

UNDERSTANDING ANTI-CORRUPTION ISSUES IN ASIA

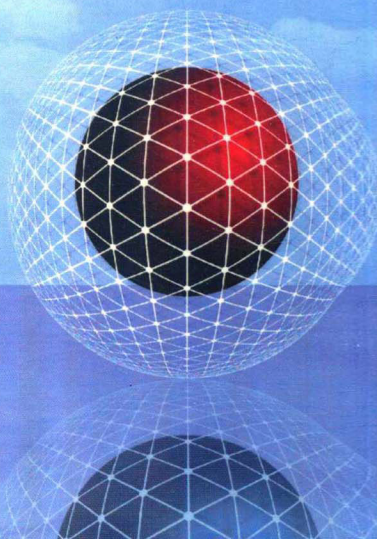
An In-Depth Look at Recent
Developments and Upcoming Trends

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ASPATORE

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The Changing Face of Corruption in Greater China

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Introduction

This chapter explores the nature of corruption in Hong Kong and the People's Republic of China (China). We discuss the way in which anti-corruption measures have evolved, influences and outcomes, and how anti-corruption measures have been implemented and their effectiveness. We look specifically at how explosive growth in capital markets and financial services has required anti-corruption agencies to turn their attention away from their public sector beginnings. We conclude by looking at the trends to see how international businesses are adjusting their operational practices to stay in line with changes in anti-corruption legislation across multiple jurisdictions regulated by statutory bodies.

Focus Points

- A number of cultural and historical factors influence the type of corruption seen in Asia, such as *guanxi*, red packets (known as *bong bao*), powerful family dynasties, governmental control, and, of course, legislation and current practices. Depending on how these factors combine, an environment is created in which there is little opportunity for corrupt acts to go unnoticed.
- The formation of the Independent Commission Against Corruption (ICAC) in 1974 played a major role in the fight against corruption in Hong Kong. This body allowed investigation into the public sector. This structure has become a model other nations attempt to replicate. Hong Kong is now one of the cleanest countries when it comes to corruption; however, we have yet to see whether this model will be successfully adopted by China.
- Since 1985, the ICAC has targeted private sector corruption. This is an indicator of the growing importance of Hong Kong's capital markets and how participants in stock exchange listings at all levels come under scrutiny. The Securities and Futures Commission's (SFC's) growing power under the expanded Securities and Futures Ordinance (SFO) regime (2008) has enforced maximum penalties against those found guilty of insider dealing.
- China's move to a capital market brought rags-to-riches stories to the spotlight with an influx of family entrepreneurial businesses. These businesses are once again center stage as they face legal

charges and prosecution for bribery and corruption in the need for power and money. China has introduced a number of monitoring and governing bodies; however, they have yet to set up a unified front to tackle inbred corruption.

- International companies are attracted to Hong Kong for numerous reasons; however, operating within Hong Kong means operating in multiple jurisdictions. Businesses must consider all legislation within various countries, communicate in numerous languages, and work in and around cultural practices that are subject to different interpretations by multiple international laws. The interpretation gap between Hong Kong and China specifically is wide, and we have recently seen high-profile companies face hefty consequences because of non-compliance.
- It is important for companies to carry out internal investigations, engage external counsel, and consider the level of interaction between local and overseas regulators. Irrespective of the size and location of operations of business, detailed compliance systems must be in place.

Cultural and Historical Factors

No discussion of corruption in Hong Kong, and in turn in China, can begin without an understanding of *guanxi* and the important role it plays in social and business circles. At its most basic, *guanxi* describes the personal connection between two people in which one is able to prevail upon another to perform a favor or service, or be prevailed upon. While this may superficially appear to be no different from similar who-you-know arrangements, such as *socialismo* in Cuba, the *blat* in Russia, the *masta* in the Middle East, and, of course, the “old school ties” and alumni networks in the West, *guanxi* can be far more difficult—and sometimes impossible—to discern. Not only is there no requirement that the connection concern persons of equal social, educational, or business standing, *guanxi* can describe an entire network on which an individual can call and through which he can exert influence, whether for himself or on behalf of another. *Guanxi* can describe a state of general understanding between two people where one is aware of another’s needs and can be assumed to take them into account when deciding a course of conduct—without any specific discussion or request.

