

SFC reprimands and fines CCB International Capital Limited \$24 million for sponsor failures

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The Securities and Futures Commission (SFC) has reprimanded and fined CCB International Capital Limited (CCBIC) \$24 million for failing to discharge its duties as the sole sponsor in the listing application of Fujian Dongya Aquatic Products Co., Ltd (Fujian Dongya) in 2013 and 2014 (Notes 1 & 2).

The disciplinary action followed the SFC's investigation which found that CCBIC failed to:

- conduct all reasonable due diligence on Fujian Dongya before submitting the listing application;
- conduct proper customer due diligence; and
- keep a proper audit trail or written record of its due diligence work.

Failure to conduct all reasonable due diligence

Around 90% of Fujian Dongya's turnover during the track record period (i.e. the years ended 31 December 2011, 2012 and 2013) was derived from sales to its overseas customers, and around 90% of such sales was paid by the overseas customers through third party payers (TPP Arrangement).

As part of the verification of the genuineness of Fujian Dongya's sales, CCBIC instructed its lawyers to devise a due diligence plan on the TPP Arrangement.

The plan required CCBIC to, among other things, (i) arrange Fujian Dongya's overseas customers and their third party payers to sign a letter of confirmation; (ii) arrange overseas customers which could not terminate the TPP Arrangement to sign an indemnity agreement (Indemnity Agreement); and (iii) interview the third party payers before submitting Fujian Dongya's listing application to The Stock Exchange of Hong Kong Limited (SEHK) (Notes 3, 4 & 5).

CCBIC, however, did not complete the due diligence plan prepared by its lawyers. For instance, it did not obtain from Fujian Dongya a list of customers which could not terminate the TPP Arrangement and select some of these customers for interview. It also did not interview any third party payers (Note 6).

In the course of conducting the due diligence, CCBIC also discovered a number of red flags concerning the TPP Arrangement but there was no evidence that it had made further enquiries with the relevant customers or third party payers, nor records of its justifications for not doing so. The red flags included that:

- a number of Fujian Dongya's customers relied on multiple third party payers from different countries to pay Fujian Dongya;
- some customers of Fujian Dongya acted as the third party payers of other Fujian Dongya's customers when they also relied on third party payers to make payments to Fujian Dongya; and
- Fujian Dongya informed CCBIC that it was impossible or very costly for its customers in Taiwan to make direct payments to Fujian Dongya but our investigation revealed that various third party payers in Taiwan had made payments to Fujian Dongya on behalf of its customers.

The SFC's investigation also revealed that one of the members of CCBIC's transaction team had raised concerns about the genuineness of the signatures on the Indemnity Agreements.

After reviewing the Indemnity Agreements, the SFC found that:

- some of the Indemnity Agreements appeared to have been signed by the same person on behalf of different customers; and
- some of the Indemnity Agreements were apparently signed by the same person in different countries on behalf of different customers on the same day.

Failure to conduct proper customer due diligence

While CCBIC planned to conduct face-to-face interviews with Fujian Dongya's customers in the

absence of Fujian Dongya representatives and had made it clear to Fujian Dongya that telephone interviews would only be conducted with a small number of customers who could provide reasonable explanations as to why they could not attend face-to-face interviews, the SFC's investigation found that:

- Of the 22 overseas customers interviewed by CCBIC, only 12 of them were interviewed in face-to-face meetings and 11 of these 12 interviews were conducted in the presence of one or two Fujian Dongya representatives;
- 8 of these 12 interviews were not conducted in the customers' premises; and
- 10 customers were interviewed by telephone but there is no record as to why these customers could not attend face-to-face interviews.

Moreover, there is no evidence to show that CCBIC had taken steps to verify that the interviewees had the appropriate authority and knowledge to attend the interviews.

Failure to keep a proper audit trail or written record

The SFC's investigation also found that CCBIC did not keep a proper audit trail or written record of its due diligence work. For example, CCBIC did not maintain records that could explain its decision of not completing the above-mentioned due diligence plan (Note 7).

