

# SFC reprimands and fines BOCOM International (Asia) Limited \$15 million for sponsor failures

15 Mar 2017

The Securities and Futures Commission (SFC) has reprimanded and fined BOCOM International (Asia) Limited (BIAL) \$15 million, for failing to discharge its duties as a sponsor in relation to the listing application of China Huinong Capital Group Limited (China Huinong) (Notes 1 & 2).

## **Failure to conduct all reasonable due diligence before submitting an application**

China Huinong is a company established in Mainland China. During its track record period, the principal business of China Huinong was providing short-term loans to its customers which were small and medium-sized enterprises and individuals in Danyang City, Jiangsu Province. A majority of the loans were not secured by collateral but guaranteed by individuals or companies.

In the course of conducting due diligence, BIAL discovered that a number of China Huinong's connected persons (Note 3), including its executive director and Chief Executive Officer and a company controlled by its second largest shareholder, had guaranteed some of the short-term loans (Connected Guarantees). However, BIAL did not conduct any due diligence in relation to the Connected Guarantees or the concerned connected persons (Connected Guarantors), before submitting the listing application of China Huinong to the Stock Exchange of Hong Kong Limited (SEHK). For example, BIAL did not ascertain:

- the percentage of the Connected Guarantees to the total amount of loans granted by China Huinong during the track record period;
- the relationship between the borrowers and the Connected Guarantors;
- whether there was any dealings between the Connected Guarantors, the borrowers and China Huinong that would require closer scrutiny;
- the genuineness of the Connected Guarantees; and
- whether the Connected Guarantees would continue, and if so, how would China Huinong manage the conflicts of interests between itself and the Connected Guarantors.

By failing to conduct reasonable due diligence on issues related to the Connected Guarantees, BIAL breached the Code of Conduct, under which BIAL as a sponsor should have:

- performed all reasonable due diligence on China Huinong before submitting a listing application on its behalf; and
- done more due diligence to ascertain the truth and completeness of the information provided by China Huinong, after it becomes aware of circumstances that cast doubt on the information provided to it or otherwise indicated a potential problem or risk (Notes 4 & 5).

## **Failure to ensure that all material information has been included in the Application Proof**

The Connected Guarantees were not disclosed in the Application Proof submitted to the SEHK. As a result, the SEHK returned China Huinong's listing application on the ground that the disclosure of information in the Application Proof was not complete in all material respects to enable a reasonable investor to make a fully-informed investment decision (Note 6).

The SFC also found that the Connected Guarantees raised material issues relating to China Huinong's business model, its internal controls to manage conflicts; and whether the Connected Guarantees should have been considered as connected transactions. In the absence of reasonable due diligence on these issues, BIAL was not in a position to assess the materiality of the Connected Guarantees to the operation of China Huinong and to ensure that all material information in relation to China Huinong has been included in the Application Proof in breach of the Code of Conduct (Notes 7 & 8).

## **Failure to ensure that all information provided to the regulators is accurate and not misleading**

During the listing application, the SEHK and the SFC asked about the independence of the persons who guaranteed the loan advanced by China Huinong. Due to negligence on the part of BIAL's transaction team, BIAL initially did not disclose the existence of the Connected Guarantees or that

parties related to China Huinong had guaranteed its short-term loans, but only did so until after rounds of queries from the SEHK/SFC.

The SFC found that BIAL breached the Code of Conduct by failing to ensure that all information provided to the SEHK and the SFC is accurate and not misleading in any material respect (Note 9).

Sponsors play a crucial role in the Hong Kong stock market being responsible for assessing the listing suitability of a company to be listed and verifying the information disclosed in the prospectus. The SFC and the investing public expect sponsors to examine information provided by the listing applicants with professional scepticism and ensure that the draft listing documents contain relevant and meaningful disclosure about the listing applicants. Sponsors who fail to fulfil these requirements will face tough sanctions, even if the listing application is eventually withdrawn or returned by the SEHK.

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

- BIAL cooperated with the SFC in accepting the disciplinary action and not disputing the SFC's findings and regulatory concerns;
- there is no evidence to suggest a systemic failure in BIAL's policies, procedures and practices relating to its sponsorship work;
- the senior management of BIAL agreed to review and enhance its 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; and
- BIAL has an otherwise clean disciplinary record.

