

INVESTOR PROTECTION IN THE ASIA PACIFIC

Findings of the Asia-Pacific Regional Committee Survey on Investor Protection

5th OECD Roundtable on Capital Market Reform in Asia

19 – 20 Nov 2003

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**The views expressed herein are the personal views of the authors and do not
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1 INTRODUCTION

1.1 In February 2001, the Asia-Pacific Regional Committee (“*APRC*”) endorsed the mandate to study investor protection measures and avenues for investor recourse in *APRC* countries. With growing retail participation in the capital markets (either directly or through pension plans), an increased level of cross-border activities and proliferation of innovative financial products in the recent years, a review of investor protection regimes, with a view to adapting these regimes to keep pace with evolving markets where necessary, was considered appropriate.

1.2 The role of investor protection is crucial to the development of the capital markets. Investor protection promotes investor confidence by reassuring them that their interests are being safeguarded against market malpractices and that recourse against such malpractices is available. Issues of investor protection have become starker in the context of recent high-profile revelations in the US and elsewhere that have shaken investor confidence. These touch on issues such as corporate governance, conflicts of interest, adequacy of accounting standards, auditing oversight, sell-side research, investment banking, and more recently, the late trading and market timing practices in the mutual fund industry and governance of exchanges.

1.3 Even though these issues have been largely surfaced in the US, securities regulators in Asia recognise the importance of responding with appropriate regulatory reforms to bolster investor confidence. Against the backdrop of a prolonged bear market and global economic slowdown, regulators have had to strike a delicate balance between introducing vigorous investor protection measures to promote fair and efficient markets, and not impeding the market’s growth through unduly burdensome rules and regulations.

1.4 As a useful starting point for *APRC* members to better appreciate the diversity of investor protection regimes in the region and identify useful measures instituted by certain jurisdictions for consideration or possible

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adoption, the Monetary Authority of Singapore (“**MAS**”) circulated a questionnaire (“APRC Survey on Investor Protection from Market Misconduct, False and Misleading Statements, and Recommendations without Reasonable Basis”, hereinafter “**survey**”) in September 2002. The survey focussed on rights and remedies accorded to investors for various forms of wrongdoing, ways of detecting misconduct and types of regulatory actions (both punitive and preventive) that can be taken against perpetrators. The findings of the survey were presented at the International Organisation of Securities Commissions (“**IOSCO**”) Annual General Conference in October 2003.

1.5 From the survey, we found that all of the jurisdictions that responded ¹ have instituted fundamental regulatory safeguards to prohibit common forms of misconduct that would have adverse impact on investors, and are empowered to recommend criminal proceedings, and pursue civil or administrative sanctions against perpetrators. This paper aims to present an analysis of investor protection practices among the Asia-Pacific jurisdictions based on findings of the survey.

¹ Respondents to the survey are:

Australian Securities and Investments Commission, Australia
Securities and Exchange Commission, Bangladesh
China Securities Regulatory Commission, China
Securities and Futures Commission, Chinese Taipei
Securities and Exchange Board of India, India
Bapepam, Indonesia
Japanese Financial Services Agency, Japan
Securities Commission, Malaysia
Securities Commission, New Zealand
Securities and Exchange Commission, Philippines
Monetary Authority of Singapore, Singapore
Securities and Exchange Commission, Sri Lanka
Securities and Exchange Commission, Thailand
State Securities Commission, Vietnam

2 WHAT IS INVESTOR PROTECTION?

2.1 Investor protection may be broadly interpreted as safeguarding the interests of investors by instituting a combination of measures in areas relating to corporate governance of listed companies (*e.g.* shareholder rights, disclosure and accountability), market regulation, trading and settlement system efficiency and reliability, as well as financial institutions' dealings with investors. For the purpose of the survey, we have limited its scope to three key areas:

- (a) market misconduct;
- (b) false and misleading statements or omissions in prospectuses; and
- (c) recommendations without a reasonable basis.

Framework for Investor Protection

2.2 The basic framework for investor protection is established through statutory instruments, as it improves the level of compliance and the regulator's ability to enforce rules. Accordingly, all survey respondents have enacted securities and corporate legislation governing the conduct of market intermediaries and protecting the rights of investors. To supplement these statutory provisions, securities exchanges also stipulate listing and trading rules, which regulate the trading in securities and ensure an appropriate degree of transparency and accountability on the part of companies raising capital from the market. Exchanges are empowered to supervise and inspect members' conduct and, in accordance with rules, to impose disciplinary sanctions on any member that violates these rules. Certain jurisdictions such as Vietnam and Japan also cited reliance on criminal law and common law actions in tort, negligence, misrepresentation, or fiduciary duties as legal sources of investor protection.

