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## Regulatory Mechanisms of Securities Trading in Malaysia (with Special Reference to Insider Trading)

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# REGULATORY MECHANISMS OF SECURITIES TRADING IN MALAYSIA (WITH SPECIAL REFERENCE TO INSIDER TRADING)

**Mohd. Ishaque Qureshi†**

*Abstract:* In 1993, Malaysia established a Securities Commission to make the securities markets more secure and efficient, and to better control insider trading. This Article first presents an overview of the structure of the Securities Commission and the responsibilities of the various divisions and officers. Second, it reviews the common law and statutory law on which the Commission and other government agencies must rely to regulate the securities markets.

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Initially, the above article was published before the establishment of the Securities Commission, the most potential, single central regulatory authority. The author in the present article endeavors to portray the existing regulatory mechanism in the field of securities trading in Malaysia.

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- I. INTRODUCTION

The government's commitment,<sup>1</sup> enshrined in the VI Plan, to revitalize the capital market by regulating securities trading materialized in 1993 with the establishment of the securities commission in Malaysia. The purpose of its establishment was to bring together under one single authority the various fragmented regulatory functions which were vested in different regulatory bodies up until that point.<sup>2</sup>

The most important question that may arise is whether regulation of the securities industry is needed. It should be mentioned from the very beginning that an unregulated market cannot secure socio-economic goals sought by the nation. Therefore, the need of regulation has been based on the following grounds:<sup>3</sup> economic justification, a public justification, and a socio-political justification.

#### A. *Economic Justification*

A securities market is one of the most important sources of a country's economic growth. It serves the vital economic function of

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<sup>1</sup> In 1988, a task force was set up by the then Minister of Finance to formulate recommendations for the development of the securities market. In 1990, on the basis of the recommendation of the task force, the Sixth Malaysia Plan also included as one of its objectives, the establishment of a central authority to regulate and develop a capital market. SEC. COMM'N ANN. REP. 21 (1993) (background of the establishment of the securities commission).

<sup>2</sup> With the establishment of the securities commission, the Capital Issues Committee (CIC) and the Panel on Take-overs and Mergers were dissolved. The securities commission subsequently adopted the guidelines and code of the CIC and the Panel. *Id.* at 3.

<sup>3</sup> See *id.* at 108-109.

enabling business enterprise to obtain long term equity capital from the securities market.

Malaysia, for example, in 1993 raised a total of RM4.5 billion of equity capital on the Kuala Lumpur Stock Exchange ("KLSE"), representing some nine percent of the projected fixed capital formation for that year.<sup>4</sup>

To enable the securities market to serve its vital economic role of efficiently allocating resources, information must be available so the investing public can determine the risk, return, and liquidity of investments. To this end, the foremost objective of securities regulation is to ensure that a mandatory disclosure system is available for the sale and trading of securities so that needed information is made available to them. An equally important consideration is the integrity and systematic stability of the securities markets which is very much linked with the vital interest of the nation's economy. Large sums of money are invested by pension funds, mutual funds and individual investors. Clearly, if securities markets were to fail, i.e., if market intermediaries or participants fail to meet their obligations on a large scale, such failure could trigger devastating economic consequences for the country as a whole. To avoid such circumstances, it is in the nation's interest to ensure the security and integrity of the securities market.

### *B. Public Interest Justification*

The issuers of securities and market intermediaries have a natural advantage over investors in the access to information and access to the trading system. If the conduct of issuers and intermediaries is not regulated, market manipulation or fraud would certainly result.

A 1961 survey answered by some 1,700 executive readers of the Harvard Business Review supports this argument.<sup>5</sup> When asked what they would do if they acquired inside information: 61% would buy for

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<sup>4</sup> *Id.* If one accepts that 1993 was a vintage year for the KLSE, the fact still remains that, for the three decades between 1962 and 1992, funds raised in the capital market have grown at an average rate of 16 percent.

<sup>5</sup> See Raymond C. Baumhart, *How Ethical are Businessmen?*, 39 HARV. BUS. REV. 6 (1961). The question posed in the survey was:

Imagine that you are a member of the board of directors of a large corporation. At a board meeting you learn of an impending merger with a smaller company which has had an unprofitable year, and whose stock is presently selling at a price so low that you are certain it will rise when news of the merger becomes public knowledge. What would you do? Would you buy some stock? or tell a friend? or tell your brother? or do nothing?

themselves; 46% would tell a friend; 11% would tell their broker; and only 29% would do nothing. Therefore, approximately 72% of executives, when put in a position of temptation to gain from the use of inside information, would succumb.

Although over 34 years have passed since the above survey was conducted, one cannot help but suspect the same result in any of the countries of the world, keeping in view the human nature of common men involved in securities trading who have access to confidential price sensitive information. Thus, the unregulated securities industry would likely be detrimental to the interest of the people at large.

### C. *Socio-Political Justification*

For the restructuring of a caring society there should be equitable distribution of the nation's wealth which will make the people fully receptive to the concept of nation building through the National Development Policy. This Policy requires the spirit of competitiveness. The securities industry is not an exception to this principle. In this industry, regulations could be used to strengthen the competitive fiber of the local securities industry by enhancing internationally accepted mores and practices—practices that have already been established in Malaysia. At the same time, Malaysian market intermediaries may be encouraged to venture abroad. Emerging securities markets have received favorable attention from the investing world as it is likely that what we have witnessed over the last few years is but the start of a trend consonant with the inflow of foreign funds and the inevitable globalization of the country's securities industry. Therefore, the nation must invest not only in the infrastructure and human resources, but also in a regulatory system that will keep ahead of the pace of development that may be witnessed in the years to come.

The principle of balancing competing interests between liberalization and regulation in the securities industry must be maintained to ensure the existence of a fair market, systematic stability, smooth functioning of the market, an adequate level of investor protection, innovation, and competition in securities trading.<sup>6</sup> This balancing principle is evident in the Malaysian model of regulation. The securities markets are allowed to develop freely but the systemic risks are avoided by the regulatory framework. The need to develop a market which is free from legal constraints has

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<sup>6</sup> *Supra* note 1, at 110-11.

passed, but the interests of the market participants should be protected. The desire of the government to regulate the industry, and the wishes of the industry to be self-regulating (as well as the promotion and protection of the domestic market and the promotion of a market which is globally competitive) crystallize into the Malaysian model of regulations of securities trading. Thus, an effective, consistent, and coherent regulatory policy has been contained in the model to allow the market having regulatory measures to be consistent with the objectives of regulation.

In Malaysia, the role of regulatory authorities in securities trading is not only to police the market to ensure discipline, but also to develop, promote, and advise the market.<sup>7</sup> It cannot be denied that the regulating activities are very costly, but indispensable. Competition, duplication, and confusion between various authorities should be avoided as they lead to lesser investor protection, lower regulatory standards, and increased cost to the securities industry.

Three modes of regulations are inextricably interwoven in the fiber of the regulatory framework in Malaysia: self regulation, state regulation, and co-regulation.

### 1. *Self Regulation*

Self-regulation is regulation by the industry itself. The advantages of self regulation are flexibility, expertise, acceptability, and cost effectiveness. The disadvantage is public suspicion that the promotion of self interest may stifle competition in securities trading. Furthermore, self-regulators may not have the statutory powers to deal with market failure or cases of serious fraud in the industry.

### 2. *State Regulation*

Public control of securities trading is a necessary evil because wider policy objectives can only be established by the government. State regulation allows action to be taken in cases when self regulation may not work and allows the state to use the full force of its criminal justice system to ensure compliance with the law. However, government regulation is a departure from the principle of private control of decision making in the market place, which may be a disadvantage. Heavy-handed state

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<sup>7</sup> *Supra* note 1, at 112.

regulations can substitute for the judgment of the regulators. Such regulations can reduce efficiency, increase costs, and decrease the spirit of innovation and competition.

### 3. *Co-Regulation*

It may be noted that both self regulation and state regulation have their fair share of benefits and shortcomings. A system of co-regulation whereby regulatory powers are shared by the industry and enlightened regulators in the public domain enables the strengths of government regulations. The success of the industry depends on the co-existence between the industry and the public sector. Most importantly, only a system of co-regulation ensures the checks and balances which are necessary in any regulatory structure. In a system of co-regulation, the division of regulatory functions must be clear and concise. Broad regulatory principles must be accepted and adopted by both regulatory authorities as well as the traders. For example, it must be accepted by both of them that the securities market must operate in the public interest.

It is clear that an unregulated market cannot secure specially defined economic, social, and political goals, whereas an over regulated market will stifle the market and may eventually result on its self-destruction. Having identified clear, consistent, and coherent policies, both government and industry regulators should work on a basis of co-regulation, which helps the market to be efficient and healthy, and enables the government to achieve its various goals. Mutual trust is a necessary ingredient in the successful scheme of co-regulation.

## II. NEW DEVELOPMENTS: REGULATORY FRAMEWORK

In 1988, a task force was set up by the then Minister of Finance to formulate recommendations to revitalize the capital markets in Malaysia. In 1990, the sixth Malaysian Plan stated the establishment of a securities commission, a central authority to regulate and develop the capital market as one of its objectives. In 1991, Dato Sri Anwar Ibrahim, on his appointment as Minister of Finance, swiftly voiced his full support for the immediate establishment of the securities commission.