A further local difference concerns the custom of giving red packets, or *hong bao* on Chinese customary festivals, such as Lunar New Year. While this may appear no different from the giving of Christmas presents in the West, there are significant cultural differences. It is not at all impolite for the young or single to request *hong bao* of those who are married, nor for junior employees to request *hong bao* of more senior colleagues or even customers. Thus, the extent to which *hong bao* are given goes well beyond close or even extended family. The Chinese believe that the giving of *hong bao* helps bring good fortune in the coming year, so when even the security guard or postman wishes local residents *Gong Xi Fa Cai* at Lunar New Year (literally “congratulations, may you make a fortune”), he will almost certainly be expecting, and be given, *hong bao*. Indeed, one of Hong Kong’s precedent legal decisions on corruption *A-G v. Chung Fat-ming* [1978] HKLR280 concerned a postman who in 1978 greeted residents in the expectation of receiving HK\$5 or HK\$10 *hong bao* and was convicted.

Principally, because of the unrelenting efforts on the part of Hong Kong’s ICAC, described further below, the city has moved on considerably since 1978, and a recent survey of government transparency and corruption in the public sector by Transparency International (TI) found less corruption in Asian nations including Singapore, Hong Kong, and Japan than many in the West.¹

However, while *guanxi* and small-value *hong bao* might be the reason public sector civil servants and private sector employees alike will still sometimes feel obliged to accord superior service to members of the public, customers, and suppliers, the main form of corruption in Hong Kong and China today mirrors that found elsewhere in Asia and the rest of the world: an abuse of accumulated financial and family influence and power.

Moreover, the extent of China’s problem—rated seventy-ninth, it featured at the other end of the TI’s scale—means that graft, bribery, embezzlement, backdoor deals, nepotism, patronage, and statistical falsification are endemic in China. One reason for that seventy-ninth ranking may be that, perhaps, like other socialist economies that have undergone large-scale transition, the movement of China into the post-Mao era has caused organizational contortion within the ruling party. This causes officials to lag behind institutions, norms, policies, and adaptation to a new environment.

¹Transparency International’s Corruption Perceptions Index, 2009, in which Hong Kong was placed at 12th position; the UK was at 17th; and the United States at 19th.

A political science professor at the City University of New York argues that it was the problem of corruption, rather than democracy, that lay at the root of social dissatisfaction that led to the Tiananmen protest movement in 1989.² Will Hutton of the British *The Observer* newspaper, writes in his book that the ruling Chinese Communist Party is “one of the most corrupt organizations the world has ever witnessed.”³

The difference in Hong Kong and China is that what influences the general forms of corruption does not generally come from random individuals or companies, but from dynasties of powerful Asian families who intermarry to maintain and increase their overall wealth and political power. This increasing power is passed down to future generations through control of political systems. Unfortunately, this ostensibly Chinese model has filtered down into other parts of Asia over the ages.

In China, the party runs everything, so corruption is still difficult to confront because party officials control the police, courts, press, and who can invest in what. Corruption begins at the top and filters down to the lowest rung of the hierarchal ladder. Therefore, it is easy to see why, for example, people processing information at desks in government offices believe the only way to make a decent income is by reaching a level of seniority where it is possible to exert some influence and derive some benefit, just like the example their seniors are setting.

Opportunity for temptation is higher when such vast sums of wealth are on show to a generation raised in times of poverty. Rapid economic growth (as seen in this region) has profound governance implications, and the change in market economies and political systems poses governance challenges. Laws, practices, and institutions that have not developed as fast as economies are often poorly run and monitored, resulting in bad governance, creating a hotbed for corruption.

A distinguishing feature of Hong Kong anti-corruption law is that the term “bribe” is not used. Instead, the neutral word “advantage” is employed,

² Yan Sun, associate professor of political science at the City University of New York, *Corruption and Market in Contemporary China*, 2 (2004).

³ WILL HUTTON, *THE WRITING ON THE WALL: CHINA & THE WEST IN THE 21ST CENTURY* (2007).

which has been given a very wide definition to include all kinds of benefits such as money, goods, choices in action and land, interest and profit, present or future, vested or contingent, arising out of or incident to the property, any payment, release, discharge, or liquidation of any loan, obligation, or other liability, any other service, or favor (other than entertainment), including protection from any penalty or disability incurred from any proceedings of a disciplinary, civil, or criminal nature.

