Response to the Consultation Paper on Proposed Amendments to the SFA (Part XII and section 324) (P013-2015 dated August 2015)

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18 September 2015

1. On the proposal to revise section 199 to clarify that there is no requirement for material price impact: Consultation Paper para 3.1.

1.1 The proposal is, presumably, borne out of Chan Sek Keong CJ's *dictum* in Madhavan Peter [2012] 4 SLR 613 at [45]:

> In respect of s 199, the words "material particular" apply to a false or misleading particular that is likely to have the effect of, *inter alia*, "raising, lowering, maintaining or stabilising the market price of securities" (see s 199(*c*)), and not simply any kind of false or misleading particular. The focus of this provision is on the price impact of false or misleading statements. It follows from the nature of the offence under s 199 that the false or misleading particular in question must, just as in the case of the offence under s 203 (read with rule 703(1)(b)), be of sufficient importance to significantly affect the *price or value* of securities. As such, I shall also refer to information falling under s 199 as "materially price-sensitive information".

1.2 I have argued in an article currently being prepared for publication that one must read this passage carefully:

> In the context of the limbs of s. 199 relied upon to prefer the misleading disclosure charges against the directors in *Madhavan Peter* – s. 199(c)(ii) – Chan CJ is arguably right to characterize the information in question as involving materially price-sensitive information. One misinterprets Chan CJ if s. 199 is read to generally involve materially price-sensitive information. Materially price-sensitive information is only implicated if the charge is based on s. 199(c). Sections 199(a) and (b) do not necessarily involve materially price-sensitive information. Instead, they involve another shade of materiality.
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> For sections 199(a) and (b), the information containing the false or misleading material particular must be "likely to induce" either a subscription for the securities, or a sale or purchase of the security. This echoes "materially trade-sensitive information", the appellation Chan CJ applied to information covered by s. 216. However, a closer look reveals that it is materiality of yet another shade. Whereas s. 216 refers to information likely to *influence* decisions whether or not to buy or sell securities, s. 199(b) refers to information likely to *induce* such decisions. The relevant definitions of 'induce' found in the Oxford English Dictionary are: "to lead (a person), by persuasion or some influence …, to … some action", and "to bring about, bring on, produce, cause, give rise to." By contrast, to "influence" is to "affect the mind or action of". Whereas s. 216 can arguably encompass information relevant to one's deliberations whether or not to transact; the use of 'induce' in s 199(a) and (b) suggests a greater degree of influence, one which extends beyond deliberation to action. Indeed, the term 'induce' might support a construction that the threshold involves an outcome-determinative degree of influence. "Influence", on the other hand, can affect without being the determinative. As such, s. 216 is capable of accommodating information which exert a

> lesser degree of influence compared to that referred to in s. 199(a) and (b).
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> Loke, "The shades of materiality and the boundaries of securities market misconduct" (unpublished manuscript, p. 16-17)

1.3 I therefore agree with the view expressed in Consultation Paper (para 3.3.1) that s. 199(a) and (b) do not relate to materially price-sensitive information. As has been pointed out by Young CJ in *R v Wright* [1980] VR 593 at 595:

> As a matter of the grammatical formation of the section the subject of the verb "is" before the word "false" is "information" and the subject of the verb "is" before the words "likely to induce" is also "information". Thus it is the information that must be likely to induce the sale or purchase of securities or likely to have the effect of raising or lowering the market price of securities. There is no difficulty in my opinion in giving effect to what I regard as the plain grammatical meaning of the section and having regard to the evident intention of the section there seems to be every reason for doing so. It would have been unreal and ineffective to have drafted the section so as to strike at the dissemination of information which is false or misleading in a material particular only where the material particular was likely to have one or other of the results mentioned in the section

1.4 The s 199 charge in Madhavan Peter related to s. 199(c)(ii). As to s 199(a) and (b), Chan CJ's opinion is merely *dictum*. It is not *ratio*, and does not bind the lower courts. If the matter arises in relation to a charge preferred under s. 199(a) and (b), the matter will have to considered afresh as Chan CJ did not consider *R v Wright*.

1.5 As regards s 199(a) and (b), I believe the MAS' view will prevail if the matter is properly before the courts. It is not, in my view, imperative that a legislative clarification be made to s 199(a) and (b). However, given the breadth of what is proposed in Proposal Paper para 3.1.3, if the clarification is be made, a distinction needs to be made with s 199(c). Why? This is because s 199(c) is more nuanced than what is set out in the Proposal Paper.