2.3 In certain jurisdictions, investor protection in the capital markets forms part of the broader framework for consumer protection in general. Hence investors in these countries can also seek redress under the more general consumer protection laws mandating fair dealings with consumers, which may

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be applied to violations of securities law. For example, New Zealand has enacted the Fair Trading Act 1986 and the Consumer Guarantees Act 1993. The Consumer Guarantees Act deems certain guarantees to be given on the supply of goods and services to consumers and confers rights of redress for any breach of these guarantees ². India also has a Consumer Protection Act. In Australia, provisions prohibiting unconscionable conduct in relation to financial services are found in the Australian Securities and Investments Commission Act 2001. Retail investors have recourse to the above-mentioned consumer protection laws in addition to protection that is afforded under securities legislation. Singapore has taken a different approach – the financial sector will be carved out of the draft Consumer Protection (Fair Trading) Bill to be enacted by end 2003 ³.

Holistic Approach to Investor Protection

2.4 The regulatory framework only provides a foundation – it is still necessary to consider how the framework is implemented and how the process of investor protection actually takes places. Most of the survey respondents generally use of a three-pronged approach to achieve this:

i. On-going Supervision

The first level of investor protection is the licensing and continuous supervision of market intermediaries, and approval of documents for offers to the public. The former ensures that prudential, fit and proper and conduct standards are met, and the latter is necessary for allowing only documents with accurate and adequate disclosure to be circulated to

² For instance, the Consumer Guarantees Act provides a guarantee that a service will be carried out with reasonable care and skill. Applying this to the activities of an investment adviser, it would appear that the adviser must make a reasonable analysis of the products about which he or she advises before making a recommendation.

³ The decision to exclude the financial sector from the general consumer protection legislation is premised on the fact that changes to the regulatory framework governing the capital markets have only recently been made and industry dispute resolution mechanisms recently launched. This exclusion will be reviewed two years after the legislation comes into effect.

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the public. Certain jurisdictions conduct on-going supervision through inspection of entities and review of periodic reports received.

ii. Enforcement and Remedial Action

The supervision of intermediaries should be complemented by rules that clearly set out acceptable and non-acceptable conduct and are enforceable by the regulator. Enforcement action could include civil penalties and injunctive powers, as we will further discuss in subsequent sections of this paper. Certain jurisdictions such as Singapore and Taiwan complement their supervisory/enforcement approach with civil claims by investors spelt out in securities legislation, while others address this through general law (such as contract, tort or consumer protection laws).

iii. Investor Education

Differing levels of investor awareness of securities laws and their rights, as well as that of financial literacy influences both the nature and intensity of regulation needed for investor protection. Investor education empowers investors to look after their own interests and minimises their reliance on the regulator to examine each investment for its merit. Indeed, consumer education is important in disclosure-based regimes, as consumers need to be empowered to know how to deal with disclosed information. The majority of the jurisdictions surveyed also have a system to receive and address public complaints, and in the process, reinforce public confidence in their capital markets.

2.5 It is accepted that there is no “one size fits all” approach to regulation, as circumstances differ in each jurisdiction. By and large, the appropriateness of any regime depends on the level of market development and investor sophistication, state of legal and judicial system, and resources availed to the regulator. This is recognised by the IOSCO in the “Objectives and Principles of Securities Regulation”.

Investor Education

2.6 Though the survey circulated did not cover investor education, a couple of respondents, including Australia, highlighted investor education as an important function of the regulator and a keystone in investor protection efforts. Hence we will briefly discuss the role of investor education here.

2.7 Securities regulators in jurisdictions such as Australia, China, India and Singapore have actively taken steps to educate the investing public to complement their other regulatory activities. For example, the Australian Securities and Investments Commission (“*ASIC*”) hosts a website “fido” that is dedicated to consumer protection and publishes discussion papers on consumer education related matters. Similarly, MAS recently launched a consumer portal on its website which provides useful links to education resources and offers practical tips to help investors understand their rights and responsibilities.

2.8 Investor education can be conducted through various channels – mass media, Internet and community organisations – depending on the target audience. Investor education is typically slanted towards pension and retirement planning issues, as these are particularly relevant and provide a wider coverage for investor education initiatives. Special attention should be given to the elderly and the less-educated segment of the population, as they are likely to be more susceptible to being victims of opportunistic behaviour.

2.9 At the very least, investors need to be aware of the importance to deal only with licensed entities, their rights, and the general rules that are in place. They should also have some working understanding of the types of financial instruments and how the stock market works. In particular, the public needs to be aware of the risks involved in common investment instruments, and to be wary of unrealistic and fraudulent claims.

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2.10 Another aspect of investor education is to equip members of the public with the knowledge and ability to seek recourse in the event of misconduct. They must be aware of the existence of complaints channels in order for them to be effective. The responsibility for the existence of such channels is often shared between different agencies, such as the securities regulator, industry associations, criminal law enforcement agencies, the securities exchange or even consumer tribunals.