One peculiarity that arises from this wide definition is that even benefits of a trivial nature—e.g., the provision of ferry tickets (that cost less than US\$50)—have been held to constitute an advantage. In that ferry ticket case, the judge had held that in deciding whether the benefit falls to be construed as an advantage under the Prevention of Bribery Ordinance, the substance, the position of the recipient, the relationship between the donor and the recipient, and whether an obligation might be created must all be considered.

However, the more trivial the benefit, the harder it will be for the prosecution to prove that the advantage offered, solicited, or accepted was “an inducement to, reward for or otherwise on account of” the doing of an act by the agent. Another interesting feature of Hong Kong anti-corruption law is the entertainment exemption. “Entertainment” is defined as the provision of food or drink, for consumption on the occasion when it is provided, and of any other entertainment connected with, or provided at the same time as, the food or drink.

Thus, in one Court of Appeal case *HKSAR v. Tang Hoi-on Barney & Anor* [2003] 3 HKC123, it was said that companionship provided by a hostess to a customer when he eats or drinks at her place of employment, might fall within the entertainment exemption. Yet money paid to the hostess to leave her place of employment where food or drink has been provided, to accompany her customer elsewhere, would not be regarded as falling within the entertainment exemption.

Independent Commission against Corruption: Early Days

Facing widespread corruption in the public service and law enforcement services in particular, Hong Kong's government could not rely on its regular police force to deal with the problem. The last straw came in 1973

when a senior police officer, Chief Superintendent Peter Godber fled Hong Kong while under investigation for corruption. The public perception was that he managed to flee only because of corrupt assistance. Public demand for anti-corruption action turned hostile in protests, and the government had no choice other than to act. The government's response was to form its anti-corruption agency as the ICAC in 1974, giving it power to investigate the police, as well as other law enforcement agencies.⁴ The ICAC has successfully helped pave the way to Hong Kong's current clean reputation. The fight against corruption has gradually transformed from a city where "back-handers," or facilitative payments, were quite common, into one of the cleanest places in the world, according to the World Bank⁵ and the Heritage Foundation.⁶ Other countries are even looking into adopting the ICAC model for combating their own corruption problems, viewing Hong Kong as an excellent anti-corruption model.

Since the time when Godber's corruption case initiated the birth of the ICAC in 1974, cases of public sector graft have decreased considerably in Hong Kong, thanks to the assignment studies the ICAC makes into all major public functions, such as law enforcement, the licensing and regulatory system, procurement, contract administration, staff management, and public works. Almost all government departments and most public bodies have had their key procedures studied.

Since 1985 and as explained further below, The ICAC's mission has begun to focus on the private sector. The Advisory Services Group (ASG) was set up to assist private companies, on request, to identify and advise about vulnerabilities in their systems. Since it was set up, the ASG has advised more than 3,000 companies on systems control.

The overall anti-corruption and anti-bribery situation has definitely changed in Hong Kong in recent years. Corruption is certainly less endemic than it was before the establishment of the ICAC. Even in the last few years, the international inertia surrounding anti-corruption measures has been further dispelled. First, high-profile corruption and bribery cases have served to

⁴ Thus, it was the ICAC, which in 2009 prosecuted a member of the Securities and Futures Commission's enforcement division and his wife for housing allowance fraud.

⁵ Daniel Kaufmann, *Corruption: The Facts*, FOREIGN POLICY (Summer 1997).

⁶ STEPHEN YATES, HONG KONG UNDER CHINESE RULE (1999).

demonstrate the effect of national anti-corruption measures and the commercial risks attendant with corruption. Second, the requirement by national authorities for greater transparency has exposed a large number of unacceptable and improper business practices. Finally, civil society organizations have proved extremely successful at pressuring national governments to take action.

It is fair to say that the ICAC has led the fight against corruption since 1974. Before that time, as previously mentioned, Hong Kong was probably one of the most corrupt cities in the world, and as a result, few people thought the ICAC's mission would be successful. But within just three years, the ICAC had weeded out all corruption syndicates in the government and prosecuted 247 government officials, including 143 police officers.⁷ Since its beginnings in 1974, the ICAC has successfully achieved:

- Eradication of all overt types of corruption in the government
- Enforcement of private sector anti-corruption measures
- Ensuring clean elections
- Changing the public's attitude toward corruption

The ICAC also has a wide range of education strategies, operated through its Community Relations Department, including media publicity drives, a school ethics education program (kindergarten up to university level), a voluntary workers in community education club issuing corruption prevention seminars, guidelines, and best practice notes, an Ethics Development Center, exhibitions, fairs, TV shows, and Web sites.

