

## Keynote speech at 8th Pan Asian Regulatory Summit

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Good morning everyone. I would like to thank Thomson Reuters for inviting me back for this year's Pan Asian Regulatory Summit. It is a pleasure to be invited back.

When I spoke to you at this forum last year, I was only five months into my role. I was feeling my way through the local regulatory environment – learning as I go. I am still learning and I continue to be impressed by Hong Kong's exciting and dynamic market.

Last year when I spoke, I was busy identifying the key challenges faced by the Enforcement Division and putting together a strategic plan to tackle these challenges. A year on, we have now implemented many of the initiatives from this strategic plan, which I will share with you today.

But before we get started, I want you to keep something in mind. Hong Kong is still one of the safest securities markets in the world. Only a small minority of the 2,000 listed companies have issues that cause us concerns.

The problem is that there have been a series of corporate fraud cases which have caught the eyes of the international press. To protect the reputation of Hong Kong as an international financial centre, we are laser-focused on stamping out these problems.

While the regulatory challenges are difficult, take comfort in that they are solvable and we have the best people, organised properly to meet these issues head on.

So like every market in the world, we have problems, but they are being managed. Hong Kong remains a great place for capital formation and investment.

Now let me tell you about some of the developments from the strategic plan. One of our most important achievements is the strategic alignment of our priorities with those of the SFC as a whole. We have established an ongoing dialogue with each division of the SFC to ensure that our enforcement priorities will continue to remain aligned.

We have also completed a reorganisation of the division. Our specialised teams are now up and running – each organised around the key risks facing our markets. These teams have enhanced our focus on the most serious cases which pose the greatest threats to our markets.

To allocate cases to these teams, we have to first categorise and group them. Sometimes, it is not a simple task, as complex cases often have multiple elements. But, this grouping of

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Note: This is the speech as drafted and may differ from the one delivered.



cases gives us a great “line-of-sight” advantage – allowing us to evaluate the nuances of each case so we can prioritise them with greater precision.

### **Intake filter and prioritisation**

Other than prioritisation, we also made a special effort to reduce our overall caseload through culling low-priority cases and filtering out new cases which do not meet our threshold. We have succeeded in reducing our caseload by a third.

This is partly good news for you too. Now, you do not have to expend resources on matters which are not a priority for us. The bad news is – when we knock on your doors, it will probably be for something quite serious.

The Enforcement Division has changed significantly since the last time I spoke to you. We have fully re-organised our teams, we have re-aligned our priorities and we have generally become more focused on the hard problems that are important.

So, why did we make all these changes? It is all about finding smarter and more efficient ways to tackle enforcement challenges – some of which are unique to the Hong Kong markets.

### **Hong Kong’s unique enforcement challenges**

It is no secret that, cross-border evidence gathering poses some of the greatest enforcement challenges for us. Securing evidence across the border such as locating suspects who have fled Hong Kong is particularly challenging. We are actively looking at a new regulatory response that will partially address the problem. So, please watch this space.

Although other markets may have similar problems, the very high percentage of non-Hong Kong businesses listed here means that these problems have a much greater impact on our markets than on any other market in the world.

So, as I will mention in a minute, we have emphasised specific strategies to deal with our unique problems. One of these strategies is to actively build upon our already very strong relationship with our Mainland regulatory partner – the China Securities Regulatory Commission (CSRC).

As our CEO, Mr Ashley Alder, pointed out yesterday, cross-border cooperation with the CSRC is crucial for Hong Kong’s continual development as an international financial centre.

To mitigate the risks, any proposal for further cross-border capital flows with the Mainland must come with corresponding advancements in regulatory cooperation.

Let me tell you a bit about how we have been developing our relationship with the CSRC.

We have been holding regular **high-level meetings** between senior members of our respective enforcement teams. At these meetings, we discuss key enforcement challenges such as gaining access to evidence on the Mainland.

We have held a **joint training** on market manipulation in Xi'an last year which was attended by over 100 delegates from both organisations. We are planning a similar training in December this year.



To ensure that staff members on both sides truly understand each other's cultural and business practices, we have maintained a very **active staff secondment programme**.

Through years of hard work, the CSRC and the SFC have formed a strong and reliable partnership. This relationship is the cornerstone for all future developments in cross-border capital flows.

One of the key risks that this strategic partnership will help to address is corporate fraud involving companies on the Mainland which I alluded to in my introduction.

### **Corporate Fraud**

You will remember that last year I told you that we believe the greatest threat to the reputation of Hong Kong as an international financial centre was corporate fraud and misfeasance. I said this because corporate fraud severely undermines the integrity of our markets. A market's reputation is hard earned and easily lost, which is why we have prioritised these cases. The SFC currently has 136 active corporate fraud and misfeasance investigations. Of these, we are *laser-focused* on 28 that are particularly serious.

