Kenanga Investors

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Putting a stop to front-running.

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By: *Cheah Chor Sooi*

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direct market access technology. Imagine how a milisecond advantage in the queue order can allow investors with privileged information to reap handsome profits from their trading activities. In essence, such discreet practice is often associated with dealer representatives handling accounts of several big institutions/ retail clients.

Front-running made headlines recently when it was rumoured that the drastic slide in four iliquid stocks – United U-Li Corp Bhd, SAM Engineering & Equipment (M) Bhd, SLP Resources Bhd and SCGM Bhd – in mid-August could be linked to the change of personnel at RHB Asset Management Sdn Bhd.

However, the speculation was put to rest by Datuk Khairussaleh Ramli, the group managing director of RHB Banking Group, who denied that the group's asset arm was involved in any selldown of those counters.

Coincidentally, Singapore's financial regulator charged three bankers on Aug 26 with front-running stocks in trading incidents dating back to before the financial

crisis of 2008 – 2009. This marks the first criminally-pursued case of its sort in the city-state.

Leong Chee Wai and Toh Chew Leong – both dealers with First State Investments Singapore – and Simon E Seck Peng, a dealer's representative at UOB Kay Hian, were charged with front-running or trading on information not yet available to the bank's clients.

The Monetary Authority of Singapore has accused the trio of having traded based on information they were privy to 49 Singapore-listed securities, including Allgreen Properties, CapitaLand, City Developments, DBS Group and Keppel Corp, as well as 51 listed in Australia, Taiwan, Malaysia and Hong Kong.

Stringent guidelines

A check with Kenanga Investors Bhd (KIB) reveals that investment decisions made by the company's investment team are guided by stringent guidelines comprising both regulatory and internal policies.

"Besides fulfilling the limits and restrictions under the guidelines which apply only on a per fund basis, we also have additional prudential internal limits and restrictions on a group-of-funds basis or firm-wide basis," KIB's CEO/executive director Ismitz Matthew De Alwis tells ***FocusM***. We are fully guided by our investment policy, processes and risk management."

On the fund level, De Alwis says informaiton could be obtained through the respective prospectuses which generally prescribe the percentage of maximum holding versus the net asset value of the fund. Moreover, there are also internal benchmarks imposed on a firm-wide level.

"To provide an insight into all stocks purchased by the fund managers must be within our investment universe and are segregated into Core One, Two and Three," he rationalises. "The maximum holding for each stock allowed for each portfolio is 5%, 3% and 2% respectively of the company's total share base." Additionally, the stocks must be supported with research reports, in-depth analysis and with strong fundamentals.

For an employee's personal trading account, De Alwis says KIB adheres to strict monitoring oversight. The company's compliance unit conducts a yearly review on each staff and fund

manager's trading activities directly with Bursa Malaysia against their declaration and their nominees' holdings.

"This is to ensure that not only our investment team's activities are monitored but also that of all the firm's employees," justifies De Alwis. "Furthermore, this is to ensure there is no conflict with our clients' best interests."

The next – and final – "line of defence" is the company's investment risk analytics units. This independent unit (residing out of the investment division) also monitors investments made by its fund managers per portfolio to assess the risks taken by those fund managers.

Punitive action

Given that it is diffuclt to nail unscrupulous fund managers who are involved in front-running, enforcement agencies should endeavour to prosecute cases as soon as there is sufficient evidence to act on them, according to the Minority Shareholder Watchdog Group CEO Rita Benoy Bushon.

"Swift action by the enforcement agencies would promote and instill investors' confidence in the capital market while sending a clear message that nobody can escape the long arm of the law if they have comitted offences," she tells ***FocusM***. "This would thus act as a deterrent to both insiders and other market players."

If gone unchecked, Bushon expresses concern that front-running would undermine both investors' confidence and efforts to maintain fair play and orderly market. "It would affect, not only the interest of the minority/retail investors, but all stakeholders in the capital market as well," she asserts.

Insider trading is an offence under Section 188(2) of the Capital Markets and Services Act 2007, punishable under Section 188(4) with imprisonment term not exceeding 10 years and a fine of not less than RM1 mil.

