THE SILENT PARTY: *THE ROLE OF THE COURTS IN FINANCIAL REGULATION*

Introduction

1. It is impossible for any set of regulations, no matter how intricate, complex or comprehensive, to predict and prevent all manner of financial misconduct. To some extent, regulators will forever be fighting a losing rear-guard action against the inexhaustible ingenuity that people will display where money is involved. Despite this challenge, regulators have not stopped trying. Since the Global Financial Crisis of 2008, legislatures the world over have rushed to plug perceived gaps in their respective regulatory regimes that allowed the crisis to take place. A staggering volume of legislation has been passed since then.

2. Just as an example, the mammoth Dodd-Frank Wall Street Reform and Consumer Protection Act, which was passed in 2010, stands at 2319 pages. I can assure you that, even by lawyers' standards, it is a formidable piece of legislation. Closer to home, the Securities and Futures (Amendment) Act 2012 was drafted following an extensive series of public consultations conducted by the Monetary Authority of Singapore ("MAS"). It strengthened our existing regulatory framework by introducing the mandatory reporting of over-the-counter ("OTC") derivatives and by introducing safeguards for retail investors by requiring intermediaries to formally assess a retail investor's investment

knowledge and experience before selling them more complex investment products.

3. Much ink has been spilt on the subject of these post-crisis regulations. To the pessimists, all this is too little, too late. To borrow Donald Rumsfeld's now infamous phrase, it is the "unknown unknowns - the things we don't know we don't know" that will eventually do us in. I do not propose to join the debate over the efficacy of the new laws that have been passed. Instead, having recently returned to the Supreme Court, I thought that I would take this opportunity to share some of my thoughts on the role that the courts play in financial regulation.

4. At the risk of stating the obvious, regulation inevitably entails legislation. And legislation invariably leads, unfortunately, to litigation. What this means is that the silent party to every discussion on regulation must be the courts. The courts have the task of interpreting the relevant statutory instruments (many of which are extremely complex and technical), resolving their perceived ambiguities, and ensuring the peaceful resolution of the disputes which have arisen between the parties. Given that, it might come as a surprise that there is an absolute dearth of commentary on the subject. This morning, I would like to focus on three broad themes: (i) the rule of law and certainty; (ii) internationalisation and convergence; (iii) the sentencing function in the administration of criminal justice.

The Rule of Law and Certainty

5. My first theme is the "rule of law and certainty". While it might be somewhat impossible to offer a definition of the rule of law that will satisfy all, most will agree that the notion of the rule of law is to be distinguished from the rule *by* law. The rule of law is not simply a matter of governing by way of written laws printed and made available for general reading. The rule of law is a more comprehensive notion: it demands that government exercise its powers in a manner which is certain, clear, predictable, and prospective. At its essence, the rule of law demands that people must be able to plan their affairs in accordance with the law. The late Friedrich Hayek expressed it in the following way:

> "Stripped of all technicalities [the rule of law]… means that government in all its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to **plan one's individual affairs on the basis of this knowledge.**"

6. What does this have to do with financial regulation, you might ask? A lot, I think. Investors abhor uncertainty as nature abhors a vacuum and certainty is at the heart of the rule of law. I believe the courts can contribute to financial regulation by promoting compliance with the rule of law and, as a result, contribute to market stability.

7. Let me illustrate how this operates with reference to a recent case. In the case of *Tan Chong Koay v Monetary Authority of Singapore* [2011] 4 SLR 348, the Appellant, "Mr Tan", was the founder and CEO of several fund management

companies which operated in both Malaysia and Singapore. During the material time, both the Singaporean and Malaysian arms of his fund management companies held 15 trading accounts, all of which held shares in United Envirotech Ltd ("UET", for short). In order to boost the performance of the Singapore arm, Mr Tan instructed the Malaysia arm to purchase a total of 360,000 UET shares in the last 3 trading days of 2004 (i.e. from 29 December 2004 – 31 December 2004). As a result, the value of UET shares rose from $0.38 on 27 December 2004 to $0.445 on 31 December 2004. This caused 3 of the Singapore arm's accounts to outperform their year-end benchmark returns in 2004 (which would not have occurred but for the rise in value of the UET shares). For this, Mr Tan was held liable for contravening s 197(1)(b) of the Securities and Futures Trading Act (Cap 289, 2006 Rev Ed) by intentionally creating a misleading appearance in the market and was made to pay a civil penalty of S$250,000/-.

