to stretch their ringgit to meet the demands of retirement, more Malaysians will turn to the capital market. In this connection, Lachlan (2010) highlights that the importance of the retail securities market to the EU will inevitably result in more regulation. As a corollary, Lachlan opines that market failure must be prevented because of

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<sup>34</sup> Benjamin, Joanna *op cit*

<sup>35</sup> Ibid

<sup>36</sup> Black, Barbara *Are Retail Investors Better Off Today?* 2 Brook. J. Corp. Fin. & Com. L. 303 2007-2008 he cites that forty-four percent of all American households owned mutual funds in 2007 (51 million households in total), and 65% of those households held funds in some form of employer sponsored retirement account. Trends in Ownership of Mutual Funds in the United States, 2007, ICI RES. FUNDAMENTALS (Inv. Co. Inst., Washington, D.C.), Nov. 2007, at 1, available at <http://www.ici.org/home/fm-v16n5.pdf>; see also Jennifer O'Hare, Retail Investor Remedies under Rule 10b-5, 75 U. CIN. L. REV. (forthcoming 2008) (citing statistics showing that a substantial number of individual U.S. investors invest directly in the markets). 12 See Stuart Banner, What Causes New Securities Regulation? 300

<sup>37</sup> Burn, Lachlan, 2010, *KISS, but tell all: short-form disclosure for retail investors*, Capital Markets Law Journal, Vol 3. No. 2, page 143

<sup>38</sup> Please see <http://www.bbc.com/news/business-30107006> and <http://www.thestar.com.my/News/Nation/2015/01/27/Malaysians-retirement/> for an insight into the Malaysian retirement crisis.

its potentially catastrophic effect on the state, onto whose shoulders will fall the burden of looking after those who have lost their old-age provision.

*Interplay between the CMSA and the FSA*

It is noted that investment banks are regulated by the CMSA by virtue of its holding a Capital Markets and Services Markets Services licence under the CMSA. However, investment banks are also required to be licensed under section 10 of the Financial Services Act 2013 (“**FSA**”), an act which repeals the Banking and Financial Institutions Act 1989<sup>39</sup>, the Exchange Control Act 1953<sup>40</sup>, the Insurance Act 1996<sup>41</sup> and the Payment Systems Act 2003<sup>42</sup> and consolidates the relevant provisions relating to banking, exchange control, insurance and payment systems in a single umbrella legislation. As such, an issue arises as to the interplay between the CMSA and the FSA with regard to investor/consumer protection.

From the outset, the FSA states that its primary regulatory objective is to promote financial stability and in doing so, the Central Bank of Malaysia) shall strive to protect the rights and interests of consumers of financial services and products.

While evidence of a pro-consumer approach is scattered throughout the FSA<sup>43</sup>, the clearest manifestation of a consumer approach is set out in Part VIII of the FSA which relates to business conduct and consumer protection. Under Division 1, ‘*Interpretation*’ of Part VIII, Section 121 FSA defines ‘financial consumer’ to mean

*‘any person who uses, has used or may be intending to use, any financial service or product—*

*(a) for personal, domestic or household purposes;*

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<sup>39</sup> Act 372

<sup>40</sup> Act 17

<sup>41</sup> Act 553

<sup>42</sup> Act 627

<sup>43</sup> For example, section 20(1)(h) of the FSA provides that authorization of an approved person may be revoked where it is in the interest of consumers of financial services and products to do so.

*(b) in connection with a small business as may be specified by the Bank under section 123;*  
*or*

*(c) whether or not for the purposes set out in paragraph (a) or (b), if—*

*(i) the value of the financial services or products does not exceed an amount as may be specified by the Bank under section 123; or*

*(ii) such person is of a class, category or description of persons as may be specified by the Bank under section 123.*

Under Division 2 ‘*Business conduct, complaints, disputes etc*’ of Part VIII, Section 123 FSA further stipulates that the Central Bank may specify standards on business conduct to a financial service provider to ensure that a financial service provider is fair, responsible and professional when dealing with financial consumers. The Central Bank may also specify any class, category or description of persons for purposes of the definition of ‘financial consumer’. Section 124 provides that a financial service provider shall not engage in any prohibited business conduct as set out in Schedule 7 to the FSA<sup>44</sup>.

Given that there is an overlap between the entities regulated under the CMSA and FSA and the possibility that Malaysians will turn to the capital markets to raise income for retirement, it is interesting to observe the contrast between the expressly pro-consumer approach in the FSA and the more subtle investor protection approach embedded in the CMSA and its related guidelines. It

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<sup>44</sup> Schedule 7 of the FSA lists prohibited business conduct as follows:-

1. Engaging in conduct that is misleading or deceptive, or is likely to mislead or deceive in relation to the nature, features, terms or price of any financial service or product.
2. Inducing or attempting to induce a financial consumer to do an act or omit to do an act in relation to any financial service or product by—
  - (a) making a statement, illustration, promise, forecast or comparison which is misleading, false or deceptive;
  - (b) dishonestly concealing, omitting or providing material facts in a manner which is ambiguous; or
  - (c) recklessly making any statement, illustration, promise, forecast or comparison which is misleading, false or deceptive.
3. Exerting undue pressure, influence or using or threatening to use harassment, coercion, or physical force in relation to the provision of any financial service or product to a financial consumer, or the payment for any financial service or product by a financial consumer.
4. Demanding payments from a financial consumer in any manner for unsolicited financial services or products including threatening to bring legal proceedings unless the financial consumer has communicated his acceptance of the offer for such financial services or products either orally or in writing.
5. Exerting undue pressure on, or coercing, a financial consumer to acquire any financial service or product as a condition for acquiring another financial service or product.
6. Colluding with any other person to fix or control the features or terms of any financial service or product to the detriment of any financial consumer, except for any tariff or premium rates or policy terms which have been approved by the Bank.



