Regulatory Investigations - Do's & Don'ts

Jill Wong

2017 Awards
Client Choice : International Law Office & Lexology
Who's Who Legal: Banking
Legal 500
IFLR 1000
First Steps
Do - Consider All Angles
Do - Understand the regulator

Industry?

IA

HKMA

SFC

HKEx

HKCC

Police

PCO

Overseas?
Do - Understand your obligations

- Review the inquiry received
  - Verbal/email/writing
  - Voluntary/mandatory/unclear
- Voluntary/unclear
  - Pros and cons of co-operation
  - Clarify
- Mandatory
  - Scope of notice – subject matter/time period/parties/relevance
  - Deadline
  - Jurisdictional issues
  - Documents or interview
  - Reasons not to disclose – legal privilege/documents not in possession, custody or control
  - Secrecy/confidentiality obligations
- Competition regulator
  - Are you too late for the leniency program
### Do - Understand the powers

<table>
<thead>
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<th>SFC</th>
<th>Powers</th>
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<tr>
<td>s 179 SFO</td>
<td>Investigation of listed companies</td>
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<tr>
<td>s 180 SFO</td>
<td>Authorized person (incl. HKMA) can inspect/make inquiries</td>
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<td>s 181 SFO</td>
<td>Authorized person can ask for information relating to transactions</td>
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<td>s 182 SFO</td>
<td>SFC can direct employee / any person to investigate a matter</td>
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<td>s 183 SFO</td>
<td>SFC can compel a person to produce documents or attend interview</td>
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<table>
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<th>HKMA</th>
<th>Powers</th>
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<tr>
<td>s 55/56 BO</td>
<td>Examine and access to books &amp; records</td>
</tr>
<tr>
<td>s 72A BO</td>
<td>RIs, CEs, directors &amp; controllers to submit information</td>
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<tr>
<td>s 117/118 BO</td>
<td>HKMA asks FS to appoint investigator/powers of investigator</td>
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<table>
<thead>
<tr>
<th>HKEX</th>
<th>Powers</th>
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<td>s 21 SFO</td>
<td>HKEX has duty to ensure an orderly, informed and fair market</td>
</tr>
<tr>
<td>Listing Rules</td>
<td>HKEX investigates, refers to Listing Committee, LC - range of sanctions</td>
</tr>
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</table>
Do – understand AMLO

Anti-Money Laundering & Counter-Terrorist Financing (Financial Institutions) Ordinance

- Knowing contravention of specified AMLO provision
  2 years imprisonment / Fine HK$1mn

- Contravention of specified AMLO provision with intent to defraud
  7 years imprisonment / Fine HK$1mn

- Employee or Management knowingly causing or permitting FI to contravene specified AMLO provision
  2 years imprisonment / Fine HK$1mn

- Employee or Management causing or permitting FI to contravene specified AMLO provision with intent to defraud
  7 years imprisonment / Fine HK$1mn

HKMA, SFC, IA, C&E
Assessment
– do it quickly
Do – gather information

- Small and focused team
- Identify location/sources of information
- Document security/retention, especially electronic evidence
- Moving data between jurisdictions
- Interviewing staff
- Use of experts – IT forensics, investigators, etc.
Do - interview staff

- When?
- Preparation is important
- In-house team or external counsel?
- Tone: are you friend or foe?
- Record-keeping: notes, verbatim, tape?
- Language
- Sequence of interviews
Do – understand legal privilege


- The plaintiffs (the liquidators and creditors of the BCCI bank) brought an action against the defendant Bank of England (the Bank) for misfeasance in public office in respect of its supervision of BCCI before its collapse.

- Legal advice privilege only applied to communications between a client and his lawyer. Here the 3 employees who had been appointed to deal specifically with the Bingham Inquiry constituted the "client" and other employees fell outside the ambit of being the client.
The RBS Rights Issue Litigation [2016] EWHC 3161 (Ch): interview notes with employees are not legally privileged & disclosable to third parties in litigation.
Legal privilege: Citic Pacific

- Hong Kong: wider approach in *Citic Pacific Ltd v Secretary for Justice (2011) MP No 767 of 2010*.

- FACTS:
  - The client was a large HK company whose activities were under investigation by the SFC.
  - Documents were handed over to SFC, subsequently discovered some of them were legally privileged. Police sought access to these documents. Company wanted to restrict access.
HELD (Court of Appeal):

• The law of Hong Kong incorporates the concept of a partial waiver of privilege. When Citic surrendered the documents to the SFC, it had done so on the basis that it waived privilege only for the limited purpose of the SFC's investigation.

• "Client" not narrowly defined. Here, the client was Citic Pacific, the corporation. Documents prepared by employees are privileged if the purpose is to obtain legal advice.
Legal privilege: accountants' tax advice

*R (on the application of Prudential plc and another) v Special Commissioner of Income Tax and another [2013] (UK)*

- Claimant company obtained legal advice from a firm of accountants on the tax law aspects of a proposed transaction
- An inspector of taxes served a notice on the company requiring it to discover to the inspector documents containing information relevant to the company’s tax liability, including materials of communications passing between the company and its accountants
- The company claimed legal advice privilege

**HELD**

Legal advice privilege only applied in relation to advice given by members of the legal profession and did not extend to the members of other professions who gave advice on points of law, even where that advice was legal advice which the professional person was qualified to give.

