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Regulatory Investigations by the SFC in Hong Kong

For Joint ForensIG-RIF-CFIG Webinar

By Sherman Yan, ONC Lawyers

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Speaker

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Some Features of the SFC's Investigative Powers

1. Wide scope of investigation under the SFO

Power is invoked where there is reasonable cause to believe:

- any offence
- any wrongdoing in connection with dealing in securities, management of investment in securities...
- market misconduct
- any activity not in the public interest
- any misconduct of licensed corporation/ person – questions of “fitness and properness” and so on

has been committed.



2. Wide power to demand information and documents

- Wide power to demand documents, even overriding confidentiality obligations: s.179;
- Supervision of intermediaries – power to enter premises and conduct compliance audits: s.180
- Power to require information relating to transactions: s.181
- Information obtained can be shared by other government bodies
- Publication of investigation reports



Challenging request for documents

Securities and Futures Commission v Ernst & Young
[2015] 5 HKLRD 293

- Standard Water Limited engaged Ernst & Young (“**EY**”) for its intended IPO
- EY engaged its PRC affiliate, HM, to conduct audit field work
- EY subsequently resigned as reporting accountant and auditor, citing “inconsistencies in documentation”
- Resignation prompted the SFC to investigate requesting production of certain documents including audit working papers
- EY refused

Reasons for objecting production

1. Documents requested created by and belong to HM rather than EY itself?

Court: No, HM being the agent of EY had a duty to produce to EY all such documents even created HM itself

2. Documents requested amounted to state secrets or commercial secrets?

Court: Accepted that papers involving state secrets etc cannot be transmitted overseas without prior approval, but no evidence was adduced that documents requested were indeed state secrets.





3. China Securities Regulatory Commission (CSRC) being the proper channel for the SFC to obtain documents?

Court: NO, because the audit working papers belong to EY who, as opposed to the SFC, should be the party requesting the papers

4. EY being at risk of incurring criminal, administrative or civil liabilities by producing the documents?

Court: NO, there being no evidence on any offence being committed in the PRC

Challenging request for documents

S.380(4) Legal Professional Privilege

Nothing in the SFC affects “any claims, rights or entitlements which would... arise on the ground of legal professional privilege.”

Right to confidential legal advice: Art. 35 Basic Law

i.e. – It is perfectly lawful to object production of confidential documents on grounds of LPP

Types of LPP:

- Litigation privilege
- Legal advice privilege





Litigation privilege

- documents and communications for the sole or dominant purpose of assisting a person involved in litigation
- the litigation is either underway or is reasonably in contemplation
- this includes communications between a client and third parties.

Legal advice privilege

- documents and communications made between a lawyer in his/her professional capacity and his/her client
- for the purpose of giving or seeking legal advice

Assessing the claim of LPP - the Case of Lehman Brothers

- SFC commenced an investigation into allegations of misrepresentations relating to the Lehman Brothers Minibonds and requested production of certain documents
- Documents requested included assessments of Minibonds by an internal New Product Review committee of Lehman Brothers
- Of the documents requested, 17 were, according to LB, protected by LPP,
- Upon the SFC's application, the Court reviewed the documents in question in the privacy of the judge's own chambers
- **HELD:** certain section of 7 documents out of the 17 were not subject to LPP and should be produced

Disclosing privileged documents for a limited purpose - Partial Waiver?

Citic Pacific Ltd v Secretary of Justice [2012] 2 HKLRD 701

- The SFC commenced investigation against Citic Pacific Ltd (“**Citic**”) for its delay in publishing profit warning
- SFC served notice on Citic requiring production of all records relevant to the SFC investigation
- Amongst all the requested documents, Citic argued 6 documents were subject to LPP
- Citic surrendered all the requested documents and later argued the surrender was only for single purpose of permitting the SFC to conduct its investigation

Partial Waiver

Citic Pacific Ltd v Secretary of Justice [2012] 2 HKLRD 701

- Police subsequently commenced criminal investigation as the SFC passed the 6 documents to the Department of Justice for the purpose of seeking legal advice
- Citic sought return of the 6 documents on the ground of LPP

Partial Waiver

Court of Appeal decision

- Privilege is not lost generally where a privileged document has been disclosed for a limited purpose only
- Privilege is retained even when the privileged information came into the hands of prosecuting authorities through inadvertence or mistake
- Citic had only waived privilege in favour of the SFC for the limited purpose of its investigation, including the taking of legal advice from the DOJ

When handing over documents to regulators in regulatory investigation..

- Consider if any of the documents is privileged;
 - confidential communications?
 - communications in the professional capacity of lawyer? In house lawyer?
 - the fraud exception



- If so, decide whether to hand over the privileged document;
 - any adverse inference drawn from refusal?
 - waiving privilege to cooperate?
 - to whom the privilege belongs? Who is the “client”?
 - What if the lawyer involved objects to disclosure?
 - what if the company is already dissolved?