is noted that the Central Bank of Malaysia and the SC had signed a Memorandum of Understanding (“**MOU**”) in 2012 to enhance joint regulatory oversight, covering areas such as the formulation of legislations and policies, regulation and supervision of entities which come under the joint regulatory oversight of the Central Bank of Malaysia and the SC, supervision of payment system, mutual recognition of financial planners and financial advisers and the conduct of investigation and enforcement actions<sup>45</sup>.

In the event a test case scenario should arise, it is likely that the Central Bank and SC will rely on the terms of the said MOU in taking the relevant enforcement action. However, instead of the *ex post* act of reliance on the MOU and discussion between both regulators, perhaps there is room for an *ex ante* harmonisation of the approaches taken in the CMSA and FSA with regard to consumer and investor protection, similar to MiFID II?

The following section of the paper will present a few modest proposals to further strengthen and refine the Malaysian retail investor protection framework.

## **6.0 Strengthening and Refining the Malaysian Retail Investor Protection Framework**

Thus far, the Malaysian approach towards retail investor protection has been cautious as evidenced by the SC’s careful construction of the sophisticated investor model in the CMSA and the strategies outlined in the CMP2 which while ambitious and wide-ranging, also draw on the lessons learned from other jurisdictions .e.g. with regard to structured products such as the Lehman Minibonds.

Be that as it may, this paper would like to highlight areas in the retail investor protection framework which may merit closer attention, one of which is the Survey on Retail Investors (“**the Survey**”) which was carried out in 2014 to provide insight into trends and gaps in the market. It is noted that all information gathered will be used in the development and implementation of future Investor Education strategies and programmes as well as in the overall development of the capital market<sup>46</sup>. In view of the principle that retail investors are not homogenous and possess different characteristics, it would be fruitful to discover the demographics and risk profile of retail investors

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<sup>45</sup> Please see [http://www.bnm.gov.my/index.php?ac=2694&ch=en\\_press&pg=en\\_press\\_all](http://www.bnm.gov.my/index.php?ac=2694&ch=en_press&pg=en_press_all)

<sup>46</sup> Please see <http://www.sc.com.my/retail-investor-profile-survey-2014/>

in Malaysia as the findings of the Survey could act as a basis for discussion with industry to align the incentives with regard to product design, innovation and distribution. Indeed, the real retail market risk lies in the failure of the industry to develop, test and provide transparent and investor-facing products which support long term-savings, manage market risks and reflect investor needs<sup>47</sup>

Further to the above, the SC may also draw on insights from behavioural economics and finance in designing a stronger framework for retail investor protection. While the trend has shifted towards meaningful rather than more voluminous disclosure, a question which needs further study is how far individuals act as rational investors as well as how they have processed and made use of the information which has been disclosed in light of their limitations and cognitive biases<sup>48</sup>. In this connection, the US courts have recognised the dangers of information overload and devised materiality standards to reflect the cognitive limitations that investors face<sup>49</sup>.

The fresh perspective provided by behavioural economics is also invaluable to financial educators who are beginning to use these findings to identify the psychological barriers to investment and to develop educational strategies. At its June 2013 meeting, the IOSCO Board agreed to build upon the learnings of behavioural economics in IOSCO's approach to regulatory work going forward<sup>50</sup>.

## **Conclusion**

Having examined the retail investor protection framework in Malaysia, the author believes that it would be apt to begin placing consumers and retail investors on a similar footing in view of the increasingly important role that the capital market plays in a secure retirement and to seek to harmonise the approaches taken under the CMSA and the FSA. However, the author believes that

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<sup>47</sup> Moloney, Niamh, *op cit*

<sup>48</sup> Lint, Tom C.W, *A Behavioral Framework for Securities Risk* Volume 34 Seattle University Law Review, 2010-2011

<sup>49</sup>See *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49 (1976) (warning against the tendency "to bury the shareholders in an avalanche of trivial information-a result that is hardly conducive to informed decision making"); see also *Kohn v. Am. Metal Climax, Inc.*, 322 F. Supp. 1331, 1362-65 (E.D. Pa. 1970), modified, 458 F.2d 255 (3d Cir. 1972) (leading case on the buried facts doctrine of materiality) cited in Lint (2010-2011)

<sup>50</sup> *IOSCO consults on strategic framework for Investor Education/Financial Literacy*, Available from <http://www.iosco.org/news/pdf/IOSCONEWS331.pdf> [29 May 2014]

the current framework stands on a solid footing and that an entire overhaul of the system is not needed. While the ETP and CMP2 provide clear direction with regard to the growth of the economy and the capital markets, the devil is always in the details. In addition, with the advent of the ASEAN Economic Community, more thought and consideration would need to be given to the applicable investor framework protection throughout ASEAN.