

# SFC CONFIRMS ENFORCEMENT PRIORITIES AND APPROACH FOLLOWING STRATEGIC REVIEW

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Legal Briefings - By **William Hallatt**, **John Siu** and **Alice Dillon**

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In its recently relaunched [Enforcement Reporter](#) newsletter (see [first issue](#)), the Securities and Futures Commission (**SFC**) has confirmed that corporate fraud and misfeasance, anti-money laundering (**AML**), Growth Enterprise Market (**GEM**) companies and multiple intra-group failings are issues high on its agenda and will be pursued as a priority, as part of its shift towards a more targeted approach to enforcement.

The SFC has also confirmed changes to the way it will go about pursuing its enforcement objectives, including the establishment of various specialised internal teams to address key and emerging risk areas, in alignment with its enforcement priorities, as well as increased collaboration with Mainland and Hong Kong regulators.

In addition, the SFC has indicated that in the appropriate case (with the exception of criminal proceedings), it may notify the relevant parties towards the end of an investigation of its intention to take enforcement action. The parties will be afforded an opportunity to first make submissions (which may be on the record), bring any relevant facts to the SFC's attention, set out any legal reasons as to why the enforcement action should not proceed, and/or propose a settlement, before the SFC formally commences enforcement action.

We consider these issues in more detail below.

## 1. BACKGROUND

In a [speech](#) at the 7th Pan Asian Regulatory Summit in November 2016, following his appointment as the SFC's new Executive Director of Enforcement in May 2016, Mr Thomas Atkinson confirmed that the SFC had undertaken a “comprehensive and structured strategic review of the entire Enforcement Division”, with a view to re-assessing its enforcement focus, organisational structure and its tools of enforcement.

As part of that review, the SFC has continued to increase its enforcement personnel and has established the following four permanent specialised teams within the Enforcement Division:

- Corporate Fraud Team;
- Corporate Misfeasance Team;
- Insider Dealing and Market Manipulation Team; and
- Intermediary Misconduct Team.

Separately, the SFC has four temporary specialised teams focusing on emerging risk areas including sponsor misconduct during IPOs, irregularities in the GEM, AML and the mis-selling of specific investment products. Such teams will be disbanded when the underlying risks have been addressed. The SFC may also form new temporary teams to focus on any new emerging risks, as they arise.

While the SFC may be building its internal enforcement workforce, that does not necessarily correlate with a desire to pursue more inquiries and investigations. On the contrary, under the new leadership of Mr Atkinson, it seems clear that the SFC would like to accelerate the large number of inquiries and investigations currently before it and to focus on high impact cases which pose the greatest threat to investor protection and market integrity. In practice what that means is “more of the big stuff, less of the small stuff”.

## 2. THE SFC'S KEY PRIORITIES

### Corporate fraud and misfeasance

The SFC has unequivocally stated that listed-company fraud and misfeasance is its top priority and so much is evident from the two dedicated teams the SFC has established to tackle this risk area. The SFC cites the billions in market capitalisation wiped from Hong Kong stock markets in recent years as a result of corporate fraud and misfeasance and the associated damage caused to investors and markets alike.

In his Pan Asian Regulatory Summit speech, Mr Atkinson noted that these incidents often relate to companies with business operations in Mainland China and involve evidence and witnesses in the Mainland. That makes those investigations particularly complex, but one way the SFC is tackling this problem is by building strong mutual relationships with the Mainland regulators, particularly the China Securities Regulatory Commission (CSRC). Indeed, the SFC and CSRC have an executive staff exchange programme and regularly hold joint training initiatives for regulatory staff.

## **AML**

Another key risk area the SFC is particularly focused on is ensuring licensed and regulated entities have proper and adequate AML systems and controls in place to prevent and detect criminal activities. As mentioned above, the SFC currently has a dedicated AML team which targets customer due diligence failings by licensed and regulated entities.

