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HONG KONG SFC REITERATES EXPECTATIONS FOR LICENSED CORPORATIONS AND MANAGERS-IN-CHARGE FOR FOREIGN REGULATORY BREACHES AND SELF-REPORTING

To Our Clients and Friends:

On 12 October 2022, the Hong Kong Securities and Futures Commission (“SFC”) reprimanded and imposed a HK\$1.75 million fine on Asia Research & Capital Management Limited (“ARCM”), a Hong Kong licensed corporation (“LC”), for its failure to:

- comply with Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps (“EU Regulation”); and
- promptly notify the SFC of its regulatory breaches.[1]

The SFC also banned ARCM’s Manager-In-Charge (“MIC”) for Compliance, Mr. Billy Wong Yim Chi (“Wong”), for 2 months in relation to the above failures.

This disciplinary action is particularly noteworthy given that the SFC has imposed disciplinary action in relation to a licensed firm’s failure to comply with foreign regulatory requirements. [2] [3] Further, this matter is also the second time that the SFC has announced disciplinary actions against an MIC since the introduction of the MIC regime in 2017. The SFC’s first disciplinary action against an MIC was in November 2021 against Fulbright Securities Limited and its MIC.[4]

I. Disciplinary action against ARCM

The disciplinary action against ARCM by the SFC followed a similar action against the firm by the Financial Conduct Authority (“FCA”) in the United Kingdom in relation to its failures to comply with the EU Regulation in relation to disclosures of its net short position in Premier Oil Plc, a company listed on the London Stock Exchange.[5]

The SFC was unsympathetic towards ARCM’s explanations that its breach of the EU Regulation was due to ARCM’s unfamiliarity with the EU Regulation, its reliance on reference materials provided by its prime brokers rather than on legal advice regarding the EU reporting regime and the absence of alerts from ARCM’s investment bank counterparts.

Instead, the SFC attributed ARCM's failures to:

- a lack of any formal process in its compliance framework requiring its staff members to analyse and understand reporting requirements which might apply when the firm invests in a new jurisdiction and implement appropriate controls;
- its failure to incorporate controls to ensure continuous compliance with the EU Regulation; and
- its decision to rely on reference materials provided by its prime brokers without conducting any further analysis. The SFC noted that if ARCM had sought legal advice on its reporting obligations or taken steps to independently check on reporting obligations under the EU Regulation, it would have identified its obligations to report short positions held through swap transactions.

The SFC considered that the above failures amounted to a breach of:

- General Principle 2 (Diligence) of the Code of Conduct for Persons Licensed or Registered with the Securities and Futures Commission (“**Code of Conduct**”)[6], which requires licensed corporations to act with due skill, care and diligence in the best interests of its clients and the integrity of the market; and
- General Principle 7 (Compliance) and paragraph 12.1 of the Code of Conduct, which require licenced corporations to comply with all regulatory requirements applicable to the conduct of its business activities and to implement and maintain measures appropriate to ensuring compliance with the law, rules, regulations and codes administered or issued by the Commission, the rules of any exchange or clearing house of which it is a member or participant, and the requirements of any regulatory authority which apply to the licensed or registered person.

The SFC also found that ARCM's notification of its breaches of the EU Regulation two months after notification of such breaches to the FCA constituted a breach of the requirement under paragraph 12.5 (Notifications to the Commission) of the Code of Conduct to notify the SFC immediately of any material breach of any regulatory requirements applicable to the licensed corporation.

II. Disciplinary action against Wong

Wong was ARCM's Head of Compliance and Operations, and the MIC for Compliance during the relevant time periods. As MIC for Compliance, his responsibilities included handling regulatory filings in relation to ARCM's portfolio positions, and consulting external legal advisors where necessary. The SFC took the view that ARCM's failures were attributable to Wong's neglect in discharging his responsibilities as MIC for Compliance and as a member of senior management. In particular, the SFC noted that Wong failed to:

- implement adequate controls to ensure ARCM's compliance with the EU Regulation; and
- seek legal advice on the short position reporting obligations under the EU Regulation despite Wong and his team's unfamiliarity with the EU regulatory regime.