8. At that time, s 197(1)(b) of the SFA stated that "no person shall create, or do anything that is intended **or likely to create** a false or misleading appearance with respect to the market for, or the price of, such securities." As is clear, a person is liable if he either (i) creates; or (ii) performs an act with the intention of creating a misleading appearance; or (iii) performs an act which is likely to create a misleading appearance. One of the questions that the Court of Appeal had to consider was this: **does a person who performs an act which is likely to create a false or misleading appearance <u>have to know</u> that his act would have the effect of misleading?** This is critical because an innocent

investor could fall foul of s 197(1) without even realising it. As the Court observed, if "s 197(1) proscribes the effects of an investor's activities in the securities market without considering his intention or knowledge regarding those effects, there would be **nothing he could do in advance to prevent himself from incurring liability, short of not trading at all. In other words, he would be trading at his peril."**

9. The point did not have to be decided in *Tan's* case because the court found that, on the facts, Mr Tan had clearly intended to create a false appearance in the market to benefit the Singapore company. However, the Court of Appeal recommended that Parliament revisit the issue and it did. In 2012, Parliament amended s 197 to clarify that, in order for a person to be liable, he must have done the prohibited act either knowingly or recklessly. During the 2nd Reading of the Securities and Future (Amendment) Act 2012, Deputy Prime Minister Tharman Shanmugaratnam specifically stated that the amendment was made pursuant to judicial comment on the issue.

10. This seems to me to be to be an example of what Canadian Scholars Peter Hogg and Alison Bushell have called "constitutional dialogue": it describes the process by which the judiciary indirectly contributes to the legislative process through the decisions it hands down. In my view, this can only be a good thing. While it is clearly Parliament which is democratically empowered to draft and pass our laws, the judiciary is the guardian of the rule of law in Singapore. This is not to say that the courts should engage in "judicial

legislation". However, in disposing of cases, the courts have a constitutional duty to alert the other coordinate bodies of the State to issues which might have an impact on the rule of law as it did in this case by highlighting that s 197(1) of the SFA was possibly over-inclusive in its reach.

Internationalisation and Convergence

11. My second theme is that of internationalisation and convergence. If we examine the financial markets of today, you will observe a curious juxtaposition between the diversity of the market participants and the uniformity of legal instruments which are being used. Parties to a contract routinely hail from different jurisdictions and speak different languages but still choose to use the same common-law governed standard-form contracts. Just as an example, the Bank for International Settlements recently estimated the notional amounts of outstanding OTC (over-the-counter) derivatives stood at a staggering US$691 trillion at the end of June 2014. These derivatives are being traded in all corners of the globe but most of them are governed by standard form contracts issued by the ISDA ("International Swaps and Derivatives Association").

12. What this means is that national courts in many jurisdictions could be dealing with cases involving the same contractual terms. Decisions made on these international standard form contracts can have huge international ramifications with a single "wrong" decision having ripple effects in the global economy.

13. This phenomenon – the transnational convergence of commercial laws – was addressed by the Chief Justice in his speech at the opening of the legal year. In his speech, the Chief Justice announced the creation of a committee under the auspices of the Singapore Academy of Law which will look into promoting the development of a settled body of commercial law in Asia. To some extent, Singapore has already initiated this process through the establishment of the Singapore International Commercial Court where cases will be heard by specialist commercial judges comprising of the existing judges of the Singapore Supreme Court as well as ad hoc Associate Judges comprising eminent international jurists. For cases heard in the SICC, foreign law need not be pleaded as a matter of fact. The SICC can take judicial notice of foreign law directly with the assistance of submissions from parties, and apply it directly to determine the issues in dispute between the parties. This will, in time to come, allow for the two-way percolation of foreign legal concepts into our jurisprudence and vice versa.