1.6 The correct approach to construing s 199(c) is not to ask whether the material particular in question has the stipulated price effect. As the Full Court of Victoria in *R v Wright* has pointed out, the subject to which the elements in (a), (b) and (c) relate is the term "information", not the material particular. My view is that the phrase "likely … (c) to have the effect of raising, lowering, maintaining or stabilising the market price of securities" does speak to the likely price sensitive nature of the information as a whole. Given that the effect relates to prices, there is a quantitive effect posited. Further, given that the prices of securities can fluctuate with every trade, "likely to [have the requisite price effect]" requires a link to be drawn between the (misleading) information as a whole and the likely price effect. The provision does not stipulate that the price effect must be observed; however, the absence of a price effect does require an explanation. The necessary question to be answered is: if it was likely to have the

effect alleged in the charge, why was it not observed? Was it mitigated or nullified by other price sensitive events?

1.7 The requisite price effect cannot not be trivial; otherwise, the physical element will be meaningless. In my view, there is a threshold price effect inherent in the statutory ingredient which I term "embedded materiality": Loke, "The shades of materiality and the boundaries of securities market misconduct" (unpublished manuscript, p. 21 *et seq*). Importantly, it is the embedded materiality that renders the price sensitivity meaningful.

1.8 If the proposal is to state that s. 199(c) does not contemplate a material price effect, it raises the question – what is likely price effect prescribed? No more than a trivial price effect? This is a difficult proposition to sustain.

1.9 I suspect the concern with *Madhavan Peter* is the nature of the empirical evidence that s. 199 demands. Strictly, s. 199 does not demand empirical proof that the price effect actualised. What it does require, however, is satisfaction of the 'likely' price sensitive nature of the information. This ingredient contemplates some examination of the empirical evidence. If there is no discernable price effect even after the misleading information has been corrected and the charge is that the misleading information had the effect of raising the price of the securities, howbeit established that it was "likely to have the effect of raising the price of the securities"? There is a burden of persuasion. Whether or not one agrees with Chan CJ's view of the evidence in *Madhavan Peter* that the information in question did not satisfy the threshold, it is difficult to argue that a certain threshold price effect is contemplated by the current provision. Importantly, this physical element integral to the definition of the offence usefully serves to make a distinction between a trivial and the non-trivial price effect – what I term 'embedded materiality' in price sensitivity.

1.10 Summary:
(a) I do not regard clarification of s 199(a) and (b) necessary; I believe that *R v Wright* is correct in its interpretation and that when the matter comes before the Singapore courts, the position of the MAS will be confirmed.
(b) As regards s 199(c), a careful interpretation which seeks to render it meaningful will necessarily see the provision as incorporating a threshold price effect – if a *'likely'* price effect. I do not support any suggestion that the price effect can be trivial; to be meaningful, such a price effect must be of some significance. There is therefore embedded materiality in the posited likely price effect even if it is not expressly stated. In other words, Chan CJ's reading of s 199(c) is defensible, and indeed, desirable. I urge great caution in any statutory amendment that might raise the suggestion that the likely price effect can be trivial.

2. On the proposal to insert a statutory definition for the phrase 'persons who commonly invest' in section 214 of the SFA (Consultation Paper para 3.2).

2.1 I support the proposal to introduce a definition of "persons who commonly invest", a phrase found in SFA s. 215(b)(i) and 216.

2.2 The current statutory language is hard-stretched to support the gloss placed on the phrase in *Lew Chee Fai Kevin v MAS* [2012] 2 SLR 913. To the extent that the Court of Appeal excludes from the definition of 'common investors' those without the ability to do technical and fundamental analysis on information and the ability to read and analyse financial statement (the requirement for 'general professional knowledge'), it excludes momentum traders who may not necessarily satisfy the criteria set out by the Court of Appeal. One can see the motivation behind the gloss placed by the Court of Appeal - the investors who possess the qualities set out are those to whom the information is relevant. As such, there is something to be said for using the perspectives for such investors as the gauge for determining the relevance of the information for insider trading purposes. However, the desirability for such criteria underscores the importance of a statutory basis; the initiative undertaken by the MAS to clarify this element and to put it on a statutory basis is therefore a welcome one.

