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When Does Regulatory Misconduct Justify "Life"?

In our May publication, we reported on the issue of how much leniency persons under investigation who cooperate with the SFC are entitled to expect. Since then, the SFC has completed some 227 enforcement cases resulting in the issuance of 42 disciplinary sanctions (with seven life bans imposed in 2010 alone), commenced 41 criminal prosecutions and brought 10 civil proceedings: see SFC Enforcement Reporter Issue Nos. 66 & 67. Furthermore, the SFC has also reported that its market surveillance team has been initiating more than 350 inquiries into suspicious trading activities every month. This constitutes a significant increase in work levels. Faced with this apparent staggering increase in the severity of sanctions imposed, in this publication we address below the changing philosophy of the regulator on life bans.

Introduction

Since 1997, the SFC has imposed 32 life bans, of which the vast majority has been imposed within the last five years. Broadly speaking, life bans have been imposed:

- whenever misconduct involves the misappropriation/theft (or attempted theft) of client assets of whatever value (e.g., attempted theft of $12,000 in 2003 resulted in a life ban);
- where the dishonest behaviour was designed to deceive or otherwise harm the interests of investors, especially when deliberately concealed to prevent detection; and
- where the misconduct takes place over a long period of time and involves the abuse by responsible officers of their seniority in procuring the assistance of subordinates to conduct unlawful activities.

Furthermore, it also seems clear that even where the person under investigation has received no direct benefit, the SFC has sought to impose penalties commensurate with the indirect benefit derived, such as bonuses paid.

The SFC's Guidelines

As a starting point, it is important to note that life bans reflect the statutory maximum (indirect) non-pecuniary sanctions available to the SFC: section 194 SFO.

According to the SFC's guidance note ("Disciplinary Proceedings at a Glance"), when making disciplinary decisions, the SFC will have regard to its previous decisions unless changed circumstances warrant an adjustment to its penalties and will aim to impose sanctions which are considered "proportionate" to the gravity of the alleged improper conduct. It also provides a non-exhaustive indication of the factors which the regulator will take into account in determining the level of sanction, which include:

- the impact of the conduct in question upon market integrity;
- the degree of losses caused to clients;
- the duration and frequency of the conduct, whether such conduct is widespread within the industry;
- whether there has been a breach of fiduciary duty;

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- the degree of cooperation with the SFC's investigation; and
- the past disciplinary record, experience and position/role of the person accused of misconduct.

The Right to Review "Life Bans"

Whilst in theory a person aggrieved by an SFC decision to impose a ban may apply to the Securities & Futures Appeal Tribunal ("**SFAT**") to review such a penalty, the SFAT has shown itself to be extremely reluctant to interfere with SFC sanctions, or substitute its own view for that of the regulator.

To date, three appeals[1] to the SFAT to lift life bans have been made and none has succeeded. The attitude adopted by the SFAT is that unless the SFC has failed to take into account relevant factors (or took into account irrelevant factors), or the applicant has not been afforded sufficient opportunity to present its case or respond to the SFC's case, it would be inappropriate to interfere with the SFC's decisions and primacy must be afforded to the views of the regulator "on the ground".

The SFAT New Philosophy to "Life"

In *Ng Chiu Mui & others v SFC* (CACV 141/2009), the Court of Appeal recently considered the role of the SFAT in evaluating the SFC's disciplinary findings in the course of which it commented on the SFAT's willingness to impose life bans.

In *Ng Chiu Mui*, the SFC took disciplinary action arising out of offers made by an off-shore entity to Hong Kong investors to induce the use of off-shore unlicensed foreign exchange services. The regulatory regime in Hong Kong prohibits active marketing (whether in or outside Hong Kong) to Hong Kong investors of services that would otherwise be regarded as regulated activities. The rationale is that Hong Kong investors would otherwise be deprived of statutory protection for resulting losses.

The SFC's Notice of Proposed Disciplinary Action (NPDA) invited the appellants to make submissions to answer the case against them but neither did so (notwithstanding an extension of time to make such submissions). Thereafter, the SFC proceeded to issue its Notice of Final Decision, together with reasons, against each appellant and, among other things, imposed a life ban on one appellant.

The appellants later applied to the SFAT to review the SFC's findings and the life ban. This appeal was primarily based on a jurisdictional challenge—the appellants asserted that the unlicensed activities were conducted outside Hong Kong and therefore not subject to the Hong Kong regulatory regime. During the course of a directions hearing, the appellants indicated that they would give evidence before the SFAT but then ultimately declined to do so to avoid cross-examination.

Although the SFAT (Stone J) upheld the SFC's findings, among other things, the SFAT reduced the SFC's life ban to a 10 year prohibition. The SFAT stated it "*was philosophically disinclined to favour life bans*" (see paragraph 96).

The Court of Appeal's Attitude to "Life"

The appellants, however, pursued a further appeal to the Court of Appeal (CA), arguing, among other issues:

- A procedural point that the SFAT merely accepted the SFC's findings without conducting an independent evaluation. This ground of appeal was dismissed. The CA ruled the SFAT's conclusions were considered in "light of the available material". The appellants had elected to decline to make any submissions in response to the NPDA and then declined to give any evidence before the SFAT. Accordingly the SFAT was entitled to reach the conclusions it did.
- The imposition of a 10-year suspension was manifestly excessive and implicitly reflected the SFAT's displeasure that the appellants had not given evidence. The CA disagreed. It held even if the SFAT felt frustrated by the appellants' failure to give evidence it did not impose a "heavier" sentence and the appellants should therefore consider themselves fortunate.

