

# The SFC's recent regulatory enforcement trends

Recent annual and quarterly reports published by the Securities and Futures Commission (**SFC**) of Hong Kong highlight the SFC's regulatory work for the period dated April 2020 to December 2021 (the **2020/2021 Period**). The reports take a look back at the 2020/2021 Period and also sets out the SFC's strategic priorities which it plans to pursue in order to fulfil its intention to strengthen Hong Kong's status as an international financial centre. This article summarises the key trends in the SFC's enforcement agenda which market participants can expect to continue in the year ahead.

## Key enforcement trends in a snapshot

- A continued front-loaded regulatory approach and the value of regulatory enforcement fines is increasing
- A focus on combating intermediary misconduct and corporate fraud
- Market misconduct, including insider dealing, is one of the SFC's main areas of enforcement
- Continued intervention in IPO applications
- A preference for pursuit of civil enforcement measures over criminal prosecution
- A strong emphasis on senior management accountability
- Potential reform of AML and CFT guidelines to align with international standards

As part of these reports, the SFC has published information on its enforcement actions in addition to its regular enforcement **news** alerts. For more detail on the SFC's enforcement actions, please see our Enforcement Actions Tracker below, which provides details of the SFC's enforcement actions from May 2011 for actions resulting in fines of more than HKD1 million.

## A continued front-loaded regulatory approach and the value of regulatory enforcement fines

The SFC continues to focus on "high impact" cases and adopts a targeted approach to enforcement.

The total number of actions commenced by the SFC had declined from 2015 to 2019, and remained low in the 2020/2021 Period. Nevertheless, the SFC appears to have regained some momentum in enforcement actions within this period despite the Covid-19 pandemic; the number of section 179<sup>1</sup> inquiries having increased by 35%, and there being a 3.6% increase in the number of investigations started by the SFC compared to the previous financial year.

Meanwhile, the cost of disciplinary fines had significantly increased between 2015 and 2019, and within the 2020/2021 Period, the SFC's fines rocketed to an historical high.<sup>2</sup>

Specifically, the SFC disciplined 18 corporations and 13 individuals, with a combined value of fines levied of HKD2.81 billion. Of that sum, HKD2.71bn was a result of the SFC's record fine against a single financial institution for multiple rule breaches in relation to the 1Malaysia Development Berhad bond offerings.

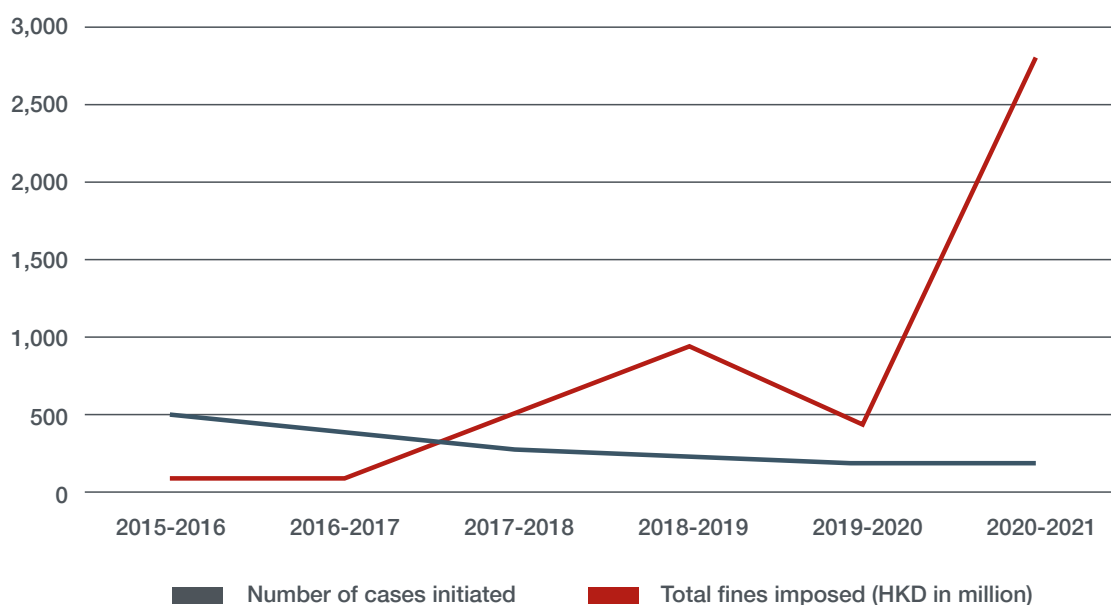
In Q2 2021, a financial institution was reprimanded and fined HKD2.45m for issuing incorrect statements to prime brokerage clients and for its delay in reporting the failures to the SFC.