The SFC has made it clear that it will consider taking enforcement action where a licensee is deemed to have inadequate KYC/AML systems and controls, even where there is no suggestion of a reportable AML issue. In this regard, the SFC has been working closely with the Hong Kong Monetary Authority (HKMA) on KYC/AML matters, particularly as they relate to dual-regulated entities, and has engaged in joint training and expertise sharing with the HKMA as part of its broader objective to collaborate with other regulators in the region.

## **GEM**

GEM is an alternative stock market to the Main Board of the Hong Kong Stock Exchange and offers an opportunity for emerging enterprises that may not fulfil the profitability and track record requirements for listing on the Main Board to raise capital. Investment in a GEM company is therefore a “high growth, high risk” proposition for investors and accordingly, it has the attention of the SFC. In particular, the SFC has expressed concern regarding the rise in the number of shell companies created and listed on GEM and has formed a dedicated team to investigate suspected misconduct in this area.

### **Multiple failings within a corporate group**

Perhaps the best examples of the kind of “high impact” cases that the SFC is deliberately focusing on are those that involve multiple failings within the same corporate group. The SFC has indicated that where multiple intra-group failings are found to have occurred, it will consider those failings together to determine whether they are attributable to wider systemic weaknesses within the group. The SFC believes that tackling systemic issues is an effective way to send clear and strong deterrent messages to the market. Accordingly, it is likely that we will see higher monetary fines and more severe non-monetary sanctions being determined by the SFC in this space.

### **Individual accountability**

Consistent with the global regulatory shift to individual accountability, the SFC has emphasised that senior management (whether or not they are licensed by the SFC) should be “fully aware that they are accountable for the misconduct of their firms” and the SFC “stands ready to take enforcement actions against both the corporate group and its senior management” for internal control failures and misconduct. We can expect the SFC to continue to pursue and hold individuals accountable in the appropriate case.

## **Market surveillance**

To support the Enforcement Division's agenda, the SFC's surveillance team continues to monitor unusual patterns of behaviour and conduct in the market. Particular trends which the SFC has recently observed as part of its routine monitoring and surveillance activities include a rise in cyber-hacking of customer accounts and a rise in incidences of extremely high shareholding concentrations. These observations will no doubt continue to inform the SFC's regulatory agenda.

## **3. REWARDS COME TO THOSE WHO COOPERATE**

It is not all doom and gloom for parties under SFC investigation as there are ways to mitigate the ultimate outcome in an enforcement investigation. As previously mentioned, in appropriate cases the SFC will afford the relevant parties an opportunity to be heard (which may be on the record) towards the end of the investigation, before it formally commences enforcement action. The SFC has also indicated a willingness to consider settlement proposals at this stage. The SFC has stated that it will use the above process in disciplinary, civil and Market Misconduct Tribunal proceedings if appropriate, but not in criminal proceedings.

The SFC will also “recognise and give credit for cooperation” during an enforcement investigation. In the *Enforcement Reporter*, the SFC cited a number of recent enforcement actions where it took into account the cooperation of the regulated entity in reaching its determination on the applicable sanction. Of course, this should also be complemented by a culture of open and transparent self-reporting of breaches and misconduct and it is important that such notifications are communicated to the regulator in a timely fashion.

In the appropriate case, the SFC will also look kindly on the engagement of independent reviewers to provide further assurance that the underlying causes of regulatory failings are being (or have been) properly addressed by licensed and regulated entities.

## **4. CONCLUDING REMARKS**

The SFC's recent *Enforcement Reporter* confirms that it is adopting a more streamlined and specialised approach to enforcement, with a focus on high priority cases that pose the greatest risks to investors and market integrity. Licensed and regulated entities would do well to take heed of the risk areas identified by the SFC in the newsletter and ensure they have appropriate compliance systems in place to manage the associated risks.

The SFC has indicated it will issue the *Enforcement Reporter* newsletter on a biannual basis going forward, which will provide the market with valuable insight into the SFC's enforcement work and priorities.

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