HONG KONG COURT CLARIFIES INDIVIDUALS' RIGHT AGAINST SELF-INCRIMINATION UNDER SECTION 181 AND SFC'S POWER TO ASSIST FOREIGN REGULATORS

Key issues

- The Hong Kong courts have now confirmed that the privilege against self-incrimination is permissible under section 181 of the SFO
- Cross-border investigations with foreign financial regulators remain a priority for the SFC's

On 11 February 2019, the Court of First Instance finally handed down its final decision in *AA & EA v The Securities and Futures Commission (HCAL 41/2016)*. This important decision clarifies two issues:

- The right against self-incrimination of the recipients of the Securities and Futures Commission's (SFC's) section 181 notices, which are issued by the SFC in its preliminary enquiries for obtaining trading information
- The SFC's power to give investigatory assistance to overseas regulators pursuant to section 186 of the Securities and Futures Ordinance (SFO) and the International Organization of Securities Commissions' Multilateral Memorandum of Understanding (IOSCO MMOU)

BACKGROUND

The 1st applicant (AA) was an SFC-licensed investment manager of a hedge fund (the Fund). The 2nd applicant (EA) was the majority shareholder and a responsible officer of the 1st applicant. In April 2014, the SFC received a self-report from another licensed corporation regarding suspected market manipulation activities of its client, the Fund. It was suspected that the Fund manipulated the share price of a Japanese company listed on the Tokyo Stock Exchange after this company announced in September 2013 that it would become a constituent stock of the Nikkei Index.

In May 2014, the SFC conducted a preliminary enquiry by issuing a notice under section 181 of the SFO (section 181 notice) to the 1st applicant asking for the details of its trades in the shares of the Japanese company. The 1st applicant and its then solicitors responded to the section 181 notice and provided the trading data requested without claiming privilege against self-incrimination.

In June 2014, the SFC informed the Japanese Financial Services Authority (FSA) and its enforcement arm, the Securities and Exchange Surveillance Commission (SESC), of the suspicious transaction report submitted by the licensed corporation. Thereafter, the Japanese regulators requested the SFC's assistance in investigating the suspected misconduct of the 1st applicant pursuant to the IOSCO MMOU.

THE SFC'S INVESTIGATION

The SFC then commenced a formal investigation by issuing directions under section 182 of the SFO (section 182 investigation directions) in respect of the suspected breaches of the false trading/price rigging provisions of the SFO (which cover market manipulation of overseas stocks) and also the corresponding provisions of the Financial Instruments and Exchange Act of Japan. In August and September 2014, the SFC issued investigation notices under section 183 of the SFO (section 183 notices) to the 1st applicant asking it to produce documents and provide written answers regarding the Fund's trading in the shares of the Japanese company. Again, the 1st applicant and its then solicitors responded to the section 183 notices without claiming privilege against self-incrimination.

In October 2014, the SFC compelled the 2nd applicant to attend an interview at the SFC's office. The interview took place on 27 and 28 November 2014. At the interview, the 2nd applicant claimed privilege against self-incrimination in respect of his answers.

At the request of the FSA and SESC, the SFC passed the information and documents obtained from the 1st applicant pursuant to the section 181 and 183 notices to the FSA and SESC in September and October 2014. The audio recording of the interview with the 2nd applicant was subsequently provided to the FSA and SESC in March 2015.

THE ANNOUNCEMENT BY THE SESC

On 5 December 2014, the SESC published an announcement that it intended to impose an administrative monetary penalty of ¥430,740,000 (later increased to ¥684,240,000) on the 1st applicant for manipulating the shares of the Japanese company in September 2013.

In January 2015, the former solicitors of the applicants complained to the SFC about the media leakage prior to the SESC announcement and its adverse effect on the 1st applicant's business. However, not until February 2016 did the applicants make an application to the Hong Kong court for leave to commence judicial review.

GROUNDS FOR JUDICIAL REVIEW

The applicants submitted three major grounds for the judicial review:

1. The administrative monetary penalty proceedings in Japan were, in substance, criminal proceedings according to the characterisation criteria set out by the Court of Final Appeal in *Koon Wing Yee v Insider Dealing Tribunal [2008] HKCFA 21*. As such, the SFC should not have passed the materials obtained through its compulsory powers to the Japanese regulators.
2. The SFC failed to ensure that the Japanese regulators had complied with the secrecy requirements, leading to the leakage of information about the investigation to the media prior to the SESC announcement.
3. Section 181 of the SFO is unconstitutional because it contravenes Articles 10 and 11 of the Hong Kong Bill of Rights Ordinance (BOR) by abrogating the privilege against self-incrimination.