<sup>1</sup> Section 179 of the SFO gives the SFC the power to compel the production of records and documents from persons related to a listed company in relation to fraud or other misconduct.

<sup>2</sup> Sources: Annual Reports of the SFC from 2015/2016 to 2020/2021.

In Q3 2021, a financial institution was reprimanded and fined HKD9.8m and HKD1.75m for internal control failures concerning the disclosure of interests in listed securities covered in their research reports, telephone recordings of client instructions, KYC requirements and product risk disclosures in the sale of a structured note to clients.

In Q4 2021, a financial institution was reprimanded and fined HKD5.5m for its failure to discharge its duties as sponsor in a listing applications; a financial institution was reprimanded and fined HKD8m for failure to comply with anti-money laundering requirements.



## Enforcement focus

From April 2020 to early December 2021, the SFC's disciplinary actions demonstrate a focus on combating:

- Intermediary misconduct: this includes IPO sponsor failures, anti-money laundering (AML) related breaches and deficient selling practices (such as internal control failures). In particular, the SFC reprimanded and fined a securities company HKD25.2m for multiple internal control failures and regulatory breaches concerning AML, third party fund transfers, placing activities and the detection and reporting of wash trades. In addition, the SFC reprimanded and fined a financial institution HKD7m for internal control system failures and failures in the sale of collective investment schemes.
- Corporate fraud: the SFC obtained disqualification orders and other orders under section 214 of the Securities and Futures Ordinance (SFO), and commenced legal proceedings against certain listed companies and senior executives. In particular, three former directors of a company previously listed on the Stock Exchange of Hong Kong were disqualified for six to nine years for their roles in the company's misapplication of funds. In addition, the SFC successfully obtained compensation orders under the SFO against these three individuals for HKD622m for the company's loss of funds.

Such actions demonstrate that intermediaries should be aware that IPO sponsor failures, AML and internal control failures are still on the SFC's enforcement radar. Further, senior executives of listed companies should ensure their conduct does not breach their duty to act in the interest of the company.

## Market misconduct is one of the SFC's main areas of enforcement

One of the SFC's top priorities is to crack down on investment fraud and scams on online platforms. In this regard, in March 2021, the SFC conducted a joint operation with the Hong Kong Police Force against an active and sophisticated syndicate suspected of operating ramp and dump schemes.

During the 2020/2021 Period, the Market Misconduct Tribunal found against a total of four individuals for insider dealing. In one of the cases, two former executives of a listed company were banned from dealing in securities in Hong Kong for three years for insider dealing in the company's shares, and were ordered to disgorge the losses of HKD4.2m they avoided. The courts also imposed jail sentences and fines against certain other individuals for insider dealing.

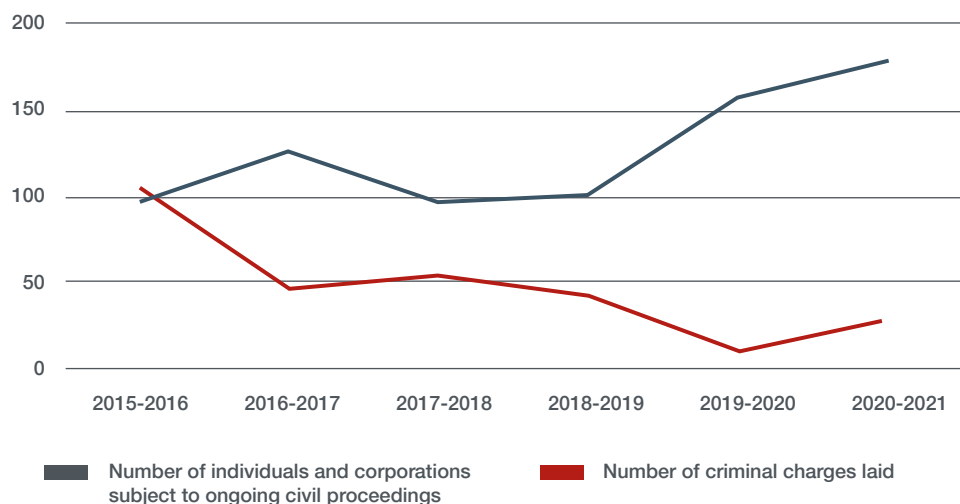
This serves as a timely reminder. Although insider dealing is usually carried out by individuals rather than corporations, licensed corporations and registered institutions should ensure they have sufficient internal training and policies in place against insider dealing by employees, and should report suspected insider dealing immediately upon it being detected.