Critically, however, the CA endorsed the views of the SFAT and said that few cases of misconduct could be said to justify "life" in the true sense and, in the case of the second appellant, that there was arguably a lack of internal consistency in the penalties meted out and varied 'downwards' the sentence.

[1] See *Paul Lee v SFC* (SFAT 4/2007) per Stone J ruling dated 9 November 2007; *TSE Shiu Hoi v SFC* (SFAT 10/ 2007) per Stone J ruling dated 20 March 2009 & *Eddie Ng v SFC* (SFAT 15/2007), per Stone J ruling dated 20 March 2009.

Conclusion

The Courts and the SFAT have clearly emphasized the need for proposed disciplinary sanctions to be carefully calibrated to ensure that maximum penalties are only pursued if "proportionate" to the gravity of the alleged improper conduct. Past precedent of SFC sanctions in itself is unlikely to usurp the SFAT's view calling for a more proportionate and tailored regulatory approach. However, at the same time, persons under investigation ought to carefully assess the potential downside of adopting a forensic 'strategy' of failing to make any representations to the SFC upon receipt of the NPDAs or declining to give evidence. The SFC's disciplinary process will be upheld as fair provided the SFC acts reasonably in giving an affected person an opportunity to be heard on the substance of any charges and proposed penalties.

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This update was authored by David C. Chu and Dominic James.

David C. Chu
Partner
Head of Litigation, Asia
+852 3518 4778
david.chu@dechert.com

Dominic James
Senior Associate, Hong Kong
+852 3518 4732
dominic.james@dechert.com

Practice group contacts

If you have questions regarding the information in this legal update, please contact one of the attorneys listed or the Dechert attorney with whom you regularly work. Visit us at www.dechert.com/securities.

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Catherine Botticelli
Washington, D.C.
+1 202 261 3368
catherine.botticelli@dechert.com

David C. Chu
Hong Kong
+852 3518 4778
david.chu@dechert.com

Steven A. Engel
Washington, D.C.
+1 202 261 3403
steven.engel@dechert.com

Stephen D. Brown
Philadelphia
+1 215 994 2240
stephen.brown@dechert.com

Philip Dunham
Paris
+33 1 57 57 80 20
philip.dunham@dechert.com

Steven B. Feirson
Philadelphia
+1 215 994 2489
steven.feirson@dechert.com

G. Eric Brunstad, Jr.
Hartford
+1 860 524 3960
eric.brunstad@dechert.com

William K. Dodds
New York
+1 212 698 3557
william.dodds@dechert.com

Daniel Gal
London
+44 20 7184 7618
daniel.gal@dechert.com

Bernard Caulfield
London
+44 20 7184 7533
bernard.caulfield@dechert.com

Michael S. Doluisio
Philadelphia
+1 215 994 2325
michael.doluisio@dechert.com

Michael J. Gilbert
New York
+1 212 698 3886
michael.gilbert@dechert.com

Robert A. Cohen
New York
+1 212 698 3501
robert.cohen@dechert.com

Joseph F. Donley
New York
+1 212 649 8724
joseph.donley@dechert.com

Jeremy Grose
London
+44 20 7184 7430
jeremy.grose@dechert.com

Andrew Hearn
London
+44 20 7184 7466
andrew.hearn@dechert.com

Robert C. Heim
Philadelphia
+1 215 994 2570
robert.heim@dechert.com

Frederick G. Herold
Silicon Valley
+1 650 813 4930
frederick.herold@dechert.com

David S. Hoffner
New York
+1 212 649 8781
david.hoffner@dechert.com

Nicolle L. Jacoby
New York
+1 212 698 3820
nicolle.jacoby@dechert.com

Robert J. Jossen
New York
+1 212 698 3639
robert.jossen@dechert.com

Michael L. Kichline
Philadelphia
+1 215 994 2439
michael.kichline@dechert.com

David A. Kotler
Princeton
+1 609 955 3226
david.kotler@dechert.com

Cheryl A. Krause
Philadelphia
+1 215 994 2139
cheryl.krause@dechert.com

Matthew L. Larrabee
San Francisco
+1 415 262 4579
matthew.larrabee@dechert.com

Thomas H. Lee II
Philadelphia
+1 215 994 2994
thomas.lee@dechert.com

Andrew J. Levander
New York
+1 212 698 3683
andrew.levander@dechert.com

Daniel C. Malone
New York
+1 212 698 3861
daniel.malone@dechert.com

Kathleen Massey
New York
+1 212 698 3686
kathleen.massey@dechert.com

Pierre Mayer
Paris
+33 1 57 57 80 11
pierre.mayer@dechert.com

Edward A. McDonald
New York
+1 212 698 3672
edward.mcdonald@dechert.com

Gary J. Mennitt
New York
+1 212 698 3831
gary.mennitt@dechert.com

Xavier Nyssen
Paris
+33 1 57 57 80 01
xavier.nyssen@dechert.com

Kevin J. O'Brien
New York
+1 212 698 3697
kevin.obrien@dechert.com

Charles I. Poret
New York
+1 212 698 3532
charles.poret@dechert.com

Eduardo Silva Romero
Paris
+33 1 57 57 80 14
eduardo.silvaromero@dechert.com

Benjamin E. Rosenberg
New York
+1 212 698 3606
benjamin.rosenberg@dechert.com

Louis M. Solomon
New York
+1 212 698 3690
louis.solomon@dechert.com

Neil A. Steiner
New York
+1 212 698 3822
neil.steiner@dechert.com

Claude M. Tusk
New York
+1 212 698 3612
claude.tusk@dechert.com

Adam J. Wasserman
New York
+1 212 698 3580
adam.wasserman@dechert.com

Dechert LLP

www.dechert.com