Finally, on March 1, 1993, the Securities Commission came into being with four Divisions divided into fourteen Departments. Since then,

the commission has been performing regulatory functions. From March to December 1993, the commission considered 192 applications of corporate proposals, 61 submissions pertaining to the code on take-overs and mergers, and 25 applications on investment management schemes. The success of the commission within these first ten months could be seen in five successful prosecutions for short selling in Union Paper Holdings Berhad ("UPHB"). There had never been any such prosecution before the establishment of the commission.<sup>8</sup> A short account of the regulatory bodies of the commission follows.

#### *A. Issues and Investment Division*

With the establishment of the securities commission, the Capital Issues Committee ("CIC") and the Panel on Take-Overs and Mergers ("TOM") were dissolved. The Issues and Investment Division ("IID") assumed all functions previously performed by the above two bodies. The main functions of the IID are to regulate the issues of securities by public limited companies, the listing of such securities on the stock exchange, the take-overs and mergers of companies, and all matters relating to Unit Trusts as well as other collective investment schemes. Specific guide lines have been issued for the operation of the following three departments of the Division, the Securities Issues Department, the Takeovers and Mergers Department, and the Investment Management Department.

##### *1. Securities Issues Department*

The Securities Issues Department ("SID") plays a key role in regulating all primary offers of securities in the Malaysian Capital Market. In carrying out its role, the Department seeks to safeguard the interests of investors, particularly minority share holders of public companies.

The commission views seriously any material deviation in the information disclosed in prospectuses. The commission will continue to publicly reprimand errant listed companies and their directors, as and when circumstances dictate. Public reprimands were issued by the commission to the following companies for various shortcomings during the period between March 1, 1993 and December 31, 1993.

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<sup>8</sup> *Supra* note 1, at 4.



**Table A<sup>9</sup>**

Cases in which the Securities Commission issued public reprimands to the following errant companies between March 1 and December 31, 1993:

<b>Company</b>	<b>Date of Issues</b>	<b>Reason</b>
UCM Industrial Corporation Berhad	July 2, 1993	Material deviation in actual pretax profit achieved relative to forecast pretax profit.
Berjaya Textile Berhad	July 2, 1993	Material deviation in utilization of proceeds of rights issue.
Samanda Holdings Berhad	October 11, 1993	Material deviation in utilization of rights issue proceeds and deviation in actual pretax profit achieved relative to forecast pretax profit.

## 2. *Takeovers and Mergers Department*

The main function of this department is to administer the Malaysian Code on take-overs and mergers to ensure efficient monitoring of these matters.

## 3. *Trust and Investment Management Department*

TIM, as an integral part of the IID, plays an important role in overseeing all matters relating to unit/property trusts and investment management schemes. One of the main functions of the TIM is to consider applications for the setting up of unit trusts and property trusts, as well as other forms of fund management, and the issue and offer for sale of such instruments to the public.

### B. *Market Supervision Division*

The Market Supervision Division works as the enforcement arm of the commission. It comprises three departments, namely, Surveillance and Compliance, Investigation and Enforcement, and Licensing.

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<sup>9</sup> SEC. COMM'N ANN. REP. 53 (1993).

The Division has general oversight of the stock exchange, the stock market, and the market intermediaries under the Securities Industry Act of 1983 ("SIA"). The Division has officers of varied experience, from the legal and accounting professions, the Royal police, the KLSE, the Bank Negara Malaysia, and the Registrar of Companies. The Division benefits from its balance and mixed expertise in carrying out its activities, which cover: the analysis of trading patterns and data and the taking of appropriate action, general oversight of the KLSE, carrying out raids and the seizure of documents, and the initiation of prosecution by the Division's own prosecuting officer. Many of the Division's activities for 1993 were conditioned by the extremely active stock market. An incidence of short selling cases was handled by the division, as a consequence of the unusual market movement of the UPHB shares in June 1993.

A brief account of all three Departments of this Division follows:

#### *1. Surveillance and Compliance Department (SCD)*

The most important function of this department is the supervision and monitoring of the activities of the stock exchange. In carrying out its activities, it constantly monitors the movement of shares traded on the KLSE. In this respect, close liaison is established with the KLSE, especially with the AWAS and Listing Departments. One of the most important areas initially addressed was the forging of a close working relationship with the KLSE on the basis of the KLSE acting as a front line self regulatory agency. A constant dialogue is now established with the KLSE. In matters pertaining to its functions, the KLSE is expected to act as more than a market operator. MSD acts as regulator of last resort, although it has not hesitated to intervene directly when necessary, or where speed is of the essence in particular circumstances.

Moreover, during the middle of the year, the Department's officers were also actively involved in the preliminary investigation of the UPHB case, and provided the necessary technical assistance and support in the detailed analysis of trading data and patterns pertaining to the counter. Thus, the department generally provide back up and technical personnel to the Investigation and Enforcement Department in addition to its primary functions.

As a necessary component of the departments' surveillance and compliance functions, officers of the Department devoted serious attention

to the activities of stock brokerage companies. The Department collected information in the first half of 1993 by sending their personnel to visit numerous stock brokerage companies.

## 2. *Investigation and Enforcement Department*

This is the second most important department of this division. The statutory functions of the commission which fall within the preview of MSD under section 15(1) of the Securities Commission Act of 1993, such as suppressing illegal, dishonorable, and improper practices in dealing in securities trading, are done by this department. In performing these functions, the department acts as the primary investigative arm of the commission, collecting evidence to support prosecution for breaches of various provisions of securities laws.

The investigating officer of the commission is empowered by the enforcement and investigation provisions in the Securities Commission Act of 1993 to investigate any offenses under that Act, the Securities Industry Act of 1983, and the Securities Industry (Central Depositories) Act of 1991, as well as the Futures Industry Act of 1993. The enforcement and investigation provisions are important as they enable an investigating officer in carrying out an investigation or inspection to enter into any place or building, to require individuals to produce documents, and to appear before an investigation officer to be questioned orally. It is by virtue of this arrangement that the commission has exercised its power to investigate and to prosecute the related offenses under the 1983 Security Industry Act ("SIA"). Thus, MSD with the help of its two departments is doing the task of investigating improper or prohibited market practices which can create a false market for securities and enable persons involved in such securities to derive unfair advantages. The improper or prohibited market practices can be classified as follows:

- illegal trading;
- short selling;
- market manipulation;
- insider trading;
- improper utilization of proceeds from rights issue; and
- improper corporate disclosure and dissemination of false information.

The director of the Market Supervision Division ("MSD") is responsible for coordinating the Division's resources to ensure that efficient and effective investigations are carried out.

The chairman of the commission is empowered to appoint any of its officers to conduct the prosecution under section 39(2) of the Securities Commission Act of 1993 ("SCA"). In exercising this power under section 39(2), the chairman as of December 1993 appointed three officers to conduct prosecution of offenses coming within the purview of the commission. However, any prosecution of offenses relating to the securities industry within the ambit of the Securities Industry Act of 1983 (section 126) or the Futures Industry Act of 1993 (section 93), must first be endorsed with the Public Prosecutor's consent to prosecute. Under section 376 of the Criminal Procedure Code, the Attorney General is the Public Prosecutor and in his absence or inability, the Solicitor General shall act as the Public Prosecutor.

During the period from March 1993, through December 1993, the Department referred nine investigation papers to the Public Prosecutor for his consent. These cases related to the offense of short selling UPHB shares under section 41(1) of the SIA. Out of nine cases referred, the Public Prosecutor consented to prosecute only five cases. Immediately upon processing the said consents from the Attorney General, the Commission pressed charges against all five short sellers in various courts depending on where the offenses took place. All the accused persons pleaded guilty to the charges and paid the fines imposed by the respective courts. The fines ranged from RM10,000 to RM100,000.

**Table B<sup>10</sup>**

Cases prosecuted under section 41(1) of the Securities Industry Act of 1983  
for short selling since December 31, 1993

<b>Date</b>	<b>Accused</b>	<b>Court</b>	<b>No. of shares</b>	<b>Fines imposed/status</b>
Sept. 22, 1993	Yap Swee Yeow	Jalan Duta, Sessions Court	20,000 Units	RM100,000 in default six months imprisonment.
Sept. 24, 1993	Mustapha Ibrahim	Ampang, Session Court	10,000 Units	RM90,000, in default nine months imprisonment
Sept. 30, 1993	Wong Hua Seh	Kuching, Session Court	30,000 Units	RM12500 in default three months imprisonment
Oct. 21, 1993	Ho Tong Leng	Johor Bahru, Sessions Court	2,000 Units	RM10,000, in default two months imprisonment
Dec. 10 and Dec. 21, 1993	Koay Chee Him	Penang, Sessions Court	6,000 Units	RM40,000 in default nine months imprisonment

In view of the increasing internationalization and globalization of the securities market, the Division has also actively pursued the development and promotion of information sharing arrangements and cooperative relationships with regulators abroad, formally and informally. In addition, as a part of its efforts to up grade and enhance the level of competency and professionalism among its staff, the commission has also introduced various training and attachment programs from the MSD staff, both locally and abroad. In this connection, the officers of the MSD have attended training programs at SIMEX in Singapore, the Australian Securities Commission and the American Securities and Exchange Commission ("SEC").

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<sup>10</sup> *Id.* at 66.

