



Hong Kong

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CCB INTERNATIONAL CAPITAL LIMITED FINED \$24 MILLION FOR SPONSOR DUE DILIGENCE FAILURES

Introduction

CCB International Capital Limited (**CCBIC**) has been reprimanded and fined \$24 million by the Securities and Futures Commission (the **SFC**)¹ for its failure to discharge its duties as a sole sponsor in the listing application of Fujian Dongya Aquatic Products Co, Ltd (**Fujian Dongya**). In particular, CCBIC breached paragraph 17 of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**) for its failure to:

- a) perform all reasonable due diligence on Fujian Dongya prior to submitting a listing application on its behalf;
- b) carry out proper due diligence interviews with Fujian Dongya's customers; and
- c) keep a proper audit trail/written record of the work conducted regarding the due diligence for the listing application of Fujian Dongya.

This follows the SFC's HK\$57 million fine of Citigroup Global Markets Asia Limited² on 16 May 2018 for failings in relation to its performance of its duties as sponsor in the listing application

of Real Gold Mining Limited. For more information, please see Charltons' May 2018 newsletter.³

Summary of facts

Fujian Dongya (together with its subsidiaries) acquires raw seafood from suppliers which is then processed at its own facilities in the PRC. Fujian Dongya sells the processed seafood to overseas and PRC customers.

Sales to overseas customers constituted approximately 90% of Fujian Dongya's turnover during the track record period, and approximately 90% of such sales were paid via third party payers (**TPP Arrangement**).

CCBIC submitted the listing application of Fujian Dongya to the Stock Exchange of Hong Kong Limited (the **Stock Exchange**) on 21 March 2014. Two weeks later on 4 April 2014, the Stock Exchange and the SFC made a number of queries on the TPP Arrangement, and in particular:

"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."

1 <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=18PR77>

2 <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/openAppendix?refNo=18PR51&appendix=0&lang=EN>

3 <https://www.charltonslaw.com/sfc-outlined-market-regulation-approach-and-fined-citigroup/>

Following CCBIC's submission of a response to the comments and a revised prospectus, the Stock Exchange and the SFC made additional queries relating to the TPP Arrangement on 19 and 25 August 2014:

"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."

CCBIC did not respond to these comments, and the listing application lapsed on 22 September 2014.

Breaches and reasons for action

Failure to conduct all reasonable due diligence

Sponsors are subject to the following requirements under the Code of Conduct:

- a) prior to submitting an application on behalf of a listing applicant, a sponsor should have conducted 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 (paragraph 17.4(a) (i) of the Code of Conduct); and
- b) where the sponsor becomes aware of circumstances that may cast doubt on information provided to it or otherwise indicate a potential problem or risk, it should undertake additional due diligence to ascertain the truth and completeness of the matter and information concerned (paragraph 17.6(c) of the Code of Conduct).

CCBIC was aware that the TPP Arrangement was a material issue in the listing application as early as September 2013. CCBIC instructed its lawyers to create a due diligence plan in relation to the TPP Arrangement, and, in December 2013, a plan consisting of 11 due diligence steps was created (**DD Plan**). Pursuant to this plan, CCBIC was required, prior to submitting the listing application, to inter alia, (i) arrange for the overseas customers and their third party payers to sign a letter of confirmation, (ii) arrange for the overseas customers which were unable to terminate the TPP Arrangement to sign an indemnity agreement (**Indemnity Agreement**), and (iii) interview the third party payers.

CCBIC did not complete the 11 steps of the DD Plan, including (i) arranging for the parties to sign letters of confirmation, (ii) obtaining a list of customers which could not terminate the TPP Arrangement and select customers to interview, and (iii) interviewing the third party players. It stated to the SFC that it had changed its due diligence plan, although no record was kept of the alleged changes as required by paragraph 17.10(c) (ii)(B) of the Code of Conduct. Indeed, evidence suggests that CCBIC and the other professional parties had intended to follow the DD Plan.