14. From the perspective of financial regulation, this process of convergence can only be a good thing. Market participants presently have to navigate through a labyrinth of different regulations depending on the jurisdiction they function in. Complexity in regulations increase compliance costs which, in turn, drive profits down and discourage investment. Courts can contribute to the harmonisation of global regulations by considering the positions taken by other jurisdictions carefully in arriving at their own decisions.

The Deterrence of Malfeasance through Sentencing

15. My final theme concerns the deterrence of malfeasance through sentencing in the administration of criminal justice.

16. Most jurisdictions have laws which provide for the imposition of custodial sentence for corporate crimes. However, it is only occasionally that we find the perpetrators of commercial crime incarcerated. The more common forms of penalty involve the payment of fines and, in the case of the United States, the entry of Deferred Prosecution Agreements ("**DPAs**") which impose fines and other conditions in lieu of prosecution. One example is the LIBOR fixing scandal. In its wake, Barclays paid US$200 million to the United States Commodity Futures Trading Commission ("**CFTC**"), US$160 million to the United State Department of Justice, and £59.5 million to the United Kingdom Financial Services Authority ("**FSA**") to avert criminal prosecution.

17. One must question whether the imposition of a fine is a sufficient deterrent. The sentencing policy of the courts has to reflect the wider public interest involved in the criminalisation of dishonest or fraudulent conduct in our financial markets. Without a suitable sentencing policy, the effectiveness of our criminal laws in deterring criminal conduct would be greatly attenuated. In *Public Prosecutor v Wang Ziyi Able* [2008] 2 SLR(R) 1082, the offender was charged under s 199(b)(i) of the SFA for two internet posts in which he asserted

that the offices of a particular company had been raised by the Commercial Affairs Division. In upholding the sentence of 6 months' imprisonment and rejecting the offender's appeal for a fine, Justice Rajah (now the Attorney-General) observed,

> "[28] Trading in the securities market carries an inherent element of risk, and a shrewd calculation of the potential pecuniary gains from disseminating false information weighed against the possibility of being fined *up to $250,000* could too often lead to the conclusion that this sort of crime does pay. **To impose a mere fine as punishment for an offence of reckless dissemination of false information would thus in effect relegate the threat of criminal sanction to just another pecuniary liability to be casually written off** by the offender.
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> …
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> [29] **Sentencing judges should painstakingly seek to ensure that the punishment adequately addresses the harm caused** by the offence in these circumstances."

18. In *Public Prosecutor v Law Aik Meng* [2007] 2 SLR(R) 814, the court observed that "[t]he public interest vested in a secure and reliable financial system that facilitates convenient commercial transactions is extraordinary, especially in light of Singapore's reputation as an internationally respected financial, commercial and investment hub." The courts thus take an uncompromising stance in meting out appropriate custodial sentences to offences in this category. It is after all the duty of the courts to consider the degree to which the offending conduct has adversely affected public interest.

19. With that being said, however, it is clear that the courts have a duty to hand down a sentence that is *fair*, considering all the circumstances of the case. Courts have to avoid "gratuitous loading" in sentences. There is a delicate

balance that has to be struck here and it means that the courts – assisted by appropriate submissions from the Public Prosecutor and the Defence Bar – must carefully consider the facts and circumstances of each case before arriving at an appropriate sentence.

Conclusion

20. In conclusion, the financial markets are integral to the health of Singapore's economy and the courts have a vital role to play in ensuring that Singapore retains its eminence as a trusted centre for financial services. Looking around the room, I see people who represent the finance industry, the legal fraternity, and the financial regulators. Judging by the turnout, it is clear that this subject is one which has generated great interest and rightly so, given its importance.

21. I wish the conference every success.

Steven Chong
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Supreme Court
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