



HERBERT  
SMITH  
FREEHILLS



# RESPONDING TO CROSS-BORDER FINANCIAL SERVICES INVESTIGATIONS

THE LONG ARM  
OF REGULATION

**LEGAL GUIDE**

THIRD EDITION

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# THE LONG ARM OF REGULATION: RESPONDING TO CROSS-BORDER FINANCIAL SERVICES INVESTIGATIONS

Welcome to the third edition of "The long arm of regulation: responding to cross-border financial services investigations". Reflecting the increased breadth and depth of our global expertise, this edition includes new chapters covering Germany, Singapore and the US.

The growth of cross-border financial services and sustained pressure on regulators post financial crisis to deliver tangible results are driving regulators to increasingly seek assistance from their overseas counterparts in investigating issues, most notably in cases involving abuse of the markets. Firms, in turn, are increasingly subject to scrutiny by overseas regulators and may be investigated and ultimately sanctioned in multiple jurisdictions in respect of the same conduct. These trends seem set to continue: questions such as how and when regulators interact with each other and with firms across borders, how firms are expected or required to respond, and whether duplicate proceedings can be brought in different jurisdictions, are more pertinent than ever. This publication gives an overview of the answers across 14 key jurisdictions, and seeks to assist firms in navigating the differing regimes.

In compiling this publication, we have sought to highlight some of the interesting similarities, and divergences, which have emerged.

## Breadth of powers

In each of the jurisdictions surveyed in this guide, the regulators have sweeping powers to assist overseas regulators. This reflects the influence of the principles embodied in the IOSCO Memorandum of Understanding on consultation, cooperation and the exchange of information, and in EEA jurisdictions, of the Committee of European Securities Regulators Memorandum of Understanding on the exchange of information, and requirements to cooperate in a range of European legislation, most notably the Markets in Financial Instruments Directive (**MiFID**) and, from July 2016, the new Market Abuse Regulation (**MAR**).

Perhaps unsurprisingly, all the regulators surveyed in this guide (with the exception of the Hong Kong Monetary Authority) can, at the request of an overseas regulator, appoint an investigator to investigate an issue, obtain information/documents from firms/individuals, and compel attendance at interviews and answers to questions. Whilst a wide range of firms/individuals can be required to respond in this situation, in many jurisdictions (the UK, Australia, Hong Kong, France, Netherlands, Dubai\*, the US and Singapore), the powers may be exercised in respect of any person, whether or not involved in the financial services industry. In Dubai and the Netherlands, the regulators' powers to obtain information extend to anyone outside of the jurisdiction. Further, in half of the jurisdictions surveyed (ie Spain, UK, Switzerland, Russia, France, Germany and Singapore), regulators are ultimately able to change or cancel a firm's permission to carry out financial services activities following a request by an overseas regulator.

Where national regulators intend to share information with overseas regulators, the scope and opportunity for affected firms to object may be limited. This follows from the fact that in the 14 jurisdictions, regulators have a very wide discretion to comply with requests, and there is no general requirement (except in certain situations in Switzerland and Australia) for firms to be notified before any information is transmitted.

It is interesting to note that despite sweeping powers enabling national regulators to assist overseas regulators, none of the regulators included in this publication have to date been under a strict obligation to cooperate. That said, all indications are that regulators are eager to, and do, comply with requests. The position is however set to change when new European regulations (notably including MAR and MiFID II) come into application. These provisions will create an obligation for European regulators to cooperate, with each other and with the relevant European Supervisory Authority, where necessary for the purposes of the relevant regulation or directive (save in defined "exceptional" circumstances).

## Mechanisms exist for overseas regulators to obtain information directly from firms, but may not be enforceable

In eight of the jurisdictions surveyed (ie, UK, France, Netherlands, Spain, Hong Kong, Switzerland, Germany and Russia), there are mechanisms that enable an overseas regulator to request information directly from firms. It is particularly noteworthy that the number of direct requests from regulators in EEA Member States to overseas EEA firms has risen over recent years, as increasing use is being made of an enabling protocol in MiFID. However, only in three of these eight jurisdictions is there a mechanism to enforce these direct requests. In the Netherlands and Germany, the regulators can issue a formal direction requiring compliance that may result in a penalty. In France, firms can be

sanctioned as if they had refused to comply with a request from the national regulator. The Spanish authorities have fined a Gibraltar bank (passporting services in Spain without a place of business there) for failing to provide information direct to the Spanish authorities, despite the Gibraltar regulator's suggestion to use the established mutual cooperation route in order to protect the firm from breach of confidentiality obligations under Gibraltar law. In Singapore, although there is no express provision enabling direct requests from overseas regulators, the Monetary Authority of Singapore can order compliance with such a request; non-compliance may result in a penalty and/or imprisonment.

### **Whether information can be withheld from regulators varies considerably**

Whether information can be withheld from regulators on the basis of legal privilege varies to a significant extent across the 14 jurisdictions. Such divergences can create difficulties for firms in determining whether certain information can be disclosed or withheld in any particular case. In many jurisdictions, the concept of legal privilege is enshrined in the law. Nevertheless, regulators may put pressure on firms to disclose legally privileged material even when production cannot be compelled. In Spain, where the regulator has conclusive evidence of a regulatory infraction, a firm can be sanctioned for failing to provide information even if it is legally privileged (although the sanction may be appealed on the basis that the information was protected from disclosure). It is not uncommon for the UK's conduct regulator to be in disagreement with firms about the scope of privilege.