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Notes:

1. BOCOM International (Asia) Limited is licensed under the Securities and Futures Ordinance to deal in securities and advise on corporate finance.
2. China Huinong applied for the listing on the Main Board of the SEHK on 10 November 2014 with BIAL as its sole sponsor. The SEHK has not approved China Huinong's listing application.
3. "Connected person" is defined in rule 14A.06(7) of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (Listing Rules).
4. Under paragraph 17.4(a)(i) of The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct), before submitting an application on behalf of a listing applicant to the Stock Exchange, 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.
5. Under paragraph 17.6(c) of the Code of Conduct, a sponsor should not merely accept statements and representations made and documents produced by a listing applicant or its directors at face value. Depending on the nature and source of the information and the context in which the information is given, the sponsor should perform verification procedures that are appropriate in the circumstances, such as reviewing source documents, inquiring of knowledgeable persons or obtaining independently sourced information. Where the sponsor becomes aware of circumstances that may cast doubt on information provided to it or otherwise indicate a potential problem or risk, the sponsor should undertake additional due diligence to ascertain the truth and completeness of the matter and information concerned. Over-reliance on management's representations or confirmations for the purposes of verifying information received from a listing applicant cannot be regarded as reasonable due diligence.
6. Under rule 9.03(3) of the Listing Rules, an applicant must submit a listing application form, an Application Proof and all other relevant documents under rule 9.10A(1), and the information in these documents must be substantially complete except in relation to information that by its nature can only be finalised and incorporated at a later date.
7. Under paragraph 17.4(a)(ii) of the Code of Conduct, before submitting an application on behalf of a listing applicant to the Stock Exchange, a sponsor should ensure that all material information as a result of this due diligence has been included in the Application Proof.
8. Under paragraph 17.4(b) of the Code of Conduct, before submitting an application on behalf of a listing applicant to the Stock Exchange, a sponsor should come to a reasonable opinion that the information in the Application Proof is substantially complete except in relation to matters that by their nature can only be dealt with at a later date.
9. Under 17.9(a) of the Code of Conduct, a sponsor should reasonably satisfy itself that all information provided to the Stock Exchange and the SFC during the listing application process is accurate and complete in all material respects and not misleading in any material respect and, if it becomes aware that the information provided does not meet this requirement, the sponsor should inform the Stock Exchange and the SFC (as the case may be) promptly.

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

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## STATEMENT OF DISCIPLINARY ACTION

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### The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined BOCOM International (Asia) Limited (**BIAL**) \$15 million pursuant to section 194 of the Securities and Futures Ordinance.
2. The disciplinary action is taken because BIAL has failed to discharge its duties as a sponsor in relation to the listing application of China Huinong Capital Group Limited (**Company**), in that BIAL has failed to:
  - (a) perform reasonable due diligence on the Company before submitting its listing application to the Stock Exchange of Hong Kong Limited (**SEHK**);
  - (b) ensure that all material information of the Company has been included in the draft prospectus and other application documents; and
  - (c) ensure that all information provided to the SEHK or the SFC during the listing application process is accurate and not misleading,

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. On 10 March 2014, the Company appointed First Shanghai Capital Limited (**First Shanghai**) as its sponsor but the appointment was terminated on 22 October 2014.
4. On 8 September 2014, BIAL was appointed by the Company to act as its sponsor. It is the position of BIAL that it has independently performed due diligence work in relation to the Company's listing application and it has not relied on any work conducted by First Shanghai.
5. On 10 November 2014, BIAL submitted the Company's listing application together with the draft Application Proof Prospectus (**AP Prospectus**) to the SEHK. Since then and in view of the queries raised by the SFC/SEHK, BIAL had submitted 5 revised versions of the prospectus:
  - Post AP1 Prospectus submitted on 12 December 2014 (**Post AP1 Prospectus**)
  - Post AP2 Prospectus submitted on 5 May 2015 (**Post AP2 Prospectus**)
  - Post AP3 Prospectus submitted on 18 May 2015 (**Post AP3 Prospectus**) together with the Renewed Application.
  - Post AP4 Prospectus submitted on 17 August 2015 and 21 August 2015 (**Post AP4 Prospectus**)
  - Post AP5 Prospectus submitted on 7 September 2015 (**Post AP5 Prospectus**)

6. The Company's connected persons<sup>1</sup> had, during the track record period (**TRP**), provided guarantees for short-term loans advanced by the Company's subsidiary, Danyang City Tiangong Huinong Small Loan Company Limited (**Tiangong Huinong**), to its customers (**Connected Guarantees**). This information was not included in the AP Prospectus and other application materials and it was only disclosed in the Post AP5 Prospectus after rounds of queries/comments from the SFC and the SEHK.
7. As a result, the SEHK returned the Company's listing application on the ground that the disclosure of information in the Application Proof was not complete in all material respects to enable a reasonable investor to make a fully-informed investment decision in breach of rule 9.03(3) of the Listing Rules.
8. On 5 October 2015, BIAL sought to review SEHK's return decision by the Listing Committee but the Listing Committee upheld the return decision after a hearing on 8 October 2015.
9. On 16 October 2015, BIAL requested to review the Listing Committee's decision by the Listing (Review) Committee. The Listing (Review) Committee upheld the return decision after a hearing on 27 October 2015.

