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Insider trading and its faceless victims

- **It** is always better to play by the rules so as not to end up on the wrong side of the law
- **Punishment** is heavy: up to 10 years' jail or fine of at least RM1 mil

By **Devanasan Evanson**

BLOOMBERG

Bursa Malaysia and regulator Securities Commission Malaysia are always on the alert for insider trading

They say insider trading is easy to commit without a guilty conscience, (and easy to rationalise its commission), because it is a crime with a faceless victim.

You buy from the market (based on inside information) through your broker and the shares you are buying are from an investor who sells through his broker. The buyer does not know the identity of the seller. The buyer's immediate counter party is his broker.

In fact, the buyer does not even know the identity of the selling broker. (One can also sell shares based on inside information to avoid a loss).

Here, there are two levels of intermediation between the buyer and the seller - their respective brokers. Sometimes, it can occur that both the buyer and seller may have the same broker. Even then, you never know the identity of the seller.

And hence the faceless victim - the seller.

Material effect on price and value of securities

Not all information is inside information, which is subject to insider trading laws. The information must be such that, if it were to become generally available, it would tend to have a material effect on the price or value of securities and consequently be able to influence the investment decisions of reasonable investors as to whether to buy or sell the shares.

This is the tricky part because it involves a little bit of crystal-ball gazing. Just how does one know whether the information obtained 'would tend to have a material effect on the price or value of securities' which would render it as 'insider information'?

For all you know, the information that you considered would have a material effect, on public dissemination, may not end up having a material effect on price or value of securities.

On the contrary, information that you may have concluded as not likely to have a material effect may, on its public dissemination, end up having a material effect.

Hindsight is 20-20. But you are required to decide well before the benefit of hindsight whether the inside information that you have would have a material effect.

You are sometimes required to take a 'very educated guess,' almost a gamble. In most instances, it is obvious that the information that you have 'would tend to have a material effect on the price or value of securities and consequently be able to influence the investment decisions of reasonable investors as to whether to buy or sell the shares.'

The golden rule to follow is, of course, that if you are unsure, err on the side of caution. You should deem that the information you have as insider information, and that you may be caught under the insider trading laws.

What information is covered

What is covered is just about every type of information which, if it were to become generally available, would tend to have a material effect on the price or value of securities (and consequently be able to influence the investment decisions of reasonable investors as to whether to buy or sell the shares).

Such information includes even matters relating to the likely intention (not just intention) of a person, matters relating to negotiations or proposals and matters relating to the future.

Therefore, if you are aware that there is a 'likely intention' that a public-listed company (PLC) may undertake a mega-merger and this information is not publicly available, that information may be deemed as inside information.

Prohibited conduct of person in possession of inside information

An 'insider' therefore is a person who possesses information that is not generally available which, on becoming generally available, would be expected to have a material effect on the price or value of securities in the eyes of a reasonable person.

The words 'in the eyes of reasonable person' implies that it is an objective test (that the courts would apply) and it does not really matter what you honestly thought. What matters is what a reasonable person would have thought.

Again, the requirement casts a wide net. What you know is secondary and what matters is whether you 'ought reasonably' to have known.

So, you can imagine the typical conversation, "But I honestly and genuinely did not know" and the response, "But you ought reasonably to have known. You were not behaving like a reasonable man. A reasonable man would have (ought to have) known."

Tippers and tippees

Even though the insider with the inside information does not trade for his own benefit, he may still be caught under the insider trading laws if he 'procures' an acquisition or disposal.

Therefore, if you procure the act of another person, the tippee, you (the tipper) are caught as an insider even if you as a tipper did not trade.

Therefore, the famous Malaysian capital market practice of passing 'hot tips,' often from the 'horse's mouth,' may be caught under the provisions of insider laws if the tip turns out to be true.

'Procure' is also an all-embracing word. You are deemed to procure from another person if you incite, induce, encourage or direct an act or omission by another person.

And that 'procurement' can be done directly or indirectly.

Only if the tipper knows or ought to have reasonably known

The tipper is caught only if he knows or ought to have known that the tippee would or would tend to deal in the shares or the tippee would get another person to deal in the shares (the tippee of a tippee and the causal link chain can go on and on).

For example, if I share insider information with my friend who is a regular trader, then I know or ought to have known that my friend would trade on that information.

Suppose I share the information with another friend who does not trade, but that friend's spouse trades.

According to the law, it may be held that I ought to have reasonably known that my friend would or would tend to share the information with his spouse.

Criminal and civil punishment

Section 188(2) of the Capital Markets and Services Act 2007 (CMSA) prohibits the conduct of a person in possession of inside information and that person can be punished on conviction to imprisonment for a term not exceeding 10 years and to a fine of not less than RM1 mil.

Alternatively, the Securities Commission (SC) may issue a letter of demand pursuant to its civil enforcement powers under the securities laws and a settlement may be reached.

The settlement offer is often agreed to, without admission or denial of liability, to settle the claim that the SC proposes to institute against a person.

The SC will use these proceeds to reimburse its cost of investigations and proceedings in respect of the contravention and then to compensate the sellers and buyers who have traded and suffered as a result of the insider trading offence.

Aspersions arising from civil settlements

Why would anyone want to settle with the SC a huge settlement sum (of RM3.64 mil, as in a recent case) if that person was 'not guilty'? Note that the terms of the settlement indeed say 'without admission or denial of liability.'

This recent case relates to the chairman of a PLC who settled with the SC for a sum equivalent to three times the estimated gain from the insider trading activity. Is not the settlement of RM3.64 mil an 'admission of guilt' in the court of public opinion?

The purported act and settlement would raise doubts on the fit and proper criteria demanded of directors of listed companies as prescribed under paragraph of 2.20A of the Listing Requirements of Bursa Securities.

The clause states that every listed corporation must ensure that each of its directors, chief executive or chief financial officer has the character, experience, integrity, competence and time to effectively discharge his role in the listed corporation.

Practice 1.2 of the Malaysian Code on Corporate Governance (MCCG) 2017 states that a chairman of the board is responsible for instilling good corporate governance practices, leadership and effectiveness of the board.

In this regard, a chairman's purported act and settlement with SC (although "agreed without admission or denial of liability") may cast aspersions and undermine the expectations placed upon a chairman of the board. As the chairman and member of the board of directors, that person is expected to lead by example.

Better to err on the side of caution

Beware the seemingly innocent insider trading crime with its seemingly faceless victim, which is a crime that seems so easy to rationalise as not doing any harm at all.

Hence, it is always better to err on the side of caution with whatever information one has. It is always better to play by the rules so as not to end up on the wrong side of the law. Focus

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