Corporate Governance

Insider Trading – What Directors of Public Listed Companies Need to Know (Part 2)

Insider trading has received increased regulatory scrutiny in the Malaysian market over the past decade, posing several important questions for those who are privy to confidential information.

In our previous Legal Update titled "Insider Trading – What Directors of Public Listed Companies Need to Know (Part 1)", we looked at what exactly is insider trading, determining materiality in the context of insider trading, as well as the interface between the Capital Markets and Services Act 2007 ("**CMSA**") and Bursa Malaysia's Main Market Listing Requirements ("**Bursa's Listing Requirements**"). In this Legal Update, we will delve into: (i) considerations that directors need to take into account in the event they do not trade but procure another person, whether directly or indirectly, to buy or sell securities when the directors are in possession of inside information; (ii) closed periods as defined by Bursa's Listing Requirements; and (iii) actions that can be taken by Malaysian regulatory authorities in the event of a breach of insider trading prohibitions.

A Director Who Doesn't Trade

What if the director does not trade but procures another person, whether directly or indirectly, to buy or sell securities when the director is in possession of inside information? This is also a breach of the law under section 188(2) of the CMSA. Therefore, an insider who induces or encourages another person to buy or sell securities would be equally caught by the law (section 187 of the CMSA defines the term "procure" as "*inciting, inducing, encouraging, or directing another person to carry out an act or omission*").

Similarly, a director who communicates inside information to another person who then goes on to trade in the securities, also commits a breach of the law. Section 188(3) spells this out in clear terms. A famous case involving the tipping of inside information by a corporate insider is that of Rajat Gupta (*Gupta v. United States 747 F.3d.19*) who was convicted of engaging in and conspiring to engage in an insider trading scheme while serving on boards of directors of various companies. The charges involved Gupta having tipped Raj Rajaratnam, a fund manager of the Galleon Group who himself was convicted of insider trading.

Closed Periods

But surely, I can trade if it isn't a closed period, as defined in Bursa's Listing Requirements? The answer to this is clear. While the Listing Requirements of Bursa Malaysia place certain restrictions on trades during closed periods[1], this does not preclude the application of insider trading prohibitions which are set out in the law, namely the CMSA, to windows of time other than closed periods. This means that directors, while complying with the closed period trading rules set out in the stock exchange rules, would also have to apply their minds to their potential trades to determine if they are in possession of non-public material information. If they are in possession of such inside information, then regardless of whether they are outside of a closed period, the director should not trade. This is clear from Bursa's Listing Requirements themselves which state that "*an affected person must not deal in the listed securities of his own listed issuer or of other listed issuers as long as he is in possession of price-sensitive information relating to such listed securities*". (Rule 14.04 MMLR).

Directors and principal officers of a listed issuer or its major subsidiary are considered to be "affected persons" under Bursa's Listing Requirements (Rule 14.03(1) MMLR). As far as listed issuers are concerned, a "principal officer" is defined as "*the chief executive who is not a director, the chief financial officer or any other employee of the listed issuer or its major subsidiary respectively who has access or is privy to price-sensitive information in relation to the listed issuer*" (Rule 14.02(i) MMLR).

What Actions Can Be Taken for Insider Trading

Under the CMSA, a breach of the insider trading prohibitions can be visited with either criminal or civil actions. Criminal actions for breaches of the law, including the CMSA, as provided under Article 145(3) of the Federal Constitution, can only be instituted with the consent of the Public Prosecutor (section 375 of the CMSA). Such charges are laid before the Sessions Court and can proceed up to the Court of Appeal.

Another route which may be taken for insider trading breaches is by way of a civil action which is filed in the High Court. In such an instance, the Securities Commission Malaysia ("**SC**") may be able to claim up to three times the difference between the actual purchase or sale price and the likely price had the information been generally available (see subsections 201(5) and (201(6) of the CMSA). This is typically regarded as the profit made or the loss avoided by the insider. In addition, a civil penalty can also be claimed from the offender, up to a sum of RM1 million. In *Suruhanjaya Sekuriti Malaysia v. Chan Soon Huat [2018] 9 MLJ 782*, the court ordered the defendant to pay a sum of RM 3,238,761, which constituted three times the value of the loss avoided by the defendant due to his insider trades. In

[1] *A closed period as defined in Chapter 14 of Bursa Malaysia's Main Market Listing Requirements refers to a period commencing 30 calendar days before the targeted date of announcement up to the date of the announcement of the following to the Exchange – (i) in relation to a listed issuer, its quarterly reports; or (ii) in relation to a listed collective investment scheme or listed business trust, the quarterly reports or annual reports of the listed collective investment scheme or listed business trust.*

addition, he was ordered to pay a sum of RM500,000 as a civil penalty under section 201(6) of the CMSA.