### 3. *Licensing Department*

A licensing officer ("LO"), appointed by the Minister of Finance, is responsible for the issuance of the relevant licenses under the Securities Industry Act of 1983 as well as under the Futures Industry Act of 1993.

### C. *Research and Development Division*

The function of this Division is to develop the local capital market with the help of its various departments: the Regulations and Law Reform Department, the Product Development Department, the Economic Research Department, and the Information Technology Department.

The Division, in coordination with its various departments, especially the Regulations and Law Reform Department, reviews the regulatory framework governing the securities and futures industry. The review focuses on the determination of the underlying policies of existing laws and regulations, the identification of weaknesses and deficiencies in the regulatory framework, and the submission of legal reform proposals to the Commission.

The Product Development Department is designed to promote and ensure the efficiency, integrity, and competitiveness of Malaysian's financial futures market, to monitor and encourage the development of new capital market and derivative instruments, to investigate the means to protect the investors' interest, and to create commercial certainty and reduce business costs.

The Economic Research Department provides economic, industrial, and corporate information to the Commission. The main function of the department is the preparation of weekly and monthly market reports for the information of the Commission. These reports also cover the performance of other stock markets, including Singapore, Hong Kong, Japan, and New York.

The Information and Technology Department ("IT") is a critical component for the success of the Commission. The important function of the department is to develop and implement an efficient and effective information system, which supports the strategic objectives and other operations of the commission. As such, it caters to the commission's internal information needs, as well as supports the Commission in its role as a regulator.

#### D. *Finance and Administration Division*

This is a support division that comprises the Administration and Human Resources Department, the Finance and Accounts Department, the Library Unit, and the Security Unit. The main functions of this division are to give maximum support to the other divisions and top management through the procurement and maintenance of materials, development of human resources, financing, provision of library and information services, and provision of security for the Commission as a whole.

The library unit is still in its infancy. Its collection includes reports, thirty volumes of seminar and conference proceedings, and a few titles of journals and magazines. Apart from the standard library services, the library is planning to introduce several technology-based informational services, including a computerized library integrated system. An integrated library package will be selected and installed in the future to provide fast, organized, and accurate information storage.<sup>11</sup>

### III. INSIDER TRADING

#### A. *An Overview*

Corporate bodies have a vital role to play in the promotion of business and industry in all parts of the world. The lifeblood of such bodies is provided by securities<sup>12</sup> (shares, debentures, etc.) which are bought and sold in stock exchanges. Like any market place, people will be more inclined to use stock exchanges if they believe that the prices correctly represent the value of what is bought and sold. A person who buys something which

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<sup>11</sup> *Id.* at 86.

<sup>12</sup> The definition of "securities" as provided under Part 1(2) of the Securities Industry (Amendment) Act, 1993 reads, "[S]ecurities means debentures, stocks and shares in a public company or corporation, or bonds of any government or of anybody, corporate or unincorporate, and includes any right or option in respect thereof and any interest in unit trust schemes."

The definition of the phrase "on stock exchange" as provided in §.89(5)(b) of the Act is as follows: "to deal in the securities of that corporation in the expectation that, if this information becomes generally known the price of the securities of that other corporation on stock exchange might be materially affected." An argument can be made that this definition covers only the situation of a listed public company.

It may also be noted that the British Columbia Supreme Court in *Pelling v. Pelling*, 130 D.L.R. (3d) 761 (1981) refused to limit an analogous provision in the above manner. But in Singapore, the phrase "on stock exchange" has been removed and also no reference is made to public companies. See Walter Woon, *The Statutory Control of Insider Trading—S 103, Securities Industry Act, 1986*, 28 MALAYAN L.R. 275 (1986). Whether or not our Malaysian courts would adopt the *Pelling v. Pelling* approach remains to be seen.

turns out to be worth less than the price he has paid for it will feel aggrieved. So will a person who sells something for less than its real value. Deals in a market are more likely to be at a price correctly reflecting value if the information used in valuation is available to both buyers and sellers. Such information in modern corporate literature is called "confidential price sensitive information" until it is known to the people at large. Those who obtain such information by virtue of their office in order to affect the price of securities to their own advantage are called "insiders." The purchase or sale of securities by such persons on the basis of confidential price sensitive information which has not been made public is called "insider trading" or "insider dealing."

The misuse of confidential price sensitive information by unscrupulous insiders is likely to shake the confidence of potential investors in the fairness and probity of the concerned corporate bodies and the financial health of the economy, which is highly detrimental to the national interest of a country. Attempts have therefore been made to curb the unhealthy practices of insider trading by the civil remedies afforded by the common law and criminal sanctions provided by statutory laws.

In this paper we will consider the effectiveness of the aforesaid civil remedies and criminal sanctions in strengthening the legal regimen to prevent the cancer of insider dealing from eating into the vitals of the Malaysian economy. We will, therefore, examine the common law as well as statutory approaches in dealing with the problem of "insider trading," particularly in the Malaysian context, where the securities industry is governed by the following acts of Parliament:

- (1) the Companies Act of 1965 ("CA");
- (2) the Securities Industry Act of 1983 ("SIA");
- (3) the Securities Industry (Central Depository) Act of 1991 ("SI(CD)A");
- (4) the Securities Commission Act of 1993 ("SCA"); and
- (5) the Futures Industry Act of 1993 ("FIA").

There are five regulatory bodies responsible for the supervision and management of the securities industry:

- (1) The Securities Commission ("SC") established under the Securities Commission Act of 1993 to regulate, and to advise, the



Minister of Finance on all matters relating to the securities and futures contract industries. Thus, the work of this body is regulatory as well as advisory.

- (2) The Registrar of Companies ("ROC"), which administers the Companies Act of 1965 as well as the relevant provisions of the Securities Industry Act of 1983 and the relevant provisions of the SI(CD)A.
- (3) The Licensing Officer (Securities/Futures Trading) of the Ministry of Finance ("LO"), who is appointed by the Minister of Finance and is responsible for the issuance of the relevant licenses under the SIA as well as under the FIA.
- (4) The Foreign Investment Committee ("FIC") which implements the government's guide lines on the regulations of acquisition of assets or interests, mergers or take-overs of companies, and is responsible for major issues on foreign investment.
- (5) The Kuala Lumpur Stock Exchange ("KLSE"), a self-regulated organization with its own memorandum and articles of association, which governs the conduct of its 119 members, which include 41 corporate members and 78 individual members in securities dealing. It is also responsible for the surveillance of the market place, and for the enforcement of its listing requirements which spell out the criteria for listing, disclosure requirements, and standards to be maintained by listed companies.

The KLSE is approved by the Minister of Finance under the SIA to conduct the business of a stock exchange in Malaysia. The affairs of the KLSE are supervised by a nine member committee headed by an executive chairman. Out of nine committee members, four, including the executive chairman, are appointed by the Minister of Finance while the remaining five members are elected from the members of KLSE. This is an example of co-regulation which has increased the volume of trading activities in the market place, according to information from KLSE's communication department dated May 30, 1994. In 1990, it became mandatory for every stock brokerage company to have a minimum paid-up capital of RM20 million, up from the RM2 million previously required. This requirement was aimed at beefing up the financial strength of the brokerage houses to

cope with the increasing scope of trading activities in the Kuala Lumpur Stock Exchange.

Although the KLSE is the official stock exchange of the country under the SIA, there is also the Bumiputra Stock Exchange ("BSE") which was set up in 1969 for Bumiputra companies.<sup>13</sup> Presently, there are only seven companies listed on the BSE and trading is generally inactive.

A question may arise regarding the application of the common law when deciding cases that arise under the Malaysian Companies Act of 1965. According to section 5 of the Civil Law Act, in the absence of any written provision, common law may be applied. The Federal Court of Malaysia, in a decided case, held that English common law will not be applied in the presence of a codified law in Malaysia.<sup>14</sup> It is only when there is no written law that English law can be applied. Professor Sinnadurai is of the opinion that even if there is an Act, the Court should look to the particular issue in question to be decided.<sup>15</sup> He says, "It is seldom that a particular Act would cover every aspect of law pertaining to a subject, unless the whole law on the subject had been codified in the Act. To give a narrow interpretation to section 5 would be to render the provision superfluous as most of the matters specified in the section are now contained in some written law."<sup>16</sup> It is submitted that in the field of corporations the learned writer's opinion may be followed.

### B. Conception Of "Insider" And "Insider Trading"

The terms "insider" and "insider trading" or "insider dealing" have not been used and defined in the Companies Act of 1965. However, from the Companies (Amendment) Act of 1985, it may be inferred that insiders include agents of the company, such as auditors, accountants, solicitors, consultants, and officers of the stock exchange who acquire all confidential information regarding the affairs of the company in their official capacity.<sup>17</sup>

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<sup>13</sup> History of the Malaysian Securities Industry: The Regulatory Structure of the Malaysian Securities Industry 3 (Apr. 30, 1994) (unpublished document, on file with the *Pacific Rim Law & Policy Journal*).

<sup>14</sup> *Tan Moot Liang v. Limsoon Seng*, 2 M.L.J. 60 (1974).

<sup>15</sup> DATO' VISU SINNADUARI, *THE LAW OF CONTRACT IN MALAYSIA AND SINGAPORE: CASES AND COMMENTARY* 11-12 (1987).