2.11 To promote investor education and awareness, we noted that India has established two types of investor protection funds, namely the Investor Service Fund and the Investor Education and Protection Fund ⁴. These funds cover programmes for all investors in the securities market. In Singapore, one of the purposes of the Financial Sector Development Fund ⁵ is to provide co-funding for financial education initiatives.

⁴ The Investor Service Fund is maintained by the stock exchange and funded from a portion of the contribution received through listing fees. The Investor Education and Protection Fund is established under the Companies Act 1956 and administered by a Committee specified by the Central government of India.

⁵ The setting up of the financial sector development fund ("FSDF") was legislated in October 1999. The FSDF is also used to provide for the development and upgrading of skills, research programmes and infrastructure to support the financial sector as a whole in Singapore.

3 MARKET MISCONDUCT

3.1 Market misconduct refers to opportunistic behaviour that interferes with the operation of fair, efficient and transparent markets. The types of behaviour generally considered as market misconduct include but are not limited to the following:

- (a) market manipulation;
- (b) false trading or market rigging;
- (c) dissemination of information about illegal transactions;
- (d) false or misleading information
- (e) fraudulently inducing persons to deal;
- (f) dishonest or deceptive conduct;
- (g) insider trading;
- (h) bucketing;
- (i) failure to disclose, in a continuous manner, material information relating to the company; and
- (j) dealing on behalf of customers without permission.

3.2 All survey respondents consider market misconduct as serious offences and subject them to criminal and/or pecuniary penalties, including imprisonment terms.

Detection of Market Misconduct

3.3 In most jurisdictions, the statutory regulator is given responsibility for detecting and enforcing market misconduct. In other jurisdictions such as Philippines and Sri Lanka, this is jointly carried out by the statutory regulator and securities exchange. The main approaches to detecting market misconduct are surveillance and member-dealer supervision. In the case of Japan, a separate regulatory body (Japan Securities and Exchange Surveillance Commission, “**SESC**”) is formed to perform this role and other market surveillance bodies such as the Tokyo Stock Exchange and Japan Securities Dealers Association report to the SESC where there are suspicious trading activities.

3.3 Where self-regulatory organisations (“**SROs**”) (e.g. surveillance units of exchanges) or industry groups (such as dealer associations) uncover suspicious trading activity or receive feedback from the public, they may raise this to the attention of the lead regulator. Certain regulators such as the Thailand Securities and Exchange Commission and Indonesia’s BAPEPAM also review documents submitted by intermediaries (e.g. beneficial ownership reports and registration statements) to examine if a possible contravention of any securities law has occurred. The lead regulator may then, either by itself or in co-operation with law enforcement agencies (such as the police) investigate the alleged misconduct.

3.4 The survey also reveals other sources of detecting market misconduct – complaints from the public, media reports and through conducting inspections of market intermediaries and other investigations. In particular, feedback from the public (as a source of detecting market misconduct) is commonly cited, and is typically received via telephone, written communications as well as electronic media (E-mail or Internet). Several jurisdictions such as Sri Lanka, China and Australia have set up specialised complaints units to deal with complaints and assess if the matter should be raised to the appropriate authority for further investigation.

Regulatory Actions

3.5 Apart from criminal sanctions, most regulators are empowered to impose civil penalties and administrative sanctions. In Bangladesh, Malaysia, New Zealand and Singapore for example, the securities regulator may commence civil proceedings for certain forms of market misconduct (such as insider trading), and the penalty sought is typically subject to a cap ⁶.

⁶ For example, the maximum penalty payable by a defendant in a civil proceeding initiated by MAS is three times the profit gained or loss avoided by the offender as a result of his misconduct. This is also the case in Korea and Malaysia.

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3.6 Administrative sanctions serve as an effective deterrent, as the reputational risk to market intermediaries can be severe. The more commonly used administrative sanctions include revocation of licence, warning letters, public reprimands and fines. Other types of sanctions include restraining persons from accessing the securities market (India), giving orders to securities firm to dismiss a director or corporate auditor who conducted a fraudulent activity (Japan) and appointing an independent auditor (Malaysia). The choice of administrative sanction depends on the specific contravention that it is supposed to address and severity of the breach. In Taiwan and Indonesia, administrative sanctions are not imposed for contraventions amounting to criminal offences.

3.7 Regulators in Sri Lanka and Singapore also have the power to compound offences. Composition refers to the process by which the regulator imposes a monetary fine for certain offences in lieu of criminal prosecutions, and can usually be done only with the consent of the public prosecutor (or its equivalent)⁷. Aside from these actions, regulators generally do not impose monetary fines or other punitive measures on their own authority⁸. Only the Bangladesh SEC has specifically indicated that it has the power to impose financial penalties.

3.8 ASIC and the New Zealand Securities Commission are also empowered to accept enforceable undertakings from entities alleged to have breached securities

⁷ The Sri Lanka Securities and Exchange Commission Act provides that the Commission may, having regard to the circumstances in which the offence under the Act was committed, compound such offence for a sum of money not exceeding one-third of the maximum fine imposable for such offence. In addition, all composition fines received by the Commission would be credited to the Compensation Fund established by the Commission.

