

The SFC clarifies licensed corporations' obligation to disclose internal investigations against outgoing employees

May 2019

Introduction

The Securities and Futures Commission (“SFC”) recently revamped its licensing process to enhance the efficiency and transparency of its gatekeeping function. In particular, it introduced the requirement that a licensed corporation (“LC”) should disclose information about any investigation it has commenced against a licensed individual who ceases to be accredited to it. On 21 May 2019, the SFC published frequently-asked questions (“FAQs”) clarifying what it expects LCs to do to fulfil this disclosure obligation.

FAQs

As clarified in the FAQs, an LC is now required to:

- inform the SFC, at the time when it notifies the SFC of the cessation of accreditation of a licensed representative, whether it has commenced an investigation against him in the past 6 months;
- so inform the SFC even if the internal investigation does not lead to any negative finding against the outgoing employee;
- disclose as soon as practicable if the investigation is commenced after the departure of the outgoing employee, regardless of the lapse of time since the departure of the employee;

- provide sufficient information (as far as legally permissible) on the investigation for the SFC’s thorough understanding of the subject matter of the investigation; and
- update the SFC as soon as practicable on new developments in the investigation previously disclosed to the SFC.

What should be disclosed?

LCs are required to disclose all investigative actions, whether the actions are described internally as an inquiry, enquiry, investigation or review, and whether the subject matter concerns regulated activities or other activities of a licensed individual. The FAQs provide a list of obvious examples of investigations which LCs are required to disclose. They include investigations in respect of actual or suspected breach of applicable laws, rules and regulations, and the LC’s internal policies and procedures, misconduct raising concerns about the outgoing employee’s fitness and properness, and any matter potentially involving fraud, dishonesty and misfeasance. It should be noted, however, that the list is not exhaustive.

Unlike the self-reporting obligation in respect of a breach or non-compliance with laws, rules, regulations and codes under the current Code of Conduct for Persons Licensed by or Registered with the SFC (“Code”)¹, the disclosure obligation

¹ The Code requires LCs to notify the SFC of, among others, any material breach, infringement of or non-compliance with (whether by itself or persons it employs), any law, rules, regulations, and codes, administered or issued by the

SFC, and the rules or requirements of other regulatory authorities.

in respect of internal investigations against outgoing employees has no materiality threshold. This means that LCs should proceed on the basis that any investigation in respect of the misconduct of a licensed individual during his employment - from a breach of the Securities and Futures Ordinance (“SFO”), workplace harassment, to improper use of the firm internet or email system is reportable.

The only limitation in respect of the disclosure obligation is that LCs need only disclose what they can lawfully disclose. Since the FAQs provide no elaboration, LCs may need to seek legal advice as to what they can or cannot lawfully disclose. It appears that, in general, if an LC is prohibited by other regulatory bodies from disclosing the information, it may have a reasonable excuse not to disclose that to the SFC. LCs’ right not to disclose information protected by legal professional privilege would equally excuse them from complying with the disclosure obligation.

How will the information be used?

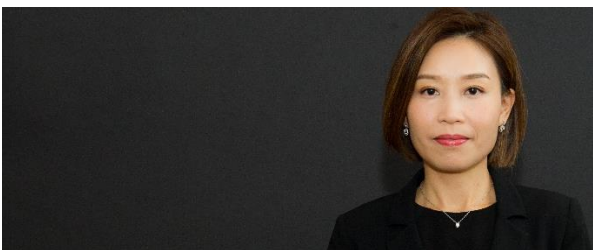
The SFC makes it clear in the FAQs that the information is gathered for the purpose of assessing the fitness and properness of licence applicants. It is obligated to preserve the secrecy of the information under section 378 of the SFO.

Nevertheless, it seems possible that information disclosed by an LC is used for the performance of other regulatory functions of the SFC, especially given the emphasis on internal collaboration and the front-loaded regulatory approach in recent years.

The SFC also has the power to disclose information to a foreign regulator provided the disclosure is in the public interest and will enable or assist the recipient of the information to perform its functions. The possibility of information of an internal investigation provided by an LC falling into the hands of a foreign regulator cannot be ruled out.

Conclusion

The disclosure obligation significantly widens LCs’ notification obligations. As long as an LC has inquired into the conduct of an outgoing licensed representative within 6 months prior to his departure (whether he is summarily dismissed or leaves the employment of his volition), the LC must inform the SFC of such investigative action when making a notification of the cessation of accreditation. This requirement could potentially be burdensome for licensed corporations, especially for sizeable firms.



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