The SC's Reporter, which provides regulatory and enforcement updates by the capital market regulator, reports in its Issue 1 of 2021 (covering its updates for the period between July 2020 – June 2021) insider trading actions taken and outcomes involving more than 12 individuals in trades involving eight public listed companies ("**PLCs**") over a period of time. The specific actions taken by SC involve criminal charges, civil actions, both in cases of consent judgments being recorded and one case involving a full trial, and in several instances, regulatory settlements being entered into with SC.

Breaches can also mean that directors and chief executives can lose their board positions as ordered by the court when a civil action is instituted by the regulator (see section 360(1)(L) of the CMSA). Section 318 of the CMSA also provides that SC has the ability to apply to court to disqualify a director or chief executive who has breached specific provisions in the CMSA, including the prohibition on insider trading.

In a recent case as disclosed in SC's Reporter (Issue no.1 of 2021), the individuals concerned entered into consent judgments with the regulator where the terms of the judgment involved barring them from becoming a chief executive officer or director in any PLC or subsidiary of any PLC for a period of eight years; barring them from being involved in the management of any PLC and/or subsidiary of any PLC for a period of eight years; and being restrained from trading in any counter on Bursa Malaysia for a period of eight years. In another case, the consent judgment involved a barring of five years from being a director and trading on the stock exchange. In the case of *Suruhanjaya Sekuriti v. Sreesanthan Eliathamby* [2021] 7 CLJ 913, (currently on appeal to the Court of Appeal), the High Court ordered that the defendant be barred from being a director of any PLC for a period of 10 years.

An extended limitation period of 12 years from the date of the breach or the date on which SC discovered the breach, allows the regulator a longer period than normal to be able to institute the action.

Conclusion

Insider trading laws are designed to ensure that markets operate fairly and that those who have inside information do not abuse the informational advantage that they have by trading while in possession of such information or communicating such information to others. It is useful therefore for insiders to know the limits prescribed by the CMSA to ensure that they do not run afoul of the law, and are better positioned to discharge their obligations, given the far-reaching consequences that such breaches can bring about.

You can also find this opinion piece published on **The Edge Malaysia** on 3 April 2022.

Contacts

John Mathew
Partner

T +603 2273 1919
M +601 2377 7792
F +603 2273 8310
john.mathew@christopherleeong.com

Shanti Geoffrey
Partner

T +603 2273 1919
M +601 7963 1117
F +603 2273 8310
shanti.geoffrey@christopherleeong.com

Our Regional Contacts

RAJAH & TANN | *Singapore*
Rajah & Tann Singapore LLP
T +65 6535 3600
sg.rajahtannasia.com

R&T SOK & HENG | *Cambodia*
R&T Sok & Heng Law Office
T +855 23 963 112 / 113
F +855 23 963 116
kh.rajahtannasia.com

RAJAH & TANN 立杰上海
SHANGHAI REPRESENTATIVE OFFICE | *China*
Rajah & Tann Singapore LLP
Shanghai Representative Office
T +86 21 6120 8818
F +86 21 6120 8820
cn.rajahtannasia.com

ASSEGAF HAMZAH & PARTNERS | *Indonesia*
Assegaf Hamzah & Partners

Jakarta Office
T +62 21 2555 7800
F +62 21 2555 7899

Surabaya Office
T +62 31 5116 4550
F +62 31 5116 4560
www.ahp.co.id

RAJAH & TANN | *Lao PDR*
Rajah & Tann (Laos) Co., Ltd.
T +856 21 454 239
F +856 21 285 261
la.rajahtannasia.com

CHRISTOPHER & LEE ONG | *Malaysia*
Christopher & Lee Ong
T +60 3 2273 1919
F +60 3 2273 8310
www.christopherleeong.com