In deciding the disciplinary sanction, the SFC took into account that:

- the SFC found no evidence that the breaches and deficiencies identified above were deliberate, intentional or reckless;
- CCBIC cooperated with the SFC in accepting the disciplinary action and did not dispute the SFC's findings and regulatory concerns;
- there is no evidence that suggests that there is a systemic failure in CCBIC's policies, procedures and practices in respect of its sponsor work;
- CCBIC has on its own initiative enhanced its internal controls and systems in respect of its sponsor work since Fujian Dongya's listing application and it agreed to engage an independent reviewer to review its enhanced policies, procedures and practices in relation to its sponsor work, particularly, in performing due diligence on listing applicants and preparing listing application documents;
- Fujian Dongya's listing application had lapsed; and
- CCBIC has an otherwise clean disciplinary record.

The SFC would like to remind sponsors that before submitting a listing application to the SEHK, they should have performed all reasonable due diligence in order to gain a thorough knowledge and understanding of the listing applicant's business and satisfy itself that all information concerning the listing applicant in respect of the application was fully, fairly and accurately presented.

A sponsor must also plan and execute its due diligence inquiries on information proposed to be disclosed in the IPO prospectus with professional skepticism and critically assess the information or documents provided by the listing applicant, recognising that it is possible for information or statements proposed to be disclosed in the IPO prospectus to be materially misstated due to error or fraud.

The SFC will continue to take action against sponsors who fail to fulfil these requirements.

End

Notes:

1. CCBIC is licensed to carry on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities under the Securities and Futures Ordinance.
2. Fujian Dongya applied for listing on the Main Board of the SEHK on 21 March 2014 with CCBIC as its sole sponsor. The company's listing application lapsed on 22 September 2014, i.e. six months after its submission of the application.
3. According to the draft letter of confirmation prepared by CCBIC's lawyers, the customers were asked to confirm, among other things, that: (i) they were independent from Fujian Dongya and its directors, senior executives or major shareholders etc.; (ii) the names of the third party payers that made payment to Fujian Dongya; and (iii) the amounts of such payments.
4. According to the draft letter of confirmation prepared by CCBIC's lawyers, the third party payers were asked to confirm, among other things, that: (i) they were independent from Fujian Dongya and its directors, senior executives, shareholders and staff etc.; (ii) the names of the customers whom they made payment to Fujian Dongya for; (iii) the amounts of such payments; and (iv) the reasons for making such payments on behalf of the relevant customers.
5. The customers represented and warranted in the indemnity agreement, among other things, that: (i) the payments made by the third party payers were for purchase of products from Fujian Dongya; (ii) neither

they nor their third party payers had engaged in money laundering activities, nor did the TPP Arrangement involve any money laundering activities; and (iii) their third party payers had no right to request for a refund of the amounts paid to Fujian Dongya.

6. Paragraph 17.4(a) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) provides that before submitting an application on behalf of a listing applicant to the SEHK, a sponsor should have performed all reasonable due diligence on the listing applicant except in relation to matters that by their nature can only be dealt with at a later date.
7. Paragraph 17.10(c)(ii) of the Code of Conduct provides that in respect of each listing assignment, a sponsor should keep records and relevant supporting documents and correspondence relating to, among other things, its due diligence, changes to the due diligence plan and reasons.

[A copy of the Statement of Disciplinary Action is available on the SFC website](#)

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STATEMENT OF DISCIPLINARY ACTION

The disciplinary action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined CCB International Capital Limited (**CCBIC**) \$24 million pursuant to section 194 of the Securities and Futures Ordinance.
2. The disciplinary action is taken because CCBIC has failed to discharge its duties as a sole sponsor in the listing application of Fujian Dongya Aquatic Products Co., Ltd (**Fujian Dongya**), in that CCBIC has failed to:
 - (a) conduct all reasonable due diligence on Fujian Dongya before submitting a listing application on its behalf;
 - (b) conduct proper due diligence interviews with Fujian Dongya's customers; and
 - (c) keep a proper audit trail/written record of the work done in relation to the due diligence for the listing application of Fujian Dongya,in breach of paragraph 17 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**).