In some jurisdictions, such as Japan and China, legal privilege is not recognised at all. In others, it only applies in limited circumstances. For example, in Russia financial institutions and individuals who are not lawyers cannot withhold documents on the basis of legal privilege. In Switzerland, communications by in-house lawyers are not covered by legal privilege; production of such communications could also arguably be compelled under powers exercised by the European Supervisory Authorities.

The extent to which evidence can be withheld on the basis of the privilege against self-incrimination across the jurisdictions also varies enormously. This, again, may create difficulties for those seeking to navigate the regimes. In Russia, Spain, France and the US, information can be withheld on the basis of the privilege against self-incrimination (although in France, this will be noted in the investigation report). In other jurisdictions, this privilege can be relied onto a limited extent. For example, in Hong Kong, the Netherlands, Australia and the UK, an individual must disclose incriminating information, but the information cannot be adduced as evidence in criminal proceedings; in the UK and the Netherlands, criminal proceedings include market abuse cases. In Hong Kong self-incriminating information can be adduced in civil market abuse proceedings. In Germany, it is unclear whether a

person may refuse to disclose documents on the basis of the privilege against self-incrimination. In China, the privilege against self-incrimination is not recognised at all. In Japan, the law is unclear, in that although the privilege is not explicitly applicable to regulatory proceedings, it may be engaged where a criminal investigation is involved.

Finally, in nearly all surveyed jurisdictions, client confidentiality is unlikely to provide a basis on which financial institutions can withhold information from the regulators who require its production. In Germany, firms and individuals who are subject to a statutory duty of confidentiality as a result of their profession (eg, lawyers) can refuse to provide information. A narrow exception to disclosure on the basis of confidentiality exists in the UK, but it does not apply if the firm or client is under investigation.

### **Severe consequences for failing to comply**

The importance of fully complying with requests for information, documents, interviews and answers to questions is underscored by the severe penalties that may be imposed in the event of a failure to comply. In Japan, staff responsible for a securities broker's failure to cooperate with the regulator can be punished with imprisonment for one year (with labour). In Switzerland, a person who negligently provides false information can be imprisoned for up to three years; false witness testimony can be punished with five years' imprisonment; and the regulator can remove directorships, revoke licences and prohibit individuals from acting in any management capacity. In Hong Kong, a failure to comply with a request from the Securities and Futures Commission (**SFC**), or knowingly or recklessly providing false and misleading information to the SFC, could result in up to seven years' imprisonment, where there is an intent to defraud. In the US, failure by an entity regulated by the Securities and Exchange Commission (**SEC**) to comply with a request for information (other than pursuant to subpoena) can result in imprisonment; however, if the request is made under subpoena, then failure to comply will expose the person to contempt proceedings. In Singapore, a failure to comply with an order to provide assistance can be punished with two years' imprisonment.

### **Firms/individuals may be sanctioned in multiple jurisdictions for the same conduct**

The question of whether firms or individuals can be subject to sanctions in multiple jurisdictions in respect of the same conduct is a key question considered in this publication: the answer varies across the jurisdictions. Spain and Germany are the only jurisdictions covered by this publication where the principle against double jeopardy would prevent the domestic regulator from bringing regulatory and criminal action where the same firm/individual has already been sanctioned by an overseas regulator. In other jurisdictions (namely Hong Kong, Switzerland, the UK,



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Australia, Singapore, the Netherlands and the US), the regulators can bring regulatory, administrative or civil proceedings, even where the firm has already been sanctioned overseas in respect of the same conduct. However firms in these jurisdictions are protected from duplicative criminal proceedings to a large extent. In other jurisdictions, such as Dubai, Japan and China, the principle against double jeopardy does not apply at all (although in Japan and China, criminal penalties may be reduced where a criminal sanction has already been imposed abroad).

Whilst it is clear that firms can simultaneously be subject to investigation by regulators in different jurisdictions in respect of the same matter, it is less clear how regulators are required to coordinate with each other. A failure on the part of regulators to synchronise their actions, together with variances in regimes as highlighted above, can cause real practical difficulties for firms in the internal management of the process. The European Securities and Markets Authority (**ESMA**) is likely to play an active role in the coordination of European national regulators' investigations and interventions under MAR.

In addition, the ruling of the European Court of Human Rights (the **Court**) in *Grande Stevens and Others v. Italy* (4 March 2014) has already had an impact in France, and is likely to affect other jurisdictions which are signatories to Protocol 7 of the of the *European Convention on Human Rights, 1950 (ECHR)*. Article 4 of that Protocol prohibits criminal proceedings being brought against an individual where that person has already been acquitted or convicted of the same offence in that jurisdiction. Italy sought to bring a criminal prosecution for market manipulation against a person in respect of whom the Italian regulator had taken administrative proceedings for market manipulation (market abuse offences are considered to be "criminal offences" in ECHR terms). In holding Italy in violation of Article 4, the Court confirmed that the primary consideration is whether the conduct targeted in both proceedings is essentially the same.

In producing this publication, we have drawn on the expertise of our financial services regulation practice across our international network of offices. In addition, we are enormously grateful for contributions from law firms Stibbe (Netherlands), Homburger (Switzerland), Anderson Mori & Tomotsune (Japan) and ProLegis (Singapore).

We hope you find this publication of interest. If you have any questions, please do not hesitate to contact us or any of our colleagues listed at the end of each chapter.

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