

A regular communication about the SFC's enforcement work

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Enforcement priorities and approaches in 2018

Recognising the potential of close collaboration between SFC divisions, we adopted a new “real-time” regulatory approach to strategically combine our expertise and resources while front-loading regulation through earlier, more targeted intervention. Under this approach, cross-divisional collaboration has become the norm, as we apply all of our regulatory tools to tackle increasingly complex cases as “One SFC”. The Enforcement Division will continue to collaborate under this new regulatory approach to maximise the impact of our work.

Corporate fraud remains our top enforcement priority and we will continue to target groups which collude to defraud investors. We also monitor:

- companies issuing false or misleading financial statements;
- initial public offering (IPO) fraud and related sponsor failures; and
- failures to manage conflicts of interest by senior management of listed companies.

Insider dealing and market manipulation is also a major focus. We target more sophisticated market misconduct perpetrated by syndicates and adapt our investigatory approach to detect and prove these complex crimes.

Intermediary misconduct is always on our radar and we adopt a holistic enforcement approach focusing on failings which pose systemic risks. Breaches by the same firm or by multiple firms within one corporate group may be dealt with together to strengthen deterrence. We will continue to target culpable individuals and seek criminal sanctions where appropriate.





Sponsor misconduct is another key priority as we focus on resolving ongoing sponsor misconduct cases as well as investigating new ones. We have investigated 15 sponsor firms, and issued notices of proposed disciplinary actions against eight firms and four sponsor principals. As of February 2018, we are considering similar disciplinary notices and other enforcement actions against other firms and at least five sponsor principals. Our enforcement actions remind sponsors to uphold the highest standards and carry out proper due diligence which is a fundamental safeguard in the listing process. In many of the cases we have investigated, sponsors failed to scrutinise and verify key information in a prospectus and examine information with professional skepticism.

Under the rules, the purpose of due diligence is to enable the sponsor to know and understand the listing applicant and be satisfied that it complies with the Listing Rules and other legal and regulatory requirements. Sponsors are expected to ensure the listing document contains sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the shares, the financial condition and the profitability of the listing applicant.

Money laundering is a persistent risk globally and firms in Hong Kong should ensure they have robust systems and controls to combat it. In 2017, we strengthened our enforcement actions against firms with internal control failures related to know-your-client or anti-money laundering requirements.

Updated Guidance Note on Cooperation: a practical overview

We value the cooperation of firms and individuals with our investigations and enforcement proceedings. To be transparent about how we encourage cooperation, we issued a new [Guidance Note on Cooperation with the SFC](#) in December 2017¹.

Key takeaways

Applicability :	<ul style="list-style-type: none"> ✓ SFC disciplinary proceedings ✓ Civil court proceedings ✓ Market Misconduct Tribunal (MMT) proceedings ✗ Criminal proceedings
Eligibility:	For cooperation to be recognised, you must go above and beyond your statutory and regulatory obligations
Examples of recognisable cooperation:	<ul style="list-style-type: none"> ▪ Voluntarily and promptly report breaches or failings to the SFC ▪ Provide true and complete information regarding breaches or failings ▪ Accept liability ▪ Take rectification measures
Benefits of cooperation:	<p>SFC disciplinary proceedings:</p> <ul style="list-style-type: none"> ▪ Sanction reduction from 10 to 30% (barring exceptional circumstances which may warrant a further reduction) <p>Civil court/MMT proceedings:</p> <ul style="list-style-type: none"> ▪ Early resolution – submission of agreed facts and proposed orders to court/MMT ▪ SFC’s reduced proposed sanction and mitigation submissions to court/MMT ▪ Issuance of cooperation letters to other law enforcement agencies

¹ This replaces the previous version issued in March 2006.

On our watchlist: mis-selling of financial products

An Enforcement division team which specialises in combatting mis-selling of financial products worked alongside the Corporate Finance and Intermediaries divisions to complete an extensive review of cases involving these products. The team reviewed 34 offering circulars and investigated 11 licensed corporations for mis-selling practices. Firms are strongly advised to regularly review their compliance and control systems to guard against

mis-selling, and strictly adhere to laws and regulations governing the sale and marketing of financial products.

The sharing of experience and knowledge through collaboration among different divisions has enhanced the SFC's capabilities in handling this type of cases.

Manager-In-Charge regime

Corporations do not have minds of their own. Individuals make corporate decisions and manage daily operations. We announced the Manager-In-Charge regime in April 2017 requiring firms to identify individuals with oversight of core functions and map out their responsibilities and reporting lines.

While this regime was not primarily conceived as a tool for enforcement, it helps us identify responsible individuals and hold them accountable in cases of wrongdoing. Our investigation teams can then

hone in on individual culpability at the inception of any investigation. Where the evidence supports it, the SFC will take civil or criminal actions against culpable individuals.

This sends a clear message to market players about the accountability of individuals who perpetrate wrongdoing. We believe this is one of the most effective ways to dissuade misconduct, incentivise good behaviour and improve corporate governance, which in turn will promote investor confidence.





Closer regulatory ties with the Mainland

Hong Kong is an international financial centre linking capital flows from both the Mainland and overseas. The development of Hong Kong's financial markets depends on this bridging role which is contingent upon a comprehensive set of cooperative arrangements between Mainland and Hong Kong regulators.