<sup>16</sup> *Id.*

<sup>17</sup> The concept of "insider" may be inferred from the following provisions: § 132 of the Companies Act; § 132A, § 132B of the Companies Act incorporated by the Companies (Amendment) Act, 1985; § 89(4) of Securities Industry Act, 1983; and § 340(1)(a)(b) of the KLSE Listing Requirement.

In dealing with the securities of the company, the insiders might use the confidential price sensitive information for their own use or they may provide such information to another person related to them for his benefit. Both situations may be treated as insider dealing, which simply indicates the misuse of confidential information. The profit obtained by such improper use of confidential information is unfair. This confidential information which has the effect of pushing up or pulling down the prices of the companies' securities is called price sensitive information. The improper use of such confidential price sensitive information by insiders is called insider dealing.

Section 340(1)(b) of the KLSE listing requirement has given the conceptual description of insiders as follows:

All persons who come into possession of material inside information, before its public release, are considered insiders for the purpose of the Exchange's disclosure policies. Such persons include controlling shareholders, directors, officers and employees, and frequently also include outside attorneys, accountants, investment bankers, public relation advisers,

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The term "Agent," as defined by § 132A(4) of the Companies Act as amended in 1985, is identical to § 89(4) of the Securities Industry Act of 1983. The definition is very broad in its scope which reads as follows: "In this section—'agent' includes a banker, advocate and solicitor, auditor, accountant or stock broker of the corporation and *any person* who is or at any time in the preceding six months has been knowingly connected with the body corporate." Companies Act § 132A(4) (1985) (emphasis added).

The terms "includes" and "any person," as emphasized by us, suggest that the above definition is non-exhaustive and that a person, who nevertheless does not fall within the categories as outlined, could still be embraced by a general definition of agent of company.

The word "any person" requires further explanation based on the Supreme Court of New South Wales decision *Hooker Inv. Pty. Ltd. v. Baring Bros.*, 10 A.C.L.R. 462 (1986). The Court in the above case interpreted the word "person" as used in N.S.W. PUB ACTS § 128 (1)-(3) of the Securities Code. The Court observed:

[T]he whole scheme of the Act, as outlined earlier, goes in this direction. Bearing all those matters in mind in my view the proper construction of sub-ss (1), (2) and (3) of s 128 is that it is only if a natural person has the information referred to in those sub-sections that the section applies.

Thus, the whole scheme of securities industry legislation envisages that it be construed as a natural person in contrast to a corporate body.

However, the reasoning of the *Hooker* case was not accepted by E.C. Foenander, S.D.J., in *Public Prosecutor v Allan Ng Poh Meng*, 1 M.L.J. v (1990) who held that the term "person" employed in § 103 of the Singapore Securities Industry Act (Cap 289) (1985) must be read to include both the natural person as well as a body corporate. It is submitted to the Malaysian Courts with due regard that the wider view of *Public Prosecutor v. Allan* is preferable in comparison to the narrow view expressed in the *Hooker* case.

advertising agencies, consultants, and other independent contractors. The husbands, wives, immediate families, and those under the control of insiders may also be regarded as insiders. Where acquisition or other negotiations are concerned, the above relationships apply to the other parties to the negotiations as well. Finally, for the purpose of Exchange's disclosure policies, insiders include "tippees" who come into possession of material inside information.<sup>18</sup>

Similarly, a general conceptual description of insider trading is given in section 340(3)(b):

(i) Insider trading refers not only to the purchase or sale of a company's securities, but also to the purchase or sale of puts, calls, or other options with respect to such securities. Such trading is deemed to be done by an insider whenever he has any beneficial interest, direct or indirect, in such securities or options, regardless of whether they are actually held in his name or not.

(ii) Included in the concept of insider trading is tipping, or revealing insider information to outside individuals to enable such individuals to trade in the company's securities on the basis of undisclosed information.<sup>19</sup>

### *C. Prevention of Insider Trading*

#### *1. The Common Law Approach*

Insider dealing occurs where an individual or organization buys or sells securities and is knowingly in possession of some piece of confidential information which is not generally available, which is price sensitive, and which is likely, if generally available, to affect materially the price of the securities.<sup>20</sup> The term "insider trading" has been introduced into common law countries in light of the American experience. It indicates that before a transaction can be deemed insider dealing, it must involve an improper use

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<sup>18</sup> KLSE Listing Requirement § 340(1)(a)-(b).

<sup>19</sup> *Id.*

<sup>20</sup> Council for the Securities Industry Statement ¶ 3 (Oct. 11, 1978).

of specific confidential and price sensitive information by directors and others. The information must be obtained by virtue of their position in the company so as to make a pecuniary advantage or to avoid a loss for themselves at the expense of other ill-informed shareholders or investors.

The cornerstone of the common law control of insider trading emanates from the oft-quoted and much criticized case of *Percival v. Wright*,<sup>21</sup> in which certain shareholders wrote to the secretary of the company asking if he knew any one disposed to purchase shares. Negotiations took place and eventually the chairman of the company and two other directors purchased the shares at 12l. 10s. per shares. It was subsequently discovered that prior to and during their own negotiations for sale, the chairman and the board had been approached by a third party with a view of purchasing the entire undertaking of the company at prices which represented considerably more than 12l. 10s. per share. In any event, the negotiations with the take-over bidder were aborted.

The shareholders asked to have the sale of their shares to the chairman and the other two directors set aside on the ground that the defendants as directors ought to have disclosed the negotiations with the takeover bidder when treating for the purchase of the plaintiffs' shares. But, the court dismissed their action on the ground that the directors were under no obligation to disclose to their vendor shareholders the negotiations which ultimately proved abortive. Hence, the court held that there was no question of unfair dealing. The director did not approach the shareholders, but it was the share holders who approached the directors.

The directors, no doubt, owe their fiduciary duties to the company. This, however, does not mean that directors can never stand in fiduciary relationship to the members. They may owe fiduciary duties to the share holders if they are authorized by them to negotiate on their behalf.<sup>22</sup>

However, the *Percival v. Wright* rule was severely criticized by the Cohen committee<sup>23</sup> and has been forthrightly rejected by the Jenkins committee.<sup>24</sup> They recommended the adoption of a rule which comes close to the American rule 10b-5 under the Securities Exchange Act of 1934, which has virtually placed directors in a fiduciary relationship to all those with whom they have dealings in their companies' securities.

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<sup>21</sup> *Percival v. Wright*, 2 Ch. 421 (1902).

<sup>22</sup> L.C.B. GOWER, *THE PRINCIPLE OF MODERN COMPANY LAW* 517 (K.W. Wedderburn & O. Weaver eds., 3d ed. 1969).

<sup>23</sup> Cohen Comm. Rep. (Cand. 6659) ¶¶ 86, 87.

<sup>24</sup> Jenkins Comm. Rep. (Cand. 1749) ¶ 89.

The Supreme Court of New Zealand challenged *Percival v. Wright in Coleman v. Myers*.<sup>25</sup> In this case, the share holders brought an action against the directors claiming, *inter alia*, rescission of the sale of shares by them to the latter since the transaction was effected at a gross under-valuation by means of a calculated plan. This, in effect, enabled the director to reimburse to himself the initial acquisition expenses. Mohan, J., finding for the defendant, was nevertheless of the view that *Percival v. Wright* was wrongly decided and ought not to be followed. The decision of *Percival v. Wright* might no longer fit the complexity and sophistication of modern life in commerce as against the backdrop of the early 20th century when the doctrine of *laissez-faire* was much advocated and where the whole pattern of business transaction was different from the existing one.

It is thus doubtful if any future case would be decided in the same way as *Percival v. Wright*. As Lord Wilberforce stated when referring to *Percival v. Wright* in 1966, "This decision was no doubt good traditional equity but when generalized, as it has been, was surely bad economics and as the American Courts showed in 1955<sup>26</sup> with a little more flexibility these two need not go together."<sup>27</sup>

It is evident that at common law directors are not given an unqualified prerogative to deal in the company's securities without any duty to disclose to share holders any information affecting the prices of securities. Thus, the courts invented various devices like the principle of *uberrimae fidei*, constructive trust, breach of confidence, and the principle of unjust enrichment to prevent the investors and creditors from being maltreated by dishonest and incompetent controllers. But all these devices, in the modern set-up, have not proved to be very effective to check the misuse of confidential, price sensitive information. Although the hardship of *Percival v. Wright* was mitigated by these devices, the aggrieved parties of the insider trading still did not find these devices sufficient to protect them from the rising and increasing evil of insider trading. A short account of all these devices would be helpful for understanding the infirmities of such devices which paved the way to taking some effective measures for the prevention of insider trading.

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<sup>25</sup> Barry A.K. Rider, *Percival v. Wright—Per Incuriam*, 40 M.L.R. 471, 471 (1977).

<sup>26</sup> His Lordship was referring to *Perlman v. Feldman*, 219 F.2d 173 (1955).

