

INDIVIDUALS NOT OFF THE HOOK - SPONSOR PRINCIPAL BANNED FOR FIVE YEARS FOR FAILING TO DISCHARGE SUPERVISORY DUTIES IN TWO LISTING APPLICATIONS

A few years after CCB International Capital Limited (CCBIC) and BOCOM International (Asia) Limited (BIAL) had been disciplined for the deficiencies in their sponsor work, the Securities and Futures Appeal Tribunal (SFAT) confirmed the sanction imposed by the Securities and Futures Commission (Commission) on the sponsor principal who was involved in the two listing applications concerned for failing to discharge his supervisory duties.¹ This serves as a reminder of the Commission's emphasis on individual accountability and the seriousness of the consequences for sponsor principals should they fail their duties. The SFAT's decision also helps us better understand the factors taken into account by the Commission in determining the length of sanctions.

Background

Back in 2017 and 2018, the Commission reprimanded and fined BIAL HK\$15 million and CCBIC HK\$24 million for failing to discharge their sponsor duties under the Code of Conduct² in relation to the listing applications of China Huinong Capital Group Company Limited (China Huinong) and Fujian Dongya Aquatic Products Co., Ltd (Fujian Dongya) on the Main Board of the Stock Exchange respectively.

China Huinong's listing application was returned by the Hong Kong Stock Exchange (SEHK) on the ground that the disclosure of information in the application proof submitted was not complete in all material respects to enable a reasonable investor to make an informed investment decision, as required by the

Listing Rules.³ More specifically, different versions of the application proof prospectus failed to disclose any information concerning the guarantees provided by persons connected with China Huinong (including its Chief Executive Officer) for short-term loans advanced by its subsidiary to its end customers. BIAL's due diligence work was found to be substandard.

In the case of Fujian Dongya, whilst the listing application eventually lapsed, the Commission subsequently investigated CCBIC's conduct and found that whilst knowing that 90% of Fujian Dongya's sales came from overseas and around 90% of the payments due from the overseas customers were paid via third party payers, CCBIC had failed to conduct adequate due diligence in relation to the third party payment arrangement.

Appropriate mitigating factors for determination of length of sanction

On the back of the disciplinary actions against BIAL and CCBIC, the Commission also looked into the conduct of the sponsor principal concerned, Lai Voon Wai (LAI). It was found that LAI had failed to (i) adequately turn his mind to what reasonable due diligence inquiries should be conducted of certain 'red flag' issues; (ii) provide sufficient instructions, guidance and supervision to the transactions teams of CCBIC/BIAL; and (iii) critically assess the results of the due diligence performed by the transactions teams. The Commission decided to prohibit LAI for five years from re-entering the industry.⁴ Whilst accepting the

corporation, applying to be given consent to act or continue to act as an executive officer of a registered institution under the Banking Ordinance, and seeking through a registered institution to have his name registered as that of a person engaged by the registered institution in respect of regulated activities.

¹ SFAT 2 of 2020, 29 September 2020.

² Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

³ The Rules Governing the Listing of Securities on the SEHK.

⁴ He was prohibited from applying to be licensed or registered, applying to be approved as responsible officer of a licensed

Commission's decision on liability, LAI applied to the SFAT for a review of the Commission's decision on the sanction imposed. LAI's case was principally that the length of the prohibition was excessive and unfair taking into account all the circumstances of the case including:

- LAI's candid admissions of his failures which demonstrated his remorse;
- the delay by the Commission in taking disciplinary action against the individual;
- LAI having already been out of the industry for two years which, he claimed, amounted to *de facto* suspension; and
- the length of prohibitions imposed on sponsor principals in prior cases.

The SFAT decided:

1. **LAI's candid admissions and his remorse** - In giving a twelve-month discount on the originally proposed length of the disciplinary sanction of six years, the Commission had given sufficient weight to the fact that LAI did not dispute the Commission's preliminary findings on his liability which saved the Commission time and resources, and that he appeared remorseful. It was also appropriate to consider the Commission's delay in processing LAI's application for licence which was filed a few months before the service of the Notice of Proposed Disciplinary Action (NPDA) on him. Having said that, such delay was at most a matter of several months and was clearly the least significant of the factors of mitigation.
2. **The Commission's delay in taking disciplinary proceedings** - Although the investigation of BIAL's sponsor conduct concluded in 2017 (more than a year prior to the conclusion of the investigation against CCBIC), it was not unreasonable for the Commission to serve a single NPDA against LAI until after the second investigation was concluded. LAI's liability and appropriate sanction should be considered in totality particularly given that the allegations against LAI in respect of the two listing applications were strikingly similar. The Commission's delay in drafting and serving the

NPDA was not of a magnitude that merits a discount. The SFAT, however, rejected the Commission's submission that the delay could be justified by the fact that the Commission officers having conduct of the disciplinary action were involved in other disciplinary investigations of equal importance.

