News

04 March 2022

Hong Kong regulatory enforcement trends: is change on the horizon?

• Freshfields' annual analysis of regulatory enforcement trends shows that the SFC's "staple diet" of enforcement priorities remained largely unchanged last year

• But with the SFC's continued evolution being critical to its effectiveness, and a new Executive Director (Enforcement) set to take up the reins shortly, a new enforcement approach may lie ahead

Hong Kong's Securities and Futures Commission (SFC) continued to take enforcement action involving the most "high impact" cases with the greatest adverse impact on the market during 2021, according to new research from international law firm Freshfields Bruckhaus Deringer (Freshfields). These included cases of listed company misconduct, listed company fraud, market misconduct (e.g. insider dealing and market manipulation), and intermediary misconduct.

While total fines were significantly lower last year (HK$72.1m) compared to the previous year (HK$2.8bn), the general trend over the past five years is that total fines are on an upwards trajectory, largely accounted for by significant fines in a few very large matters, consistent with the SFC's "less is more" enforcement approach.

As Hong Kong's financial markets continue to grow and become more complex and fast-moving, the latest enforcement data raises questions about whether the SFC can or should maintain its current enforcement approach. Freshfields' analysis identifies various questions and issues for the incoming Executive Director of Enforcement, who has not yet been named, and for the market more broadly, to consider.

“Regulatory enforcement in Hong Kong has changed dramatically in recent years, moving from often hard-edged enforcement after-the-event more towards preventing problems and remedying emerging problems before they become bigger,” said Tim Mak, partner and head of Freshfields’ Asia dispute resolution practice. “This evolution of the SFC’s approach to enforcement makes sense – enforcement should be used alongside other, non-enforcement tools, as part of a ‘suite’. Going forward, the SFC’s ability to continue to adapt will be critical to the effectiveness of its enforcement efforts.”

Freshfields’ analysis goes on to make a number of predictions for 2022 and 2023.

• We expect regulators to continue to hold **individuals** accountable for misconduct wherever possible, whether in a listed company or regulated entity context. Over time, we expect to see the SFC take more action against those who are Managers-in-Charge of relevant control functions such as Compliance and Anti-Money Laundering.

• Regulators will be keen to learn the lessons of the **Covid-19 pandemic** and what has happened since 2020, both in terms of what market participants did well and where they could improve in the event of a similar crisis. Contingency arrangements during the pandemic will likely have created additional risk for many market participants. Trading from home and from multiple locations (for example) gives rise to a very different risk profile to trading from a central office, including with respect to supervision, monitoring, compliance and cybersecurity. Similarly, the inability to conduct IPO due diligence face-to-face in mainland China due to restrictions changes the risk profile for IPO sponsors.

• Regulatory pronouncements and areas of focus over the last several years shows how important all three aspects of **ESG** are to Hong Kong regulators. We can expect to see regulatory enforcement attention focusing more on ESG-related failures, particularly disclosure failures / “greenwashing”, which can have a direct and profound impact on market integrity.

• There are likely to be more large **IPO sponsor** enforcement outcomes in future, given the regulators’ focus on improving corporate governance and the quality of companies that come to Hong Kong to list. The SFC is likely to continue to seek its first test case for determining whether the Hong Kong High Court will grant an order against an IPO sponsor to compensate investors in connection with prospectus disclosure and due diligence failings. In other types of **fundraising** outside of IPOs, the SFC is likely to scrutinise book-building, pricing, allocation and placing activities, with new conduct rules governing these activities due to come into force in August 2022.

• The SFC's Enforcement team made significant efforts over 2021 to tackle **online frauds** such as "ramp-and-dump" schemes, particularly those where the listed companies and individuals connected to them were suspected of involvement in the potential wrongdoing. Given the prevalence of this type of conduct, we would expect this to remain in the SFC's crosshairs in future, with the regulator seeking effective ways to enforce against those who successfully target Hong Kong investors from abroad.

• **Anti-money laundering** remains high on law enforcers' agendas in the world's major financial markets. We expect AML to remain a core focus for both the HKMA and the SFC, and other market regulators such as the Stock Exchange and Insurance Authority. This is also an area that, from an internal controls perspective, we consider would benefit from the use of cutting-edge financial and regulatory technology.

• Hong Kong remains one of the world's foremost private banking centres and its size continues to grow. The increasing complexity of financial products underpins regulators' ongoing concerns about the risks around **investment product selling processes** and potential misselling. We expect regulators to continue to address this proactively, for investor protection. The SFC and HKMA recently unveiled plans for a concurrent SFC-HKMA thematic review of the distribution of non-exchange traded investment products, such as equity-linked structured products and corporate bonds. There is potential for enforcement action if the review uncovers evidence of significant compliance problems.

Click here to download Freshfields' Hong Kong Regulatory Enforcement Trends analysis.

ENDS