All of these arguments were dismissed by Zervos JA in his 11 February 2019 judgment.

In relation to the first ground, the Court of Final Appeal in *Koon Wing Yee* established that, in determining whether proceedings were criminal in nature for the purposes of Articles 10 and 11 of BOR, the following three criteria are applicable:

- the classification of the offence under domestic law
- the nature of the offence
- the nature and severity of the potential sanction

Zervos JA examined these criteria and concluded that the administrative monetary penalty proceedings commenced by the FSA and SESC in Japan were civil, not criminal, in nature. The purpose of the proceedings in Japan was merely to disgorge the profits derived from breaches of the financial regulations in relation to share trading activities of the 1st applicant. The fine proposed by the SESC was disgorgement in nature, not punitive or deterrent.

Regarding the applicant's allegation that the SFC had failed to ensure that the Japanese regulators had complied with the secrecy requirements, the court accepted the evidence of Jimmy Chan, then SFC Director of the Enforcement Division, that the various requirements that need to be satisfied for the preservation of confidentiality of information when dealing with overseas regulators were extensively addressed and the SFC had fulfilled its secrecy obligations.

In relation to the applicants' argument that section 181 contravenes Articles 10 and 11 of BOR, both the SFC and the Secretary for Justice (who intervened in the proceedings due to the constitutionality issue) submitted that section 181 did not intend to abrogate the privilege against self-incrimination, which is available to be exercised where the circumstances permit. They pointed out that section 181(7) expressly allows for non-compliance with a section 181 demand where there is "reasonable excuse" and does not contain any words that exclude the privilege (unlike section 179(16) or section 184(4)). Zervos JA accepted their submissions that the legislature did not intend to abrogate the privilege, and that privilege may constitute a reasonable excuse for non-compliance under section 181. In any event, the judge accepted the SFC's submission that the 1st applicant could not now complain on the basis of privilege against self-incrimination in relation to its written answers and materials provided to the SFC under the section 181 notice because, at the time when the 1st applicant responded, the 1st applicant and its then solicitors did not claim that privilege (as noted above, only the 2nd applicant made the claim during the oral interview).

Finally, the judge also held that the application was made out of time with no satisfactory explanation for the delay.

PRACTICAL CONSEQUENCES

This case is significant for two reasons:

1. Before this decision, whether a recipient could refuse to respond to a section 181 notice from the SFC based on the privilege against self-incrimination had been subject to academic debate. The judgment now makes it clear that a claim of such privilege can amount to a "reasonable excuse" for non-compliance under section 181. The implications can be significant: since 2014, on average the SFC has been issuing over 8,000 section 181 letters of enquiry every year. Recipients of section 181 notices

should now seriously consider whether they would exercise the right to claim the privilege in declining to reply, failing which their replies may be used by the SFC in Hong Kong criminal proceedings or passed on to foreign regulators for use in criminal or punitive proceedings. It should be noted, however, that the privilege may not be applicable where the documents sought by the SFC are "pre-existing materials" that "have existence independent of the will" of the person claiming the privilege, and may only be applicable to "materials created in response to the investigation which come into existence by an exercise of will pursuant to a testimonial obligation imposed upon the party" (and the judge recognised that it would be rare that the information failing under the scope of section 181 would not be an existing or public record). It is noteworthy that the judge held that although the failure by the SFC to caution a recipient of a section 181 notice of the right not to provide the information in the exercisable privilege against self-incrimination did not render the provision unconstitutional as a result, the SFC would "need to address" this in the future.

2. The judgment affirms the SFC's power to provide investigatory assistance to foreign regulators pursuant to section 186 of the SFO and the IOSCO MMOU. Currently the IOSCO MMOU has 121 signatories, including major securities regulators like the China Securities Regulatory Commission, the US Securities and Exchange Commission, the UK Financial Conduct Authority and the Monetary Authority of Singapore. In 2017 alone, there were over 4,800 investigatory and exchange of information requests made among the signatories. The most significant cross-border investigation conducted by the SFC recently was the CSRC-SFC's investigation into Tang Hanbo, a recidivist market manipulator from the Mainland. The SFC conducted a raid of Tang's home in Hong Kong and passed the seized materials to the CSRC. Afterwards, Tang was fined over RMB250 million by the CSRC (see *Tang Hanbo v SFC [2018] 1 HKLRD 272*). There is no doubt that the SFC, whose CEO is the incumbent Chairman of IOSCO, will continue to work closely with foreign regulators in tackling cross-border misconduct.

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