The introduction of the ICAC's whistle-blowing facility has also been an important addition. Neither full evidence nor a name is required when lodging a complaint. Complainants need to state only the known facts of the suspected corruption case, and duty officers in the ICAC Report Center or ICAC regional offices will follow up cases immediately.

⁷ Speech by Tony Kwok, SBS, IDS, former Deputy Commissioner and Head of Operations ICAC, Hong Kong, at the 22nd International Asian Organized Crime Conference.

In addition to the ICAC, the main bodies now responsible for investigating and combating corruption in Hong Kong are:

- The Commercial Crime Bureau, the Narcotics Bureau, and the Organized Crime and Triad Bureau of the police, who investigate money laundering offenses under the Drug Trafficking (Recovery of Proceeds) Ordinance (DTRPO) and the Organized and Serious Crime Ordinance (OSCO). The Narcotics Division of the Security Bureau is responsible for financial investigations arising out of the United Nations (Anti-Terrorism Measures) Ordinance (UNATM).
- The Customs Drug Investigation Bureau of the Hong Kong Customs and Excise Department
- The Hong Kong Monetary Authority and the SFC (see more below) have also issued guidelines to financial institutions in relation to their duties to prevent anti-money laundering. Most financial activities are conducted by institutions that are authorized and supervised by the above-mentioned regulatory authorities.
- The Joint Financial Intelligence Unit is jointly run by staff of the Hong Kong Police Force and the Hong Kong Customs and Excise Department, and was set up in 1989 to receive reports about suspicious financial activity made under the provisions of the DTROP and, since 1995, the OSCO. After the enactment of UNATM in 2002, the unit also receives suspicious transaction reports related to terrorist property. The role of the unit is to receive, analyze, and store suspicious transactions reports and to disseminate them to the appropriate investigative unit.

It remains to be seen whether the Hong Kong model of fighting corruption can be successfully applied in China. It could be successful up to a point, as long as the following components are in place:

- Effective government-led enforcement
- Trustworthy, professional (ICAC equivalent) staff
- Effective deterrence strategy (reporting procedures, quick response system, zero tolerance policy, media publications)
- Effective education strategy
- Adequate law and comprehensive legislation to deal with corruption
- An adequate review mechanism and annual reporting procedure

- Equal emphasis on public and private sector corruption
- A partnership approach—relying on multiple institutions to tackle corruption
- Strong political support, independence, and adequate resources (i.e., the ICAC is directly responsible to the chief executive of Hong Kong)

Corruption in Hong Kong's Capital Markets

The move since 1985 that has seen the ICAC target private sector corruption is perhaps itself an indicator of the growing importance of Hong Kong's capital markets. The local stock exchange has grown to the sixth largest worldwide and in 2006 ranked second only to London in new money raised. Over the past twenty years, not only has the number of listings increased five-fold, but also there has been an even greater surge in trading through derivative instruments, such as index futures, call warrants, and structured products. While new listings continue to enable local entrepreneurs to expand family businesses, the greatest impact on the market has been the advent of China listings and large-scale privatization of state-owned enterprises, which will be discussed below.

While Hong Kong had seen cases of corruption and corporate fraud perpetrated by listed companies, such as Carrian Investments in the early 1980s, the 1990 conviction of Ronald Li, former chairman of the Hong Kong Exchange, for soliciting share allocations to enable initial public offerings (IPOs) to proceed smoothly was an indication of how participants in stock exchange listings at all levels would come under scrutiny. The city, after all, has no natural resources or heavy industrial economic base and has grown into the premier English-speaking financial center in the region, so it comes as no surprise that today's efforts by the ICAC, often supported by the SFC, are devoted to keeping this competitive advantage free from corrupt practices.

ICAC raids in 2002 and 2003 on the offices of Fu Cheong International Holdings, Gold Wo International Holdings, Yue Fung International Group Holdings, and Global Trend Intelligent Technologies resulted in several corruption prosecutions against directors and accountants involved in their listings.