



Regulatory Enforcement Trends in Hong Kong

The Securities and Futures Commission (SFC) enjoyed a strong 2018 on the enforcement penalties front, living up to its promise to focus its resources on fewer, but bigger, “high impact” cases. It further strengthened its links with Mainland regulators, particularly the China Securities Regulatory Commission (CSRC), and secured various victories in its focus areas of insider dealing, market manipulation and sponsor misconduct. The SFC and the Hong Kong Monetary Authority (HKMA) both continued their efforts to clamp down on money laundering and encourage the implementation of good anti-money laundering controls. We also saw developments in the financial technology (*Fintech*) and regulatory technology (*Regtech*) space, as Hong Kong and international regulators focused attention on complex products such as cryptocurrencies and initial coin offerings (ICOs), and sought to make more use of technology to improve their own regulatory enforcement capabilities.

Less is more?

To ensure compliance with applicable rules, enforcement action is usually a weapon of last resort, because it is resource-intensive and takes time, largely because of the need for due process. The SFC has described it as a “blunt regulatory tool”¹. So in recent years, instead of covering a broad range of matters with broadly similar degrees of intensity through an increasing number of investigations and enforcement outcomes year-on-year, the SFC has focused its efforts and resources on fewer, but more “high impact”, cases².

More recently, the SFC’s Enforcement Division has been working proactively and collaboratively with its Intermediaries and Corporate Finance teams to try to prevent problems from occurring. In a number of cases, this preventative approach appears to have been successful in avoiding the need for urgent enforcement action to be taken³.

The effects of that approach can be seen in the SFC’s enforcement statistics below.

¹ See the SFC’s Executive Director of Enforcement, Mr Thomas Atkinson (*Thomas Atkinson*)’s speech on 9 November 2016.

² See, for example, Thomas Atkinson’s speech on 10 October 2018, available at https://www.sfc.hk/web/EN/files/ER/Speech%20-%20TA%20at%202018%20Refinitiv_final.pdf, at pages 1 and 2; the SFC’s Annual Report 2017-18, available at https://www.sfc.hk/web/files/ER/Annual%20Report/2017-18/Eng/SFC_Annual_Report_2017-18_Eng_Full.pdf, at page 7; and our March 2018 article titled “Record fines but fewer cases: SFC enforcement in 2017”, available at http://news.freshfields.com/zh/China/r/5214/record_fines_but_fewer_cases__sfc_enforcement_in_2017.

³ [https://www.sfc.hk/web/EN/files/ER/PDF/SFC%20Regulatory%20Bulletin/SFC%20Regulatory%20Bulletin_Listed%20Corporations%20\(Feb%202019\)Eng.pdf](https://www.sfc.hk/web/EN/files/ER/PDF/SFC%20Regulatory%20Bulletin/SFC%20Regulatory%20Bulletin_Listed%20Corporations%20(Feb%202019)Eng.pdf)

Georgia Dawson

Partner

T +65 6908 0789 / +852 2846 3492
E georgia.dawson@freshfields.com

Tim Mak

Partner

T +852 2913 2668
E tim.mak@freshfields.com

Royce Miller

Partner & Head of Financial Services practice

T +852 2846 3498
E royce.miller@freshfields.com

Jonathan Wong

Counsel

T +852 2913 2683
E jonathan.wong@freshfields.com

The comparative statistics⁴

	Nine months ended 31.12.2018	2017/18	2016/17	2015/16	2014/15	2013/14	2012/13
S179 inquiries commenced	19	24	27	24	21	23	16
S181 inquiries commenced (number of letters sent)	225 (6,734)	261 (8,461)	301 (8,960)	286 (7,997)	293 (9,752)	220 (5,711)	176 (5,130)
Investigations started	180	280	414	515	553	352	300
Investigations completed	191	254	591	436	362	319	306
Individuals/corporations charged in criminal proceedings	4	14	10	20	15	35	33
Criminal charges laid	37	54	46	107	71	226	116
Notices of Proposed Disciplinary Action issued	13	29	49	35	36	55	43
Notices of Decisions issued	27	32	56	42	46	51	36
Individuals/corporations subject to ongoing ⁵ civil proceedings	Annual figure not yet available	97	126	100	93	69	59
Compliance advice letters issued	182	277	548	453	302	337	330
Cases with search warrants executed	24	22	34	31	53	59	40

