



Hong Kong

March 2020

SFC AND HKEX LISTING COMMITTEE RECENT ENFORCEMENT NEWS

Recent disciplinary actions include:

1. The criticism of a number of directors (current and former) of Asia Resources Holdings Limited by the Listing Committee of the Stock Exchange of Hong Kong Limited (“**the Listing Committee**”) for breach of the Listing Rules; and
2. Two SFC enforcement actions in relation to:
 - The lifting of UBS’ suspension to act as a sponsor of applications to list on HKEx, which was imposed on 14 March 2019¹ in relation to due diligence failures; and
 - The public censure of a number of individuals and entities for breaches of the Code on Share Buy-backs in relation to two transactions in February and May 2016 involving the shares of Beijing Enterprises Holdings Limited.

1. Listing Committee Criticises a Number of Current and Former Directors of Asia Resources Holdings Limited for Breach of the Listing Rules

On 20 January 2020, following a hearing on 12 November 2019 conducted by the Listing Committee, HKEx announced² that two current and five former directors (executive (**ED**), non-

executive (**NED**) and independent non-executive directors (**INED**)) had been criticised for breaching Rule 3.08(f) of the Listing Rules.

Rule 3.08(f)³ states that every director must, in the performance of his duties as a director, apply such degree of skill, care and diligence as may reasonably be expected of a person of his knowledge and experience and holding his office within the issuer.

The breach concerned the directors’ failure to exercise sufficient skill, care and diligence in respect of the acquisition of a spring water mine business.

i. The Conduct of the Directors

On 23 May 2017, Asia Resources Holdings Limited announced it had entered into an agreement to acquire a 67 percent stake in a water mine business (**the target**), which was engaged in exploitation, production and sales of spring water in Hunan, for HK\$244 million.

Of relevance is that:

- The target had not yet commenced business;
- The bottled water business was a new business to Asia Resources Holdings; and
- None of the directors had experience in this type of business.

¹ <https://www.charltonslaw.com/sfc-imposes-record-fines-for-sponsor-failures/>

² https://www.hkex.com.hk/News/News-Release/2020/200120news?sc_lang=en

³ <https://en-rules.hkex.com.hk/node/2074>

The directors submitted in the hearing that they had relied on the professional parties instructed by them and on the documents provided by the vendor, however the Listing Committee ultimately concluded that the directors had breached their duties under Rule 3.08(f).

In concluding this, the Listing Committee considered the following actions/inactions of the directors:

- Failure to take steps to verify the documents provided by the vendor, even where necessary;
- Placing excessive reliance on a valuation report when it was unreasonable to do so; and
- Failure to procure sufficient professional advice in regards to the acquisition.

ii. Disciplinary Action

Ultimately, as mentioned above, two current directors and five former directors were criticised.

The two current directors were:

- Mr Liu Yan Chee, James, current ED of Asia Resources Holdings Limited; and
- Mr Huang Yi Lin, current NED and former ED.

The five former directors were:

- Mr Chan Shi Yin Keith, former ED;
- Mr Chan Yuk Sang Peter, former ED;
- Mr Zhang Xian Lin, former INED
- Mr Kwok Hong Yee Jesse, former INED;
- Mr Ng Ping Yu, former INED.

The following were also emphasised:

- The importance of directors exercising their fiduciary duties and duties of skill, care and diligence to a sufficiently high standard when making investment decisions on behalf of the company, particularly as the board of directors of a listed company is entrusted with public funds; and

- That directors must ensure proper and adequate due diligence is conducted in respect of any potential investments, in particular where the investment is a new business.

2. SFC Lifts Suspension of UBS to Act as Sponsor

On 14 January 2020, The Securities and Futures Commission (SFC) announced⁴ the lifting of the suspension of the licence of UBS Securities Hong Kong Limited (**UBS Securities**). The suspension was imposed in March 2019 as a result of UBS Securities' failure to perform adequate due diligence in respect of three applications for listing⁵, particularly the verification of the existence of an applicant's assets and the conducting of customer interviews.

i. Sponsor Failings in relation to China Forestry's IPO

UBS AG and UBS Securities (**UBS**) and Standard Chartered Securities (Hong Kong) Limited were reprimanded for failing to conduct adequate and reasonable due diligence inquiries for the listing application of China Forestry Holdings Company Limited in 2009. The SFC found that the joint sponsors failed to verify the existence of the applicant's forestry assets, forestry rights. They did not verify the authenticity of the written confirmations from the relevant forestry bureaus that the applicant was compliant with relevant laws and regulations. They also did not perform adequate due diligence on the applicant's insurance coverage for its forestry assets and its customers.