In Singapore, MAS may compound an offence by collecting from a person reasonably suspected of having committed the offence a sum of money not exceeding the maximum fine prescribed for that offence, and such person accepts the offer of composition made by MAS in writing.

⁸ For example, the New Zealand Securities Commission has indicated that it is unable to impose fines on market participants.

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laws or regulations ⁹, whereas MAS is currently conducting a study on whether enforceable undertakings could be included as part of its enforcement toolkit. The purpose of such undertakings is to ensure compliance with securities law by requiring that an entity refrains from (or performs, where appropriate) a certain action. These undertakings are enforceable in courts if entities fail to comply.

3.9 Where the regulator or stock exchange either suspects that a breach of rules has occurred and which warrants further investigation, it may take certain preventive measures to either discontinue the trading in securities or avert further loss suffered by investors. Hence all jurisdictions surveyed have empowered the regulator or stock exchange to implement trading suspensions. Such suspensions may apply to only a particular security, but may also be used to halt the entire securities market in extreme cases. Generally, the use of such powers may be curtailed by a list of conditions. As an example, the Kuala Lumpur Stock Exchange (“***KLSE***”) may suspend the trading in securities where, in the opinion of the KLSE, it is necessary or expedient in the interest of maintaining an orderly and fair market ¹⁰.

3.10 Other forms of preventive measures include temporarily prohibiting or restraining members’ trade in the securities (India and Thailand ¹¹), and ordering the shares of such listed company to be changed to full-delivery shares ¹² (Taiwan). In addition, Taiwan has put in place a trigger alert system which

⁹ ASIC will generally only accept an enforceable undertaking where it has considered taking civil or administrative action against the alleged offender. In accepting such undertakings, it will consider the seriousness of the contravention, and prospects for expeditious resolution of the matter.

¹⁰ KLSE is required to promptly notify the Malaysia Securities Commission in writing and give the reasons for the suspension. This ensures that this power to suspend securities is only exercised judiciously, as a trading suspension could adversely affect investor confidence.

¹¹ In Thailand, the prohibition applies to trading in which a member provides a margin to its clients for purchasing the securities and the sale of securities in which the securities must be borrowed for settlement purposes. This measure would be used by the Stock Exchange of Thailand if its board of directors is of the view that the position of the trading of any securities is likely to have an adverse effect on the overall trading position due to a drastic change in the price or trading volume of such securities, or a high concentration of the trading in such securities.

¹² The full-delivery system is a trading barrier for investors, as they must pledge stock certificates or cash before placing a trading order.

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cautions investors if any abnormal trading price or volume in the market is detected by the Taiwan Stock Exchange, and such situation reaches certain pre-set criteria.

Powers to Seek Injunctions or Court Orders

3.11 Regulators and law enforcement agencies may often have to go to court to seek injunctions or court orders. In certain jurisdictions such as Thailand and Malaysia, the purpose of such orders may be to facilitate investigations through the seizure of property or records. Other jurisdictions such as Vietnam and China provide for injunctions to be filed to freeze the assets of the defendant to prevent the illegal gains from being moved to a third-party or even offshore ¹³.

3.12 Provisions for the power to seek such injunctions may be found in securities legislation or in common law. As such powers are an essential part of the regulatory toolkit, it may be prudent to explicitly spell out such powers in securities law and to develop clear operating procedures which can be followed when there is a need to apply injunctive relief.

¹³ A variation of this measure is adopted in Japan where the Financial Services Agency orders the entity to deposit such property at the deposit office.

4 FALSE OR MISLEADING STATEMENTS AND OMISSIONS IN PROSPECTUSES

4.1 It is a widely accepted principle of company and securities regulation of most jurisdictions that any offer of securities made to the public should be accompanied by a prospectus (or registration statement, as it is termed in some jurisdictions). The prospectus is meant to set out material financial and other information related to the issuer, as well as risk warnings and other facts that are relevant for making an informed investment decision. The prospectus plays an important role as it is a document, and oftentimes the only one, that investors can rely upon to decide whether to subscribe for the securities on offer. Hence disclosure in the prospectus should be clear, adequate and accurate and not contain any false or misleading statements, or omit material information.

Review of Prospectuses

4.2 The survey findings show that the process by which contents of prospectuses are reviewed for whether they meet the requisite level of disclosure varies among jurisdictions. In most jurisdictions (such as Bangladesh, China, India, Indonesia, Malaysia, Singapore, Taiwan, Thailand and Vietnam), the securities regulator has lead responsibility¹⁴ for either pre-vetting the prospectus or reviewing it for compliance with regulatory requirements¹⁵. In Japan and New Zealand, this is done by other government agencies (e.g. registrar of companies). In Sri Lanka, the vetting of prospectuses is delegated to the stock exchange, which may refer infractions to the SEC for remedial action.

