

NEW GUIDANCE NOTE ON COOPERATION WITH THE SFC AND ITS BENEFITS

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Legal Briefings - By **Will Hallatt, Michael Tan and Valerie Tao**

Yesterday, the Securities and Futures Commission (the **SFC**) published its [*Guidance Note on Cooperation with the SFC*](#) (the **Guidance**).

The Guidance contains an updated section on disciplinary proceedings and a new section on proceedings in the civil courts and the Market Misconduct Tribunal (**MMT**). It does not apply to criminal proceedings, which is subject to the unfettered discretion of the Department of Justice. The Guidance replaces the previous version issued in March 2006.

This will be of keen interest to the increasing number of firms and individuals who are subject to regulatory scrutiny. The Guidance covers several key topics which are considered below:

Clarification on the kind of action that will be viewed as cooperation;

The factors that the SFC will use to assess cooperation;

The measures the SFC will use to encourage cooperation in disciplinary proceedings, including discounts to sanctions; and

The SFC's current practice of resolving proceedings in the civil courts or the MMT with cooperative parties.

The SFC has also issued [FAQs](#) to help the industry and the public understand the Guidance.

Clarifying what constitutes cooperation

The Guidance clarifies what action will amount to "cooperation" in the eyes of the SFC and the factors it will take into account when assessing cooperation. Mere compliance with statutory or regulatory requirements will not be enough since this is already expected of firms and individuals. Cooperation means going above and beyond these requirements.

The Guidance sets out a number of "forms of cooperation" which relate to reporting, providing evidence and information to the SFC, accepting liability, taking rectification measures, waiving legal professional privilege, commissioning third-party reviews and giving directors' undertakings to address the SFC's regulatory concerns. Further details on each of these areas are summarised in the table at the bottom of this bulletin.

Assessing cooperation

While the Guidance stresses that each case will depend on its facts, the SFC will generally take into account the following factors when assessing cooperation:

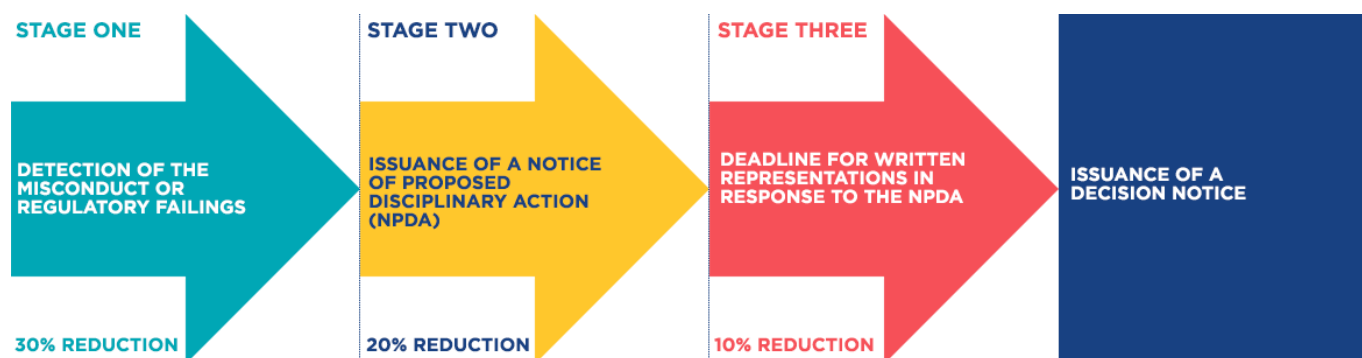
- The value of the assistance provided, including the timeliness of the cooperation, the quality, extent and substance of the assistance provided, the time and resources saved as a result of the cooperation and whether its investigation was initiated based on information provided by the party;
- The nature and seriousness of breach or failing and its impact on the securities and futures market; and
- The general conduct of the party after the breaches or failings and other circumstances of the party.

Uncooperative conduct which has the intent or effect of impeding investigations or enforcement proceedings may also be taken into account by the SFC. This might include for example failing to promptly and fully report a material breach or failing to disclose, or withholding relevant information.

Measures to encourage cooperation in disciplinary proceedings

In general, the SFC will be more willing to enter into an agreement to resolve disciplinary proceedings at an early stage pursuant to section 201 of the *Securities and Futures Ordinance* (**SFO**) if cooperation has been demonstrated.

