Application No. 3 of 2015

IN THE SECURITIES AND FUTURES APPEALS TRIBUNAL

IN THE MATTER OF a Decision made by the Securities and Futures Commission under section 194 of the Securities and Futures Ordinance, Cap. 571

AND IN THE MATTER OF section 217 of the Securities and Futures Ordinance, Cap. 571

BETWEEN

HSBC PRIVATE BANK (SUISSE) SA	Applicant
and	
SECURITIES AND FUTURES COMMISSION	Respondent

Tribunal: Mr. Michael John Hartmann, Chairman

Mr. Vincent Chin, Member

Ms. Helen Zee, Member

Date of submissions : 10 January, 5 and 23 February 2018

Date of ruling : 27 April 2018

RULING ON COSTS

1. Reasons For Determination in respect of this application for review were handed down on 21 November 2017. The Tribunal's judgment was over 200 pages long, an indication that the matters that fell for determination were many and varied. It has been said that they were matters also of some importance to the banking industry in Hong Kong. At the end of its judgment, in summarising its orders, the Tribunal did not make an *order nisi* as to costs but directed instead that it would hear submissions from the parties.

2. It was agreed that the submissions would be made in writing. Accordingly, both parties filed their respective submissions on 10 January 2018. The Respondent ('the SFC') sought permission to respond to the submissions of the Applicant ('the bank'), filing its response on 5 February 2018. The bank, given the last word, filed its reply submissions on 23 February 2018.

3. The power of the Tribunal to award costs is to be found in s.223 of the Securities and Futures Ordinance, Cap. 571, which directs that, in respect of an application for review, the Tribunal may award such costs as it considers appropriate to any party to the review. The award of costs, therefore, lies within the discretion of the Tribunal. That discretion is not to be exercised on the basis that costs are to be broken down and awarded in accordance with each argument won or lost, resulting in some sort of detailed profit and loss account. Costs are to be awarded on the broader

basis of where the justice of the matter demands. In this regard, see the ruling of the Tribunal dated 21 August 2015 in *The Pride Fund Management Ltd v SFC* (SFAT 2/2015, paragraph 4). It is to be remembered also that essentially costs are awarded not to punish an unsuccessful party but to compensate the successful party for the costs it has had to outlay to achieve that success.

4. In the present case, the Tribunal was required to conduct a review of both the SFC's findings of culpability and assessment of penalties. In respect of the three broad areas of culpability that fell for consideration, the Tribunal found that the bank had been culpable in respect of all three. In respect of penalty, however, it took a more lenient view of the seriousness of the bank's culpability and the consequent need for protective orders. Orders of revocation were substituted with orders of suspension for a year; the financial penalty was reduced by more than one third.

5. In the submissions placed before the Tribunal, counsel for the SFC, Ms. Janet Ho, placed emphasis on what may be called the 'bulk of time argument', pointing to the fact that the bulk of time taken up in the hearing was related either to legal arguments, in respect of which the bank was essentially unsuccessful, or related to matters of culpability in which the bank was, by way of outcome, entirely unsuccessful. While the Tribunal has accepted the force of these submissions and has accepted that there are many cases in which it would be of central relevance, in this particular case it has been persuaded that, as Mr. Anthony Neoh SC, counsel for the bank, put it, the award of costs must reflect the fact that the review was a *de novo* hearing and - particular to this case - determining where the great bulk of preparation and argument did or did not lie was not merely a question of allotting time between liability and sanction but also of setting out the

necessary and complex background to the case without which determinations could not have been made between liability and sanction.

6. Turning in more detail to the three broad issues of culpability, in respect of the first issue, that of failing to inform clients to whom certain derivative instruments had been sold of the precarious credit worthiness of the issuer, the Tribunal was satisfied that the bank had clearly fallen below the professional standards required of it under the Code of Conduct and ancillary guidance : see paragraph 208 of the judgment.

7. In respect of the second issue, that of failing to ensure suitability of product for clients who purchased certain derivative instruments, the Tribunal concluded in paragraph 322 of its judgment that –

> "On a consideration of all the evidence, the Tribunal is satisfied that in the period under review, in its marketing and sale of [the derivative instruments in question], the bank's internal processes designed to ensure the interests of clients were materially flawed. They were flawed, first, in the fundamentally important process of understanding each client's true risk profile; second, in the process of ensuring suitability of product for each client and, third, in the process of supervising and monitoring sales process to detect and avoid risk mismatch. The Tribunal is further satisfied that this systemic failure put each client unjustifiably at risk."

8. In respect of the third issue, that of failing to ensure the suitability of product for 13 clients who had purchased derivative instruments known as forward accumulators, including a failure to explain the inherent risks of such instruments, the Tribunal was again satisfied that there had been a systemic failure on the part of the bank.

9. In summarising its findings as to the bank's culpability generally, the Tribunal said in paragraph 403 of its judgment that –

> "The Tribunal is satisfied that during the periods under review clients of the bank who had been asked to consider purchasing or had purchased derivative instruments were not given the guidance demanded by the Code of Conduct. The failures of the bank in this regard were systemic. In the result, many of the bank's clients had suffered material losses."

10. Put succinctly, therefore, as to outcome, the bank failed in respect of all three issues. In respect of penalty, however, as already mentioned, the bank was more successful.

11. The SFC had imposed two forms of penalty, first, revocation and, second, a financial penalty. The SFC had ordered that the bank's registration for Type 4 regulated activity (advising on securities) be revoked and that its registration for Type 1 regulated activity (dealing in securities) be partially revoked to the extent that the bank would only be allowed to handle trading in listed securities for clients and in that limited capacity to provide incidental advice to clients. The SFC further ordered that the bank pay a total financial penalty of HK$605 million.

