HERBERT SMITH FREEHILLS

THE LONG ARM OF REGULATION

RESPONDING TO CROSS-BORDER FINANCIAL SERVICES INVESTIGATIONS

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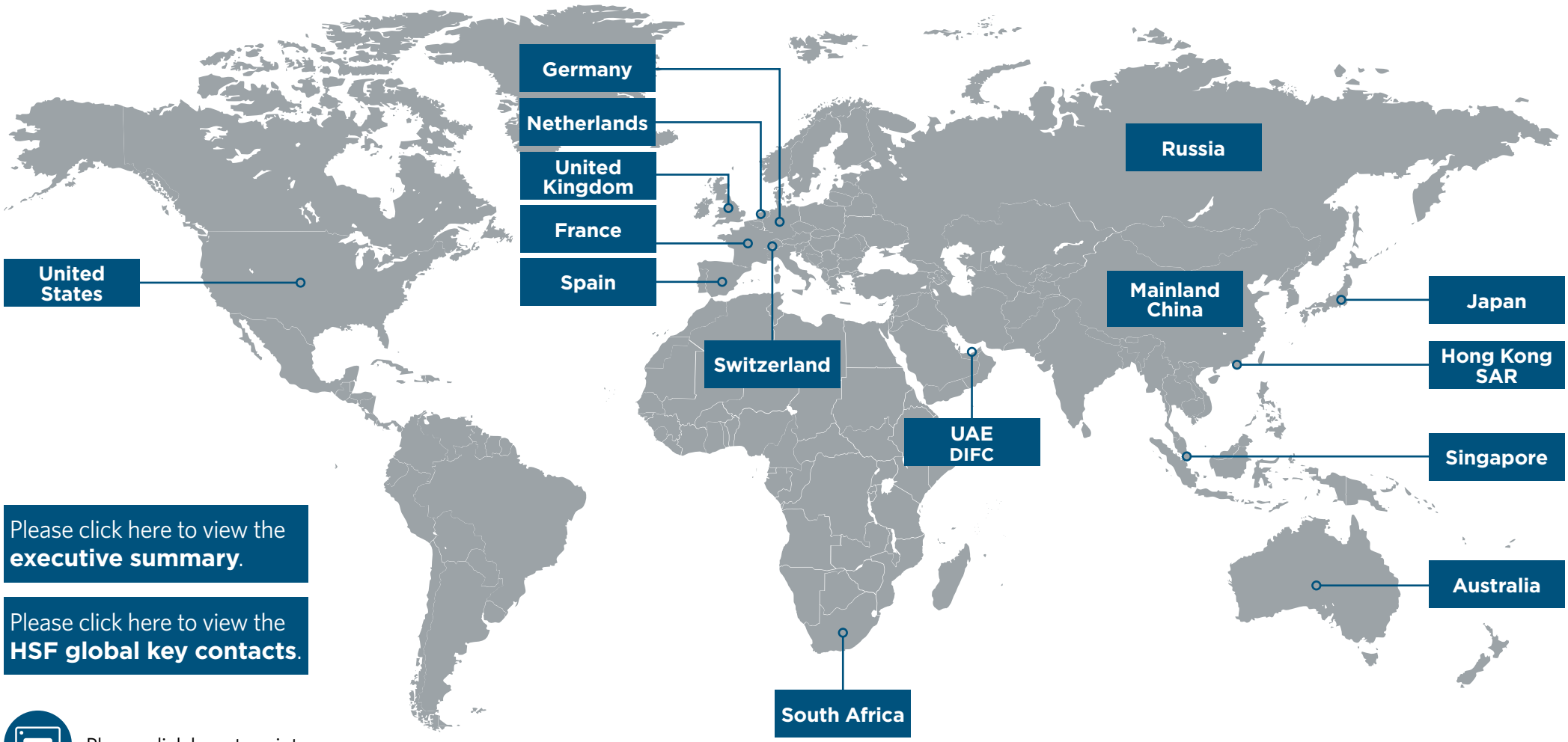

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The long arm of regulation:

Responding to cross-border financial services investigations

Welcome to the fourth edition of "The long arm of regulation: responding to cross-border financial services investigations".

The continued scrutiny of financial services firms globally and sustained pressure on those charged with regulating them to deliver tangible results continue to drive financial services regulators to seek assistance from their overseas counterparts in investigating issues. This trend is not abating and 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 to these questions across 15 key jurisdictions, with South Africa added for the first time in this edition, and seeks to assist firms in navigating the differing regimes.

In compiling this publication, as in previous editions, we have sought to highlight here 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 Multilateral Memorandum of Understanding on consultation, cooperation and the exchange of information, and in EEA jurisdictions, of the European Securities and Markets Authority (**ESMA**) Multilateral Memorandum of Understanding on Cooperation Arrangements and Exchange of Information, and requirements to cooperate in a range of European legislation, most notably the recast Markets in Financial Instruments Directive (**MiFID II**) and the Market Abuse Regulation (**MAR**).

Perhaps unsurprisingly, in the majority of jurisdictions surveyed in this guide, regulators 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 most jurisdictions, the powers may be exercised in respect of any person, whether or not involved in the financial services industry. Further, in five of the jurisdictions surveyed (Germany, Russia, Spain, Switzerland and the UK), 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 15 jurisdictions, regulators have a very wide discretion to comply with requests, and there is no general requirement (except in certain situations in Australia, the Dubai International Financial Centre (**DIFC**) and Switzerland) for firms to be notified before any information is transmitted. By contrast, forthcoming legislation in South Africa, when in force, will mandate such a notification.