4.3 In Australia, a slightly different approach is adopted, whereby neither the regulator nor self-regulatory organisations pre-vets or reviews the contents of

¹⁴ The stock exchanges may also review the draft prospectuses, but for the purpose of assessing whether it is eligible for listing and for compliance with listing rules.

¹⁵ Apart from reviewing prospectuses, the Thailand SEC will also (a) verify the auditor's worksheet and interview the auditor for significant issues; and (b) conduct company visits to interview the company's executives, management team, and members of the audit committee.

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prospectuses for compliance with disclosure requirements ¹⁶. Instead, prospectuses are filed with the regulator for uploading on a website and “exposed” for public comment ¹⁷. These comments would be taken into account by the regulator when assessing if the offer should be allowed to continue.

Remedial Actions for Defective Prospectuses

4.4 Where any false, misleading statements or omissions are detected during the review process, regulators may request the offeror to make a correction. In other instances where the regulator deems that a prospectus is defective, it may refuse registration of the prospectus ¹⁸ or, in certain jurisdictions, refuse grant of a securities issuing license.

4.5 In addition, where new circumstances have arisen after the filing or registration of a prospectus such that it renders information contained in the prospectus inaccurate, ASIC and Singapore allow offerors to issue supplementary or replacement prospectuses to correct or supplement the original prospectus. To ensure that investors are aware of such documents, offerors are required to take reasonable steps to inform potential investors of such documents and keep the offer open for a certain period after that. Investors may also be given the option to withdraw their applications.

Regulatory Actions for Defective Prospectuses

¹⁶ Instead of pre-vetting prospectuses, ASIC carries out random surveillance of prospectuses. At the same time, it relies on investor comment to detect false and misleading statements in or an omission of a material fact in the offer document.

¹⁷ In addition to reviewing prospectuses for compliance with regulatory disclosure requirements, MAS will also post prospectuses on its website for public comment before registration.

¹⁸ For example, MAS may refuse registration of a prospectus if MAS is of the opinion that the prospectus contains false or misleading statement, there is an omission from the prospectus information required to be included, and MAS is of the opinion that it is not in the public interest to do so.

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4.6 Where a material defect is detected in a prospectus after it is registered, most jurisdictions would halt the offering. One common tool used by regulators in Australia, Japan, Malaysia and Singapore is stop orders, which has the effect of freezing the offer and preventing further issuance of shares or collection of funds from subscribers ¹⁹. Should the stop order not be revoked, the offeror is typically required to return all monies and it had received back to applicants.

4.7 Other more general forms of regulatory actions that can be undertaken for market misconduct in terms of public reprimands, warning letters, and applying for injunctions or court orders are also used by regulators in China, Philippines and Taiwan for the issuance of defective prospectuses. The Thailand SEC goes further to impose orders barring individuals who have been found guilty of making a false statement or concealing material facts in the prospectus from company directorships or management positions in listed companies.

4.8 False or misleading statements in, or omission of material information from a prospectus is a criminal offence in all jurisdictions surveyed, punishable by both fines and imprisonment terms (typically, of up to 5 years).

4.9 Because of the reliance placed by investors on prospectuses as the primary source of information about the offeror, it is important to identify persons who should be held accountable for the content of such documents. Most jurisdictions recognise the liability of the issuer (such as directors of the company). Other jurisdictions such as Australia, China, Malaysia and Singapore also place a burden on the underwriters, other entities to the due diligence process (such as auditors) and persons who have consented to being named in the prospectus as having made a statement that is included in the document ²⁰.

¹⁹ In Singapore, MAS will not issue a stop order if any of the shares to which the prospectus relates have been issued and listed on a securities exchange, and trading in them has commenced.

²⁰ Such persons are however only liable for any loss or damage caused by the inclusion of the statement in the prospectus.

5 RECOMMENDATIONS WITHOUT REASONABLE BASES

5.1 With the increased availability of financial products to retail investors, the way such products are marketed and sold, as well as advice provided ²¹ on such products has become an important regulatory concern in many jurisdictions. Hence investment advice is a regulated activity in most jurisdictions surveyed ²². However, the regulation of advice provided is an area where practices in jurisdictions surveyed vary, such as the scope of financial advisory regulation, approaches to ensuring that investors are protected from improper advice, ways of addressing conflicts of interest.

5.2 In many jurisdictions, investment advisory activities is a separately licensable activity while in others such as Taiwan and India, such activities fall under the securities law and apply to securities firms. Nevertheless, most jurisdictions set out statutory obligations or exchange rules for member firms on the quality of investment advice rendered, as well as relevant disclosures about the professional fitness of the adviser (e.g. their qualifications and experience, whether the adviser has previously committed fraud or has a criminal record).