- If so decide to hand over, must state clearly whether the privilege is to be waived entirely or partially;

- If only partially, state clearly the scope of the waiver at the time of surrender



3. SFC - Power to conduct interview – No right to silence

Avoiding interview:

Chan Chin Yuen case

- Chan did not show up at the 1st interview
- SFC obtained a court order with penal notice compelling him to attend another scheduled interview
- Service of order by personal service failed
- Personal service was substituted by sending the order by post
- He did not show up at the 2nd interview: left HK
- SFC then applied to commit him to prison for contempt in disobeying the order to attend interview
- Arrested, released from prison subject to his undertaking to attend interview; paid costs of the proceedings on an indemnity basis

Failing to answer questions at SFC interview:

No Right to silence

Koon Wing Yee v The Securities and Futures Commission 1 HCAL 7/2007

- SFC's investigation on possible market misconduct
- Notice requiring Koon to attend an SFC interview
- Koon sought to quash that notice on that basis that it breached his "right to silence"
 - Art. 10 HKBORO – "...everyone shall be entitled to a fair and public hearing by a competent, independent and impartial tribunal..."
 - Art 11(2) HKBORO – In the determination of any criminal charge against him, everyone shall be entitled to the following minimum guarantees ... (g) not to be compelled to testify against himself or to confess guilt.



- Court's decision:

- Compelled answers or self-incriminating evidence are generally inadmissible in criminal proceedings but criminal proceedings not yet taken place at the time of interview
- Thus, compelling answers during the investigation stage does not amount to erosion of the “right to silence”

Failing to answer questions at SFC interview:

Chan Chin Tat case

- Chan attended the interview in the presence of 2 lawyers engaged by Chan
- refused to answer any questions: why?
- Plead not guilty, convicted after trial
- Mitigation: legal advice
- one month imprisonment

Providing false and misleading information to SFC:

Ha Pon Lin Emily case

- D1: Ng, stock broker
- D2: Ha, solicitor representing Ng in SFC investigation
- SFC became suspicious that Ha and Ng had invented a story and lied to cover up the suspected thefts
- SFC referred the case to ICAC
- Ha was convicted on one count of conspiracy to pervert the course of justice and sentenced to 12 months' imprisonment

Penalties

SFO

- Failure to comply:
a fine of \$200,000/ 1 year imprisonment or level 5 fine/ 6 months, notwithstanding provision of information might tend to incriminate
- Providing misleading information:
a fine of \$1,000,000/ 2 years imprisonment or level 6 fine/ 6 months
- Intending to defraud the SFC:
a fine of \$1,000,000/ 7 years imprisonment or level 6 fine/ 6 months

4. SFC - Use of dawn raids

- Warrant to enter and search premises (possibly multiple premises at the same time)
- Legal representation unlikely available if raid takes place in early morning
- Removal of documents and devices containing information outside the scope of warrant?
- Questioning people unprepared for the questions

Items to be seized

- Nature of records and documents usually broadly defined
- Reasonable grounds to believe in relevance of seized items?
- Seizing devices containing irrelevant records and documents?
- Disputed items to be sealed pending Court's hearing

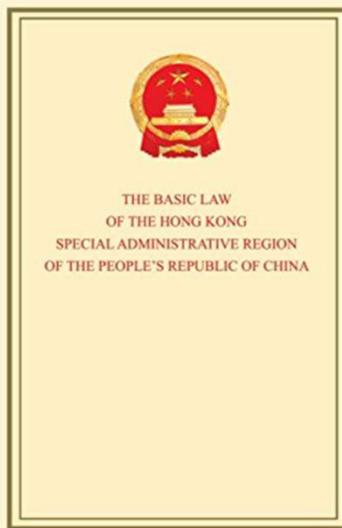


Challenging Search Warrant

- Art.29 of the Basic Law:

“The homes and other premises of Hong Kong residents shall be inviolable. Arbitrary or unlawful search of all intrusion into, a resident’s home or other premises shall be prohibited.”

- Also see Art.14 of the Hong Kong Bill of Rights



Challenging Search Warrant

S 191 Search Warrant

- Application for a search warrant from the Magistrate
 - reasonable grounds to suspect that there are/ likely to be...
 - on premises specified in the search warrant...
 - record/ documents which are/ maybe relevant to the SFC investigation

Apple Daily Ltd v ICAC (No 2) [2000] 1 HKLRD 647:

- a warrant amounts to an erosion of a citizens' rights and must be justified by law;
- the court has a constitutional duty to safeguard citizens against abuse;
- the court adopts a strict and restrictive construction of the relevant empowering statute, resolving any doubt which might arise in favour of the citizens; and
- the court is to balance two competing aspects of the public interest: detection of crimes vs protection of citizens' rights and privacy.