Onus on market regulators

Under the Singapore Securities and Futures Act, insider trading carries a fine not exceeding S$250,000 (RM757, 899) or imprisonment for a term not exceeding seven years or both. "In our

opinion, the punishment accorded under the Malaysian law for offenders is considered punitive," asserts Bushon. "However, the process of the law to ensure the culprits are taken to task is long.. The longer the regulators take to prosecute these offenders would indirectly impact on the success rate which is dependent on the availability of evidence and witnesses who are willing to testify in such cases."

Malaysian Investors' Association president Datin Ho Choy Meng reckons that it does not entail a delicate task to detect front-running. At the simplest level, Bursa Malaysia should be able to detect such nefarious activities manifested through the numerous instances of unusual market activity query issuance, according to her.

"For front-running, the offenders make use of their knowledge of client orders and intersperse them with their own trade to profit," Ho tells ***FocusM***. "There will be a trail of sequences of trades linking the two or more related trade accounts."

For preventive measures, Bursa Malaysia should put in place supervisory rules whereby trading participants are required to maintain a proper system to supervise the activities of each registered representative, agents and other personnel. This is reasonably designed to achieve compliance with the Rule of the Capital Markets & Services Act.

"Indeed, the regulatory authorities have already put in place some – though not an exhaustive list – of well-established rules and regulations, specifically to deal with market misconduct," Ho points out. "But the enforcers must be vigilant at all times, ready to haul the suspects up and prosecute them based on the evidence gathered without fear or favour."

On this note, Ho suggests:

- Emulate measures by the US Securities Exchange Commission and Department of Justice whereby brokerage firms and investment advisers are required under Section 15(f) of the Exchange Act and Section 204A of the Investment Advisers Act to establish, maintain and enforce written policies to prevent the misuse of material non-public information by the firms or their associated persons;

- Education and training to better understand the responsibilities and obligations in order to avoid violating securities laws;

- Keep sensitive information on a need-to-know basis in order to minimise the risk of information abuse and limiting possible suspects;
- Secure sensitive information;
- Establish and maintain "quiet periods" and pre-clearance process; and
- Monitor company share re-purchase programmes to secure compliance.

Bursa shows it means business

IF Aug 26 marks the maiden legal pursuit of front-running case by the Monetary Authority of Singapore, such unethical business conduct has been detected much earlier in Malaysia.

On June 5, 2014, Bursa Malaysia Securities Bhd publicly reprimanded, fined and ordered to strike off two former dealer's representatives (DRs) for conduct that involved front-running activities, pre-arranged/coordinated trades, abuses of clients' trade information and the undertaking of unauthorized trades in a client's account.

Sazail Shaharudin, a salaried DR of AmInvestment Bank Bhd was publicly reprimanded, fined RM50,000 and ordered to be struck off the register of Bursa Malaysia Securities.

Wong Lup Mun @ Wong Cheng Hoh, a commissioned DR of Kenanga Investment Bank Bhd, was fined RM55,000 aside from being publicly reprimanded and ordered to be struck off the register of Bursa Malaysia Securities.

The Securities Commission (SC) in its Guidelines on Market Conduct and Business Practices for Stockbroking Companies and Licensed Representatives (revised on Nov 20, 2014) has listed front-running as one of the 13 examples of market abuses and unethical business conduct.

The regulator describes front-running as follows: "Dealer's representatives handling accounts of several big institutions/retail customers executed trades for their individual customers or accounts of related persons prior to the execution of trades of the big institutions/retail customers with the view to front-run and make quick profits."

Other forms of market abuses and unethical business conduct identified by the SC are (i) action-based manipulation; (ii) trade-based manipulation; (iii) "painting the tape"; (iv) unethical trades; (v) "roll-over"; (vi) third party payment; (vii) "marking the close"; (viii) conflicts (a person with knowledge of a favourable or unfavourable research report purchases or sells securities in advance of the report being released); (ix) "scalping"; (x) "spoofing"; (xi) "pump and dump", and (xii) "trash and cash".

Article Source: *Focus Malaysia* (October 1 to October 7, 2016)

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With high frequency trades and direct market access, it's difficult for regulators to trace if an offence was committed

By Cheah Chor Yeet

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