12. Although the matter was not the easiest to determine, in the light of all relevant circumstances the Tribunal decided that, while in no way diminishing the default of the bank in the period under review, a period of suspension, would in all the circumstances be the appropriate penalty. The most serious penalty of revocation was therefore reduced to one of suspension for one year. As to the financial penalty imposed by the SFC,

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the Tribunal was of the view that, having regard to all relevant circumstances, it should be reduced to $400 million.

13. On a broad view, this was a case, therefore, in which the challenge made by the bank to the SFC's findings of misconduct failed but the challenge made by the bank to the severity of penalties was materially successful. Counsel for the SFC referred the Tribunal to a number of earlier cases with similar outcomes and to the costs rulings made in those cases.

14. In the costs ruling of the Tribunal in *Chu Kwok Shing Godwin v SFC* (SFAT 1/2009), although the applicant was unsuccessful in challenging the findings of the SFC that he had created a false or misleading appearance of active trading in respect of three stocks, he was successful in having his suspension of three years reduced to 18 months. The Tribunal ordered that the applicant should pay two thirds of the costs of the SFC (with a certificate for two counsel). Having originally made an *order nisi* to that same effect (which seemingly on balance it preferred not to alter), the Tribunal commented that the costs order was generous to the applicant.

15. In the present case, of course, the Tribunal has not already made an *order nisi* stating its provisional findings as to costs.

16. In *Chu Kwok Shing Godwin v SFC*, the case of which mention has just been made, the Tribunal was referred to three earlier cases in which the findings of misconduct were upheld but penalties reduced. In the first case cited in the written ruling, in which suspensions (in respect of three applicants) were reduced, first, from 9 months to 6 months; second, from 6 months to 4 months and, third, from 4 months to 3 months, the SFC was awarded 80% of its costs. In the second case, in which a prohibition for life

was very materially reduced to suspension for just 18 months, the applicant was awarded 50% of his costs. In the third case, in which one applicant had his penalty of prohibition for life reduced to suspension for 10 years and a co-applicant had his penalty reduced by 25%, the SFC was awarded 85% of its costs.

17. On behalf of the bank, it has been submitted that each of the cases referred to by the SFC are distinguishable on the facts. The Tribunal accepts that to be the case. Accordingly, only very limited assistance is provided by the earlier authorities.

18. In the present case, clearly looking to the general trend in earlier cases where liability has been confirmed but penalty reduced, counsel for the SFC has submitted that, in all the circumstances, it would be appropriate for the SFC to be awarded 85% of the costs of the review (with a certificate for two counsel).

19. Mr. Neoh, for the bank, has agreed that costs should be awarded to the SFC but has submitted that an appropriate order would be one in which the SFC was awarded just 50% of its costs. He has qualified that submission by saying that in any event, should the Tribunal come to the view that a sterner order of costs was appropriate, such order should not exceed two thirds of the SFC's costs.

20. In his submissions, Mr. Neoh, for the bank, said that the finding by the Tribunal that the bank had not egregiously avoided its responsibilities under the Code of Conduct had itself been a significant success. The Tribunal, he said, had found that the bank, while culpable, had tried continually to review and improve its systems and was not to be marked as

an organization bent on exploitation of its clients. In respect of this submission, the Tribunal accepts that its material reduction of penalty reflects its view that there were material mitigating factors. In this regard, see, for example, its comments made in paragraph 433 –

> "… it has to be recognised that the bank's failings were not shown to be dishonest, they were not shown to be intentional or reckless. There were at all times systems in place albeit in a number of crucial respects those systems were materially inadequate. In addition, steps were taken from time to time during the period under review to improve those systems, doing so in order to protect the interests of clients. While, with the cold comfort of hindsight, it can now be shown that those systems were inadequate, it has not been demonstrated that there was at the time an institutionalised cynical disregard for the interests of clients."

21. The outcome of course was a material reduction in penalty, a reduction by more than one third of the financial penalty and a reduction of the licensing penalties from revocation to suspension for one year. In the view of the Tribunal, it is in respect of this outcome that the bank's submissions have found their greatest strength.

22. Other submissions, while taken into account, have not been as telling. For example, the fact that the Tribunal's reasoning may have been different from or even contrary to that of the SFC at first instance does not in this instance, in the view of the Tribunal, particularly advance the costs argument. It is now well-established and therefore well understood that the Tribunal does not conduct an appeal of the classic kind from the original regulatory decision of the SFC. It makes a full merits review pertinent to the matters that were the subject of the SFC's findings. It acts as if it is the original decision maker. In such circumstances differences of approach,

preferences as to the form of reasoning and the like, are not necessarily determinative of costs.

23. Similarly, the fact that the judgment of the Tribunal may be one which clarifies a number of important principles is not of itself a reason for reducing costs. The principles which govern the award of costs in public interest cases are restrictive and are not applicable in this case.

24. In the final analysis, therefore, looking to the broad equities of the matter, the Tribunal has been drawn to the conclusion that the SFC should be awarded 70% of its costs including provision for two counsel. It follows that the costs involved in determining this present issue must also be awarded on the same scale. An order is therefore made to that effect, costs to be taxed on a party and party basis if not agreed.

(Mr. Michael John Hartmann)
Chairman, Securities and Futures Appeals Tribunal

(Mr. Vincent Chin)
Member

(Ms. Helen Zee)
Member

Mr. Anthony Neoh, SC
instructed by Davis Polk & Wardwell
for the Applicant

Ms. Janet Ho, instructed by SFC
for the Respondent