ii. Sponsor Failings in relation to Tianhe's IPO

UBS, Morgan Stanley Asia Limited and Merrill Lynch Far East Limited were reprimanded for conducting inadequate due diligence interviews for the listing application of Tianhe Chemicals Group Limited in 2014. The joint sponsors did not follow the guidelines on due diligence interviews set out in paragraph 17.6 of the SFC Code of Conduct. The applicant was involved in the due diligence interviews (six of the ten interviews were conducted by telephone or at the applicant's offices), red flags were not followed up (UBS encountered resistance in interviewing the applicant's largest customer) and the questions were not clear enough to establish that the alleged customers dealt with the applicant.

4 <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/enforcement-news/doc?refNo=20PR4>

5 <https://www.charltonslaw.com/sfc-imposes-record-fines-for-sponsor-failures/>

iii. UBS Licence Suspension Lifted

Following the suspension, UBS AG and UBS Securities arranged a 10-month independent review of its policies, procedures and practices. The reviewer examined two listing applications in 2017 and 2018 for which UBS Securities acted as sponsor, and found that they performed adequate due diligence and implemented the following key controls:

- processes, reviews, governance and oversight within the first line of defence to support the transaction team's compliance and to enable effective management oversight;
- policies setting out specific responsibilities for dedicated first line of defence control functions with respect to quality assurance, control monitoring and testing, and issue reporting and escalation;
- adequate forums for escalation of material issues that have been identified for discussion with senior management to the sponsor principal (including managers-in-charge);
- adequate involvement of the independent second line of defence (compliance and operational risk functions); and
- an adequate audit program as a third line of defence.

The SFC lifted UBS Securities' suspension after assessing the independent reviewer's findings.

3. **SFC Publicly Censures Entities and Individuals for Breach of the Code on Share Buy-backs**

On 30 December 2019, the SFC announced⁶ it had publicly censured the following entities and individuals for breaches of the Codes on Takeovers and Mergers and Share Buy-backs⁷ in regards to buy-back transactions in the shares of Beijing Enterprises Holdings Limited in 2016.

The relevant entities include:

- CLSA Limited (**CLSA**), licensed to carry out Type 1, Type 4 and Type 7 regulated activities;

- CITIC Securities Brokerage (HK) Limited (**CSB**), licensed to carry out Type 1 and Type 4 regulated activities; and
- Beijing Enterprises Holdings Limited (**Beijing Enterprises**), the shares of which are listed on the Main Board of the Stock Exchange of Hong Kong (**HKEx**).

The relevant individuals include:

- Mr Andrew James Walters, Head of Block Trading at CLSA (Type 1 Licensed representative);
- Mr Stuart Richard Wilson, Managing Director – Head of Equity Syndicate of CLSA (Types 1 and 4 licensed representative);
- Mr Ka Yip Eddy Lau, responsible officer at CSB (Type 1 licensed);
- Mr King Yuen Lau, responsible officer at CSB (Type 1 licensed);
- Ms Stephanie Li, Managing Director – High Networth Brokerage of CSB (Types 1 and 4 licensed representative);
- Mr Woon Cheung Eric Tung, Assistant President and General Manager of Beijing Enterprises' Finance Department.

The Executive Statement⁸ is available on the SFC website.

i. Conduct of the Individuals and Entities Involved

The conduct involved share buy-backs in the shares of Beijing Enterprises on 17 February 2016 and 11 May 2016.

The February Trade

Prior to the execution of the trade, CLSA approached Beijing Enterprises and asked if it would be interested in acquiring a block of its shares from one of its clients. Subsequently, the buy-back of 10.362 million shares at HK\$34 per share was executed on the Exchange and matched with the sell orders for a total of approximately 10.4 million shares of an institutional client of CLSA.