Summary of facts

3. Fujian Dongya and its subsidiaries procure raw seafood from suppliers, process it at their processing facilities in the PRC, and sell the processed seafood to overseas and PRC customers.
4. Around 90% of Fujian Dongya's turnover during the track record period (i.e. the years ended 31 December 2011, 2012 and 2013) derived from sales to its overseas customers, and around 90% of such sales were paid by the overseas customers through third party payers (**TPP Arrangement**).
5. On 16 May 2013, Fujian Dongya appointed CCBIC as its sole sponsor. On 21 March 2014, CCBIC submitted the listing application of Fujian Dongya together with the Application Proof prospectus to The Stock Exchange of Hong Kong Limited (**SEHK**).
6. On 4 April 2014, SEHK and SFC raised a number of queries on the TPP Arrangement (**1st Round Comments**). In particular, the SFC queried:

"it is unclear how the Sponsor and the Reporting Accountants could ascertain the identity of the Third Party Payers, the existence of the Group's customers, the genuineness and completeness of the Group's sales, and the matching of settlements made by Third Party Payers to the actual trade receivables from the Relevant Customers during the Track Record Period."
7. On 24 July 2014, CCBIC submitted its response to the 1st Round Comments together with a revised prospectus to the SEHK. On 19 and 25 August 2014, SEHK and SFC made further queries on the TPP Arrangement (**2nd Round Comments**):

"The Sponsor's submission fails to illustrate clearly how the Sponsor and the Reporting Accountants could ascertain the identity of the Indirect Payers. It appears that neither the Sponsor nor the Reporting Accountants has interviewed the Indirect Payers and the Sponsor has not conducted site visit to any of the Relevant Customers and Indirect Payers. We also note from the Risk Factors section that the Group did not perform independent verification of the Indirect Payers' identity, background, and relationship with the Relevant Customers or the sources of their funds..."

"Despite our previous comment, the Sponsor's submission fails to illustrate how the settlements made by the Indirect Payers were matched to the actual trade receivables from the Relevant Customers during the Track Record Period."

8. CCBIC did not respond to the 2nd Round Comments and Fujian Dongya's listing application lapsed on 22 September 2014, 6 months from the date of its submission.

Breaches and reasons for action

Failure to conduct all reasonable due diligence

9. Paragraphs 17.4(a)(i) and 17.6(c) of the Code of Conduct require a sponsor:
 - (a) to have performed all reasonable due diligence on the listing applicant before submitting an application on its behalf, except in relation to matters that by their nature can only be dealt with at a later date; and
 - (b) to undertake additional due diligence to ascertain the truth and completeness of the matter and information provided by the listing applicant, after the sponsor becomes aware of circumstances that may cast doubt on information provided to it or otherwise indicate a potential problem or risk.
10. As early as September 2013, CCBIC had become aware that the TPP Arrangement was a material issue in Fujian Dongya's listing application. Accordingly, CCBIC instructed its lawyers to devise a due diligence plan on the TPP Arrangement.
11. After rounds of discussions between CCBIC, its lawyers and other professional parties, a plan containing 11 due diligence steps was devised in December 2013 (**DD Plan**). The DD Plan required CCBIC to, among other things, arrange for the overseas customers¹ and their third party payers² to sign a letter of confirmation, arrange for the overseas customers which could not terminate the TPP Arrangement to sign an indemnity agreement (**Indemnity Agreement**)³

¹ According to the draft letter of confirmation prepared by CCBIC's lawyers, the customers were asked to confirm, among other things, (i) they are independent from Fujian Dongya and its directors, senior executives or major shareholders etc.; (ii) names of the third party payers used by them to make payment to Fujian Dongya; and (iii) amounts of such payments.