It is up to the parliament to provide for such an extension of privilege, not the court.
Don't

- **Waive Privilege**
- **Forget about the use of "common interest" privilege**

Common interest?
Under investigation – what next?
Privilege against self-incrimination

Do you have the right to "claim"?

Generally this right is abrogated in a regulatory investigation

You need to provide the documents or information

However, if you make a "claim", your answer cannot be directly used against you (save for perjury)

BE PREPARED!
Troubled Waters

SFC v Ernst & Young

s 183: not extra-territorial, SFC has no power to compel persons outside Hong Kong
Do's and Don'ts

- Refuse to answer questions
- Refuse to provide documents not in HK
- Refuse to attend interview

- Claim privilege against self-incrimination
- Provide documents not in HK
- Agree to attend interview

It Depends!
Do - Understand the sanctions

- SFO
- Fine
- Reprimand
- Licence
- Referral

NEW!

s 300
S 213
BO s 52
Section 213

Where a person has contravened any provisions of the SFO or it appears to the Commission that such matter has occurred, is occurring or may occur, the Court of First Instance at the application of the SFC may make certain orders –

• restraining or prohibiting the misconduct
• restraining or prohibiting a person from dealing in property, or appointing an administrator to a person's property
• requiring steps to restore parties to the position they were in
• directing a person to do or refrain from doing an act
• declaring a contract to be void or voidable
• requiring payment of damages

And...any ancillary order the court considers necessary
Hontex

- Discrepancies in financial information
- SFC applied for court order under section 213
- H acknowledged it was "reckless in allowing materially false and misleading information to be included in its prospectus"
- On this basis, the SFC obtained an order requiring H to repurchase shares – repurchase completed October 2012
- No determination of a contravention under sections 298, 300 or 384 SFO

SFC

- Assets (just under HK$1bn) frozen under s.213 application
- s298: provision of false or misleading information inducing investors to purchase shares in its IPO
- s300: a fraudulent and deceptive scheme
- s384: false or misleading information to HKEx/SFC
- s342F CO: Untrue statements in prospectus
- Sponsor investigated and fined HK$42mn; licence revoked
Tiger Asia

• Short selling by TA, a New York hedge fund, of HK listed shares based on inside information; SFC applied for court orders (injunctions, etc.)
• No MMT or court proceedings commenced

Landmark Decision:
In May 2013, Court of Final Appeal confirmed section 213 is a free standing remedy, meant to augment the SFC's ability to protect the investing public.

Section 213 may be used without the need for proceedings before the Market Misconduct Tribunal or relevant criminal court
Legislation intended remedial and preventative orders to be available separately from criminal or deterrent sanctions
## Compensation: Du Jun

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>February – April 2007</td>
<td>Insider dealing</td>
</tr>
<tr>
<td>July 2007</td>
<td>SFC obtains injunction to freeze assets</td>
</tr>
<tr>
<td>June 2008</td>
<td>Arrested and charged with insider dealing</td>
</tr>
<tr>
<td>September 2009</td>
<td>Convicted and jailed for 7 years. Appealed</td>
</tr>
<tr>
<td>September 2012</td>
<td>Court of Appeal upholds conviction, jail term reduced to 6 years. (Appeal to CFA was withdrawn in January 2013)</td>
</tr>
<tr>
<td>March 2013</td>
<td>Banned for life by SFC</td>
</tr>
<tr>
<td>December 2013</td>
<td>Court orders payment of $23.9 million to investors</td>
</tr>
<tr>
<td>August 2015</td>
<td>Completed distributions (including to overseas investors)</td>
</tr>
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Section 300

Offence involving fraudulent or deceptive devices, etc. in transactions in securities, futures contracts or leveraged foreign exchange trading

(1) A person shall not, directly or indirectly, in a transaction involving securities, futures contracts or leveraged foreign exchange trading-

(a) employ any device, scheme or artifice with intent to defraud or deceive; or

(b) engage in any act, practice or course of business which is fraudulent or deceptive, or would operate as a fraud or deception.

(2) A person who contravenes subsection (1) commits an offence.

