

Can you remain silent upon receiving a section 181 notice:

AA & Anor v The Securities and Futures Commission

February 2019

Introduction

Cooperation amongst regulators around the world has become increasingly important to effectively deal with cross-border crime and misconduct. The Securities and Futures Commission (the **SFC**) has entered into cooperation arrangements with various foreign counterparts whereby investigative assistance can be rendered to one another and intelligence can be exchanged. Section 186 of the Securities and Futures Ordinance (Cap 571) (the **SFO**) provides the SFC with the legislative gateway to assist an overseas regulator which performs a similar function in the latter's investigation by exercising its investigative powers under Part VIII of the SFO. Provided that the conditions for providing investigative assistance are met and subject to certain safeguards, the SFC may disclose materials which it has compelled a person to provide in Hong Kong to the overseas regulator. One of the safeguards is that if a person is required to give an explanation by the SFC and if he claims privilege against self-incrimination before giving the explanation, the requirement for the explanation and the explanation itself cannot be disclosed to the foreign regulator for use in criminal proceedings against that person in the foreign jurisdiction.

The SFC's exercise of its investigative powers to assist its Japanese counterparts, together with the constitutionality of section 181, has recently been subject to judicial challenge. Section 181 empowers the SFC to demand licensed persons to provide routine trading information. However, uncertainty arose as to whether section 181 overrides privilege against self-incrimination, which is an integral part of the right to a fair trial

protected by Article 10 of the Bills of Rights (**BOR10**) and extends to answers compulsorily obtained before criminal proceedings are instigated.

Background to the Judicial Review

The 1st Applicant of the judicial review application is an investment manager of a hedge fund (the **Fund**) licensed by the SFC and the 2nd Applicant is one of its Responsible Officers. In early 2014, the SFC received a report from a licensed corporation regarding suspected market manipulative activities by the Fund in relation to the shares in Nitto Denko Corporation (**Nitto Denko**) listed on the Tokyo Stock Exchange. It then issued a notice under SFO section 181 (the **Notice**) asking the 1st Applicant to provide information about the Fund, including the identity of its clients and particulars of all trades in Nitto Denko shares or warrants executed by the 1st Applicant or on behalf of the Fund at the material times. The SFC subsequently commenced a formal investigation against the Applicants.

The 1st Applicant duly responded to the Notice and also the notices subsequently issued by the SFC pursuant to section 183 of the SFO by providing the information requested. Indeed, the 1st Applicant volunteered more information to the SFC. In these responses, the 1st Applicant did not assert any claim of privilege against self-incrimination. On the other hand, the 2nd Applicant claimed privilege against self-incrimination when later answering questions at the SFC interviews.

Following the issue of the Notice, the SFC informed the Japanese Financial Services Agency (FSA) that it had received a suspicious transaction report concerning the Fund. The FSA and the Securities and Exchange Surveillance Commission (SESC) (together, the **Japanese regulators**) later made a request for the SFC's investigative assistance. In response to this request, the SFC disclosed the trading information provided by the 1st Applicant pursuant to the Notice, as well as responses to some subsequent investigation notices. A FSA officer also sat in an interview of the SFC with the 2nd Applicant with his consent.

Soon after this interview, the SESC announced that it had recommended to the Japanese Prime Minister and the Commissioner of FSA to issue an administrative monetary penalty in light of its findings of the 1st Applicant's market manipulation concerning the trades of Nitto Denko shares. The FSA, in subsequent administrative proceedings, made an administrative monetary penalty order in the sum of approximately JPY 684 million against the 1st Applicant. The SFC's investigation, on the other hand, is still ongoing.

Constitutionality of Section 181

The applicants sought to challenge the actions of the SFC on a number of grounds. The ground of more general significance is the complaint that section 181 is intended to abrogate the privilege against self-incrimination, as read in context with the other sections under Part VIII which contain powers to compel production of materials and information for investigative purposes and override privilege against self-incrimination. As far as these other provisions (i.e. sections 179, 183 and 184B) are concerned, section 187 stipulates that when compelled to answer, a person may claim privilege against self-incrimination and if he so claims, the answer provided by him shall not be used against him in criminal proceedings. To the extent that section 181 does not provide such direct use prohibition, it encroaches the provisions of BOR10 and is unconstitutional. The Court accepted both the

SFC's and the Secretary of Justice's submission that section 181 does not abrogate privilege against self-incrimination and a recipient of a s181 notice can invoke the privilege when circumstances permit. The assertion of the privilege against self-incrimination may constitute a "reasonable excuse" for non-compliance with the requirement imposed under section 181. This is different from the corresponding provisions in sections 179, 184 and 184D which expressly remove possible self-incrimination from the scope of the "reasonable excuse" defence.