² According to the draft letter of confirmation prepared by CCBIC's lawyers, the third party payers were asked to confirm, among other things, (i) they are independent from Fujian Dongya and its directors, senior executives, shareholders and staff etc.; (ii) names of the customers whom they made payment to Fujian Dongya for; (iii) amounts of such payments; and (iv) reasons for making such payments on behalf of the relevant customers.

³ In the indemnity agreement, the customer represented and warranted, among other things, that (i) payment made by its third party payer was for purchase of products from Fujian Dongya; (ii) neither it nor its third party payer engaged in any money laundering activities, and the TPP Arrangement did not

and interview the third party payers, before submitting Fujian Dongya's listing application to the SEHK.

12. However, CCBIC did not complete the 11-step DD Plan. For example, CCBIC did not:
 - (a) arrange for customers who made payment through third party payers and the relevant third party payers to sign letters of confirmation;
 - (b) obtain from Fujian Dongya a list of customers which could not terminate the TPP Arrangement and select some of such customers for interview; and
 - (c) interview the third party payers.
13. When asked why it did not follow the DD Plan to verify the TPP Arrangement, CCBIC asserted that it had changed its due diligence plan. However, CCBIC did not maintain any record relating to the alleged changes⁴. On the contrary, the evidence suggests that both CCBIC and the other professional parties had intended to act in accordance with the DD Plan.
14. The evidence also reveals that, in the course of conducting due diligence, CCBIC discovered a number of red flags concerning the TPP Arrangement:
 - (a) a number of customers relied on multiple third party payers from different countries to pay Fujian Dongya, for example, a Taiwanese customer relied on 66 third party payers from 9 different countries to pay Fujian Dongya;
 - (b) some customers acted as third party payer for other customers whilst relying on third party payers to make payment to Fujian Dongya;
 - (c) Fujian Dongya informed CCBIC that it was impossible or very costly for customers in Taiwan to make direct payment to Fujian Dongya but our investigation reveals that there were various third party payers in Taiwan making payments to Fujian Dongya on behalf of its customers.
15. There was no evidence that CCBIC had made further enquiries on the red flags with the relevant customers or third party payers, nor records of its justifications for not doing so.

involve any money laundering activities; and (iii) its third party payers had no right to request for refund of the amounts paid to Fujian Dongya.

⁴ Paragraph 17.10(c)(ii) of the Code of Conduct provides that:

"In respect of each listing assignment, a sponsor should keep records, including relevant supporting documents and correspondence, within its control relating to:

...

(ii) due diligence

(A) a due diligence plan identifying the required time and skill sets of persons needed to implement the plan;

*(B) **changes to the due diligence plan and reasons;***

(C) the nature, timing and extent of due diligence procedures; and

(D) the results of due diligence performed together with its assessment of these results. . ."

(emphasis added)

16. Our investigation also reveals that one of CCBIC's transaction team members had raised concerns about the genuineness of the signatures on the Indemnity Agreements.
17. After reviewing the Indemnity Agreements, the SFC found that:
 - (a) A number of the Indemnity Agreements were apparently signed by the same person on behalf of different customers.
 - (b) A number of Indemnity Agreements were apparently signed by the same person in different countries on behalf of different customers on the same day.
18. Taking into account CCBIC's due diligence on the TPP Arrangement as set out in paragraphs 10 to 17 above, the SFC found that CCBIC has breached paragraphs 17.4(a)(i) and 17.6(c) of the Code of Conduct by failing to conduct reasonable due diligence in relation to the TPP Arrangement.