⁶ <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=19PR123>

⁷ <https://www.sfc.hk/web/EN/assets/components/codes/files-current/web/codes/the-codes-on-takeovers-and-mergers-and-share-buy-backs/the-codes-on-takeovers-and-mergers-and-share-buy-backs.pdf>

⁸ https://www.sfc.hk/web/EN/files/CF/pdf/Public_censure/Executive%20statement%20E_FINAL%2020191230.pdf

On the face of it, this was an on-market trade, however the following communications and coordination between the relevant individuals at CLSA, CSB and Beijing Enterprises occurred prior to the trade:

- Agreement on the price and quantity of shares to be bought back;
- Discussion of sequencing of the orders to be placed on the Exchange; and
- Coordination on timing of the execution via unrecorded phone lines during the placing of the trades.

This enabled the buy and sell orders to be matched almost simultaneously and ensured that Beijing Enterprises bought the shares at the agreed price.

While the individuals at CLSA obtained internal advice and followed internal procedures on the method of execution of the trade, they received flawed advice and no advice was obtained from compliance or legal departments by the individuals at CLSA and CSB prior to execution of the trade. Accordingly, there was no assurance that such complied with relevant rules and legislation.

The May Trade

This trade was executed on the Exchange on 11 May 2016, involving the buy-back of 7.953 million shares at HKD\$38 per share by Beijing Enterprises from another institutional client of CLSA and primarily the same personnel as the February trade were involved.

Subsequently, on 13 May 2016, the compliance department of CLSA and CSB informed the SFC of the February and May Trades, following enquiries by the Exchange.

ii. SFC Comments on the Share Buy-backs

The SFC concluded that:

1. The February and May trades, while executed on the Exchange, were in substance off-market share buy-backs and so should have complied with the requirements of Rule 2 of the Code on Share Buy-backs;
2. Beijing Enterprises breached Rules 1 and Rules 2 of the Code on Share Buy-backs as shareholders were deprived of the opportunity to vote;

3. The conduct of CLSA, CSB and their licensed persons fell short of the standards expected of them under the Codes; and

4. CLSA and CSB did not have proper systems in place to ensure that share buy-backs were conducted in compliance with the Code.

As regards the first finding, the SFC referred to the definition of share buy-backs in the Codes on Takeovers and Mergers and Share Buy-backs, which states:

“a buy-back of shares, or an offer to buy back, redeem or otherwise acquire shares of an offeror made by an offeror, including a privatisation, scheme of arrangement or other form of reorganization that consists in whole or in part of such an offer.”

Further, the SFC emphasised that off-market share buy-backs and on-market share buy-backs are differentiated in the Codes:

Definition of Off-market Share Buy-back	Definition of On-market Share Buy-back
<i>“a share buy-back is not a share buy-back by general offer, an exempt share buy-back or an on-market share buy-back”.</i>	<i>“a share buy-back made by (1) a company having a listing on the Stock Exchange through the facilities of the Stock Exchange in accordance with the Listing Rules”.</i>

Importantly, an off-market share buy-back must be approved in accordance with Rule 2 of the Code on Share Buy-backs, which states that such must be approved by the Executive Director of the SFC’s Corporate Finance Division or his delegate before a repurchasing company acquires any shares pursuant to such share buy-back and this approval will normally be conditional on the approval of the proposed off-market share buy-back by at least three-fourths of the votes cast on a poll by disinterested shareholders in attendance in person or by proxy at a general meeting of shareholders duly convened and held to consider the proposed transaction.

Accordingly, both the February and May trades should have complied with Rule 2, namely approval should have been sought from the Executive and Beijing Enterprises’ independent shareholders.

The SFC emphasised that this Rule is derived from General Principle 1 of the Codes and the fundamental requirement that all shareholders should be treated even-handedly and all shareholders of the same class are to be treated similarly.

In an off-market share buy-back, the offer to buy back shares is only available to a limited number of shareholders and so all shareholders are not treated equally.

iii. SFC Reminder to Practitioners and Parties

Ultimately, the SFC emphasised that practitioners and parties wishing to take advantage of the securities market in Hong Kong must conduct themselves in accordance with the Codes, pursuant to section 1.7 of the Codes,⁹ and where there is any doubt about the application of the Codes, the Executive should be consulted.

⁹ See section 1.7: The role and responsibility of financial and other professional advisers is of particular importance given the non-statutory nature of the Codes, and it is part of their responsibility to use all reasonable efforts, subject to any relevant requirements of professional conduct, to ensure that their clients understand, and abide by, the requirements of the Codes, and to co-operate to that end by responding to inquiries from the Executive, the Panel or the Takeovers Appeal Committee.

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