The statistical trends

Since 2015/2016⁶:

- the number of section 179 and 181 inquiries (and section 181 letters sent) has remained relatively stable;
- the number of investigations started has fallen year-on-year;
- in 2016/17, 177 more investigations were concluded than were started. In contrast, in each of the three periods between 2013/14, 2014/15 and 2015/16, the number of investigations started outnumbered the number of investigations concluded. This suggests a rationalisation of the SFC Enforcement Division's portfolio of cases in 2016/17;
- in 2017/18 and 2018 (for the nine months ended 31 December 2018), the number of investigations started was broadly similar to the number concluded;

⁴ These statistics have been extracted from the SFC's annual and quarterly reports.

⁵ The SFC notes that "Ongoing enforcement proceedings may be accounted for and continue for more than one quarter. As a result, annual figures for these items are not the sums of figures of individual quarters but that of the number of persons subject to concluded proceedings during the year and the number of persons subject to ongoing proceedings at year-end" (<https://www.sfc.hk/web/EN/regulatory-functions/enforcement/enforcement-statistics/people-subject-to-ongoing-or-concluded-enforcement-proceedings.html>). Accordingly, we have not included figures for the nine months ended 31 December 2018, as the SFC has not yet released its full annual figures for 2018/19.

⁶ The last full year before Thomas Atkinson joined the SFC in May 2016.

- the number of criminal charges laid has fallen significantly;
- the number of disciplinary actions taken has fallen;
- there has been a noticeable fall in the number of search warrants executed; and
- in 2015/16 and 2016/17, there was significantly greater use of “compliance advice letters”, rather than enforcement action, to resolve regulatory concerns. This is consistent with the rationalisation of the Enforcement Division’s portfolio described above. Since then, the number of such letters issued each year has fallen.

Yearly aggregate enforcement fines: a comparison⁷

The SFC’s focus on bigger cases and a “less is more” approach is reflected in the SFC’s fines. The total amount of fines that the SFC imposed in 2017 and 2018 (approximately HK\$691 million) is more than three times the total amount of fines that it imposed in 2014, 2015 and 2016 together (approximately HK\$201 million).

Even disregarding the record fine in 2017 on a private bank of HK\$400 million for failures relating to the sale of derivative products, aggregate fines have increased steadily in the past five years (from around HK\$60-70 million in 2014, 2015 and 2016, to almost HK\$195million in 2018). A similar, upward trend can be observed in the average amount of each fine.

Year	No. of enforcement actions against individuals	No. of enforcement actions against firms/corporations	Total fines	Average amount of fines across individuals, firms and corporations
2018	57	38	HKD194,201,000	HKD6,696,586
2017	73	24	HKD497,081,071	HKD10,144,512
2016	85	25	HKD67,938,830	HKD2,717,553
2015	55	33	HKD70,929,500	HKD4,728,633
2014	107	21	HKD62,800,000	HKD4,038,000

The key areas of focus

In February 2018, the SFC indicated that corporate fraud, insider dealing and market manipulation, intermediary misconduct, sponsor misconduct and money laundering remain priority areas for enforcement⁸.

Corporate fraud

In February 2018, the SFC obtained orders from the Hong Kong Court of First Instance in proceedings against Qunxing Paper Holdings Company Limited (*Qunxing*), its former directors and its subsidiary, to compensate investors who subscribed for Qunxing shares in its 2007 initial public offering or bought them in the secondary market between 2007 and 2011. The Court found that the defendants had disclosed false or misleading information in Qunxing’s 2007 prospectus and in its results announcements for the financial years ended on 31 December 2007 to 31 December 2011, by materially overstating turnover and understating bank borrowings.

Insider dealing

The SFC saw two victories in the Court of Final Appeal (CFA) in October 2018.

The CFA allowed the SFC’s appeal against the Market Misconduct Tribunal’s (*MMT*) determination that two former executives of Asia Telemmedia Limited had not engaged in insider dealing⁹. In doing so, the CFA clarified an important point of law about the scope of section 271(3) of the Securities and Futures Ordinance (Cap. 571) (*SFO*) (the “innocent purpose defence”).

⁷ This section has been prepared using data extracted from enforcement news published on the SFC’s website.

