China's 'One Belt, One Road' Initiative Creates Opportunities and Regulatory Challenges

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In a time of shifting opinions on the benefits of globalization, China's "One Belt, One Road" initiative (OBOR) offers an unexpected bright spot for multinational companies able and willing to participate in this infrastructure-building initiative. Unveiled by the Chinese government in 2013, OBOR seeks to connect — through roads, ports, railways, pipelines, airports, transnational grids and energy hubs — over 60 countries spanning Asia, Europe, the Middle East and Africa with US$900 billion worth of trade-boosting transportation infrastructure projects.

Some major U.S. companies, such as General Electric, Caterpillar and Honeywell, have publicly announced their participation. General Electric already has received orders of more than US$2 billion from the initiative, and it plans to bid for an additional US$7 billion in business in the next 18 months, according to a May 14, 2017, article in *The New York Times*. Similarly, embracing OBOR's "unprecedented opportunities," Caterpillar announced that it has teamed up with Chinese companies in the OBOR economies and is working closely with builders and developers in the region.

Hong Kong has enthusiastically embraced the opportunities OBOR offers. It created the Commission for Belt and Road to coordinate its efforts on the initiative, and in April 2017, its Securities and Futures Commission (SFC) announced a move to ease listing conditions for companies associated with OBOR projects.

But excitement should be tempered by the regulatory challenges ahead. In Hong Kong, where the financial markets have become increasingly integrated with those of mainland China, regulators have taken note of the compliance risks. The SFC has been aggressive in pursuing enforcement actions against companies for alleged market misconduct, and it is expected to continue that trend as OBOR ramps up and more companies, including those from mainland China, tap Hong Kong's capital markets.

These compliance challenges stem from a confluence of factors. To start with, many of the countries along the OBOR trade route score at the low end of Transparency International's Corruption Perceptions Index. Moreover, infrastructure projects often require multiple layers of government approvals — for land rights, licenses and inspections — that present numerous opportunities for corruption. The temptation to engage in under-the-table payments may be particularly strong given the large sums that are often at stake. Finally, the frequent use of third-party agents and consultants — from local suppliers to logistics companies to customs brokers — and the limited visibility into how money is being spent by these third parties aggravate the compliance risks. With corruption comes the need to launder unlawful proceeds, giving rise to another set of challenges to prevent and detect money laundering.

US and Hong Kong: Common Enforcement Themes

The SFC's recent public statements and actions have aligned with U.S. regulators' enforcement priorities. These parallels are expected to multiply as law enforcement authorities in the U.S. and Hong Kong continue to fine-tune their evidence-sharing mechanisms and improve their coordination.

Individual Accountability

For American practitioners, any compliance discussion must involve the Yates memorandum. Issued in September 2015 by then-Deputy Attorney General Sally Yates, the Yates memo reaffirmed the U.S. Department of Justice's (DOJ) commitment to holding individuals accountable for their misconduct through penalties such as substantial prison sentences and fines to achieve both deterrence and punishment. In DOJ's views, "[o]ne of the most effective ways to combat corporate misconduct is by seeking accountability from the individuals who perpetrated the wrongdoing." Accordingly, the memo directs prosecutors to "focus on individual wrongdoing from the very beginning of any investigation of corporate misconduct."

Recent statements by the SFC in Hong Kong echo these views. Ashley Alder, SFC's CEO, said in a December 2016 press release that "[s]enior managers bear primary responsibility for the effective and efficient management of their firms, and they should be well aware of the obligations currently imposed on them as well as their potential liability if they fail to discharge their responsibilities." Around the same time, the SFC issued a circular directed at licensed corporations that spelled out the SFC's views as to the types of positions within a company that count as "senior management," reminded these managers of their oversight responsibilities and outlined the severe consequences that would result from their failure to fulfill them.

Enforcement actions since then have backed up these muscular pronouncements. The SFC started the year with legal proceedings against the Hong Kong-listed Chinese solar energy company Hanergy Thin Film Power Group and its directors for alleged market manipulation. In a case currently under trial, the SFC sought disqualification orders for up to 15 years against the chairman and four independent nonexecutive directors for entering into transactions with "connected parties" against the interests of the company. A few weeks later, the SFC announced that it was investigating China Forestry and its two bank sponsors for making misrepresentations in its initial public offering disclosure documents. The investigation has resulted in the suspension of trading for China Forestry, which went into liquidation soon thereafter.