3. **LAI's absence from the industry for around two years** - the principle of *de facto suspension*, as discussed by the SFAT in *Sun Xiao v SFC*,⁵ is only engaged where an applicant can show that he has obtained new employment but, by reason of the Commission's investigations, has been shut out of that employment. LAI's absence from the industry between 2017 and 2019 was voluntary and it did not justify a sanction discount. The SFAT also rejected LAI's submission that he had been informed by BIAL that the Commission intended to keep him out of the industry for two years and he acted accordingly. Quite apart from the fact that LAI did not adduce any supporting evidence, it was wholly unreasonable to infer that the Commission's concerns about his conduct would be assuaged by an informal 'nod and a wink' arrangement in which the applicant stayed out of the industry.
4. **Other cases** - Whilst acknowledging that there should be broad equality of treatment of persons culpable of similar misconduct, each case should be judged by its own facts. The point of distinction of this case is that LAI's misconduct related to two separate and distinct listing applications with different sponsors and different transaction teams, whereas in all prior cases the misconduct related only to one listing application.

The standards expected of sponsor principals

A five-year prohibition is by no means insignificant. This highlights the importance of sponsor principals to perform their job properly in accordance with the relevant requirements, or risk their chosen livelihood being deprived of.

A sponsor principal has the primary responsibility to supervise sponsor work and ensure such work comply with applicable regulatory standards. In particular, he/she is expected to determine the breadth and

⁵ SFAT 3 of 2014, 22 May 2015.

depth of due diligence review and the amount of resources to be deployed for carrying out due diligence work, make a critical assessment of the results of the due diligence, and ensure that proper steps have been taken to properly resolve all issues arising out of the due diligence exercise.⁶

In LAI's case, although there was no allegation of dishonesty made against LAI, who otherwise had a 'clean disciplinary record', a substantial period of ban was still imposed, on the basis of the seriousness of his failings in two listing applications. This was despite the fact that neither Fujian Dongya nor China Huinong had been listed, which meant that no harm was actually caused to the public. Drawing from the case, sponsor principals should:

- Ensure full implementation of due diligence plans: it is not sufficient for sponsor principals to be involved in devising due diligence plans. They should ensure that the plans are properly and fully implemented, their results are documented, and that any 'red flags' are followed up and issues are resolved;
- Take responsibility in due diligence work: there is no room for rubber stamping what others had done, and it is unacceptable to delegate duties to subordinates to the point of disregarding or neglecting sponsor principal's responsibilities. The fact that you have relied on your capable subordinates to do a proper job will not be good defence and certainly will not be taken as a mitigating factor;
- Critically assess the results of due diligence exercise: LAI took over as the sole sponsor

principal a few days before A1 filing of the listing application of China Huinong. Still, it was found inappropriate for LAI to simply sign off on the application documents without independently and critically appraising the due diligence results;

- Provide sufficient instructions, guidance and supervision to the transaction teams;
- Escalate matters to the management: sponsor principals should raise 'red flags' to the management of the sponsor and draw their attention to material issues discovered during due diligence;
- Set priority in the right way: Whilst sponsor principals may juggle multiple tasks, quality of their work can never be compromised. More importantly, they cannot put revenue boosting prior to their responsibilities as sponsor principals.

Conclusion

Sponsor misconduct continues to be a focus of the Commission. The Commission looks beyond corporate culpability to individual culpability. Last month, in a separate case, the Commission prohibited a former responsible officer and chief executive officer of Yi Shun Da Capital Limited, from re-entering the industry for twenty months, for failing to discharge his duties as a sponsor principal.⁷ This demonstrates that the Commission will not let individual sponsor principals get off the hook if sponsor work is found to be substandard. Consequences for sponsor principals' failings could be severe.

⁶ Paragraph 17 of the *Code of Conduct*; paragraph 1.3.3 of the *Additional Fit and Proper Guidelines for Corporations and Authorised Financial Institutions applying or continuing to act as Sponsors and Compliance Advisers*.

⁷ See the news published by the Commission on Fabian Shin Yick on 16 September 2020 [here](#).



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