5.3 Generally, regulators expect advice rendered to be accurate, objective and suitable for the investor. For example, the Sri Lanka stock exchange requires a member firm to give unbiased and fair advice to clients and not withhold information that will be prejudicial to the interest of the client. China requires any analysis, forecast or advice to be based on relevant information and in line with principles of completeness, objectivity and accuracy. The more common approach is to require advisers to have a reasonable basis for giving the advice, and is adopted by majority of jurisdictions surveyed ²³.

²¹ This can be in the form of advising investors on the type of financial products they should purchase and recommendations by research analysts on securities.

²² Bangladesh has yet to put in place specific rules for regulating the conduct of investment advisers.

²³ Australia, India, Indonesia, Japan, Korea, Malaysia, Philippines and Singapore.

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5.4 What does “having a reasonable basis” for advice mean? This typically consists of three elements. Firstly, the adviser should gather information concerning the investment objectives, financial situation and particular needs of the investor for the purpose of ascertaining that the advice is appropriate. Secondly, the adviser should give consideration to, and conduct an investigation of the subject matter of the advice as may be reasonable. Lastly, the recommendation should be based on such consideration and investigation.

5.5 Other requirements are also imposed on investment advisers to address conflicts of interest concerns ²⁴. At the minimum, disclosure of its conflicts of interest – whether he receives commission for recommending certain investments, his relationships with relevant organisations, his interests in those securities that he is recommending his clients to buy or sell – are required. These measures help investors evaluate the independence of the advice rendered, and play a critical role in enhancing investor confidence.

Other Avenues for Regulating Investment Advisers

5.6 New Zealand has adopted a slightly different approach by also relying on provisions in its Consumer Guarantees Act and Fair Trading Act to protect investors from being disadvantaged by the actions of an investment adviser ²⁵.

²⁴ For example, Japan’s Law for Investment Advisers prohibits investment advisory companies from providing advice considered needless in the light of market condition with the aim of the benefit of a related securities firm. Indonesia’s Capital Market Law prohibits investment advisers from influencing or pressuring clients to act contrary to their interests.

²⁵ Under the Consumer Guarantees Act, a guarantee is provided that all services (include advisory services) will be reasonably fit for any particular purpose and of such a nature and quality that it can reasonably be expected to achieve a particular result. This may prevent an adviser from recommending an investment that is unsuitable for the client’s stated needs.

Although the Fair Trading Act has wide application, several provisions also appear to apply to the activities of advisers. One such provision prohibits persons from engaging in conduct that is misleading, or deceptive, or is likely to mislead or deceive. If an adviser has breached this provision, the court may make orders under the Act to declare the contract void, vary the contract, require the adviser to refund monies or compensate investors who have suffered losses.

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Several jurisdictions also rely on general laws relating to negligence, contract and adviser's fiduciary duties to the client.

5.7 We also observed in some jurisdictions, efforts are being made to improve standards of investment advice through the use of industry codes of conduct, either in place of or to complement statutory provisions. For example, New Zealand, Thailand and Vietnam have promulgated code of conducts and best practice guides on principles that investment analysts should follow when providing advice.

5.8 One issue to be considered is whether such compliance with such codes should be monitored and enforced. It is recognised that non-statutory codes may be useful when an industry is still in its state of infancy, as it affords the industry flexibility to develop its own standards. Even in developed markets, non-binding codes are still beneficial as a self-regulatory tool. Hence such instruments have its role in the overall regulatory framework.

Regulation of Advice Provided Through Mass Media

5.9 We recognise that advice may also be provided through media channels in the form of reports on market analysis and general recommendations on types of financial products that are investment-worthy. Hence, a distinction is sometimes made for investment advice provided through this medium. Regulators in Australia, Malaysia, Singapore and Thailand exempt investment advice provided through newspapers or periodicals, as long as they are generally available to the public and the provision of advice is incidental to the main business as a mass-media information provider. In Japan, the Law for Investment Advisers does not apply to the analysis of securities published in newspaper, magazines or books.

5.10 Despite this exempted status of the mass media, we note that the exemption applies in respect of investment advice only and not in terms of market misconduct in general. Thus, if these entities were to publish an article containing false or misleading statements about any financial product, they

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would still be liable for an offence under market misconduct, notwithstanding the fact that they are not regulated entities ²⁶.

Regulatory Actions

5.11 The type of actions that regulators can undertake for breaches of rules governing the conduct of advisers is largely similar to those described in the preceding two sections. However, the Japan Financial Services Agency may order an investment advisory company to improve the method of conducting its business if it uncovers any fact relating to its business that is detrimental to the interest of investors. In addition, if an analyst is a member of the Securities Analyst Association of Japan (“**SAAJ**”), the SAAJ may expel the analyst from it if he is found to have made a recommendation without a reasonable basis.

²⁶ The Japan Securities and Exchange Law prohibits the “circulation of rumours” or fraudulent securities trading, and this would apply to advice provided through the mass media.