⁸ See Thomas Atkinson’s speeches on 9 November 2016 and 11 October 2017 and the SFC’s Enforcement Reporter of 26 February 2018.

⁹ *Securities and Futures Commission v Yiu Hoi Ying, Wong Nam Marian and Market Misconduct Tribunal* [2018] HKCFA 44 (<http://www.hklii.hk/eng/hk/cases/hkcfa/2018/44.html>).

Later that month, the CFA unanimously upheld the decisions of the Court of First Instance and the Court of Appeal in the SFC's favour in a case brought by the SFC under section 300 of the SFO against an individual and two of his sisters for, in effect, insider trading in the shares of Hsin Chu International Bank Company Limited (*Hsin Chu*), a Taiwan-listed stock. The CFA confirmed, amongst other things, that fraudulent or deceptive conduct involving non-Hong Kong listed securities, such as shares in Hsin Chu, can be properly dealt with under section 300 of the SFO, in circumstances where "substantial activities constituting the [fraud or deception]" occurred within Hong Kong.

Market manipulation

In August 2018, the MMT found the former CEO of China AU Group Holdings Limited (*China AU*) and her related persons had engaged in false trading in China AU shares. The conduct in question appears to have involved the former CEO, with the assistance of two others, using various securities trading accounts to buy and sell a substantial amount of shares in China AU, thereby creating a false or misleading appearance of active trading in China AU shares and in their price.

Sponsor misconduct

In May 2018, the SFC reprimanded and fined a global investment bank HK\$57 million, to resolve concerns over its work as sole sponsor for a 2009 listing¹⁰. The SFC found what it regarded to be deficiencies in customer due diligence, and in supervision of the deal team.

In July 2018, the SFC reprimanded and fined a Chinese investment bank HK\$24 million over concerns about its work as sole sponsor in a listing application during 2013 and 2014. The SFC found that the sponsor failed to conduct reasonable due diligence before submitting the listing application, including with respect to the listing applicant's customers, and to keep a proper audit trail of work performed.

Other sponsor cases

In a published speech on 10 October 2018, Thomas Atkinson indicated that the SFC had, by that time:

- investigated 30 cases of suspected sponsor misconduct involving 28 sponsor firms (up from 15 sponsor firms in February 2018)¹¹ and 39 listing applications¹²; and
- issued Notices of Proposed Disciplinary Action to 9 firms (up from 8 in February 2018)¹³ and 4 sponsor principals¹⁴.

In light of that, further public actions can be expected in the next 12 to 24 months.

Anti-money laundering

In August 2018, the HKMA reprimanded and fined a local bank HK\$5 million for non-compliance with various provisions of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO). The HKMA found that the bank failed to continuously monitor customer relationships, including by examining the background and purpose of certain unusual transactions, and also failed to carry out customer due diligence with respect to transactions involving "pre-existing" customers under the AMLO.

In December 2018, the HKMA reprimanded and fined a global bank HK\$12.5 million for non-compliance with the AMLO. The HKMA found that the bank had not established and maintained effective procedures to: (i) obtain from customers certificates of incumbency and comparable documents, or verify the identities of beneficial owners, for the purposes of customer due diligence; (ii) continuously monitor business relationships; and (iii) identify and handle wire transfers which did not comply with the requirement to include the originator's name in the message or payment form accompanying the wire transfer.

In February 2019, the SFC also reprimanded and fined a Hong Kong brokerage for anti-money laundering failures in handling third party deposits, having found that over 100 of the brokerage's clients received third party deposits that were incommensurate with their financial profiles, and in certain cases, that the third party had no apparent relationship with the client. The SFC also found that some third party deposits were withdrawn by clients shortly after receipt, without being used for trading.

¹⁰ <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/openAppendix?refNo=18PR51&appendix=0>

¹¹ https://www.sfc.hk/web/EN/files/ER/Reports/Enforcement%20Reporter/Enforcement%20Reporter_Feb2018.pdf

¹² https://www.sfc.hk/web/EN/files/ER/Speech%20-%20TA%20at%202018%20Refinitiv_final.pdf

¹³ https://www.sfc.hk/web/EN/files/ER/Reports/Enforcement%20Reporter/Enforcement%20Reporter_Feb2018.pdf

¹⁴ https://www.sfc.hk/web/EN/files/ER/Speech%20-%20TA%20at%202018%20Refinitiv_final.pdf

Closer regulatory cooperation

Coordination with regulators in Mainland China

Last year saw further close enforcement cooperation between the SFC and Mainland regulators, particularly the CSRC and China Banking and Insurance Regulatory Commission (*CBIRC*).