2.3 The common investor test currently serves two purposes. It is useful to keep in mind those two purposes in order to forge a targeted solution to the problem at hand. Section 215 definition of 'information generally available' speaks to the question of when the use of the information is regarded as fair and for that matter, unfair. Once the information is regarded as generally available, one may legally use the information. Section 215(b)(i), in particular, contemplates fair use when the information has been disseminated through channels of communication that would bring the information to those influential in the price formation process. Both the channel of communication and the target group are important. The former points to the *where* interested investors should look to for developments, while the latter relates to the characteristics of these investors in determining whether the channel of communication is the legally relevant mode of communication. In this regard, the qualities of such common investors as set out in para 3.2.7 are apposite.

2.4 Section 216 provides an extended definition of a phrase (Material effect on the price or value of a security) which is an element to establishing the offence under s. 218 and 219. The ambit of persons 'who commonly invest in securities in deciding whether or not to [transact] the first mentioned-security' speaks to a slightly different category of investors than s 215, and extends the relevant information to that which Chan CJ terms, 'trade sensitive information'. Whereas the common investors in 215 might not be necessarily be interested in the subject securities and might instead be interested in securities whose values might be impacted by information relating to the subject securities (e.g. an investor who invests in a down-stream business corporation may be interested in a supplier's fortunes.), s 216 relates to investors who have an interest in the

price of the subject security. Notwithstanding this, the characteristics set out in para 3.2.7 are apposite and deserving of support. The class of relevant investors is somewhat wider than that contemplated in *Kevin Lew*; however, I think the boundary drawn in the Consultation Paper is preferable to that articulated in *Kevin Lew* as it marks out the class of persons who have a legitimate claim to being interested in the information. To put it simply, knowledgeable common investors who do not approach the level of sophistication contemplated in *Kevin Lew* have no less a claim to being counted as persons who matter for the purposes of determining when the person holding the information should not trade. Moreover, the proposal has the merit of not requiring the empirical evidence to distinguish between trading by the '*Kevin Lew*' common investor and by those less sophisticated. It makes the evaluation of empirical evidence much more tractable.

I therefore support the proposal set out in para 3.2.9.

3. On the proposal to provide for MAS' civil penalty claims to have priority over other unsecured debts that accrue subsequent to the contravention: (Consultation Paper para 3.4).

3.1 My comments consider first the corporate-defendant and then, the case of the individual who is liable to a civil penalty.

3.2 Given the punitive aim of a civil penalty, the proposal to accord the MAS civil penalty claim priority over a corporation's unsecured creditors invites an examination of the rationale for the priority.

3.3 The priority accorded to claims by the Central Provident Fund Board seeks, in the main, to protect the superannuation contributions to be held by the fund. The social policy underlying the CPF asserts a justifiable claim to priority. The underlying policy rationale is defensible and indeed, worthy of support.

3.4 One can also support the priority accorded to claims by the Inland Revenue Department found in section 328(1)(g) of the Companies Act. Insofar as the state provides the environment in which the income is generated, taxes are claims not only for the provision of public goods, but can also be regarded as a debt for the enjoyment of the public goods provided in the generation of the taxable income. The claim to priority is again justifiable.

3.5 Section 10 of the Government Proceedings Act is framed broadly. Nonetheless, insofar as it pertains to a claim under civil law, it can be seen as a claim for the benefit of the public coffers. In other words, an asset of the body politic. Thus, it may very well be that the character of the claimant (the Government) and the ultimate beneficiary of the entitlement (the public coffers) – justifies the priority of the claim over those of private parties.

3.6 The civil penalty stands on somewhat different premises. As the aim of civil penalty is to punish, the necessary question one needs to ask is whether one is punishing the right person(s). In the case of an insolvent company, the priority over unsecured creditors means that it is this class of claimants who in actuality suffer the punishment. It is puzzling to this commentator why they should *effectively* be made to bear burden of the civil penalty. This especially if they are unrelated third parties (e.g. trade creditors) who in no way contributed to the market misconduct.

3.7 Indeed, the same question can be raised with regard to an individual who is liable to a civil penalty. If he is bankrupt, the priority of the penalty is in effect visited upon the unsecured creditors. The bankrupt does not feel the penal effect of the civil penalty through the greater priority accorded to the MAS over other creditors. Indeed, if the punitive effect of the civil penalty is to have bite, one should adopt a slightly different strategy: for example, require the full payment of the civil penalty or the consent of the MAS before the bankrupt may be discharged. This would direct the pain where it should properly be applied – the individual who has contravened the provisions of the Securities & Futures Act.

3.8 Absent more convincing justifications, I hesitate to support the proposal set out in 3.4.