6 INVESTOR RECOURSE TO REMEDIES

6.1 An important aspect of investor protection is the recourse availed to investors to recover any losses suffered as a result of fraud, misconduct, or other breaches of fiduciary or regulatory obligations. This fosters market discipline, which in turn, deters misconduct.

Civil Action

6.2 In majority of the jurisdictions surveyed, aggrieved investors may initiate civil action in courts to enforce their legal rights and obtain compensation for misconduct. However, this can be difficult to accomplish. Indeed, several jurisdictions have indicated that despite these actions being available under their laws, no such cases involving securities fraud have ever gone to the courts.

6.3 However, civil action on the basis of a successful criminal prosecution by a regulatory authority is an approach that is recognised as helping to reduce barriers to successful lawsuits by independent investors (who have less resources). ASIC as well as the Malaysia Securities Commission are empowered to institute civil proceedings on behalf of investors to recover losses if it feels that it is in the public interest to do so. In Singapore, aggrieved investors may latch on to a successful criminal conviction or civil penalty action and file their claims in court for damages, without having to re-prove the incidence of misconduct.

6.4 Besides relying on securities law and common law principles relating to tort, negligence or failure in fiduciary responsibilities, investors in jurisdictions such as India ²⁷ and New Zealand may also rely on consumer protection laws. These laws allow investors to pursue their cases in court if they feel that their rights as consumers have been violated, even if no clear contravention of securities law has occurred.

²⁷ In India, investors may file a complaint before its Consumer Court to claim for damages due to deficiencies in service provided.

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6.5 The amount of money that can be recovered in court is typically subject to limits. Generally the amount recoverable is limited to the actual loss suffered by the investor. For offences relating to prospectus inaccuracies or material omission of information, an offeror may be required to refund all monies invested even after secondary trading has commenced. Australia allows for extreme cases where even if the offeror is winding up, its directors will still be liable to refund all investors if they can prove that the prospectus was deficient.

6.6 Class action suits can also be helpful, by making it easier and more affordable for large groups of aggrieved investors to band together to seek redress in courts. Class action regimes are not common in the Asia Pacific region²⁸. We also observed that certain jurisdictions allow investors to be represented by the statutory regulator or investor organisations. This is practiced in jurisdictions such as Australia, India, Sri Lanka, Taiwan and Vietnam²⁹.

Arbitration and Alternative Dispute Resolution Mechanisms

6.7 We observed that arbitration is a common avenue for investors to seek recourse in China³⁰, India, Indonesia and Thailand. For example, as provided in the arbitration byelaws of the India exchanges, an investor may file his complaint before an arbitration panel in respect of a claim against a broker.

²⁸ Indonesia, New Zealand and Philippines are the only jurisdictions that have a class action regime. Korea, Singapore and Thailand are currently studying the feasibility of introducing class action suits.

²⁹ ASIC may, if it appears to be in the public interest, bring a representative action in a person's name for the recovery of damages or property.

In Taiwan, the Investors Protection Law grants the Securities and Futures Investors Protection Centre ("SFIPC") the right to pursue class action or class arbitration on behalf of more than twenty investors. However, investors may place restrictions on the SFIPC to waive a right, accept a liability, withdraw an action or make a compromise.

³⁰ Arbitration is the only avenue for investors in China to make their claims against wrongdoers for market misconduct, as they cannot sue wrongdoers in court. There are currently no relevant provisions allowing them to do so. However, the Supreme People's Court of China is currently drafting a new judicial interpretation on this issue.

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6.8 A variant of the arbitration process is a dispute resolution mechanism, which can be further categorised into one that is internal and external. The former is essentially a system/procedures instituted by the market intermediary to address investor complaints in a fair and efficient manner. The latter is a set up, which aims to provide investors with an independent, affordable and quicker avenue for resolving their disputes³¹, as opposed to filing civil suits in courts. As an example, ASIC requires all its licensees to have an internal dispute resolution system³² and be a member of one or more external dispute resolution schemes³³. Singapore is also studying an external dispute resolution scheme for the capital market intermediaries³⁴. However, we recognise that external dispute resolution mechanisms may be difficult to set up and enforce.

Investor Compensation Funds

6.9 Another common practice to enhance investor protection is to set up investor compensation funds³⁵. These would usually be funded by a levy on exchange turnover, and protect investors from intermediaries that are unable to meet their obligations to investors. The exact use of the fund differs. Most jurisdictions use the fund to protect investors from the collapse of a broker, or to compensate investors where a broker is unable to meet its obligations. Other funds may be used to compensate investors for fraud by an intermediary.

6.10 The key reason behind such funds is to allow retail investors who may not have the means to seek legal recourse or properly establish their claims as

³¹ The hearing of a complaint in an external dispute resolution scheme is usually presided by an independent panel. The complaints that may be filed under the scheme may also be subject to a monetary limit.

