

Hong Kong Court Confirms the SFC's Broad Powers to Share Investigation Materials With Overseas Regulators

27 February 2019

Background. In 2014, the Securities and Futures Commission (the "SFC") commenced an investigation into share trades undertaken by the First Applicant in 2013, after receiving a report from another licensed corporation indicating suspected market manipulation activities by a fund managed by the First Applicant. The trades concerned shares in Nitto Denko Corporation, a Japanese company listed on the Tokyo Stock Exchange.

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During the course of the investigation, the SFC sought and obtained various materials from the First Applicant and its majority shareholder and responsible officer, the Second Applicant, pursuant to section 181 of the Securities and Futures Ordinance (the "SFO"). This section empowers the SFC to require the production of information including information about a client, details of a transaction and instructions relating to a transaction from a licensed person. Failure to comply with a demand from the SFC under section 181 without a reasonable excuse is a criminal offence.

In July 2014, the SFC received and acceded to a request for assistance from two Japanese regulators, the Financial Services Agency (the "FSA") and the Securities and Exchange Surveillance Commission (the "SESC"). In particular, the SFC permitted the Japanese regulators to attend an SFC interview with the Second Applicant and provided them with materials previously disclosed by the Applicants in response to the SFC's requests for information.

Under section 186 of the SFO, the SFC may provide assistance to an overseas regulator by directing that its powers, including under section 181, be exercised where it is satisfied that:

- it is desirable or expedient that the assistance should be provided in the interests of the investing public; or
- the assistance will enable or assist the overseas regulator to perform its functions, and it is not contrary to the interest of the investing public or to the public interest; and

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- the overseas regulator performs a similar function and is subject to adequate secrecy provisions.

Pursuant to section 186(6) of the SFO, statements subject to a claim of privilege against self-incrimination shall not be provided to an overseas regulator.

In requesting the SFC's assistance, the FSA and the SESC relied upon a Multilateral Memorandum of Understanding of the International Organization of Securities Commission (the "MMOU"). The Japanese regulators further stated that they would use and maintain the confidentiality of any information provided by the SFC in accordance with the terms of a Statement of Intent between the SFC and the FSA as well as the MMOU. They also confirmed that this information would only be used for administrative or regulatory purposes and would not be used for criminal investigation or proceedings.

Following receipt of materials from the SFC, the SESC publicly announced that it had recommended the issuance of an administrative monetary penalty against the First Applicant to the Japanese Prime Minister and the Commissioner of the FSA. This decision was in light of findings that the First Applicant was involved in market manipulation arising out of its share-trading activities in Nitto Denko Corporation. The FSA subsequently imposed a penalty of JYP684,240,000 (approximately HK\$48.5 million) on the First Applicant on 11 June 2018.

The Applicants commenced judicial review proceedings in Hong Kong to challenge the lawfulness of the SFC's provision of compelled materials to the Japanese regulators. The Applicants relied on three grounds:

- Ground 1—The SFC acted unlawfully by transmitting to the Japanese regulators materials derived through compulsion for use in criminal proceedings in Japan;
- Ground 2—The SFC acted unlawfully by transmitting materials to the Japanese regulators without ensuring that they were subject to adequate secrecy, as required under the SFO; and
- Ground 3—Section 181 of the SFO is unconstitutional as it contravenes article 10 of the Hong Kong Bill of Rights, which guarantees equality before the courts and the right to a fair and public hearing. In particular, the Applicants argued that section 181 violates the privilege against self-incrimination and that, accordingly, the materials were unlawfully obtained by the SFC and should not have been provided to the Japanese regulators.

Decision. On 11 February 2019, the Hong Kong Court of First Instance (the “Court”) dismissed the Applicants’ judicial review application on all grounds in its decision in *AA & EA v. The Securities and Futures Commission*, [2019] HKCFI 246. It also held that the application failed as it had been made out of time without any satisfactory or sufficient explanation that could justify granting an extension of time.

As to Ground 1, the Applicants had argued that the Japanese regulatory proceedings were criminal rather than administrative such that the disclosure of information by the SFC to the Japanese regulators breached articles 10 and 11(2)(g) (privilege against self-incrimination) of the Hong Kong Bill of Rights as well as section 186(6) of the SFO.

The Court reviewed the Japanese legislative provisions and monetary penalty imposed and concluded that the proceedings were civil in nature and were aimed at disgorging illegal profits gained from breaches of the regulations or rules relating to share trading in the marketplace. Moreover, the Applicants had not made any claim of privilege against self-incrimination, aside from claims made at the interview with the Second Applicant.

In relation to Ground 2, the Court found that neither media inquiries nor the public announcement in Japan regarding the monetary penalty contravened the statutory secrecy provisions under the SFO and that the Applicants had, in any event, already sought an alternative remedy by bringing proceedings against the Government of Japan in Japan. Further, the Court held that the SFC had taken all reasonable steps and fulfilled its obligations in an “exemplary” manner by following international standard practice to ensure the confidentiality of information and documents provided to the Japanese regulators. This included sending constant reminders to, and seeking assurances from, the Japanese regulators in respect of the confidentiality of the materials provided. The Court also found that the remaining conditions under section 186 of the SFO for provision of assistance had been satisfied.

In relation to Ground 3, the Court held that section 181 of the SFO did not abrogate the privilege against self-incrimination. Importantly, the Court stated that the SFC should be required to warn and caution persons who are the subject of a demand under section 181 of this privilege and noted that the SFC would have to address this omission in the future. The Court nevertheless highlighted the privilege will only be available in limited circumstances, in particular, it will not operate in respect of pre-existing materials which exist independently of the will of the subject of the demand (as opposed to materials created in response to an investigation). In the circumstances, the information provided by the First Applicant concerned the fund and share transactions, which constituted pre-existing materials that would normally be recorded and available. The Court went on to find that, even if section 181 did operate to limit the privilege against self-

incrimination, this was proportionate to the legitimate aim underlying section 181 of ensuring the fair operation of Hong Kong's financial markets.

Significance. The SFO provides a legislative regime that empowers the SFC to share information obtained through its investigative powers to assist overseas regulators. In reaching its decision to dismiss the application for judicial review, the Court emphasised that the breadth of the SFC's powers is commensurate with its role in regulating and enforcing financial markets and ensuring Hong Kong's status as a competitive international financial centre. A key aspect of this role involves cooperating with and assisting regulatory authorities in Hong Kong and elsewhere.

The decision highlights the importance of adopting a consistent and coordinated strategy when responding to regulator demands, particularly where a regulatory investigation is likely to have multi-jurisdictional aspects. The decision is also a reminder that the subjects of regulatory demands should ensure that they expressly assert any privilege against self-incrimination where applicable including when responding to notices under section 181. Doing so will limit the breadth of materials, which may potentially be used in criminal proceedings against such persons and/or shared with overseas regulators by the SFC.

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