<sup>27</sup> L.J.C. Wilberforce, *Law and Economics*, 1966 J.B.L. 301, 307 (1966).

a. *Principle of uberrimae fidei.*

The first and most obvious obligation of persons in a fiduciary position is to act with honesty. The greatest good faith is expected in the discharge of their duties,<sup>28</sup> and good faith requires that all their endeavors must be directed to the benefit of the company. Thus, where an insider uses corporate information received by virtue of his office for personal gains, he is obliged to disgorge the profits to the company since he is under a fiduciary duty to the company not to utilize inside information improperly. Similarly, D.N. Hossie stated as follows:

A director who acquires property while in office will, however, be liable to account for his profit upon sale if two elements are present. He must have acquired property only by reason of the fact that he was a director and in the course of the exercise of the office of director.<sup>29</sup>

The scope of fiduciary duties contain the following three dimensions: (1) interest of the company;<sup>30</sup> (2) conflict of duty and interest;<sup>31</sup> and (3) proper purpose, i.e., utilization of the property of the company for proper purpose.<sup>32</sup>

Fiduciary duties are owed to the company and to the company alone. In other words, one can say that the directors owe no duties to the individual members as such or to a person who has not yet become a member, such as a potential purchaser of the company's shares.<sup>33</sup> This principle is based on the *Percival v. Wright* case, which has been criticized<sup>34</sup> and even rejected.<sup>35</sup>

<sup>28</sup> See *Bank of Poona Ltd. v. Nazayandas*, 1961 A.I.R. 252, 253 (Bombay H.C. 1961).

<sup>29</sup> D.N. Hossie, *The Civil Liability of the Directors of a Corporation*, 30 CAN. B.R. 908, 916 (1952). See *Companies Act* § 132 (5).

<sup>30</sup> On the topic of a company's interest and the company's interest alone see *In re W. & M. Roith Ltd.*, 1 All E.R. 427 (1967); *Walker v. Wimborne*, 137 C.L.R. (Austl. 1975); *Parke v. Daily News Ltd.*, 1962 Ch. 927 (1962).

<sup>31</sup> On the topic of conflict of duty and interest see *Chua Boon Chin v. McCormack*, 2 M.L.J. 156, 158 (H.C. Sing. 1979); *Furs Ltd. v. Tomkies*, 54 C.L.R. 583, 592 (Austl. 1935); *Boardman v. Phipp*, 2 A.C. 46, 123 (H.L. 1967); *In re City Equitable Fire Ins. Ltd.*, 1925 Ch. 407, 426 (1925); *Regal (Hastings) Ltd. v. Gulliver*, 1 All E.R. 378 (1942); *Mahesan v. Malaysia Gov't Officers Coop. Hous. Soc'y*, 1 M.L.J. 149 (P.C. on Appeal from Malaysia 1978).

<sup>32</sup> On the topic of utilization of a company's property or assets for proper purpose see *Steen v. Law*, 3 All E.R. 770, 775 (P.C. on Appeal from New South Wales 1963).

<sup>33</sup> *Percival v. Wright*, 2 Ch. 421 (1902).

<sup>34</sup> Cmnd 6659 ¶¶ 86, 87.

<sup>35</sup> Cmnd 1749 ¶ 89.

The directors can, therefore, stand in a fiduciary relationship to the members. Moreover, if they make a personal profit as a result of inside information in the company's dealings, they will commit a breach of their fiduciary duty to the company and be liable to account for it.<sup>36</sup> This principle has placed the directors in a fiduciary relationship to all those with whom they have dealings in their company's securities which is inconsistent with the rule of *Percival v. Wright*. The Jenkins Committee, therefore, recommended that:

a director . . . who, in any transaction relating to the securities of his company or of any other company in the same group, makes improper use of a particular piece of confidential information which might be expected materially to affect the value of those securities, should be liable to compensate a person who suffers from his action in so doing unless that information was known to that person.<sup>37</sup>

In the operation of such provision, much will depend on how the courts interpret the word "improper." Furthermore, when the transaction was effected on the Stock Exchange, it may, as the Committee recognizes,<sup>38</sup> be difficult for the other party to establish that he was dealing with a director.

*b. The doctrine of constructive trust.*

The narrowly based fiduciary relationship theory paved the way to a constructive trust relationship between the director, third parties, and the company in respect to a misappropriation of a corporate opportunity.<sup>39</sup> Thus, in *Regal (Hastings) Limited v. Gulliver*,<sup>40</sup> the company sued the former directors, alleging a breach of fiduciary duty for the secret profits made while effecting the sale of the corporation. The court held that the directors were in a fiduciary relationship to the appellant company and therefore were liable.<sup>41</sup> L.S. Sealy is of the view that the case would have

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<sup>36</sup> See the American Securities Exchange Act Rule 10b-5, 17 C.F.R. 240.10b-5 (1994), made under The Securities Exchange Act, 1934, 15 U.S.C. §§ 78a-78jj (1988).

<sup>37</sup> Cmnd. 1749 ¶ 99(b).

<sup>38</sup> *Id.* ¶ 89(b).

<sup>39</sup> See *Selangor United Rubber Estates Ltd. v. Craddock*, 2 All E.R. 1073 (1968).

<sup>40</sup> *Regal (Hastings) Ltd. v. Gulliver*, 1 All E.R. 378 (1942).

<sup>41</sup> *Id.*



been decided in the same way had it been argued that the profits made by the directors on the sale of the shares were corporate property belonging in equity to the company and that the directors were, therefore, constructive trustees. Each of the defendants could then be held jointly and severally liable.<sup>42</sup>

The courts may reach the same conclusion by the application of the doctrine of *uberrimae fidei* and the principle of constructive trust, yet an action founded on the notion of a constructive trust would avail the plaintiff of proprietary remedies which are far superior to remedies available on a suit instituted on a personal duty to account for the secret profits. In the case of a constructive trust, a basis for a tracing claim is provided, while the same is not conferred on a secret profit claim which is also subject to the statute of limitation.

The doctrine of constructive trust is a part of the larger fiduciary relationship. Professor Gower, in support of the fine distinction between the two, observed that since "information is certainly often treated as property," then in almost every case in which directors are liable to account for profits, there will have been a use of the company's property.<sup>43</sup>

This submission, of course, assumes that information is without doubt corporate property. But whether information would inevitably be deemed a corporate property or an opportunity belonging in equity to the company is far from settled law. The better view in *Boardman v. Phipps*,<sup>44</sup> and in particular that of Lord UpJohn,<sup>45</sup> would seem to be that *prima facie*, information would generally not be regarded as corporate property and therefore, a fiduciary is at liberty to use it for his own benefit without, at the same time, incurring his principal in any detriment. It might, however, not be the case if it is confidential information given to him in the circumstances which will import a breach of confidence if it is subsequently divulged to a third party.

c. *Breach of confidence*

The principle of breach of confidence also provides a vehicle for the control of insider trading. In *Dunford & Elliot Ltd. v. Johnson & Firth*

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<sup>42</sup> L.S. SEALY, CASES AND MATERIAL IN COMPANY LAW 253 (2d ed.).

<sup>43</sup> L.C.B. GOWER, PRINCIPLES OF MODERN COMPANY LAW 608 (4th ed. 1979).

<sup>44</sup> *Boardman v. Phipps*, 2 A.C. 46 (1967).

<sup>45</sup> *Id.* at 127-28.

*Brown Ltd.*,<sup>46</sup> the plaintiff company, contemplating a rights issue, suggested to the institutional shareholders (the "consortium") that they should underwrite the issue. A report relating to the plaintiff's financial prospect was prepared and given to the consortium only. It proposed that the defendant company should be invited to participate in the underwriting scheme and the report was then shown to the defendant company. The Court of Appeal held that an injunction restraining the defendant company from making a takeover bid would not be granted since the plaintiff's own directors had made considerable use themselves of the information. The court was nevertheless of the view that there had been an unauthorized use by the defendant company of the plaintiff company's financial report with the necessary quality of confidence.

The decision has been criticized on the grounds that the protection, which from the outset was available to the company, ought not to be withdrawn on the mere fact that the directors had misused the information. A more logical basis for the decision has been suggested to be that the already generally available information was in fact not confidential.<sup>47</sup> As it now stands, the decision introduces an element of uncertainty relating to the scope of the law of confidence, and at the same time creates an impression that there is reluctance on the part of the judiciary to intervene.

*d. Unjust enrichment principle*

The law of unjust enrichment may perhaps be involved to extend the parameters relating to insider trading. This unfamiliar and general principle which is incapable of having a precise definition is somewhat akin to the principle of "restitution." Its scope embraces situations where there is a transfer of property or services resulting from a mistake or coercion, and for the purpose of insider trading, where a person is in breach of fiduciary duty. Any indulgence in insider trading involves pecuniary advantages to the insider. The doctrine could thus facilitate the plaintiff to base his remedy on the grounds that: "He has a right to have restored to him a benefit gained at his expense by another, if the retention of the benefit by the other would be unjust."<sup>48</sup>

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<sup>46</sup> *Dunford & Elliot Ltd. v. Johnson & Firth Brown Ltd.*, 1977 Lloyd's Rep. 505 (1977).

<sup>47</sup> Barry A.K. Rider, *Abuse of Inside Information*, 127 N.L.J. 830, 832.

<sup>48</sup> Warren A. Seavey and Austin W. Scott, *Restitution*, 54 L.Q.R. 29, 32 (1938).

However, the plaintiff has to fulfill certain requirements before appropriate relief on this principle can be granted. He has to show that the defendant had been enriched by the receipt of an advantage at the former's expense, and that it would be unjust to allow a retention of such benefit to subsist.<sup>49</sup> An illustration of such a liability is the case of *Canadian Aero Service Ltd. v. O'Malley*. The plaintiff company brought an action against the directors of the company for improperly and wrongfully taking the benefit of the company's mapping and surveying contract with the Government of Guyana in breach of a fiduciary duty. Larkin, J., held that the defendants were liable for misuse of corporate opportunity and the remedy took the form of an award of damages based on unjust enrichment instead of an accounting of profits.