³² The internal dispute resolution system required of ASIC licensees should comply with standards set by ASIC and cover complaints against the licensee made by retail clients.

³³ The external dispute resolution schemes should also be approved by ASIC and cover complaints against the licensee made by retail clients.

³⁴ Dispute resolution schemes for the banking and insurance sectors in Singapore were launched in early 2003. This is an industry initiative, as MAS had wanted to minimise the need for statutory arrangements and burden on financial institutions.

³⁵ Vietnam, China and Thailand have not set up investor protection funds yet.

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creditors on an insolvent intermediary to recover their losses in a relatively quicker and more efficient manner. The compensation funds themselves (or the authority administering them, whether the regulator, exchange or an independent agency) can later try and recover whatever assets it can from the defaulting intermediary.

6.11 In order to ensure that the greatest number of retail investors can be covered, the payouts from such funds are usually capped, both on an individual basis and sometimes on a per-event basis. This will ensure that the fund remains sufficient to handle any crisis that might occur.

6.12 Lastly, we note that investor compensation funds serve to protect individuals by pooling together obligations from the entire industry. While the creation of compensation funds can increase investor confidence, their applicability, funding and governance should be carefully studied to avoid moral hazard on the part of investors and intermediaries. Such funds are meant to be a “protection of last resort”. In fact, several jurisdictions such as Bangladesh, Singapore and Sri Lanka indicated that their compensation funds have never been utilised. Countries that do not have such funds may consider the practices and experience in other jurisdictions as part of studying the desirability of implementing such a scheme ³⁶.

6.13 Malaysia has pointed out that the statutory deposits collected from regulated intermediaries can also be used to compensate investors who have suffered a loss from a breach of fiduciary duties. This is a common practice in many jurisdictions.

³⁶ Regulators in China and Thailand are currently studying the possibility of setting up investor protection funds.

7 CONCLUSION

7.1 Generally, the survey findings indicate that a certain baseline level of investor protection exists among the respondents, if not the entire Asia Pacific region. Market misconduct, inaccuracies in prospectuses and recommendations without a reasonable basis are generally punishable as criminal offences. Measures have been put into place for regulators to detect contraventions, and it involves the collaborative efforts of SROs and the public (by referring the misconduct of an intermediary to the regulator). Regulators are also empowered to take a wide range of civil and administrative actions for transgressions, according to the nature and severity of the breach. Lastly, there are also mechanisms in place to allow aggrieved investors to seek compensation in court, or in certain cases, from investor compensation funds or third-party arbitration tribunals/dispute resolution schemes.

7.2 The survey highlighted certain areas that regulators in the Asia Pacific region could consider to further enhance the level of investor protection:

i. **Investor Education**

Investor education empowers investors to understand the financial markets better and become self-reliant in guarding themselves against market misconduct. This helps impose market discipline on intermediaries and facilitates the attainment of fair and efficient markets. With higher levels of investor awareness and sophistication, the need for regulatory intervention could be correspondingly reduced, thereby facilitating more innovation in the markets. It may be beneficial for more jurisdictions to support investor education efforts as a complement to regulatory activities.

ii. **Investor Recourse to Remedies**

While the legal framework of most jurisdictions theoretically allows for investors to sue in court to recover their losses, this is difficult to achieve in practice. Jurisdictions could consider how they can make civil

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proceedings easier and less costly for retail investors to pursue. One approach is to allow for class actions, or representative actions (by either the statutory regulator or investor organisations).

iii. Dispute Resolution Schemes

Market intermediaries should be encouraged to set up internal and external dispute resolution mechanisms. This promotes a calibrated approach for investors to seek recourse – to first resolve the dispute directly with the institution, failing which to bring it to arbitration panels or dispute resolution schemes, and final course of action being to file civil suits in courts. Having a range of avenues for dispute resolution may prevent costly and drawn-out litigation, and expedite investor compensation for minor contraventions. This facilitates market confidence.

iv. Administrative Powers

The administrative powers of regulators surveyed are largely limited to suspending or revoking licences/approvals, issuing warning letters and directive orders, and do not extend to the imposition of administrative fines or composition of offences. It may be useful for regulators to also consider adopting “enforceable undertaking”-type of administrative powers to enhance their ability and flexibility to deal with situations where criminal prosecution is not appropriate, yet some form of substantive sanction and remedial action may be needed.

7.3 Ultimately, the extent and type of investor protection measures that individual regulators put in place would have to be tailored to the specific circumstances of each jurisdiction, such as development of the legal, regulatory framework for the capital markets and judicial system, level of investor sophistication, as well as experience and resources of the regulator. Regulators should strive to implement and effectively enforce mechanisms that safeguard the interests of investors, as the outcome of these regulatory efforts is a

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restoration of investor confidence in the integrity and fairness of the capital markets of the Asia-Pacific.