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 with all requests without exception. That said, all indications are that regulators are inclined to, and do, comply with requests. Further, under MiFID II and MAR, European regulators are obligated to cooperate, with each other and with the relevant European Supervisory Authority (**ESA**), 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 (France, Germany, Hong Kong, the Netherlands, Russia, Spain, Switzerland, and the UK), 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 appears to have risen over recent years, as increasing use is being made of an enabling protocol in MiFID II. 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 (**MAS**) 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 15 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

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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 regulators in Australia and the UK to challenge firms about the scope of privilege, including a recent high profile challenge in Australia.

In some jurisdictions, such as China and Japan, 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 'advocates' cannot withhold documents on the basis of legal privilege. In Germany and 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 ESAs.

Determining whether a firm's limited waiver of privilege in an overseas jurisdiction constitutes a loss of privilege in the firm's home jurisdiction requires a careful analysis of the laws of each jurisdiction. In some jurisdictions, such as Germany, Spain and Switzerland, privilege is maintained regardless of any waiver overseas; in the UK, English law recognises the concept of limited waiver, but firms must take certain rigorous steps to ensure that the privilege is preserved. Other jurisdictions (ie, Australia, the DIFC, Hong Kong, Singapore and South Africa) require a more detailed analysis of the facts and context to determine whether privilege can be maintained. However, in the US, privilege is unlikely to be maintained if it has been waived on a limited basis in an overseas jurisdiction, unless the disclosure overseas is compelled and occurs after the firm makes objections and takes other reasonable steps to protect the privilege.

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 France, Russia, Spain 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, and in the US, this will result in an adverse inference in a civil case). In other jurisdictions, this privilege can be relied on to a limited extent. For example, in Australia, Hong Kong, the Netherlands, Singapore, South Africa and the UK, an individual must disclose incriminating information, but, generally, the information cannot be adduced as evidence in criminal proceedings; in the Netherlands and the UK, criminal proceedings include market abuse cases. In Singapore and South Africa, incriminating information is admissible in certain proceedings relating to the provision of false or misleading information to the regulator. 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 the DIFC, an individual must disclose incriminating information to the regulator; if the regulator is required by law or court order to disclose that information, the information becomes admissible in any proceedings against the individual. In China, the privilege against self-incrimination is not recognised at all. In Japan, the position is unclear, in that, although the privilege is not explicitly applicable to regulatory proceedings, it may be operative where a criminal investigation may be involved; similarly, in Switzerland, the law is unsettled but the privilege is generally accepted to be available.

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 the Netherlands, 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 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 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 Singapore, a failure to comply with an order to provide assistance can be punished with two years' imprisonment. 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 the UK, not only is an individual's failure to comply potentially a criminal offence, but a failure by a firm or a senior manager to comply with a regulator's request is also likely to amount to a regulatory breach, which may expose the firm to enforcement action and unlimited fines. In the US, failure by an entity regulated by the Securities and Exchange Commission 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.

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

Whether firms or individuals can be subject to sanctions in multiple jurisdictions in respect of the same conduct is a key question

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considered in this publication: the answer varies across the jurisdictions. Russia and Spain 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 Australia, Germany, Hong Kong, the Netherlands, Switzerland, the UK 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 some of these jurisdictions are protected from duplicative criminal proceedings to a large extent. In other jurisdictions, such as China, the DIFC and Japan, the principle against double jeopardy does not apply at all in a multijurisdictional context (although in China and Japan, criminal penalties may be reduced where a criminal sanction has already been imposed abroad). The question remains unsettled in Singapore and South Africa.

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. ESMA is empowered to take a more active role in the coordination of European national regulators' investigations and interventions under MiFID II and MAR.

Managing competing obligations can be tricky

A perennial challenge for firms is how to coordinate their responses to simultaneous investigations in multiple jurisdictions. Competing regulatory obligations to, on the one hand, keep an investigation confidential and, on the other hand, report such an investigation to another regulator, may place firms in situations which are extremely difficult to navigate. In over half of the jurisdictions surveyed (ie, Australia, the DIFC, Germany, the Netherlands, Russia, South Africa, Switzerland and the US), firms are generally permitted to share information about domestic investigations with overseas regulators unless prohibited by direction or order; in Singapore, firms may share this information with the exception of any investigation report issued by MAS, which must be kept confidential. However, in other jurisdictions firms are generally prohibited from sharing this information with overseas regulators. In China, firms cannot directly share this information with overseas regulators; in Spain, firms are prohibited from divulging unless required to do so by cooperation agreement or court order. Sometimes consent from domestic regulators is expected or recommended: in Japan, though no restrictions apply in principle, in practice firms are expected to seek regulatory consent before sharing; in Hong Kong, firms are generally subject to statutory secrecy and therefore recommended practice is to seek regulatory consent. In the UK, regulators expect confidentiality but, subject to any statutory confidentiality requirements, firms are entitled to notify overseas regulators about domestic investigations where required; it is nonetheless generally recommended that UK regulators are given advance notice of any such notification.

Requirements to self-report regarding regulatory matters also vary considerably across jurisdictions, and the extent to which these requirements apply to notifications about the commencement of investigations by overseas regulators is mixed. In the UK, regulators generally expect to be notified of relevant overseas investigations. In Hong Kong, disciplinary actions by other regulators must be reported, and a regulatory investigation by an overseas regulator may give rise to a reporting obligation. By contrast, in Germany and the US, firms are not required to self-report regulatory breaches, though this is encouraged in the US and may lead to regulatory leniency.

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

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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