The foregoing discussion shows that the concept of fiduciary duty, which has its roots in common law, does not take account of the realities of business life relating to takeovers and mergers in interlocking directorates and associated companies in which financial journalists, securities brokers, issuing houses, underwriters, and merchant brokers play an ever increasing role. Meanwhile *Percival v. Wright* seems to confine itself only to directors of companies. No doubt a company can penalize its errant directors who misuse corporate information, but other users of such information will escape the meshes of common law.

Further, if the board of directors of a company decides not to proceed against an errant director, the latter will go scot-free.<sup>50</sup> In view of the practical difficulties caused by the narrow interpretation of the principle of good faith in *Percival v Wright* and the proper plaintiff rule in *Foss v. Barbottle*, a person who wants to sue is therefore left with hardly any choice but to seek the aid of the legislature.

## 2. *Statutory Approach*

Insider trading in Malaysia is regulated by a complex network of legislative provisions. These provisions include the Companies Act ("CA"), the Securities Industry Act ("SIA") the Futures Industry Act ("FIA"), and Securities Commission Act,<sup>51</sup> and the Securities Industry

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<sup>49</sup> Gareth Jones, *Unjust Enrichment and the Fiduciary's Duty of Loyalty*, 84 L.Q.R. 472, 472 (1968).

<sup>50</sup> PHILIP L.R. MITCHELL, *INSIDER DEALING AND DIRECTOR'S DUTIES* 195 (2d ed. 1989).

<sup>51</sup> A brief account is given of Securities Commission Act, 1993 under a separate heading "New Developments: Statutory Framework," which was not included in the earlier article of the author on

(Central Depository) Act ("SI (CD) A"). We have classified the relevant provisions of the various statutes as follows:

**Table C**  
Provisions directly controlling unfair activities of insiders:

<b>Description of Activity</b>	<b>Controlling Provision</b>
General duty of honesty	CA § 132(1)
Prohibition against use of "insider information"	CA § 132(2)
Liabilities of officers in dealing with securities	CA § 132A
Prohibition on abuse of information obtained in official capacity	BCA § 132
Prohibition of loans to persons connected with directors	CA § 133A
Substantial property transactions involving directors	CA § 132E
Prohibition on stock market manipulation and use of deceptive devices	SIA §§ 85, 87A
Prohibition on dissemination of false or misleading information	SIA § 86
Prohibition of fraudulent inducement of persons to deal in securities	SIA § 87
Prohibition on abuse of information obtained in official capacity	SIA § 90
Short selling	SIA § 41(1)
Illegal trading	SIA §§ 12, 13
Restrictions on establishment of a central depository and other restrictions	SI(CD)A §§ 44, 47-50
Duties of Central Depository	SI(CD)A §§ 8-10, 12, 27
Prohibition against trading of securities withdrawn from a central depository	SI(CD)A § 23
Restriction on disclosure of information by authorized depository agents	SI(CD)A § 44

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"Insider Trading: Prevention and Cure" because the same was written before the establishment of the Securities Commission in 1993.

General penalty	SI(CD)A § 51
Secrecy and insider dealing	Rule 30 of the Malaysian Code on Takeovers and Mergers
Policy on insider trading	KLSE listing requirement § 340

**Table D**

Provisions indirectly controlling insider activities through disclosure:

<b>Description of Activity</b>	<b>Controlling Provision</b>
Registration of substantial share holdings	CA § 135
Registration of director's interest	CA §§ 134-35
Registration of the interest of stock brokers, investment advisors and financial journalists	CA §§ 26-35
Disclosure of interest	SCA § 13
Registration of license holders	SIA § 26
Registration of securities	SIA § 30
Certain persons to disclose certain interest in securities	SIA § 39
Duty of central depository to keep certain records	SI(CD)A § 27
Record of an entry, <i>prima facie</i> evidence	SI(CD)A § 33

**Table E**

Provisions indirectly controlling activities of insiders through investigation and enforceability

<b>Description of Activity</b>	<b>Controlling Provision</b>
Inspector appointed by Minister	CA Part IX §§ 193-210

Enforcement and investigation by Registrar	SIA Part IX §§ 94-99
Power of courts to make certain orders	SIA § 100
Enforcement and investigation (by their own inspectors)	SCA § 39
Conduct of prosecution	SCA § 39
Investigation (by Registrar)	SI(CD)A §§ 52-58
Disciplinary power of the Committee of Stock Exchange	Articles of Association, Art. 27; Rules relating to member firms and member companies of the KLSE, Rule 8

The purpose of these provisions is to protect both the tangible and intangible property of the company from being misused by insiders. However, dealing with intangible property raises conceptual problems which must be understood at the outset. If an employee absconds with the only set of a company's technical plans his conduct would amount to theft of a piece of valuable tangible property. This is the same as a burglar stealing an old masterpiece from a museum. Suppose, however, that other sets of these plans exist; that it is the information on them, rather than the paper itself, which has value that the company is trying to protect. Since theft implies the wrongful appropriation of property in respect of which another person has asserted exclusive ownership rights, it might be inferred that the company was the owner of the information concerned. This is not so, since absconding with the plans still leaves the company with the benefit of other copies of them for future use. What has been destroyed in the hypothetical is the exclusivity of the information. Thus, property status has been attributed to information at the highest level.<sup>52</sup>

The codification of the provisions and the establishment of the Securities Commission in 1993 for the prevention of insider trading is clear evidence that Malaysia has moved towards regulating its securities industry. Below, an effort will be made to ascertain the application of some legal provisions particularly sections 132, 132A, and 132B of the CA. A brief reference will also be made to sections 89A, 89A, and 90 of the SIA.

Section 132(1) of the CA has been taken from a similar provision in an Australian act that has no counterpart in English legislation. It provides

<sup>52</sup> See *Boardman v. Phipps*, 2 AC 46 (1976), 3 All E.R. 721 (1966).

that: "A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office." It may be noted from the very outset that CA section 132(1) does not purport to be an exhaustive statement of directors' duties; section 132(5) specifically provides that the section<sup>53</sup> is in addition to, and not in derogation of, any other rule of law relating to the duty or liability of directors or officers of a company. Accordingly, cases reflecting the common law and equitable rules relating to the duty of directors are still relevant.

The word "honestly" in the above provision covers a multitude of rules evolved over the last century or so, regarding what are classed by the textbook writers as directors' fiduciary duties. These can be reduced to three basic propositions.<sup>54</sup> First, a director must act in what he honestly considers to be the company's interest, and not in the interest of some other person or persons.<sup>55</sup> Second, a director must not place himself in a position where his duties to the company and his personal interest may conflict.<sup>56</sup> Third, a director must employ the powers and assets that he is entrusted with for the purpose for which they were given and not for any other collateral purpose.

The scope of the section may be summarized in the following words of Gowans, J., who stated:

the background to the language of the section appears to justify the conclusions, first, that the section is not concerned with the conduct of the director in relation to creditors or other persons dealing with or concerned with the company or anybody else but the company itself, secondly, that it is concerned with the performance of his fiduciary duty to the company, and thirdly, that to act 'honestly' refers to acting bona fide in the interests of the company in the performance of the functions attaching to the office of the director . . . . In effect, the common law obligation to act with due diligence has been made a statutory duty and failure to perform it, provided there is a proper mental element, has been made a criminal offense.<sup>57</sup>

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<sup>53</sup> *Id.*

<sup>54</sup> See also *supra* notes 30, 31 & 32 on fiduciary duties of directors.

<sup>55</sup> *Chua Boon Chin v. McCormack*, 2 M.L.J. 156 (H.C. Sing. 1979).

<sup>56</sup> *Id.*

<sup>57</sup> *Marchesi v. Barnes*, 1970 V.R. 434, 438 (1970).

Perhaps the principle of 'honesty' provides the cogent reason for the control of insider trading. The arguments in favor of insider trading—that the innocent investors are not affected or that too much power vested in enforcement agencies may give rise to an autocratic bureaucracy—are not acceptable these days. For a market like Malaysia, which is dependent largely on ordinary individual investors, insider trading, if allowed to prevail, will have the effect of driving away the individual investors. The Malaysian Stock Market cannot afford to allow dishonest practices to go unpunished. Insider trading should be treated as dishonest conduct.

Section 132(2) of the CA has been enacted as a measure of reform of civil remedies. It appears that the legislators intended civil and criminal sanctions for insider dealing. Thus, the extension of criminal liability may enable the court, in addition to or in substitution of the statutory penalty, to order the person convicted to account for his profits or profits that his tippees have made. Thus, it has clearly rendered the use of insider information by officers of the company and officers of the Stock Exchange illegal. The CA provides:

An officer or agent of a company or officer of the Stock Exchange shall not make improper use of any information acquired by virtue of his position as an officer or agent of the company or officer of the Stock Exchange to gain directly or indirectly an advantage for himself or for any other person or to cause detriment to the company.<sup>58</sup>

It is clear from the above provision that the hardship of the rule in *Percival v. Wright*<sup>59</sup> has been mitigated to a large extent. Section 132(3) provides a criminal and a civil remedy for the breach of the provision of section 132(2) as follows:

An officer or officer of the Stock Exchange who commits a breach of this section shall be (a) liable to the company for any profit made by him or for any damage suffered by the company as a result of the breach; and (b) guilty of an offence against

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<sup>58</sup> CA § 132(2).