It is interesting to note that, quite a number of these serious cases involve gross overstatement of revenue and circular financing – many facilitated by related parties and false customers.

Of course, one of the risk management tools that is essential for preventing this type of fraud is our IPO sponsorship regime. As I also mentioned last year, we have concerns that some of this work is sub-standard. Some of the cases we reviewed even leaned towards reckless behaviour.

I am talking about very basic concepts like verifying material customers and failing to react appropriately to large red flags. We are currently investigating 15 sponsor firms, which we believe may have undertaken sub-standard work which has resulted in billions of dollars in investment losses.

Interestingly, what we are seeing as the common denominator is a failure of sponsors to verify critical business data such as material customers and revenue information. So we are concerned about the relationship between sub-standard sponsor work and listed company fraud. Some people have suggested that we have raised the regulatory standards and we are now applying these new standards on sponsors retrospectively.

This is just plain wrong. Sponsors have always been under a duty to make reasonable inquiries to satisfy themselves about the disclosures made by listing applicants.

So the basic steps of confirming material customers and investigating large red flags have always and continue to be the duty of sponsors. Any notion that the SFC is judging sponsors' prior conduct using new standards is hugely misconceived.

I want to emphasise that we intend to ensure the sponsorship regime – which is so critical to our listing process – serves its gatekeeping functions. We will make every effort to hold sponsors accountable, if they fail to discharge their regulatory duties.



## Front-loaded regulation and “One SFC”

Ashley mentioned this yesterday. I want to speak briefly about the SFC’s new regulatory approach. You may have already heard about terms such as “front-loaded regulation” and “One SFC” from my other colleagues, as these are not specifically enforcement initiatives. The SFC as a whole is moving towards a more proactive and preventive approach to regulation.

In this context, I want to highlight some of the quick actions we have taken in suspending the trading of the shares of some listed corporations under this new regulatory approach.

As I have told you last year, enforcement actions can take time. In Hong Kong - especially - the evidentiary challenges can substantially interrupt our investigation timelines.

By the time we commence traditional enforcement actions, it is typically too late to prevent or contain the harm to investors. By moving quickly to suspend trading, we can protect new investors from harm while we complete our investigations.

In 2017, we invoked 10 suspensions. One of these was done as recently as last week. We collaborated closely with our Corporate Finance and Intermediaries divisions in these cases, and we will continue to do so where investor interests are particularly at risk.

We have been moving *beyond* collaboration at the policy level – to collaboration at the *operational* level. A good example is the “**I-C-E**” team that we have setup. The team has officers from the **I**ntermediaries, **C**orporate Finance and **E**nforcement divisions who collaborate to tackle difficult issues relating to listed companies, especially in the Growth Enterprise Market (GEM).

The combination of expertise and resources has allowed us to undertake larger and more focused actions in response to a wider range of threats.

I want to stress that ICE is not a policy unit. We are an operational group that has been tasked with identifying the difficult problems in the markets and tackling them with regulatory strategies using the SFC’s full assortment of tools.

A good example of a difficult problem ICE took on was the price volatility of some GEM stocks. As my colleagues have discussed in other forums, we applied our tools of supervision, communication of expectations, and investigation to achieve great success. Our efforts have had the effect of curbing price volatility which was damaging our markets.

Another difficult problem undertaken by ICE is the emergence of nefarious groups of inter-related companies that work in coordination to extract value from unsuspecting investors. They exploit regulatory blind-spots and camouflage themselves with apparently legitimate transactions that may not make any business sense beyond the very superficial level. They may be engaged in everything from market manipulation to financing transactions designed to defraud minority shareholders.

ICE is now executing a complex regulatory strategy to identify and eliminate these groups, and to stop those responsible from engaging in this behaviour.



In fact, in relation to one of these groups, ICE recently authorised the largest-ever search operation in the history of the SFC. We pulled together 136 officers from three SFC divisions to search multiple premises.

We are now processing the evidence seized during this search with the continued assistance of all three divisions. So you can see that we have met this challenge head on. This type of operation would have been very difficult to undertake without close collaboration between divisions.

The SFC is now fully committed to using all the resources at its disposal in a coordinated manner to protect investors. Anyone who has been exploiting investors through this type of scheme should not underestimate our resolve to stop them.

### **Cooperation in enforcement proceedings**

Cooperating with us in enforcement proceedings is a point I regularly emphasise.

When discussing cooperation with enforcement, you need to realise it is *not* about deal-making, or compromise.

I always tell people who are facing enforcement actions that they need to consider a number of choices some of which can seem very unpleasant. So, let me give you some basic ideas about our thought processes.

Firstly, enforcement does not drive regulatory policy. It tries to ensure compliance with rules and regulatory requirements by seeking penalties for those who breach our rules. We want to deter specific behaviours and convince people not to attempt similar behaviours in the future.

