



When the inspector calls: routine inspections by regulators in Hong Kong

Recent investigations into regulated entities and financial institutions, and subsequent disciplinary sanctions, suggest that regulators will continue to take an active approach in Hong Kong. One can also expect an increase in regular on-site inspections of firms by regulators, as part of their supervisory role to ensure compliance with codes and regulations. This note sets out some practical guidelines on how to deal with supervisory inspections.

The Securities and Futures Commission, Hong Kong Monetary Authority and Insurance Authority are empowered to carry out routine inspections of regulated entities, exchange participants and insurance intermediaries to ensure compliance with the laws and codes of conduct, and with liquid capital requirements, and to ensure that proper systems of management and control are in place.

This briefing will set out some practical pointers if your firm is the subject of a routine inspection.

Authorisation documents

Generally speaking, regulators should have a copy of the authorisation in their possession when they conduct the inspection.

The terms of the authorisation must be sufficiently specific to allow your firm to obtain legal advice on the scope of the search allowed under the authorisation.

The terms of the authorisation should indicate:

- the statutory source of the power to issue the authorisation letter; and
- with reasonable certainty, the premises to be searched (which must be the premises where the inspection is being conducted) and whether there are specific regulated activities that are being inspected.

Where authorised in appropriate terms, regulators have the right to enter premises and search for and make copies of documents. A 'document' includes electronic documents.

Instructions to receptionists

When approached by a regulator to conduct a routine inspection on your firm's premises, receptionists should be instructed to:

- notify immediately the people designated by your firm;
- request identification and a copy of the authorisation letter from the regulators;
- request that the regulators wait until the company's lawyers arrive (and if they agree to wait, direct them to a room with no documents); and
- (if the regulators insist on conducting the inspection immediately) arrange for someone to shadow each of them at all times.

Instructions to inspection co-ordinators

Once the inspection co-ordinator is notified that the regulators are on your firm's premises, the co-ordinator should:

- review the authorisation and determine the scope of the investigation;
- check that the authorisation or other document of authority complies with the formal requirements of the relevant legislation and decide (if necessary, in conjunction with external lawyers) whether to submit to the inspection;
- if possible, ensure that a duplicate copy is taken of documents inspected and that a record is kept of all questions asked and answers given;

- seek to restrict the regulators only to those offices, files and documents that are potentially relevant to the matters specified in the authorisation;
- seek specialist IT assistance if the regulators ask to see computer files; and
- consider longer-term actions and consequences, for example, whether the inspection may give rise to disciplinary action or further investigation by the regulators.

Your firm should not hide or destroy documents, nor obstruct the regulators from conducting the inspection properly.

Informal document requests

There is nothing to prevent the regulators from asking for information or documents on an informal basis, however, your firm should consider carefully how to respond to any such request for the following reasons.

- Your firm may have a fiduciary duty to keep client information confidential. Your firm should not divulge any client information unless compelled at law to do so. In particular, client information regarding clients of overseas branches is governed by the laws of those jurisdictions.
- Your firm has certain obligations to safeguard the privacy of employees under the Personal Data (Privacy) Ordinance and may have other such obligations under its employment arrangements.
- Your firm should consider whether the release of information or documents would constitute a breach of any of these obligations and/or whether any notice or consent is required.
- If information is provided voluntarily, your firm should consider making that supply of information conditional on the regulators agreeing to keep it confidential.

A regulator does not have the right to seize material that is subject to legal professional privilege but can seize confidential material. If this is the case, you should make it clear that the material being provided is commercially sensitive and request that it be kept confidential.

Where an inspection is expected to take a few days, your firm should suspend any document destruction and preserve documents for a reasonable period of time.

Witness interviews

Generally speaking, there is nothing to stop the regulators asking questions of employees. The regulators may contact individual employees directly to request an interview.

Your firm may wish to consider whether it is willing to provide legal representation to employees to be interviewed by regulators (and in what circumstances) if this issue has not already been dealt with in relevant employment policies.

Your firm may request employees not to answer questions about the firm and its business unless they are authorised to do so. However, one cannot threaten or punish employees who do not comply with that request, or otherwise coerce employees to act in any way that might obstruct an inspection.

Investigation-related offences

Failing to comply with the routine inspection is an offence. An obstruction is any act that makes the execution of the regulator's duty more difficult.

Employees should not try to:

- mislead regulators, such as by making false statements or telling half-truths;
- physically hinder regulators who are carrying out their duties, such as by standing in their way and not allowing them to pass;
- put any pressure on any person to refrain from speaking to regulators; or
- destroy or hide any document or other item, including any electronic document.

It is not an obstruction to ask questions of the regulators or to make a reasonable request as to how they conduct the inspection (for example, asking them to wait for legal advisers to arrive first). However, employees should bear in mind that the regulators are not obliged to answer and comply with any request as to the conduct of their inspection. Employees should not try to physically hinder any regulator but rather allow the regulators to proceed with their duties and make a note of any difference of opinion, including what was said by all parties.

It is generally helpful if there are guidelines in place to assist decision makers in determining whether (and when) to submit to an investigation.

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