<sup>59</sup> *Supra* note 32.



this Act. Penalty: Imprisonment for five years or thirty thousand ringgit.<sup>60</sup>

It is significant that the aggrieved company may sue for any profit made by the offending insider even though, as will usually be the case, the company may not have suffered any detriment. Liability is also extended if the company can demonstrate that it suffered damage as a result of the breach. It would appear that if the company can show that the breach had caused a loss of confidence by the company's customers or creditor, the company could sue for damages regardless of any proof of benefit accruing to the offending officer as consequence of his inside dealings.<sup>61</sup>

Thus, the scope of CA section 132(2) has been extended beyond directors to include an officer or agent as well as persons who have previously held such positions. The ambit of the word agent has been extended to include a banker, advocate, solicitor, auditor, accountant or stock broker of a corporation and any person who is, or at any time in the preceding six months has been, knowingly connected with the corporation.<sup>62</sup>

The defect of this provision is that persons such as dealers, investment analysts, and financial journalists might be excluded in cases of insider trading. The problem becomes more acute when one attempts to interpret the character of information. The construction simply shows that although the information "need not be secret and confidential, it must be information acquired by virtue of his position as an officer." On the other hand, in construing section 124(2) of the Australian Uniform Companies Act (which is similar to CA section 132(2)) Bust, J., observed that "such information need not be secret but it must necessarily be confidential."<sup>63</sup>

Section 132A(1) of the CA deals with the law relating to dealings by officers in securities. Section 132A(6) provides for a penalty of imprisonment for five years or thirty thousand ringgit or both. In section 132(3), the penalty is imprisonment for five years or thirty thousand ringgit, whereas in section 132(6) the penalty is imprisonment for five years or thirty thousand ringgit or both. These provisions show the gravity of the offense under section 132A(1), which provides:

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<sup>60</sup> CA § 132(3).

<sup>61</sup> AFTERMAN, COMPANY DIRECTORS AND CONTROLLERS 115 (1970).

<sup>62</sup> CA § 132(6).

<sup>63</sup> AWATHER SINGH, 1 COMPANY LAW OF SINGAPORE AND MALAYSIA 222.

An officer, agent or employee of a corporation or officer of the Stock Exchange who in or in relation to a dealing in securities of the corporation by himself or any other person makes improper use to gain, directly or indirectly, an advantage for himself or any other person of specific confidential information acquired by virtue of his position as such officer, agent or employee or officer of the Stock Exchange which if generally known might reasonably be expected to affect materially the price of the subject matters of the dealing on a Stock Exchange shall, in addition to any penalty imposed under subsection (6), be liable to any person for loss suffered by that person by reason of the payment by him or to him or a consideration in respect of the securities greater or lesser, as the case may be, than the consideration that would have been reasonable if the information had been generally known at the time of the dealing.<sup>64</sup>

The object of section 132A(1), which is identical to section 124A of the Australian Uniform Company Code of 1971, is to alter the law as declared in *Percival v. Wright*. Thus, an officer who makes use of confidential information either to buy shares which he expects will rise in value when the information is released, or to sell shares which he expects to fall in value when the information becomes known, has gained an improper advantage from his position and should be accountable in some way to the extent of that advantage. It is evident that section 132A(1) strictly prohibits insider trading. It imposes liability on an officer which is broader than section 132 of the CA as it extends to a liability to compensate any person who suffered a loss as a result of the insider trading.

To understand the scope of liability, refer to rule 30 of the 1987 Malaysian Code on Takeovers and Mergers, which provides:

**Rule 30: Secrecy and Insider Dealing**

30.1 All persons privy to confidential price sensitive information concerning an offer or contemplated offer must treat that information as secret and must not pass it to any other person unless it is necessary to do so. No person who is privy

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<sup>64</sup> CA § 132A(1).

to such information should make any recommendation to any other persons as to dealing in the relevant securities. All such persons must conduct themselves as to minimize the chances of an accidental leak of information.

30.2 No dealing of any kind . . . in the securities of the offeree company by any person, not being the offeror, who is privy to confidential price sensitive information concerning an offer or contemplated offer may take place between the time when there is reason to suppose that an approach or an offer is contemplated and the announcement of the approach or offer or of the termination of the discussion.

30.3 No such dealings shall take place in the securities of the offeror except where the proposed offer is not deemed price sensitive in relation to such securities.

The only shortcoming in the provision of section 132A subsection (3) of CA and section 89 of the SIA is the limitation period that allows the defaulting insider to be free of liability two years after the insider trading occurred. It is submitted that the period of limitation should commence only after the misuse of the price sensitive information is discovered. Hence, the provision of section 29 of the Limitation Act of 1953 should be applied as it is applied in most of the cases relating to fraud. In such cases, the limitation period commences only after discovery of the fraud in question.

Another section, 132A(6), addresses the nature and scope of inside information. The following are the ingredients to make the accused liable under section 132 A(6): (1) The person (accused) must be an officer, agent or employee of a corporation or officer of the Stock Exchange, (2) who makes improper use of the information in or in relation to a dealing in securities of a corporation; (3) the information must be used to gain direct or indirect advantage for the accused or any other person; (4) the information must have been acquired by virtue of the accused's position as an officer; and (5) the information must be such that, if generally known, it might reasonably be expected to affect materially the price of the subject matter of the dealing on a Stock Exchange, i.e., the price sensitive information. Moreover, the information must be specific confidential information.

The phrase "specific confidential information" is not free from ambiguity. The courts have tried to explain the meaning of the phrase in various cases. In the Singaporean case of *Public Prosecutor v. Chaudhry*,<sup>65</sup> the accused was found guilty of making use of confidential information that a public trading company of which he was the chairman and chief executive "was facing a financial crisis" when he dealt with the securities by disposing 360,000 shares in a number of transactions. Sinnathuray, J., observed: "it is a question of fact in each case to be resolved on the evidence adduced at the hearing of the case as to what is specific confidential information."

However, his lordship was of the view that in the phrase specific confidential information the word "specific" is used in contradiction to "general" or "not specific."<sup>66</sup> Hence, information means knowledge of a particular event or situation such as advice, communication, intelligence, news, notification, and the like.<sup>67</sup> In another case,<sup>68</sup> specific information was interpreted as information having an existence of its own quite apart from the operation of any process of deduction. Thus, the specific information must be capable of being pointed to and identified, and must be capable of being expressed unequivocally.<sup>69</sup>

The phrase "specific information" assumed much importance when *Public Prosecutor v. Chaudhry*<sup>70</sup> was decided by the Court of Appeals. In this case, the accused was convicted and sentenced to nine months imprisonment. On appeal, he contended that the phrase "facing a financial crisis" was too general to come within the meaning of specific information under section 132A(1). The judge, Rajah, J., allowed the appeal on the ground that:

whether a company is facing a financial crisis is a matter of opinion which one deduces after having looked at matters relating to the finances of a company, its management and the support it receives from its bankers. What might strike one as constituting a financial crisis need not strike another in the same way. In other words, this is a matter of opinion or of

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<sup>65</sup> *Public Prosecutor v. Chaudhry*, 1 M.L.J. 76 (1981).

<sup>66</sup> The interpretation is given on the basis of a case decided by the Ontario Court of Appeals in *Green v. Chapterhouse Group Canada Ltd.*, 68 D.L.R. (3d) 952 (1976).

<sup>67</sup> *Id.*

<sup>68</sup> *Ryan v. Triguboff*, 1 A.C.L.R. 337, 345 (1976).

<sup>69</sup> *Id.*

<sup>70</sup> *Public Prosecutor v. Chaudhry*, 1 M.L.J. 76 (1981).

judgment. The phrase 'facing a financial crisis' is a subjective statement and not an objective one, precisely or unequivocally expressed.<sup>71</sup>

Subsequently, the Solicitor General brought the matter before the Court of Criminal Appeals for determination on a point of law of public interest.<sup>72</sup> The issue was whether in law a company facing "a financial crisis" could be described as having satisfied the term "specific information." In reversing the decision of the Court of Appeals, the Court of Criminal Appeals stated "facing a financial crisis is the kind of specific information anyone familiar with the market knows that can markedly affect the price of the particular shares and can result in the suspension of the trading of the shares on the Stock Exchange."<sup>73</sup>

The other term, "confidential," suggests that the information need not be labeled as such. It is confidential if it is not meant for general dissemination. The yardstick by which one can measure whether dissemination has taken place on a general scale would be the circulation of the information beyond the board room. To be confidential, the information must be such that if it is generally known it might reasonably be expected to materially affect the price of the subject matter of the dealing on a stock exchange. The provision is confined so long as the transaction relates to the securities of a company that are listed on a stock exchange.

It may be recalled that a major defect under section 132A(1) of the Companies Act is that "tippees" could trade on their acquired information with impunity. In *Public Prosecutor v. Allan Ng Poh Meng*,<sup>74</sup> the district court judge dismissing the contention of the defense, and emphasized the applicability of the objective test, stating:

If an insider has any doubt about the legitimacy of dealing while in possession of information acquired, by reason . . . of being a connected person, then he should not deal. He should not deal because his doubts are . . . telling him that the information may well have a price impact.<sup>75</sup>

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<sup>71</sup> Chaudhry v. Public Prosecutor, 2 M.L.J. 231, 232 (1980).

