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Compliance officers should anticipate disclosure and discovery requests, conference hears

Jun 06 2012 Ajay Shamdasani in Hong Kong

Compliance and legal staff at banking and financial institutions should expect regulatory disclosure and litigation discovery requests, said lawyers at a Hong Kong conference. Browning Marean, senior counsel with law firm DLA Piper in San Diego, said institutions needed to have up-to-date record-keeping to ready themselves for potential lawsuits, regulatory investigations and enforcement actions.

"Expect that you will get a disclosure or discovery request from regulators and have your files easily retrievable and in order," Marean told Thomson Reuters after speaking on a panel at InnoXcell's 2012 Asia eDiscovery Exchange in Hong Kong on Wednesday. “You have to be current and organised because you never know what types of disclosures you will need to make,” he said.

Electronic discovery, or e-discovery, was a necessary starting point for many organisational governance, risk and compliance programmes, the lawyers on the panel said. They said that implementing effective collection and preservation processes could reduce costs and mitigate risks. Yet, they stressed that without collecting data in a legally defensible manner, institutions would make e-discovery tougher and face higher costs and adverse outcomes.

When non-compliance isn’t an option

"Treat every case and [regulatory disclosure and litigation discovery] request differently,” said Jeff Lane, a panel participant and partner with law firm King & Wood Mallesons in Hong Kong. He added that in Hong Kong, the Securities and Futures Commission (SFC) was empowered by legislation and codes of conduct to compel parties to make available all documents and records requested. “You can’t avoid a question when they [the SFC] ask, because disclosure is mandatory,” he said.

On anti-graft matters, disclosures sought by U.S. and British authorities under the Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act — two statutes with extraterritorial reach — can be problematic when dealing some jurisdictions.

“Sometimes, you’ll get a [U.S.] regulatory request for answers under the FCPA, but in a place like China, those answers are just not forthcoming,” said Lane. He recommended that when conducting FCPA or Bribery Act investigations in other jurisdictions, it was best to delegate to local staff on the ground in such countries that understood what information could legally be disclosed and obtained.

Hong Kong has no procedural rules or practice directions relating to e-discovery. However, according to Lane, when Asian businesses withhold documentary evidence from regulators and courts — foreign or domestic — an adverse inference would be drawn.

A similar practice exists in the U.S. under the Federal Rules of Evidence, which state that where evidence is destroyed, courts will presume the evidence was damning to those that destroyed it.

Marean said that under U.S. law, documents relating to a case had to be preserved as soon as it was reasonably anticipated that litigation or regulatory action would ensue. “People need to ask if such a triggering event has occurred and when. Case law suggests that such records must be retained for four to eight years,” he said.

However, he added that in the U.S., information retention tended to be overdone. “We [in the U.S.] cast a wider net out of fear,” he said.

Regulatory intransigence

Different countries have different disclosure standards. Asking mainland Chinese regulators to disclose information to their foreign counterparts has been difficult for a long time, said panel participants. They said the matter had been exacerbated by Beijing’s sensitivity to the issue of ‘state secrets’ — as evidenced by the case of mining group Rio Tinto. Beijing’s state secrets law essentially hold that everything in the country is secret until published by the central government, even if it is widely anticipated, said a conference attendee.

“But what is a state secret is a moving feast,” said Lane.

Alfred Wu, a litigation special counsel with law firm Fried, Frank, Harris, Shriver & Jacobson in Hong Kong, said Chinese financial regulators were not keen on providing guidance or advice in disclosure matters — particularly when state secrets were involved. “When dealing with state-owned enterprises, banking and telecommunications, you’re more likely run into state secret issues,” he warned.

Wu praised Hong Kong for being an international city that was open to processes and standards from different parts of the world. “Whatever is evidence is required by U.S. rules and authorities is generally provided [by Hong Kong],” he said.

Wu attributed Hong Kong’s freer information flows to the fact that common law jurisdictions tend to be more transparent and disclosure-oriented, but stressed that documentary disclosure in civil law nations such as China was relatively limited. “China is more problematic because their information flows are more limited,” said Wu. “What’s disclosed depends widely on the country you’re in.”

Although Hong Kong regulators have signed memoranda of understanding (MOU) with their counterparts in Washington and Beijing, it can still be cumbersome seeking disclosures from mainland regulators.

“They [mainland regulators] don’t care if you’re subject to the authority from regulators abroad,” said Wu.

The issue was recently highlighted when Deloitte last year resigned as the auditor of Longtop Financial Technologies — a Chinese financial software company listed on the New York Stock Exchange (NYSE). The Big Four accounting firm is fighting information disclosure requests from the U.S. Securities and Exchange Commission (SEC) owing to its mainland Chinese legal obligations.

“Deloitte is facing sanctions from U.S. regulators, but it feels constrained by Chinese law to produce the documents that they [the SEC] want,” said Wu. He also cautioned those seeking guidance from mainland regulators from giving them important original documentation that they may need to respond to other regulators. “They [Chinese regulators] will take your documentation and just wait [sit on them]. They’ll keep the documents and then time will pass, so when you need to show them to the U.S. regulators, you won’t have them,” he said.

Access to U.S. capital markets: an incentive to cooperate

Looking ahead, several attendees suggested that as Chinese companies sought public listings on prestigious bourses such as the NYSE, Nasdaq and London Stock Exchange, Beijing would be more forthcoming towards foreign regulators’ requests as a price of entry.

“Chinese companies want to do business in the U.S. and list on its stock exchanges. Doing so carries benefits and burdens. The need to go in with their eyes open,” said King & Wood’s Lane.

Likewise, event attendee Morgana Brady, a senior associate with law firm Allens Arthur Robinson in Hong Kong, said that international insurers were not willing to take on the risks associated with Chinese companies eager to list in the U.S. “A lot of Chinese businesses want to be insured by groups like Chartis and Chubb, in both the U.S. and China, but they can’t because they’re seeing the lawsuits against Chinese companies,” she said.

Alluding to the Longtop case, Lane said that liability burdens in such cases would come back on Chinese enterprises’ auditors. “Accountants need to get more professional negligence insurance,” he said.

Similarly, DLA’s Marean recommended the companies themselves obtain greater insurance for directors and officers, as well as more securities fraud insurance.