The Court also considered that even if there is any intrusion on the privilege against self-incrimination under section 181, such intrusion would not be disproportionate, thus rendering section 181 unconstitutional. The Court took into account the fact that section 181 only applies to a specific class of persons who have voluntarily engaged in a regulated commercial activity and are therefore expected to abide by the requirements of the regulatory regime, and the type of information to be provided is limited. The nature and limitation of that provision, as the Court ruled, provides a measure that is no more than reasonably necessary for accomplishing the legitimate aim of ensuring that the financial markets of Hong Kong operates fairly and honestly.

Then, does it mean that a subject of a section 181 notice can remain silent and rely on the "reasonable excuse" defence to resist compliance with the notice if he thinks that the information provided may incriminate himself? Indeed, even the Court in *AA v the SFC* accepted that such a circumstance would be rare. The notion of "reasonable excuse" does not encompass a privilege that is unavailable on the facts. For instance, one cannot assert the privilege over pre-existing materials that have an existence independent of the will of the recipient of the notice. The rationale behind was explained by Ribeiro PJ in *HKSAR v Lee Ming Tee* (2001) 4 HKCFAR 133 - "*the purpose of the privilege is to respect the will of the accused to remain silent,*

thereby ensuring that the accused is not compelled to provide proof of his or her guilt.”

Section 181(2) sets out the categories of information which can be demanded by the SFC pursuant to section 181, which include particulars of clients and transactions and the instructions given. This information can be derived from existing records kept by licensed persons, rather than being “*materials created in response to an investigation which come into existence by an exercise of will pursuant to a testimonial obligation imposed upon the party*”. As such, no privilege against self-incrimination can be exercised.

Further, in order to claim privilege against self-incrimination, it must be shown that the information required by the SFC would expose the person providing it to self-incrimination in criminal proceedings. The SFC may exercise its powers under section 181 for the purpose of enabling or assisting it “*to perform a function under any of the relevant provisions*”, which include the provisions in the SFO. As such, if a licensed corporation is required to provide information for the SFC to ascertain whether there is any regulatory compliance issue, and the information is subsequently used in disciplinary or administrative proceedings against the licensed corporation, the privilege against self-incrimination protected by BOR10 would not even be engaged.

Whether or not the administrative proceedings commenced by the FSA against the 1st Applicant were in fact criminal in nature is another issue in dispute in *AA v the SFC*. The Applicants’ complaint was that the information provided by the Applicants to the SFC was forwarded to the Japanese regulators for use in criminal proceedings against the 1st Applicant and therefore their rights guaranteed under BOR10 were infringed. They argued that whilst the proceedings in Japan were classified as “administrative” there, they were criminal in nature given the severity of the penalty imposed.

The Court observed that the nature of the foreign proceedings in which the compelled materials were used is an issue of Hong Kong law. The classification of the proceedings in foreign jurisdiction is not decisive. The Court would have to apply the three criteria set out in *Koon Wing Yee v Insider Dealing Tribunal* (2008) 11 HKCFAR 170. The three criteria are: (1) the classification of the offence under domestic law; (2) the nature of the offence; and (3) the nature and severity of the potential sanction. The Court in *AA v the SFC* examined the Japanese legal provisions under which the FSA took action against the 1st Applicant and applied the aforesaid three criteria to determine if the Japanese proceedings were indeed criminal in nature. The Court concluded that while the provision is classified as administrative rather than criminal under Japanese law, taken also into account the nature of the provision, which in Hong Kong can be both civil or criminal in nature, as well as the sanction, which was calculated by a formula intended to reflect the disgorgement of profits and therefore was not penal in nature, the jurisdiction exercised by the Japanese regulators is civil in nature. It followed that the materials which the Applicants had been compelled to furnish were not used in criminal proceedings against the 1st Applicant.

Whilst rejecting the Applicants’ grounds for judicial review, the Court considered the Applicant made a valid point that if the privilege against self-incrimination is available to a recipient of a section 181 notice, the SFC should accordingly warn and caution such person of the privilege. The SFC is expected to take steps to address this lack of warning in the future.

Conclusion

This decision clarifies that section 181 does not abrogate the privilege against self-incrimination. In theory, one can remain silent upon receipt of a section 181 notice if circumstances permit. However, in reality, given the nature of the provision and the information to be required

under the notice, the recipient of the notice is unlikely to have any choice but to comply with it (unless it can prove it has any other reasonable excuse for the non-compliance).

Having said that, this case also serves to remind us that if, in response to the section 181 notice, the recipient wants to volunteer further information which is outside the scope of the information the SFC is entitled to under section 181(2), it should think twice before doing so,

consider and seek legal advice on its role in the inquiry (whether there is any chance that it would be under investigation), how the regulator would use the information, whether the information offered could be used against the recipient in administrative or criminal proceedings, the possibility of the involvement of foreign regulators, how the foreign regulators would utilise the information and whether the information could be used in any foreign proceedings, civil or criminal.

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