Based on the above findings, the SFC held that Wong had breached General Principle 9 (Responsibility of senior management), and paragraph 14.1 of the Code of Conduct. The provisions required Wong, as senior manager, to bear primary responsibility for maintaining appropriate standards of conduct and procedures, and to properly manage risks associated with the business of the LC.

III. Conclusion

This disciplinary action serves as a reminder to LCs and their senior management of the broad scope of the Code of Conduct in relation to foreign regulatory requirements, both from a compliance perspective as well as a self-reporting perspective. In particular, it serves as an important caution to firms considering whether foreign regulatory breaches may have triggered foreign self-reporting obligations that they must also carefully consider whether a self-report under paragraph 12.5 is required. Given the stringency of the self-reporting standard under paragraph 12.5 in comparison to foreign reporting requirements, this may put some firms in the uncomfortable position that foreign regulatory breaches may not require reports to be made to foreign regulators, but will require reporting in Hong Kong to the SFC. Similarly, given the ‘*immediate*’ nature of the Hong Kong self-reporting requirement and the SFC’s expectation that firms report prior to completion of investigations into the relevant conduct, firms may also need to report to the SFC before reporting to foreign regulators.

Further, this case is also particularly significant given the SFC’s clear expectation that senior management will seek legal advice in relation to regulatory requirements where they and their teams are unfamiliar with these requirements, rather than relying on (for example) summaries provided by counterparts. This should serve as an important reminder to senior Compliance staff of the need to carefully assess the necessity of seeking legal advice when entering new jurisdictions and/or rolling out new product types or lines of business. We would recommend that firms review their processes in relation to new types of business activity more broadly to ensure that these processes require active consideration by senior management as to whether legal advice is required, with a particular emphasis on new types of business activity which might lead to the firm being subject to foreign regulatory requirements.

[1] “SFC reprimands and fines Asia Research & Capital Management Limited \$1.75 million and bans former senior executive Billy Wong Yim Chi for two months” (12 October 2022), published by the Securities and Futures Commission, available at: <https://apps.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=22PR79>

[2] Previously, the SFC had disciplined Capital Global Management Limited (“CGML”) over breaches of foreign regulatory laws. In February 2020, the SFC reprimanded and fined CGML HK\$1.5 million for failing to ensure compliance with Taiwan’s Securities Investment Trust and Consulting Act when distributing investment funds and offering investment advice in Taiwan, and for failing to adequately supervise the business activities of its representatives to ensure such compliance. The SFC enforcement action followed the judgment of the Prosecution Office of the Taipei District Court which

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fined the owners of CGML. See “SFC reprimands and fines Capital Global Management Limited \$1.5 million” (14 February 2020). Published by the SFC, available at <https://apps.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=20PR16>.

[3] We further note that the SFC recently suspended a Responsible Officer and CEO of a licensed firm for two years following the SFAT upholding the SFC’s disciplinary action against this individual for breaches of the SFC Code of Conduct which occurred as a result of breaches of Korean legislation. See “SFAT affirms SFC decision to suspend hedge fund manager Christopher James Aarons” (29 September 2022), published by the Securities and Futures Commission, available at <https://apps.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=22PR75>.

[4] “SFC reprimands and fines Fulbright Securities Limited \$3.3 million and suspends its responsible officer for internal control failures” (1 November 2021), published by the Securities and Futures Commission, available at <https://apps.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=21PR107>

[5] “Final Note to Asia Research and Capital Management Ltd” (14 October 2020), published by the Financial Conduct Authority, available at <https://www.fca.org.uk/publication/final-notice/asia-research-and-capital-management-ltd-2020.pdf>. The FCA’s disciplinary action against ARCM resulted in ARCM being fined £873,118.

[6] “Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission” (August 2022), published by the Securities and Futures Commission, available at https://www.sfc.hk/-/media/EN/assets/components/codes/files-current/web/codes/code-of-conduct-for-persons-licensed-by-or-registered-with-the-securities-and-futures-commission/Code_of_conduct_05082022_Eng.pdf



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Gibson Dunn’s lawyers are available to assist in addressing any questions you may have regarding these developments. If you wish to discuss any of the matters set out above, please contact any member of Gibson Dunn’s Global Financial Regulatory team, including the following members in Hong Kong:

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