Application to quash a search warrant

Ground 1 :

at the time of search and seizure of documents, s.182(3)
Direction should have been produced

Court's ruling:

- no such requirement as to incorporate the s.182(3) Direction to the search warrant, as the warrant does not serve to delineate the records or documents to be seized under a warrant;



Application to quash a search warrant

Ground 2:

warrant should have identified the company whose shares were involved in the alleged insider dealing and the date(s) on which it took place

Court's ruling:

- provided there was an appropriate description of the offence, and the parameters of the warrant could be determined by the court, such further information was not necessary; Also, it was reasonable for the SFC not to include precise information in the warrant, given that the investigation was on-going

Tang Hanbo v SFC, HCAL 229/2016

Facts:

- SFC commenced investigation against Tang in relation to suspected breaches of the Takeovers Code. Meanwhile, the CSRC was investigating Tang for alleged market misconduct in mainland China.
- In June 2016, the CSRC requested the SFC for investigatory assistance. The SFC obtained a search warrant but did not inform the magistrate about the CSRC's interest in the matter.
- During the execution of the search warrant at Tang's home, the SFC officers kept the CSRC informed as to the materials to be seized/ had been seized.

- Eventually, the SFC seized notebook computers, mobile phones and documents.
- The SFC passed some of the seized materials to the CSRC. Tang was later convicted of committing certain market misconduct crimes and was fined a sum of RMB1.2 billion.



Application to challenge the search warrant

Ground 1:

by failing to inform the Magistrate about the CSRC's investigation when applying for the warrant, the SFC deliberately misled the Magistrate

Court's Ruling:

- the SFC being under a statutory duty to cooperate with the CSRC
- unnecessary to mislead the Magistrate; failing to include such information was not intentional



Ground 2:

the SFC should not have passed the seized materials to CSRC

Court's ruling:

The SFC is entitled to pass on materials to the CSRC, even if the same had been seized by the SFC for its own investigations in the first place.

Re Messrs Ip and Willis [1990] 1 HKLR 154

Application to challenge the search warrant on the ground that the terms of the warrant was too wide: reason to believe there might be anything evidence of an offence against s. 10 of the ICAC Ordinance

Court's Ruling:

- Warrant should describe the alleged offence in respect of which the search is authorised so as not to mislead the reader as to the nature of the alleged offence;



Court's Ruling:

- Search should only cover those things believed to be evidence of the commission of the particular offence;
- Must be sufficiently specific to enable the occupier, if necessary, to obtain legal advice about the permissible limits of the search;
- The warrant being silent as to (i) the particular offence in respect of which it was issued; (ii) the documents or material to be seized; (iii) the likelihood of the existence the privileged documents;
- The warrant was too wide to be valid and therefore it was quashed.

Philip KH Wong, Kennedy YH Wong & Co v ICAC (No 2) [2009] 5 HKLRD 379

Facts:

when applying for a search warrant, the ICAC gave an undertaking to the Magistrate that any material seized from the law firm for which legal professional privilege was claimed would be sealed for seven days; such undertaking was not endorsed on the warrant.

Application to quash a search warrant:

Failure to endorse the warrant with such undertaking rendered the warrant invalid



Court's Ruling:

- When applying for the warrant, the ICAC was duty bound to disclose any fact material to the magistrate's decision, including the likelihood of obtaining privileged material from the targeted premises. Failure to make such disclosure would render the warrant liable to be quashed.
- A magistrate could not authorise a search for privileged materials.
- However, a warrant is not invalid if such undertaking did not appear on the face of it.

5. Self-reporting

Paragraph 12.5 of the Code of Conduct for Persons Licensed by and Registered with the SFC

- Licensed or registered person is required to report to the SFC
- **Immediately** upon any material breach, non-compliance of laws, rules, regulations and codes issued by SFC, etc
- ...by itself or persons it employs/ appoints to conduct business



Nomura International (Hong Kong) Limited

- Nomura International (Hong Kong) Limited (“**Nomura HK**”) notified the SFC that a trader on secondment from Japan incurred a US\$3.3m trading loss (the “**11 June Report**”)
- Nomura HK also informed the SFC that a review of the trader’s activities was being undertaken and would update the SFC if any issues identified

Nomura International (Hong Kong) Limited Incident Decision

- Nomura HK was aware that the trader (i) had made false entries in its risk management system to conceal the real risk exposure of his trades, and (ii) had provided false information to Nomura HK
- Yet, Nomura HK did not disclose to the SFC in the 11 June Report - report should have been made immediately upon discovery, following internal investigation or obtaining legal advice
- Nomura HK failed to report significant misconduct **in a timely manner**
- reprimanded and fined HKD\$4.5m



Thank you!



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