Further, whilst conducting due diligence, CCBIC discovered several red flags relating to the TPP arrangement:

- a) a number of customers used multiple third party payers from different countries to pay Fujian Dongya;
- b) some customers acted as third party payers for other customers whilst relying on third party payers to make payment to Fujian Dongya; and
- c) CCBIC was informed by Fujian Dongya that it was impossible or very costly for customers in Taiwan to pay Fujian Dongya directly, but the SFC's investigation shows that there were various third party payers in Taiwan who made payments to Fujian Dongya on behalf of its customers.

There is no evidence that further enquiries were made with the customers or third party players in relation to the red flags, nor that records were made of CCBIC's reasons for failing to make such enquiries.

Concerns regarding the genuineness of the signatures of the Indemnity Agreements were raised by a CCBIC transaction team member. The SFC found that:

- a) a number of the Indemnity Agreements were apparently signed by the same person on behalf of different customers; and
- b) a number of the Indemnity Agreements were apparently signed by the same person in different countries on behalf of different customers on the same day.

The SFC found that CCBIC failed to conduct reasonable due diligence with respect to the TPP Arrangement and thus breached paragraphs 17.4(a)(i) and 17.6(c) of the Code of Conduct.

Failure to conduct proper customer due diligence

Under paragraph 17.6(f) of the Code of Conduct, where a sponsor interviews major business stakeholders (e.g. customers, suppliers, creditors and bankers), 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. In conducting interviews, the sponsor should:

- i) select interviewees independently based on objective and proportionate criteria;
- ii) conduct the interview directly with the person selected for interview with minimal involvement of the listing applicant;
- iii) 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;
- iv) hold an in-depth discussion with a view to obtaining adequate and satisfactory responses to all questions raised and follow up on any incomplete or unsatisfactory responses or outstanding matters; and
- v) identify any irregularities noted during the interview (e.g. interview not taking place at the registered or business address of the interviewee, reluctance on the part of the interviewee to cooperate) and ensure any irregularities are adequately explained and resolved.

CCBIC planned to carry out face-to-face interviews with customers without the presence of Fujian Dongya's representatives. CCBIC informed Fujian Dongya that telephone interviews would only be held with a small number of customers which could provide reasonable explanations why they could not attend face-to-face interviews.

However, the SFC found that:

- a) out of the 22 overseas customers interviewed by CCBIC:
 - 12 customers were interviewed face-to-face, however for 11 out of 12 interviews one or two representatives from Fujian Dongya were present;
 - 8 of the 12 interviews were not held at the customer's premises;
 - 10 customers were interviewed by telephone and there is no record as to the reason why they could not attend face-to-face interviews.
- b) there is no evidence that any steps were taken by CCBIC to verify that the interviewees had the appropriate authority and knowledge for the interviews.

CCBIC's interview records include sales figures provided by some of the customers, however such figures are inconsistent with those provided by Fujian Dongya to CCBIC. CCBIC failed to clarify the inconsistencies with either Fujian Dongya or the relevant customers.

Failure to keep a proper audit trail/written record

Under paragraph 17.10 of the Code of Conduct, a sponsor should maintain adequate records so as to demonstrate to the SFC its compliance with the Code of Conduct. In particular, paragraph 17.10(c)(ii) provides that in respect of each listing assignment, a sponsor should keep records, including relevant supporting documents and correspondence, relating to due diligence (including, inter alia, changes to the due diligence plan and reasons).

CCBIC failed to maintain a proper audit trail/written record of the due diligence work performed. For example, it failed to keep any records evidencing:

- a) why it decided not to complete the 11-step DD Plan;
- b) why it did not follow its customer interview plan;
- c) the telephone numbers it used for the telephone interviews;
- d) the full name of a number of persons interviewed; and
- e) the internet searches it allegedly performed on the listing applicant's overseas customers.

Conclusion

The SFC considers that CCBIC was in breach of paragraph 17 of the Code of Conduct, which was prejudicial to the interest of the investing public, and therefore, CCBIC was guilty of misconduct.

The SFC took into account the following when determining the disciplinary action of reprimand and a HK\$24 million fine:

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

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