

CONSULTATION PAPER

P020 - 2006
December 2006

Chapter 4: Market Conduct

MAS

Monetary Authority of Singapore

CHAPTER 4: MARKET CONDUCT

Section A: Corporate Derivative Liability

Introduction

Part XII of the SFA prohibits market misconduct such as insider trading, false trading and market manipulation. Market misconduct can result in criminal prosecution or civil penalty action, as well as civil liability to affected investors who have suffered as a result of the misconduct.

2 When employees of companies engage in market misconduct in the course of proprietary trading on behalf of their companies, these companies may make profits or avoid losses as a result of the misconduct.

3 Under the current law, a company may not be liable for market misconduct committed by its employees whilst trading on the company's behalf unless management is involved in the misconduct because:

- (a) Where the employee has committed insider trading, the SFA makes the company liable only where the inside information is possessed by an officer (defined as including a person employed in an executive capacity), and where there are no proper "Chinese walls" between this officer and the employee who committed the insider trading; and
- (b) Where the employee has engaged in some other form of market misconduct like false trading or market

manipulation, the common law makes the company liable only where there is complicity by management.

4 Therefore, where management is not involved in the market misconduct of the employee, the company may escape liability but still get to keep the profits or losses avoided as a result of the misconduct.

Rationale behind our proposal

5 The current law may make it possible for management to delegate trading decisions to employees in order to reap the benefits of an employee's market misconduct without the risk of liability.

6 If only the employee can be made liable, he may not have the assets to meet the claims of affected investors in a civil suit because the gains from the market misconduct reside with the company and not with the employee. This is unfair to the affected investors if the company has benefited and allowed its resources to be used for the misconduct due to its lack of diligence.

7 In addition to the current law where the company is liable when management is involved in the misconduct, MAS proposes to make the company liable when the company has failed to take reasonable steps to prevent the misconduct.

8 Making companies strictly liable for all the wrong doings of their employees would result in a disproportionate exposure of the company to liability. Making companies liable only if they have failed to take reasonable steps will encourage companies to put in place appropriate internal controls.

9 In other jurisdictions, such as the United States (“**US**”) and Australia, liability is similarly imposed on the company where it has failed to take reasonable steps to prevent illegal acts by their employees.

Proposed amendment

10 The key features of the proposed amendment are:

- (a) A company will be made liable for the market misconduct committed by an employee whilst trading on its behalf where the company has failed to take reasonable steps to prevent the misconduct;
- (b) The proposed amendment will also cover partnerships and limited liability partnerships; and
- (c) The current Sections 226 and 227 of the SFA, which deal with the attribution of knowledge within corporations and partnerships for the purposes of insider trading and the “Chinese walls” exception, will be removed. “Chinese walls” will continue to be relevant as one of the “reasonable steps” a company can take to prevent insider trading.

4.1 MAS seeks views on the proposal to make a company liable when the company has failed to take reasonable steps to prevent market misconduct by its employees. Please highlight concerns with the proposed amendment, if any.

Section B: Disgorgement by Persons who Benefit from Contravening Trades Conducted on their Behalf

Introduction

11 When trades in contravention of Part XII of the SFA (“**contravening trades**”) are conducted by a trader on behalf of a person who himself is not complicit in the contravening trades (“**third party**”), this third party may make profits or avoid losses as a result of the contravening trades (“**gains**”). This third-party may be a client whose account has been unwittingly used by his broker to conduct contravening trades, or a company on whose behalf an employee carries out contravening trades in the course of proprietary trading.

12 Where the third party is not complicit in the contravening trades, there is currently no legislation to compel him to disgorge his gains.

Rationale behind our proposal

13 MAS proposes to empower the court to order a third party who has benefited from contravening trades conducted on his behalf to disgorge his gains to affected investors because:

- (a) Under MAS’ proposed amendment in Section A, a company will avoid liability even though it benefits from contravening trades conducted on its behalf by its employees if it had in place reasonable steps to prevent such trades. But there is no reason why such a company or any third party in general who benefits from contravening trades conducted on their behalf, should get to keep such

gains, even if they are themselves innocent. These gains represent the fruits of unlawful market misconduct and anyone who retains such gains is unjustly enriched;

- (b) Under the current law, affected investors can only look to the trader for compensation by way of a civil suit. But the trader may not have the assets to meet their claims because the trader is not in possession of the gains. The gains are in the possession of the third party, who remains out of the reach of the affected investors; and
- (c) An innocent principal is not responsible for the losses incurred as a result of unauthorised trading by his trader. Similarly, he should not be allowed to keep the gains from unauthorised contravening trades conducted on his behalf.

14 Bearing in mind that the third party is innocent of any wrongdoing, the interests of the affected investors must be balanced against any unfairness to the third party. Disgorgement will not be ordered by the court if the third party has used up the money in such a way that it is unfair to compel him to disgorge it. For example, if the third party, in good faith, thinks that he has come into a windfall, and spends the money in a way which he would not otherwise have done, he will not be asked to disgorge the money he has spent.