Failure to conduct proper customer due diligence

19. Paragraph 17.6(f) of the Code of Conduct provides that where a sponsor interviews major business stakeholders (e.g. customers), the sponsor should adopt effective and adequate measures to ensure that the records of the interviews are reasonably accurate, complete and reliable in all material respects. Among other things, the sponsor should:
 - (a) carry out the interview directly with the person or entity selected for interview with minimal involvement of the listing applicant;
 - (b) confirm the bona fides of the interviewee (including establishing the identity of the interviewee and other relevant information) to satisfy itself that the interviewee has the appropriate authority and knowledge for the interview; and
 - (c) identify any irregularities noted during the interview (e.g. interview not taking place at the registered or business address of the person or entity selected for interview, reluctance on the part of the interviewee to cooperate) and ensure any irregularities are adequately explained and resolved.
20. The evidence shows that CCBIC planned to conduct face-to-face interviews with customers in the absence of Fujian Dongya's representatives. Further, CCBIC made it clear to Fujian Dongya that telephone interviews would only be conducted with a small number of customers which could provide reasonable explanations as to why they could not attend face-to-face interviews.
21. Our investigation, however, reveals that:
 - (a) Of the 22 overseas customers interviewed by CCBIC:
 - 12 of them were interviewed during face-to-face meetings but 11 out of 12 interviews were conducted in the presence of one or two representatives from Fujian Dongya;

- 8 of the 12 interviews were not conducted in the customer’s premises;
and
 - 10 customers were interviewed by telephone and there is no record as to why these customers could not attend face-to-face interviews.
- (b) There is no evidence that CCBIC had taken any steps to verify that the interviewees had the appropriate authority and knowledge for the interviews.
22. Furthermore, we note from the interview records provided by CCBIC that the sales figures provided by some of the customers to CCBIC deviated from those provided by Fujian Dongya to CCBIC. However, CCBIC did not clarify the discrepancies with either Fujian Dongya or the relevant customers.

Failure to keep a proper audit trail/written record

23. Paragraph 17.10 of the Code of Conduct provides that a sponsor should maintain adequate records so as to demonstrate to the SFC its compliance with the Code of Conduct.
24. Specifically, paragraph 17.10(c)(ii) of the Code of Conduct provides that in respect of each listing assignment, a sponsor should keep records and relevant supporting documents and correspondence relating to, among other things, its due diligence, changes to the due diligence plan and reasons.
25. CCBIC did not keep a proper audit trail/written record of the work done in relation to the due diligence for the listing application of Fujian Dongya. For example, CCBIC did not maintain any records evidencing:
- (a) why CCBIC decided not to complete the 11-step DD Plan;
 - (b) why CCBIC did not follow its customer interview plan;
 - (c) the telephone numbers used by CCBIC for the purpose of the telephone interviews;
 - (d) the full name of a number of persons interviewed by CCBIC by telephone or in face-to-face meeting; and
 - (e) the internet searches allegedly conducted by CCBIC on the overseas customers of Fujian Dongya.

Conclusion

26. Having considered all the circumstances, the SFC is of the view that CCBIC was in breach of paragraph 17 of the Code of Conduct, which, in the opinion of the SFC, was prejudicial to the interest of the investing public, and CCBIC was therefore guilty of misconduct.
27. In deciding the disciplinary sanction, the SFC took into account that:

- (a) the SFC found no evidence that the breaches and deficiencies identified above were deliberate, intentional or reckless;
- (b) CCBIC cooperated with the SFC in accepting the disciplinary action and not disputing the SFC's findings and regulatory concerns;
- (c) there is no evidence to suggest a systemic failure in CCBIC's policies, procedures and practices relating to its sponsorship work;
- (d) CCBIC has on its own initiative enhanced its internal controls and systems in respect of its sponsor work since Fujian Dongya's listing application and it agreed to engage an independent reviewer to review its enhanced policies, procedures and practices relating to its sponsorship work, particularly, in the areas of performing due diligence on the listing applicants and preparing listing application documents;
- (e) Fujian Dongya's listing application had lapsed; and
- (f) CCBIC has an otherwise clean disciplinary record.