Now, there are always litigation risks and resource expenditures which we have to consider with each action, but we accept that these are the costs of performing our functions. So when you try to discuss settlement sanctions with us, think of the following:

We are highly focused on two factors:

- Specific deterrence and
- General deterrence.

Let us start with the latter.

In order to properly achieve general deterrence, we need to ensure that the totality of the sanction will deter future mis-behaviour in the market. So no matter what your level of cooperation is, we always try to impose a sanction which achieves this goal.

Where you may have some influence is in the area of specific deterrence. We need to ensure that you will not repeat the behaviour and the penalty has to fit that proposition.

Here we consider a number of factors which are not exclusive:

- Did you promptly and fully self-report the problem to us?
- Did you provide cooperation from the beginning of the investigation?
- Did you go beyond your statutory or regulatory duties?



- Did your senior management acknowledge the problem, and provide us with their plans and undertakings to prevent a recurrence of the problem?
- Has the harm to investors or clients been remediated?
- Have you engaged an independent review of the issue, and shared the results with us?

These are all indicators that the aspect of specific deterrence has been satisfied and would encourage us to consider a penalty which takes these factors into consideration.

As I said, when dealing with enforcement, you are faced with a range of choices, but you can influence some aspects of the enforcement outcome by demonstrating responsible corporate citizenship.

We will soon be giving more granular guidance in a new guidance note designed to encourage early cooperation.

The guidance note will cover disciplinary, civil and Market Misconduct Tribunal proceedings but will not apply to criminal cases as the Department of Justice has unfettered discretion over criminal prosecutions. The guidance note is not yet finalised, so I cannot go into anything specific today.

What I can say is that within the context of what I have just said we will try to be transparent about

- what may be the benefits of cooperating with the SFC,
- what are the most important issues we care about in settlement discussions, and
- when may be the most opportune times to engage us in these discussions.

### **Cooperation between the SFC and other regulators**

On this note, I also want to speak about our cooperation with other regulatory authorities. In an increasingly interconnected world, regulators can no longer expect to do their jobs alone. We have therefore made special efforts to reach out to other key regulators both in and outside Hong Kong.

Domestically, we have collaborated with the Hong Kong Monetary Authority to conduct parallel investigations into specific types of mis-selling cases. This ensures that we apply a consistent approach in handling similar enforcement issues which would provide greater transparency to market participants.

To elevate the level of our cooperation with the Hong Kong Police, we recently signed a Memorandum of Understanding with them. We hope to further our cooperation beyond pure operational matters into policy making and training. This demonstrates that the SFC and the Hong Kong Police are both fiercely determined to tackle serious financial crimes in Hong Kong.

Externally, I have already mentioned our very close relationship with the CSRC. In addition, through our participation in the International Organization of Securities Commissions and the hard work of our small but dedicated team that deals with international requests, we have been actively building relationships with our key international regulatory partners globally.



## **Manager-in-Charge regime**

There has been some keen interest from the market in the SFC's Manager-in-Charge (MIC) regime, in particular, how it may affect our approach to enforcement. Let me say a few words on this.

First, the Hong Kong MIC regime was not conceived as an enforcement tool. It also does not introduce new conduct requirements for senior managers – as in the UK's Senior Manager Regime – nor does it add to our statutory disciplinary powers against individuals.

Under the Hong Kong MIC regime, firms are primarily required to identify those individuals in charge of core functions and map out their responsibilities and reporting lines.

In other words, we are requiring firms to consider who is accountable for what within their firms to improve overall governance.

This requirement would of course help enforcement identify responsible individuals when things go wrong. And you can assume that we will make use of this additional information to hold responsible individuals accountable.

Holding individuals accountable remains one of the most effective ways to change corporate behaviour and dissuade future misconduct.

We have instructed our investigation teams to focus on individual culpability from the inception of any investigation. Where the evidence supports it, we will take civil or criminal actions against the culpable individuals.

## **Conclusion**

We made significant changes to the Enforcement Division over the past year. Whilst all the building blocks are in place, we are still in the process of bedding down some changes.

However, a few early accomplishments have set the groundwork for future successes.

- We have fully aligned our enforcement objectives with those of the SFC.
- We have become more focused on the hard problems that are important.
- We have played a key role in the SFC's new front-loaded regulatory approach and have made a strong contribution in making it a success.
- We have strengthened our relationships with our Hong Kong regulatory partners as well as the CSRC, both of which are critical to the further development of Hong Kong as a reputable international financial centre.

My first impression when I joined the SFC was that the Enforcement Division has a highly talented, world-class team of hard working professionals.

My experience working closely with the entire team over the past year has re-affirmed this first impression.

By adopting an increasingly focused approach, I am confident that the division will transform itself into an even more powerful force for combatting financial crimes and misconduct.

On that note, thank you again to Thomson Reuters for having me here today.