In recent years, we have been building an excellent relationship with the China Securities Regulatory Commission (CSRC), our regulatory counterpart on the Mainland, and 2017 was particularly rewarding. High-level meetings between the SFC and the CSRC's enforcement units discussed enhancing the implementation of the "Memorandum of Understanding on Strengthening Regulatory and Enforcement Cooperation under the Mainland-Hong Kong Stock Connect" as well as the regulatory priorities and latest developments in both jurisdictions.

Riding on the success of the joint training on market manipulation which we held with the CSRC in Xi'an in November 2016, we organised our second joint training in Xiamen in December 2017 to share investigation strategies and experiences in cases concerning breaches of disclosure rules, fraudulent offerings and market manipulation. Enforcement experts from the US Securities and Exchange Commission also shared their experiences.

Operationally, as part of our strategic review we began to streamline and prioritise the investigatory requests we send to the CSRC. The number of investigatory requests has since been reduced, allowing the CSRC to focus its resources on our most important requests.

Surveillance requests and self-reporting by firms

- As a result of highly active trading under Mainland-Hong Kong Stock Connect, regulators in both jurisdictions cooperate more closely in market surveillance. The number of surveillance requests we sent to the CSRC for information about suspicious southbound transactions doubled in 2017. We also received a number of requests from the CSRC and the Shanghai and Shenzhen stock exchanges for surveillance information about northbound orders and transactions.
- In 2017, the number of suspicious trading notifications from licensed firms² increased by over 15% from 2016. These notifications involved hacking, insider dealing, market manipulation, naked short-selling and licensee misconduct.
- We noted a marginal increase in the number of reports of suspicious transactions relating to debt securities. Firms are expected to include over-the-counter (OTC) activities in these reports, as OTC activities are increasingly behind on-market transactions both in Hong Kong and global markets.
- We encourage firms to report to us any suspected breach of rules or regulations. Prompt, complete and insightful self-reporting demonstrates the soundness of a firm's internal control systems and helps to detect trading misconduct.

² Pursuant to paragraph 12.5 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

Recent enforcement actions

Credit Suisse

We resolved our concerns with Credit Suisse (Hong Kong) Limited, Credit Suisse Securities (Hong Kong) Limited and Credit Suisse AG over various internal control failures.

The three firms were publicly reprimanded and fined a total of \$39.3 million for failures to segregate client securities, comply with reporting requirements in relation to cross trades, short selling requirements, electronic trading requirements, contract note rules and short position reporting rules, as well as failures in internal controls to ensure suitability.

We assessed the regulatory breaches of all three Credit Suisse firms together to achieve a holistic resolution of all our regulatory concerns with the group and to drive overall enhancements to specific processes and internal controls within the group's business activities in Hong Kong.

When resolving this matter, we took into account that the group self-reported their breaches to the SFC and involved their senior management in constructive discussions to resolve our concerns. Credit Suisse has taken remedial actions to strengthen their internal controls and systems, and agreed to compensate clients who suffered losses in 10 transactions where unsuitable products have or may have been sold to them. It also engaged independent reviewers to investigate the causes of the problems and to review the adequacy of the relevant controls.

Credit Suisse's ongoing cooperation from an early stage significantly expedited a satisfactory resolution and this high-level of cooperation was taken into account when we determined the sanctions.

Qunxing Paper Holdings Company Limited

We obtained orders from the Court of First Instance against Qunxing Paper Holdings Company Limited, its former chairman and vice-chairman, as well as its subsidiary Best Known Group Limited, to compensate investors who subscribed for Qunxing shares in its IPO or purchased them in the secondary market between 2007 and 2011, as well as a subscriber of Qunxing unlisted warrants in January 2011.

The defendants disclosed false or misleading information (ie, materially overstating turnover and understating bank borrowings) in Qunxing's IPO prospectus in 2007, as well as in its results announcements for the four financial years up to 31 December 2011.

This case demonstrates the SFC's determination to hold perpetrators of corporate fraud accountable for their actions and to seek financial redress for aggrieved investors in appropriate circumstances.





HSBC Private Bank (Suisse) SA

HSBC Private Bank (Suisse) SA, the Hong Kong branch of the Switzerland-based private banking business of HSBC Group, was fined a record HK\$400 million after the Securities and Futures Appeals Tribunal upheld the SFC's disciplinary action against the bank for material systemic failures in its sale of investment products in the run-up to the global financial crisis in 2008. The bank was also suspended from advising on securities for one year and partially suspended from dealing in securities.

The bank's internal processes for understanding each client's risk profile and product suitability were found to be flawed, as was its oversight of sales processes in avoiding risk mismatch. These failings, in combination with the intrinsically high-risk nature of the products sold, magnified investor losses. The sizeable fine reflected the severity of the bank's shortcomings and signalled the need for adherence to standards of professional conduct.

Our standards are designed to protect all investors including clients of retail and private banks. This case illustrated our readiness to take action where breaches of the Code of Conduct are identified.

Tang Hangbo

Tang Hangbo, suspected of breaching the Takeovers Code, sought to challenge a search warrant obtained by the SFC and the subsequent decision to send some of the materials seized to the CSRC.

Tang argued that the SFC was assisting the CSRC in its investigation of suspected breaches of Mainland laws rather than investigating suspected breaches of Hong Kong laws. The Court rejected Tang's case as inherently improbable and contrary to common sense. It stated that the SFC's case was fully supported by the relevant contemporaneous documents and ordered Tang to pay the SFC's costs.

The SFC is empowered by law to exchange information and intelligence with other securities regulators in appropriate circumstances. Cross-boundary cooperation is of paramount importance to safeguard the integrity of markets.

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