Compliance and Corruption Across Asia
Compliance Summit Asia

Mark Steward

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The realm of enforcement, as this morning's agenda wryly puts it, is a subject well worth a few moments of reflection.

Our core enforcement mission is to vindicate obligations that are not met, especially those owed to, and harming the interests of, the investing public. It can be described in more technical ways but essentially this is it.

I would like to talk about how we go about this mission in light of a trio of decisions handed down by the High Court this year in our cases.

But first I would like to make a few observations about misconduct in our markets.

Increasing Misconduct?

The incidence of misconduct in our markets appears to be increasing rather than decreasing. More seasoned observers might think nothing much has changed over the decades. Perhaps there is more detection and more is being done about it nowadays.

I am not aware of any reliable study and perhaps such a study is impossible given the unknown variable of undetected misconduct.

But, subjectively, there may be some basis to believe misconduct has increased despite the considerable contrary efforts of many people around the world.

Since 2007 there has been an increase in the number of investigations we have commenced and completed in our key areas of interest.

Since 2007:

insider dealing investigations have increased by more than 250%;

market manipulation investigations have increased by 240%;

corporate governance cases have increased by 530%; and

intermediary misconduct cases have climbed by 280%.

The consequence of so many cases is that there has also been an increase in the number of cases before Hong Kong's courts and tribunals as well as a change in the nature, complexity and seriousness of these cases.

The most significant increase is in the amount of civil litigation, especially before the High Court where, again comparing with the position five years ago, there has been an increase in activity of over 450%.

Using insider dealing cases as a benchmark or yardstick, in the same period we have taken actions against 44 people for insider dealing:

leading to 33 criminal convictions against 13 defendants;

the Market Misconduct Tribunal has made findings that a further eight persons have contravened the insider dealing prohibition with administrative orders being made against them; and

we have commenced civil proceedings against a further 22 defendants alleging insider dealing in cases pending before the High Court.

Much of this misconduct is committed so easily too. The insider dealer or manipulator makes a phone call or pushes some buttons on a computer. No need to see the victim at the end of the process. The consequences are not visible: physically insulated from the victim perhaps leading to emotional and moral insulation from the consequences of misconduct as well.

Intuitively, it seems a person is more likely to act improperly where there is a high degree of attenuation between the act of misconduct and its consequences.

The consequences of misconduct may be a topic that deserves more attention from regulators.

Consequences of Misconduct

Would, for example, a financial institution pay more attention to its anti-money laundering processes if brought face to face with the associated harm caused by drug trafficking or corruption that its laxness is facilitating?

Would the listed company consider the almost certain losses that would be incurred by the golden age investor buying shares with his pension pot when deciding to delay the disclosure of the bad news to the market?

There remain many who believe, for example, that insider dealing is victimless because counterparties to insider dealing would have traded anyway.

The disobligation underlying this argument insulates the wrongdoer from having to acknowledge the obvious consequences of his misconduct.

The insider knows the current trading price is not accurate because highly relevant news has not been factored into it. Often the insider is also able to influence the timing of the announcement or is privy to the timetable of the announcement. The unfairness of his advantage is not limited to the price sensitive information. In these circumstances, it is difficult not to see the innocent counterparty is anything other than a victim of a deliberately orchestrated unfairness.

Underlying the disobligation of consequences is the dubious assumption that the innocent trader is no different or worse off by trading in a market that included a prohibited insider trading in the opposite direction. In most cases, the innocent trader will be worse off. In some cases, the innocent trader may well have continued to trade – for example, selling

shares to raise urgently needed cash – but in those cases, the question is not so much whether the trader would have traded anyway but whether he would have traded at the same price if he knew what was going on.

A wrongdoer who cannot or does not see the consequences of his misconduct is less likely to perceive their moral and social consequences and more likely to offend again.

In many of these cases, there is a sense that perpetrators have convinced themselves that not only is the risk worth running (because the forensic challenge of detection is in their favour) but that the consequences are not serious. This creates a moral and ethical vacuum.

For some time now we have been working on ways to make wrongdoers accountable for the consequences of their misconduct. The process sounds simple but it is not.

In the course of this year, there have been three important developments in this long term project, a trio of decisions handed down by the Court of First Instance of the High Court of Hong Kong.

Tiger Asia[1]

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We are confident that our position will be vindicated and that section 213 proceedings will form a key part of our strategy in bringing wrongdoers face to face with the real consequences of their misconduct.

Not only do we believe that the provision was intended and designed to operate in a self-standing way (and the legislative materials support this view), it makes little or no sense for an essentially remedial proceeding to be ancillary to any other type of action. Certainly there does not appear to be any public purpose or rationale to support this view and to inhibit the purpose of proceedings under this provision.

As matters stand at present, the Court of Appeal's decision handed down in February this year is the law in Hong Kong and we are

[redacted]

Hontex[3]

The Hontex case fulfils the promise of the High Court's jurisdiction under section 213 that we are fighting so hard to preserve in the Tiger Asia litigation.

The story is now well-known. Hontex was incorporated in the Cayman Islands and operated a business in the Mainland. It was listed on the Stock Exchange of Hong Kong in December 2009. In March 2010, we discovered that important elements of the IPO prospectus grossly misstated the company's financial position, in particular, its turnover, cash and the number of