Proposed amendment

15 The key features of the proposed amendment are:

- (a) MAS will be empowered to apply to the court to order a third party who has benefited from contravening trades

conducted on his behalf to disgorge such gains;

- (b) Disgorgement (or full disgorgement) cannot be ordered where the unsuspecting third party has used up the money in such a way that it is unfair to compel him to disgorge it;
- (c) The disgorged gains will be paid into court. The court will set a limitation period for affected investors to claim against the disgorged sum. The court will then assess all claims and distribute the disgorged sum equitably among the affected investors;
- (d) Affected investors will be barred from making further independent claims against the third party after the expiry of this limitation period; and
- (e) MAS can only claim the balance remaining from the monies paid into court, if any, after the expiration of the limitation period for claims set by the court.

4.2 MAS seeks views on the proposal to empower the courts to order a third party who has benefited from illegal trades to disgorge the gains. Please highlight concerns with the proposed amendment, if any.

Section C: Disqualification from Acting as a Director or being Involved in the Management of a Company

Rationale behind our proposal

16 MAS views market misconduct in contravention of Part XII of the SFA very seriously.

17 Currently, the Companies Act (Cap. 50) (“**CA**”) provides that a person can be disqualified from acting as a director or being involved in the management of a company upon criminal conviction of certain offences. It is unclear whether this covers criminal convictions for all Part XII contraventions. There is also no provision for the court to order disqualification after it has made an order of civil penalty under Section 232 of the SFA.

18 MAS proposes to give the court the discretionary power to order disqualification where a person has been convicted of or found to be liable for a civil penalty for any Part XII contravention.

19 This is consistent with the position in the US, the UK, Australia and Hong Kong which generally provide for disqualification following a criminal conviction or finding of civil penalty liability for market misconduct.

Proposed amendment

20 The key features of the proposed amendment are as follows:

- (a) The court will be given the discretionary power to order disqualification of up to 5 years for any person who has

been convicted of or found to be liable for a civil penalty for any Part XII contravention;

- (b) A person who has a disqualification order made against him shall not be allowed to act as an officer of a company or a foreign company to which Division 2 of Part XI of the CA applies, nor shall he be allowed to take part, whether directly or indirectly in the management of such a company or foreign company;
- (c) A person who acts in contravention of the disqualification order shall be guilty of an offence and liable on conviction to a fine not exceeding \$10,000, or to imprisonment for a term not exceeding 2 years, or to both; and
- (d) MAS will also be empowered to accept written undertakings as part of a civil penalty settlement, including undertakings to refrain from acting as a director or being involved in the management of any company, and to enforce such undertakings in court.

4.3 MAS seeks views on the proposal to give the courts the discretionary power to order disqualification where a person has been convicted of or found to be liable for a civil penalty for any Part XII contravention. Please highlight concerns with the proposed amendment, if any.

Section D: Transfer of Evidence between CAD and MAS

Rationale behind our proposal

21 Part XII contraventions attract both criminal and civil penalty liability under the SFA. Where criminal proceedings are contemplated, the investigation is carried out by the Commercial Affairs Department of the Singapore Police Force (“CAD”) and prosecuted in court by the Public Prosecutor. Where civil penalty proceedings are contemplated, the investigation and court proceedings are conducted by MAS.

22 Investigations may reveal that a case is less serious or more serious than initially suspected. In such cases, it may become necessary to switch from a criminal proceeding to a civil proceeding or vice versa after investigations are complete.

23 In the event of a switch, there is currently no express legislation to allow for the transfer between CAD and MAS of evidence obtained in the course of investigations. The receiving agency may therefore be required to reinvestigate the case, resulting in the unnecessary duplication of efforts.

24 MAS proposes to expressly provide for the transferability of such evidence between CAD and MAS. The amendment will also provide for the admissibility in court of the evidence so transferred in criminal and civil penalty proceedings, subject to the existing evidential and procedural safeguards under the law, such as the court’s power to reject incriminating statements on grounds of involuntariness, or to reject evidence if illegally obtained.

25 In the UK, Australia and Hong Kong, the regulator is empowered to bring both criminal and civil penalty proceedings. Evidence gathered in the course of investigations there can be used in both criminal and civil penalty proceedings without further ado.

Proposed amendment

26 The key features of the proposed amendment are as follows :

- (a) The amendment will provide for the transferability of evidence gathered in the course of investigation between CAD and MAS;
- (b) The amendment will also provide that such evidence will be admissible in court for the purposes of criminal and civil penalty proceedings, subject to the existing evidential and procedural safeguards under the law; and
- (c) The existing safeguard against self-incrimination under Section 153 of the SFA will continue to apply. Section 153 of the SFA provides that if a person states that the information he is disclosing to MAS might tend to incriminate him, that information is inadmissible against him in criminal proceedings other than for an offence of giving false information to MAS.

4.4 MAS seeks views on the proposal to provide for the transferability of evidence gathered in the course of investigations between CAD and MAS. Please highlight concerns with the proposed amendment, if any



Monetary Authority of Singapore