<sup>72</sup> This is provided by virtue of § 60 of The Singapore Supreme Court of Judicature Act (Cap 157).

<sup>73</sup> Chaudhry, 1 M.L.J. at 79.

<sup>74</sup> Public Prosecutor v. Allan Ng Poh Meng, 1 M.L.J. v (1990).

<sup>75</sup> *Id.*

In *Public Prosecutor v. Allan*<sup>76</sup> the accused was a prominent businessman. He was approached by officers of Standard Chartered Merchant Bank Asia Ltd. ("SCMBA") with a view of acquiring a stake in Sealion Hotels, Ltd. ("SHL"), a public company, whose trading was suspended at that time. The accused was informed by SCMBA that the suspension would be lifted soon. The accused purchased one million SHL shares from Felix Lim. The accused was charged with insider trading as a tippee, was convicted, and sentenced to a period of twelve months imprisonment. The court did not accept the argument of the accused that section 103(3) of the SIA of Singapore applied only if there was an arrangement between natural persons to communicate price sensitive information with a view to dealing in securities. The court held that the section applied equally to corporations as well as to natural persons.

On the question of the mitigation of punishment, the court observed that:

a sentence imposed must not only fit the offence but must be individualised to fit the offender. . . . [T]he offence is a grave one. The measure of its gravity is reflected in the punishment provided for it, namely, a fine of up to RM50,000 or imprisonment of up to seven years. He committed the offence in circumstances that makes his conduct reprehensible and deserving of a sentence not only to convince him . . . but to serve as a warning to others never to entertain thoughts of indulging in similar escapades.<sup>77</sup>

The provision of section 132A(2) provides that "an officer . . . shall not be liable under subsection (1) to a person for any loss suffered by that person if that person knows or ought reasonably to have known of the information referred to in subsection (1) before entering into a transaction relating to the dealing in securities of the corporation."<sup>78</sup> The application of the provisions of the Limitation Act of 1953 has been restricted by the provision of section 132A(3) for the recovery of the amount of a loss

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<sup>76</sup> *Id.*

<sup>77</sup> *Id.* at xii-xiv.

<sup>78</sup> CA § 132A(2).

referred to in such section (1) up to two years after the date of completion of the dealing in securities in respect of which the loss was suffered.<sup>79</sup>

Section 132B deals with the prohibition on abuse of information obtained in official capacity as follows:

Any person who . . . has any information which if generally known might reasonably be expected to affect materially the price of the subject matter of the dealing on a Stock Exchange and which (a) he holds by virtue of his official capacity or former official capacity; (b) it would be reasonable to expect a person in his official capacity or former official capacity not to disclose except for the proper performance of the functions attaching to that official capacity; and (c) he knows is unpublished price-sensitive information in relation to securities of the corporation, shall not make improper use of such information to gain, directly or indirectly, an advantage for himself or for any other person and any person who contravenes or fails to comply with the provisions of this section commits an offence.<sup>80</sup>

The information referred to in this section is unpublished price sensitive information which, unlike section 132A, may or may not be specific confidential information. The information must, however, be held by the person concerned by virtue of his official capacity which he presently holds or in the past held. Another feature that contrasts with section 132A is that no offense is committed unless the person knows that the information is unpublished price sensitive information. With regard to the penalty, both provisions provide the same punishment.

With the establishment of the Securities Commission in 1993, it is evident that Malaysia has moved positively towards regulating the nation's securities industry. The Market Supervision Division of the Commission, with the help of the Surveillance and Compliance Department, including the Investigation and Enforcement Department, is investigating improper or prohibited market practices such as illegal trading, short selling, market manipulation, and insider trading. The chairman of the Commission is

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<sup>79</sup> CA § 132B.

<sup>80</sup> *Supra* note 23, ¶ 5.

empowered to appoint any of its officers to conduct the prosecution in the above quoted improper or prohibited market practices.

During the period of March, 1993, to December, 1993, the commission prosecuted five short selling cases of UPHB shares under section 41(1) of the SIA. All the accused persons pleaded guilty to the charge and paid the fines as imposed by the respective courts,<sup>81</sup> as shown in Table B.

Apart from the convictions in short selling cases, the commission has issued public reprimands to three errant companies during the period covered by the 1993 First Annual Report for their wrong statements regarding the variance in the estimated or forecast pretax profit and actual pretax profit,<sup>82</sup> along with many other shortcomings as shown in Table A. The conviction of the five short selling cases and the public reprimands issued to three errant companies within a short period of ten months is evidence of the timely establishment of the Securities Commission in Malaysia.

#### IV. CONCLUSIONS AND SUGGESTIONS

From the foregoing discussion, it is evident that courts and legislatures are keeping a vigilant watch over unscrupulous company controllers. But it does not mean that companies are constantly embroiled in internecine strife, or that investors and creditors are routinely maltreated by dishonest or incompetent company controllers. Nothing could be further from the truth. On the contrary, "the great majority of limited companies, both public and private, are honestly and conscientiously managed."<sup>83</sup> We have tried to consider the extent to which the legal rules are conducive to this desirable result and provide adequate redress in the case of the small number of companies less scrupulously operated. We submit the following to meet with the situations in future cases of insider trading:

- (1) The provision of section 132(1) of the Companies Act should be read with the provision of section 132(5), as section 132(1) is in addition to and not in derogation of any other rule of law relating to the duty or liability of directors or officers of a company. Hence, cases reflecting the common law in this field should still be relevant.

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<sup>81</sup> See *supra* note 9, at 66.

<sup>82</sup> See *supra* note 9, at 53.

<sup>83</sup> *Supra* note 23, ¶ 5.



(2) First, section 132(2) should be treated as the reversal of the notorious common law judgment of *Percival v. Wright*. The provision is confined only to the injury caused to the company, but the scope is extended from directors to officers of the company, stock exchange, or agent as well as those who previously held such office. It is submitted that persons such as dealers, investment analysts, public servants, financial journalists, and tippees should also be included within the scope of section 132(2). Secondly, the word "information" is very broad. It is therefore submitted that the meaning of the word information should be limited to "confidential information" in the provision of section 132(1), as in section 124(2) of the Australian Uniform Companies Act.

(3) Section 132A(1) strictly prohibits insider trading in dealing with securities. The liability in section 132A(1) is broader than the liability in section 132(1) of the Companies Act, as it is extended to compensate any person who suffered a loss as a result of insider trading in securities. The traditional rule of proper plaintiff as applied in *Foss v. Harbottle* should not be applied here. Moreover, the provision of section 132A(3) should be seriously considered for modification so as to provide the extension of the period of limitation which should commence from the date the information is discovered, as opposed to the existing provision "from the date of dealing." The amendment should be enacted as: "The action for the recovery may be commenced for a period of two years from the date the knowledge of the misuse of information comes into light." This would be like any other case of fraud. The existing provision makes the defaulter free from potential liability two years after the act of insider trading.

(4) The phrase "specific confidential information" should not be construed literally. An objective test should be laid down to ascertain the nature of information. A liberal interpretation should be given to the words "confidential."

(5) Section 132B(1) does not deal with specific confidential information like section 132A(1), but rather with information obtained in the official capacity of, and abused by, the officer concerned. It is provided that no offense shall be committed if the person knows that the information is published. But, it is very difficult to ascertain the subjective knowledge of

the person concerned regarding whether information is unpublished. The element of subjective knowledge should be excluded if the information is really unpublished. It is immaterial whether the person knows or does not know the fact of its being published and he should be made liable under section 132B of the Companies Act regardless of his knowledge.

(6) The investigating authorities should be well versed in the corporate law for the effective investigation into the offense of insider trading.

(7) The burden of proof should be shifted from the prosecution to the defense to show that the information was not confidential price sensitive information, and that it was not misused for the benefit of the accused or for the benefit of the accused's tippees.

(8) As a watch dog of securities trading, and with a view of its globalization, it is respectfully submitted that the Commission should be very cautious in issuing public reprimands to the errant companies. Since the Commission is an enforcing authority, the power of issuing public reprimands should be guided by the principles of natural justice and fair play.

(9) For the internationalization of securities industry and for the encouragement of the foreign investors, a rethinking of the following fields is required: (a) tax revenue questions should keep pace with the principle of reciprocity with other governments and the liberal economic policy of the country; (b) pre-emption rights and the development of global equity market; (c) special issue requirements under the National Development Policy (NDP) regarding the Bumiputra equity participation and Alibaba types of transactions.<sup>84</sup>

(10) Any relaxation in the regulation of in socio-economic offenses is bound to open a floodgate of such offenses. It is therefore submitted that the element of *mens rea* should not be considered in the offense of insider trading, particularly in Malaysia, where the whole nation is committed to Wawasan 2020 (Vision 2020), i.e., to place Malaysia in the categories of fully developed and self sufficient nations of the world.

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<sup>84</sup> See Mohd Ishaque Qureshi, *Share Transfer Restrictions: A Malaysian Experience*, MALAYSIAN LAW NEWS (M.L.N.), Nov. 1992, at 5-8; Dec. 1992, at 10-13; May, 1993, at 35-39.