Furthermore, to encourage early cooperation and resolution of cases, the SFC has divided its disciplinary process into three stages. Where a person cooperates with the SFC and a section 201 agreement is reached, the SFC *may* reduce the sanction imposed. The scale of the reduction will depend on the stage of the proceedings:



The discounts available largely follow those applied by the Financial Conduct Authority in the UK regulatory regime. Further reductions may be possible in cases where there has been exceptional and substantial cooperation. However, as a general principle, the SFC would not be willing to resolve disciplinary matters in private or on a “no admission of liability” basis.

Civil court and MMT proceedings

Where the SFC issues proceedings in the civil court or in the MMT, the Guidance sets out further ways a party might seek to cooperate with the SFC. This includes agreeing to use the Carecraft procedure (section 214 SFO) or agreeing to use statements of agreed facts and proposed/consent orders (section 213 SFO and MMT proceedings).

The SFC may recognise cooperation through:

- Reduced sanctions and agreement to mitigation submissions in support of the proposed orders; and/or
- Cooperation letters issued by the SFC to another regulator or law enforcement agency describing the cooperation provided by that party.

FAQs

The SFC has also issued [FAQs](#) to help the industry and the public to understand the Guidance. In particular, the second FAQ sets out the SFC's rationale and approach with respect to grouping together multiple failings within a company or corporate group, and resolving these in a single resolution. Generally, the SFC will be more likely to use this approach to target systemic issues and weaknesses where the failings have not caused losses to clients or the investing public.

Conclusion

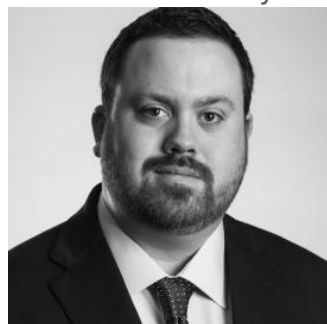
The Guidance sets out in clearer terms what a firm or individual would need to do in order to gain the benefits of cooperation from the SFC. Of course, cooperating in this way may not necessarily be to your advantage in every situation. The Guidance is nonetheless welcome in that it will allow firms and individuals to form clearer strategies in dealings with their regulator.

Forms of Cooperation

Reporting	<ul style="list-style-type: none"> • Voluntarily and promptly reporting breaches or failings.
Providing evidence and information to the SFC	<ul style="list-style-type: none"> • Early and proactive steps to preserve and collect evidence and provide it to the SFC. • Full and frank disclosure of information. • Provide information and evidence which the SFC would otherwise be unaware, including internal investigation findings. • Provide useful intelligence. • Provide oral testimony in proceedings where required. • Promptly inform the SFC about material problems occurring outside Hong Kong and provide relevant information. • Disclose relevant documents located outside Hong Kong and facilitate document production and witnesses from outside Hong Kong (to the extent legally permissible).
Acceptance of liability	<ul style="list-style-type: none"> • Take responsibility for breaches or failings, address the SFC's regulatory concerns and accept its investigation findings or proposed sanctions. • Proactive and positive approach to bringing a case to an early conclusion.
Taking rectification measures	<ul style="list-style-type: none"> • Early and active steps to contain breaches or failings. • Full and prompt compensation to the affected investors for their losses. • Instituting necessary enhancements to internal controls and procedures.
Legal professional privilege	<ul style="list-style-type: none"> • Voluntarily waive a claim to legal professional privilege over a document, including on a limited basis. • However, a bona fides refusal to grant a waiver will not constitute uncooperative conduct.
Third-party reviews	<ul style="list-style-type: none"> • Appoint a third party reviewer jointly with the SFC to conduct a: <ul style="list-style-type: none"> ◦ Fact-finding review - the SFC can use the reviewer's findings as the basis for appropriate disciplinary proceedings; or ◦ Prospective internal control review - take the remedial steps advised by the SFC and the reviewer and all other necessary enhancements to the firm's internal controls. • Agree to bear the costs of engaging the third-party reviewer. • The terms of reference of the review to be devised by the SFC. • Accept the reviewer's findings without: <ul style="list-style-type: none"> ◦ An opportunity to first review the report before it goes to the SFC; or ◦ The ability to request changes.
Directors' undertakings to address the SFC's regulatory concerns	<ul style="list-style-type: none"> • For example, undertakings to remedy deficiencies identified in a third-party review within a specified period of time and to ensure that such failings would not reoccur.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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