

## ARCM FCA Enforcement Action – October 2020

### Introduction

The Financial Conduct FCA of the United Kingdom (“FCA”) has recently imposed a fine of GBP873,118 on Asia Research and Capital Management Ltd (“ARCM”) which is an asset management firm based in Hong Kong and manages a series of long duration closed-end investment vehicles focused primarily on investing in debt and equity securities across Asia, and which infrequently trades in EU markets.

ARCM agreed to resolve the issues identified by the FSA and therefore qualified for a 30% discount on the fine from the FCA or it would otherwise have paid a penalty of GBP1,247,312.

### UK Short Position Reporting Obligations

Where an investor holds a net short position in a share on any trading venue in the UK, it has the following obligations:

- if the net short position is equivalent to 0.2% of an issuer’s issued share capital, it must report this to the FCA;
- for every increase of that net short position equivalent to 0.1% of an issuer’s share capital, it must make a further notification to the FCA;
- if the net short position is equivalent to 0.5% of the issuer’s share capital, it must be made public, through publication on a website maintained by the FCA. In practice, this requires the market participant to make the notification to the FCA; and
- for every increase of that net short position equivalent to 0.1% of an issuer’s share capital, it must make further disclosure to the public via its notification to the FCA.

Under the Short Selling Regulations (“SSR”), a net short position in relation to shares of an issuer is the position which results from the difference between any short position and any long position held by an investor in relation to the issued share capital of an issuer.

An investor must calculate whether it has passed the notification threshold, by calculating the size of the net short position as at midnight on the day on which it holds the position.

The notification must be made to the FCA by 15:30 UK time on the following trading day.

The SSR imposes obligations on all market participants trading in the UK wherever they are domiciled or established.

The SSR applies to any transferable security such as shares and a short position includes a transaction related to a share which gives the effect of conferring a financial advantage on the person entering into it in the event of a decrease in the price of the share. This includes derivatives such as equity swaps and CFDs relating to shares which replicate the effects of a short sale of the share itself.

### Facts of the Breach

On 17 October 2016, ARCM began investing in Premier Oil through the acquisition of a debt instrument, via a secondary market transaction. From this date, ARCM continued to build its credit position in Premier Oil.



Between 22 February 2017 and 3 December 2019, ARCM failed to disclose to the FCA and / or the public net short positions (both at the 0.2% and the 0.5% level as well as the subsequent disclosures at each 0.1% above those levels as required under the SSR).

In total ARCM failed to make:

- 155 notifications of its net short position to the FCA under Article 9 of the SSR, in breach of Article 5 of the SSR; and
- 153 disclosures of its net short position to the public under Article 9, in breach of Article 6 of the SSR.

ARCM had in place a trading compliance management system that integrated pre- and post-trade controls but because ARCM rarely had short positions in companies in EU markets, it relied on third party materials about the relevant UK rules. However, the information was not an exhaustive list of the instruments to which the SSR applied. Specifically, the information did not reference derivatives trading as requiring notification. ARCM therefore incorrectly believed that the obligation did not apply to its trading in Premier Oil.

Although ARCM became aware on 29 October 2019 that it had a reporting obligation, from that date until 8 November 2019, researched whether the SSR applied to its net short position, whether there were any applicable exemptions and the relevant precise disclosure and notification.

When ARCM became aware of its reporting obligation on 8 November 2019, it then began preparing the data and disclosures via external consultants. However at this point, ARCM and its consultants were both affected by the late 2019 protests in Hong Kong and as such, the notifications to the FCA were not made until then.

## FCA's Conclusions

The FCA concluded that ARCM's failures were particularly serious for the following reasons:-

- The failures to comply with the SSR were numerous and occurred over a long period of time.
- ARCM did not inform the FCA promptly when it discovered the breaches and only notified the FCA after it had collated and reviewed the relevant data that required disclosure.
- The large size of the position which at the time of ARCM's final net short position was the largest net short position (16.85%) ever held in a company listed to the main board of the LSE.
- As a result of ARCM's failure to make these disclosures, the market functioned without information that should have been available but was not and this had an impact on market confidence and transparency.

## Relevance to Hong Kong Based Firms

This enforcement action is a timely reminder about the need for Asian based firms to be sure about the rules that apply to them when trading, capital raising or investing in markets outside of their home jurisdictions. It is not enough to have a general understanding based on generic research. In this case, we are of the view that ARCM was treated generously by the FCA compared to the type of action that could be taken by Asia Pacific regulators where breaches of short selling rules often attract strict criminal liability.



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In addition to the risk of overseas enforcement actions, most Asian regulators have requirements to comply with the requirements of overseas markets or face regulatory action at home.

This type of regulatory action overseas would be a notifiable event to Asian home regulators. When something like that happens, while Asian regulators may not take further action, explaining this to them and showing them it was not evidence of a wider systemic problem is necessary and can be time consuming for the impacted party.

In Hong Kong specifically the SFC [circular](#) of January 2014 outlines the SFC's expectations of licensed corporations with regard to cross-border business activities. The SFC expects licensed corporations to maintain effective policies, procedures and controls to monitor and ensure compliance in relation to any cross-border business activities conducted. In addition, licensed corporations must adhere to any legal and regulatory requirements of Hong Kong and any relevant jurisdiction when conducting business activities outside of Hong Kong.

Prior to conducting any overseas business activities, we wish to remind licensed corporations of the importance of familiarising themselves with the laws and regulations of the overseas jurisdiction and how these may apply to the business activities they plan on conducting. This was highlighted in February this year when the SFC reprimanded and fined Capital Global Management Limited ("CGML") HK\$1.5m for its failures to ensure compliance with applicable laws and regulations when distributing investment funds and offering investment advice in Taiwan ([SFC Circular on CGML](#)).

In Singapore in April the MAS reminded firms in the context of Singapore representatives being overseas that firms must ensure compliance with all regulatory requirements in Singapore as well as the overseas jurisdiction in which the representative is located. Like the SFC, the MAS has taken enforcement actions against firms in relation to their overseas activities which were non-compliant.

## How we can help

We have recently opened an office in London and are well placed to assist Asian firms in understanding the wide range of rules and regulations that may impact their compliance obligations from UK and EU regulation. Our dedicated projects team can provide customized guidance on what compliance and regulatory obligations you need to be aware of when entering into markets in the UK or EU.

With this new office, we will also be able to provide on the ground assistance to UK and EU clients who are considering opening offices in the APAC region or who require time-zone friendly support in relation to their existing Asian offices.

To discuss this further please contact either Philippa Allen or Rob Lind on the contact details below.

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## About ComplianceAsia

ComplianceAsia is the longest established compliance consulting firm in Asia Pacific established in 2003 with key offices in Hong Kong, Shanghai, Singapore, Tokyo and London. We have an unmatched track record of completing complex compliance consulting projects for financial firms in the APAC region.



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With over 70 staff, including compliance experts with experience in dealing with the SFC, HKMA, MAS, CSRC, JFSA and Asian exchanges, we provide independent, unbiased advice on Asian financial industry legislation and regulations. Our international client base consists of asset managers, hedge funds, private equity funds, family offices, broker-dealers, insurers, wealth managers and investment banks.

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