## Continued intervention in IPO applications

During the 2020/2021 Period, the SFC received 257 new listing applications via the Stock Exchange of Hong Kong (a 15.2% decrease from 2019/2020, and the lowest number of applications in any one financial year since 2017/2018). Nonetheless, the SFC continues to seek information from or express concerns with respect to listing applicants, using its regulatory powers under the Securities and Futures (Stock Market Listing) Rules. Specifically, in the 2020/2021 Period, the SFC directly intervened in 27 applications (10.5% of the total number of listing applications) where it was aware of potentially serious disclosure or public interest issues. This is a slight drop in percentage from 2019/2020, where the SFC directly intervened in 11.6% of the total number of listing applications.

## Civil action versus criminal prosecution

The SFC can pursue enforcement action by way of criminal prosecution as well as civil, disciplinary and market misconduct proceedings. However, in recent years, the SFC has used its extensive civil enforcement measures. The number of individuals and corporations subject to ongoing civil proceedings and the number of criminal charges laid are set out in the chart below.<sup>3</sup> As illustrated, the number of individuals and corporations subject to ongoing civil proceedings continues to be on an increasing trend. On the other hand, while the number of criminal charges laid was on a decreasing trend from 2015 to 2020, the number has increased in the 2020/2021 Period by 13.3% compared to 2019/2020:



## Management responsibility

For many years, regulators across the globe have been extolling the importance of proper culture and senior management accountability for financial institutions. In APAC, the SFC arguably led the charge with the introduction of its Manager-in-Charge regime in 2017.

The SFC's focus on senior management accountability remains clear:

- In July 2021, the SFC reprimanded an individual who took up the roles of chief executive officer, director, compliance officer and money laundering reporting officer of a securities company, and fined him HKD400,000 for failures in complying with AML regulatory requirements. The disciplinary action followed the SFC's sanctions against the securities company in March 2021 over its failures in complying with AML/counter-financing of terrorism (CFT) regulatory requirements when handling third party fund transfers. The SFC found that the securities company's breaches at the material time were attributable to the individual's failures to discharge his duties as a member of the senior management.
- Further, in November 2021, the SFC reprimanded a financial institution and fined it HKD3.3m for internal control failures relating to its placing activities and recording of client order instructions. The manager-in-charge was found to have failed to discharge his duties and was suspended for six months.

Meanwhile, the Hong Kong Monetary Authority has recently published its consultation conclusions on the proposed **Mandatory Reference Checking Scheme (MRC Scheme)** to address the "rolling bad apples" phenomenon. The implementation of the MRC Scheme is a reminder of the priority regulators now place on conduct culture and governance in Hong Kong.

<sup>3</sup> Sources: Annual Reports of the SFC from 2015/2016 to 2020/2021.

## Consultation on proposals to amend anti-money laundering guidelines and virtual asset providers

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Related to the SFC's focus on AML, in September 2020, the SFC launched a consultation on proposals to amend the AML and CFT guidelines to align with international standards and to provide guidance to the securities industry on applying these measures in a more risk-sensitive manner. The proposals also address some areas of enhancement identified in the Mutual Evaluation Report of Hong Kong published by the Financial Action Task Force in September 2019.

Separately, in May 2021, the Financial Services and the Treasury Bureau published its consultation conclusions on legislative proposals to enhance AML and CFT regulation in Hong Kong, seeking to introduce a licensing regime for virtual asset service providers. The Government will proceed to prepare the amendment bill based on the consultation conclusions, with a view to introducing the amendment bill into the Legislative Council in the 2021-22 legislative session.

## Statistics in the Q4 2021 quarterly report

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It is the SFC's usual practice to present its enforcement actions statistics by way of a year-over-year comparison. As illustrated below, the SFC's enforcement actions in Q4 2021 were noticeably more active compared to Q4 2020:

- The number of section 179 inquiries (section 179 of the SFO gives the SFC the power to compel the production of records and documents from persons related to a listed company in relation to fraud or other misconduct) commenced increased by 55.2%.
- The number of section 182 (section 182 of the SFO empowers the SFC to investigate offences including market misconduct, fraud, misfeasance and disciplinary misconduct) directions issued increased by 23.6%.
- There was a 17.9% increase in the number of investigations started by the SFC.
- There was however a 42.8% decrease in the number of investigations completed by the SFC.
- There was a 55.6% decrease in the number of individuals and corporations charged in criminal proceedings.
- There was a 77.8% increase in the number of notices of proposed disciplinary action.

## Conclusion

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The SFC continues to focus its enforcement efforts on cases that have the potential to harm investors and cause serious reputational damage to Hong Kong. This trend is likely to continue. Notably, the SFC recently imposed its largest fine to date. That said, intermediaries must not get complacent regarding smaller breaches as the SFC continues to pursue action in relation to AML, internal control failures and regulatory breaches. In the current environment, with numerous issues arising from Covid-19, it is important that intermediaries ensure strict compliance with regulations in order to prevent misconduct or failure to observe regulatory requirements and internal controls.

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