On 8 June 2018, the SFC announced that it had entered into a Memorandum of Understanding with the CBIRC, to enhance supervisory cooperation and the exchange of information relating to cross-boundary regulated entities. Six months later, on 3 December 2018, the SFC announced that it had entered into a similar Memorandum of Understanding with the CSRC.

Technology

Cryptocurrencies and initial coin offerings (ICOs)

Like regulators in other major financial markets, for example the Financial Conduct Authority in the UK, the SFC has devoted significant resources¹⁵ to understanding and identifying if, and how, Fintech processes and products ought to be regulated.

In March 2018, the SFC took action to halt an ICO, secure the unwinding of the transaction and return to investors their investments in the ICO¹⁶. The SFC had concerns that the issuer of the ICO might have engaged in unauthorised promotional activities and unlicensed regulated activities, in circumstances where the ICO issuer had promoted the sale of digital tokens to Hong Kong investors through a website accessible by the Hong Kong public. The issuer had also stated that the ICO proceeds would be used to fund the development of a mobile application and holders of the tokens would be eligible to redeem equity shares in the issuer. It was considered that these arrangements might constitute a collective investment scheme and would have to be regulated accordingly.

In November 2018, the SFC issued a statement setting out a new approach aimed at bringing virtual asset portfolio managers and distributors of virtual asset funds under its regulatory remit, and providing a conceptual framework for the potential regulation of virtual asset trading platforms.

Regulatory technology

The SFC has emphasised its aim to harness the use of new technology (Regtech) to enhance traditional regulatory processes. The SFC has indicated, for example, that “with the assistance of technology, [the SFC has] been able to identify irregularities, control deficiencies and non-compliance which would otherwise go undetected”.

We understand that the SFC is looking to make greater use of data analysis / analytics for regulatory purposes, in particular new and innovative ways to better utilise the huge volumes of data it has at its disposal (including electronic evidence gathered in its investigations). Regulators in other jurisdictions are taking similar steps¹⁸, and it is essential for market participants to be similarly progressive in upskilling and in enhancing their own processes and approach with respect to technology.

On the horizon

We expect 2019 to deliver more of the same, in terms of focused action on “high impact” cases. With respect to:

- corporate fraud, in October 2018, the SFC indicated that it aimed to complete a set of high-priority investigations by the end of 2018 and to commence legal proceedings against approximately 60 companies and individuals by the first half of 2019;
- corporate and director conduct, we expect to see the outcome of a number of cases currently before the MMT relating to alleged late disclosure of inside information¹⁹;

¹⁵ See, for example, the Fintech regulatory “sandboxes” of both regulators.

¹⁶ <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=18PR29>

¹⁷ <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=18PR126>

¹⁸ See <https://www.fca.org.uk/firms/regtech> and <http://www.mondaq.com/unitedstates/x/681912/fin+tech/SEC+Commissioner+Encourages+Regtech+Innovation+And+Focus+On+Cybersecurity>.

¹⁹ See <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=18PR49> and <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=18PR131>.

- sponsor misconduct, we expect to see a number of the SFC’s sponsor actions reach a conclusion during the course of 2019;
- management responsibility, conduct and culture, we expect to see the first batch of SFC enforcement cases focused on “managers-in-charge”;
- internal controls, we expect to see continued focus on the effectiveness of internal controls (which looks beyond the existence of written policies and procedures) in managing risks, ensuring appropriate conduct and, ultimately, in preventing problems;
- anti-money laundering, we expect to see continued and further focus on the effectiveness of mechanisms which are designed to detect and prevent money laundering; and, finally,
- technology, we expect to see further developments in Regtech and the regulation of Fintech, and a more heightened focus on cybercrime / cyberfraud²⁰.

²⁰ The HKMA’s website indicates that, during the course of 2018 and on average, the HKMA warned members of the public at least 10 times per month about attempted targeted phishing attacks and suspected fraudulent websites and apps.

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