RAJAH & TANN | *Myanmar*
Rajah & Tann Myanmar Company Limited
T +95 1 9345 343 / +95 1 9345 346
F +95 1 9345 348
mm.rajahtannasia.com

GATMAYTAN YAP PATACSIL
GUTIERREZ & PROTACIO (C&G LAW) | *Philippines*
Gatmaytan Yap Patacsil Gutierrez & Protacio (C&G Law)
T +632 8894 0377 to 79 / +632 8894 4931 to 32
F +632 8552 1977 to 78
www.cagatlaw.com

RAJAH & TANN | *Thailand*
R&T Asia (Thailand) Limited
T +66 2 656 1991
F +66 2 656 0833
th.rajahtannasia.com

RAJAH & TANN LCT LAWYERS | *Vietnam*
Rajah & Tann LCT Lawyers

Ho Chi Minh City Office
T +84 28 3821 2382 / +84 28 3821 2673
F +84 28 3520 8206

Hanoi Office
T +84 24 3267 6127
F +84 24 3267 6128
www.rajahtannlct.com

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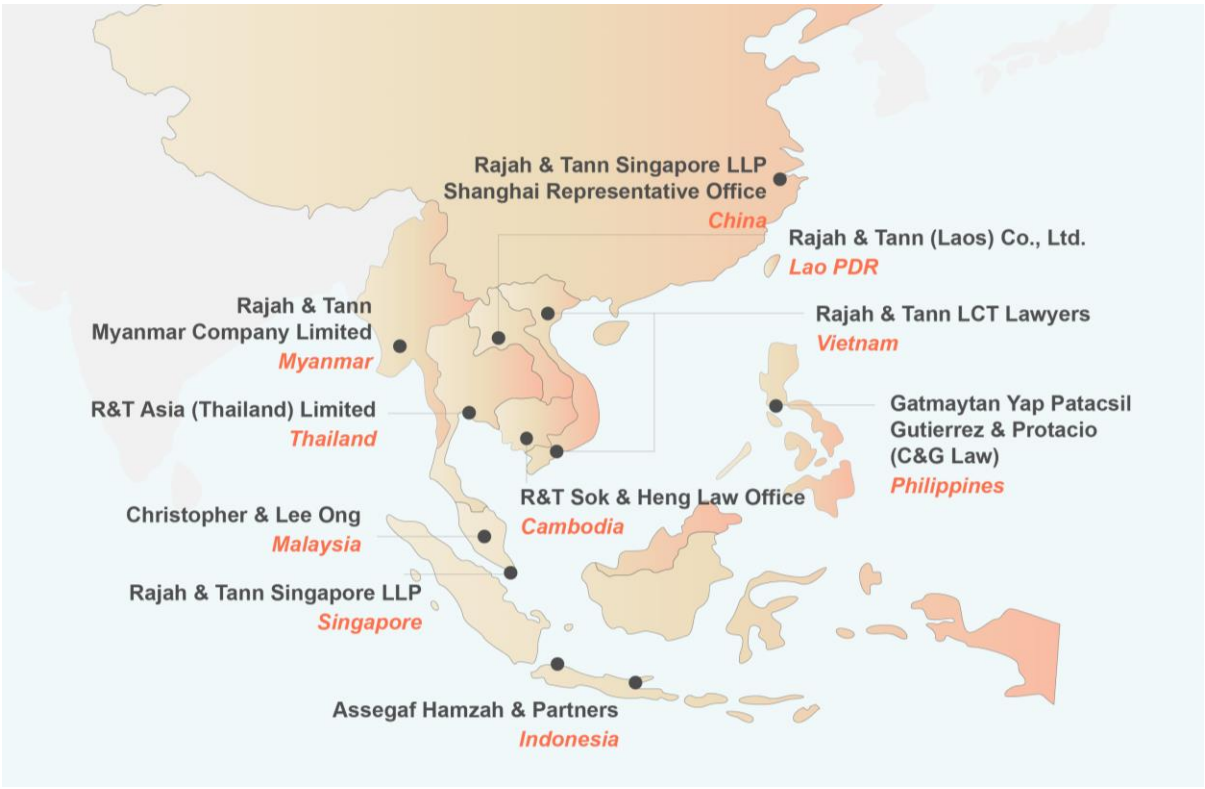

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