(3) In this section, a reference to a transaction includes an offer and an invitation (however expressed).
(Almost) new: section 300
Use of fraudulent or deceptive schemes in transactions involving securities

- Boyfriend
  - Told
  - Boyfriend's sisters
  - Knew About
    - Tender offer for Hsinchu Bank (Taiwan Listco)
  - Fraud/deception under section 300

- Girlfriend
  - Told
  - His sisters
  - Knew About
    - Privatise Asia Satellite (Hong Kong Listco)
  - Insider dealing

- Boyfriend's sisters
  - Told
  - Boyfriend

- His sisters
  - Told
  - Girlfriend
Do – consider all the consequences
Do – prepare for disclosure

Sharing between Hong Kong regulators

Bank 1 → Information → HKMA → PCO → Investigation
Bank 2 → Information
Bank 3 → Information
Bank 4 → Information
Bank 5 → Information
Bank 6 → Information
Disclosure (more)

AA &EA Securities v SFC –
Disclosure of information from SFC to Japanese regulators challenged

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
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<tr>
<td>181 SFO</td>
<td>Power to compel disclosure of information</td>
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<td>186 SFO</td>
<td>Power to assist overseas regulator</td>
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<tr>
<td>378 SFO</td>
<td>Secrecy provisions</td>
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</table>

- Disclosure of materials made without adequate protection to preserve confidentiality & prevent use in criminal proceedings
- Disclosure made without ensuring confidentiality
- s.181 compels potentially self-incriminating information without any protection against use in criminal proceedings

s.181 offends privilege against self incrimination & HK Bill of Rights
Do – prepare for announcement

- Timely
- Not false or misleading
- Internal procedures for approval / issuance
## Part 14A SFO: Disclosure of Price Sensitive Information

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<tr>
<th>Date</th>
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<tr>
<td>20 December 2012</td>
<td>First Media filed &quot;Petition for Suspension of Obligation for Payment of Debts&quot; against AcrossAsia, on the basis that AcrossAsia could not continue paying its debts</td>
</tr>
<tr>
<td>26 December 2012</td>
<td>Petition registered with the Indonesian courts</td>
</tr>
<tr>
<td>28 December 2012</td>
<td>Summons issued by Indonesian courts requiring AcrossAsia to appear in court on 4 January 2013</td>
</tr>
<tr>
<td>2 January 2013</td>
<td>AcrossAsia receives petition and summons in Indonesian Bahasa</td>
</tr>
<tr>
<td>4 January 2013</td>
<td>AcrossAsia receives English translation of petition and summons</td>
</tr>
<tr>
<td>8 - 15 January 2013</td>
<td>Hearing in Jakarta</td>
</tr>
<tr>
<td>15 January 2013</td>
<td>Indonesian courts grant orders sought by the petition</td>
</tr>
<tr>
<td>17 January 2013</td>
<td>AcrossAsia issues announcement on Hong Kong Exchange</td>
</tr>
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</table>
Do – consider remedial action

• Co-operation
• Compensation
  • Can this be done on a “without prejudice” basis
• Improve internal controls
  • Written policies (updated as needed)
  • Demonstrate effectiveness
  • Automated controls (but not a “checklist” mentality)
  • More experienced staff
• Encourage ethical conduct
  • Escalation/whistle-blowing procedures
  • Disciplinary action re employees
  • Training
• External Advisors
• Senior management involvement
• Change dealing with counterparties – eg terminate relationship?
Do – observe Section 378

Secrecy obligation: a “specified person” must –

• not disclose any matter coming to his knowledge
  – in the course of assisting [the SFC]
• not communicate any such matter to any other person
• not suffer or permit any person to have access to any
  – record of information, however compiled or stored; or
  – any document, which is in his possession

Who is caught
- Person under investigation
- Witness
- Anyone “assisting” SFC

Any exceptions
- Professional Advisors
- Already public
- Court order
- SFC Consent
- Otherwise, limited

Other comments
- See SFC "blanket" consent
- Or, seek SFC consent (insurers, auditors)
- Wider than section 120 BO
- Need-to-know basis
Do – deal with employees

No Action
- Warning
- Training
- Enhanced Management Oversight

Suspension

Summary Dismissal

Termination Of Contract
- Employment Ordinance
- Continued Co-operation

Loss of Bonus / Deferred compensation
Do – know about HKCC Leniency Regime and whistleblowing

WHAT IS IT?

• Immunity and/or reduction in penalties in exchange for whistle-blowing and provision of information

WHY HAVE IT?

• To discover and break up cartels by incentivising whistle blowers

BASIC STRUCTURE

• Full immunity to first whistle blower prior to start of investigation. Others may obtain reduction in penalties
The best "Do" for a regulatory investigation...
Avoid It!

- Competition law
- Fraud/misfeasance
- AML/CTF
- Listed Companies, Directors & advisors
- New initiatives: suitability, MiC
- E-money, bitcoin
- Insurance

Regulatory Scrutiny
Questions? Call us

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- Jill specialises in financial services and corporate regulatory and compliance issues. Uniquely, Jill handles both contentious and non-contentious matters.
- She was previously Deputy General Counsel at the Hong Kong Monetary Authority and was in-house counsel as Head of the Asia-Pacific Regulatory Advisory Group, Legal and Compliance at Credit Suisse. In addition, Jill has also worked in leading international law firms in Hong Kong.
- Jill is an author of "Securities & Futures Ordinance, Commentary and Annotations" published by Sweet & Maxwell. This is now in its 2nd edition.
- She sits on the HKICPA Disciplinary Committee and is Vice Chair of the Financial Markets Group, BritCham

She shows "exceptional understanding of Hong Kong's regulatory environment, and her relationships with many of the regulatory bodies allow her to provide us with excellent guidance"