In another case initiated by the SFC involving an environmental engineering firm Greencool Technology Holdings Ltd., the SFC alleged, and the Market Misconduct Tribunal found in June 2017, that the company's chairman and senior executives "perpetrated a massive, systemic fraud" by overstating the company's earnings and the value of its net assets. The Market Misconduct Tribunal entered the largest disgorgement order ever imposed — approximately US$62 million — and issued disqualification orders, ranging from three to five years, against various individuals.

Cooperation Credit

Another area of convergence is the incentives offered to companies to self-report violations, potentially in exchange for leniency. In April 2016, the DOJ announced a one-year pilot program — since extended indefinitely — under which a cooperating company can receive up to 50 percent off the low end of the applicable U.S. Sentencing Guidelines fine range. Equally important from the company's perspective, it may potentially be able to avoid the appointment of a corporate monitor. There have been a total of seven declinations since the start of the program, each of which was purportedly the result of these companies' "prompt voluntary self-disclosure," "thorough investigation undertaken," "fulsome cooperation," "agreement to continue to cooperate in any ongoing investigations of individuals" and "full remediation."

With only minor modifications, the above-quoted language on cooperation could just as well have appeared in public announcements issued by Hong Kong regulators. Since the issuance of a Guidance Note in 2006 encouraging companies to cooperate, the Hong Kong SFC has regularly touted companies' cooperation as the primary reason for the reduced penalties they were ordered to pay, variously citing these companies' "cooperation," "self-reporting," and "agree[ment] to engage an independent reviewer to conduct a review."

Anti-Money Laundering and Internal Controls

Both U.S. and Hong Kong authorities have ramped up their anti-money laundering (AML) efforts, bringing enforcement actions not just against money launderers but also against individuals, banks and financial institutions whose internal control failures allegedly enabled money launderers to circumvent the law. In the United States, a major German bank was fined US$41 million in May 2017 for Bank Secrecy Act violations, allegedly because its U.S. operations failed to maintain adequate protections against money laundering. At the state level, the New York State Department of Financial Services issued new rules, effective January 1, 2017, that impose stringent obligations on regulated institutions to maintain effective programs to monitor and filter transactions for potential Bank Secrecy Act and AML violations, and to prevent transactions with sanctioned entities.

Since the enactment of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance in April 2012, Hong Kong has taken a number of high-profile actions against banks. In the first reported enforcement action under this law in July 2015 initiated by the Hong Kong Monetary Authority (HKMA), it reprimanded and fined the State Bank of India close to US$1 million for its alleged failure to conduct proper due diligence on customers and verify whether they were "politically exposed persons." Similar actions against other banks have followed, including earlier this year, when a U.K. bank's Hong Kong branch was fined US$900,000 and given a public reprimand for alleged AML violations — specifically, failure to establish and maintain effective procedures to screen politically exposed persons.

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Increased Cooperation Demands Strong Compliance

Given the rise in international law enforcement cooperation, the convergence in enforcement priorities and approaches should not be surprising. Reaffirming the importance of international cooperation and their commitment to it has become de rigueur in recent public statements by both U.S. and Hong Kong regulators.

And it is more than just talk. To cite just one example, earlier this year, the U.S. Securities and Exchange Commission (SEC) and the Hong Kong SFC entered into a memorandum of understanding on evidence and information sharing that covers a spectrum of regulated entities, including investment advisers, broker-dealers, securities exchanges, market infrastructure providers and credit rating agencies. In certain circumstances, it even allows the commission in one jurisdiction (for example, the SEC) to conduct on-site examinations of registered entities in the other jurisdiction (for example, an SEC-registered entity's Hong Kong office) — something that would have been unthinkable just a few years ago.

Companies would be well-advised to bolster their compliance programs to prepare for a reality where a regulatory inquiry from one jurisdiction may be followed by related inquiries from regulators in another jurisdiction, and to establish protocols to ensure well-coordinated responses to these multijurisdictional inquiries.