#### **Breaches and reasons for action**

##### *Failure to perform all reasonable due diligence before submitting an listing application*

10. 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.
11. During its TRP, the principal business of the Company was providing short-term loans to its customers which accounted for over 90% of the Company's operating income. A majority of the loans were not secured by collateral but guaranteed by individuals or companies (**Guaranteed Loans**). The Guaranteed Loans were a key aspect of the Company's business considering their predominance in the Company's loan portfolio throughout the TRP.
12. In the course of conducting due diligence, BIAL discovered that a number of Company's connected persons, including its executive director and Chief Executive Officer and a company controlled by its second largest shareholder (**Shareholder's Company**), had guaranteed some of the short-term loans, i.e. Connected Guarantees, advanced by the Company's subsidiary, Tiangong Huinong, to its customers.

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<sup>1</sup> "Connected person" is defined in rule 14A.06(7) of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (**Listing Rules**).

13. BIAL also became aware that as well as providing guarantees for loans advanced by Tiangong Huinong to its customers, the Shareholder's Company had also obtained a number of loans from Tiangong Huinong during the TRP, and such loans were guaranteed by another party. In other words, BIAL was aware that the same connected person, i.e. the Shareholder's Company, had during the TRP:
- (a) guaranteed a number of loans advanced by Tiangong Huinong to its customers; and
  - (b) obtained a number of loans from Tiangong Huinong as a borrower and such loans were guaranteed by another party.
14. However, BIAL did not conduct any due diligence in relation to the Connected Guarantees or the concerned connected persons (**Connected Guarantors**), before submitting the Company's listing application to the SEHK. For example, BIAL did not ascertain:
- the percentage of the Connected Guarantees to the total amount of loans granted by the Company during the TRP;
  - the relationship between the borrowers and the Connected Guarantors;
  - whether there was any dealings between the Connected Guarantors, the borrowers and the Company that would require closer scrutiny;
  - the genuineness of the Connected Guarantees; and
  - whether the Connected Guarantees would continue, and if so, how would the Company manage the conflicts of interests between itself and the Connected Guarantors.
15. When the SFC asked BIAL whether it had followed up with the Company or the Shareholder's Company as to:
- (a) the reason(s) why the Shareholder's Company had to rely on another party to guarantee its loans from Tiangong Huinong while it provided guarantees for loans that Tiangong Huinong advanced to other parties,
  - (b) whether the Shareholder's Company had used the money borrowed from Tiangong Huinong to guarantee the loans advanced by Tiangong Huinong to its customers, and
  - (c) the relationship between the Shareholder's Company and its guarantor and the relationship between the Shareholder's Company and the borrowers of Tiangong Huinong for whom the Shareholder's Company had provided guarantees,

BIAL informed the SFC that it did not consider such information material or that further due diligence was necessary on this matter.

16. The issues set out in paragraphs 14 and 15 above are material issues relating to the Company's business model, the authenticity of the transactions involving connected persons, the Company's internal controls for managing conflicts of

interests, as well as whether the Connected Guarantees should be considered as connected transactions under the Listing Rules. The SFC finds that BIAL 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 any of those issues.

*Failure to ensure that all material information of the Company has been included in the draft prospectus and the application documents*

17. Paragraphs 17.4(a)(ii) and 17.4(b) of the Code of Conduct provide that before submitting an application on behalf of a listing applicant, a sponsor should:
- (a) ensure that all material information as a result of this due diligence has been included in the Application Proof; and
  - (b) come to a reasonable opinion that the information in the Application Proof is substantially complete except in relation to matters that by their nature can only be dealt with at a later date.
18. As BIAL has failed to conduct reasonable due diligence in relation to the Connected Guarantees and the issues surrounding the Connected Guarantees as set out in paragraphs 14 and 15 above, it was not in a position to:
- assess the materiality of the Connected Guarantees to the business/operation of the Company; and
  - ensure that all material information on the Company's business model in relation to the Connected Guarantees, including the extent to which the Guaranteed Loans were guaranteed by connected persons of the company, were disclosed in the Application Proof,
- in breach of of paragraph 17.4(a)(ii) and 17.4(b) of the Code of Conduct.
19. Indeed, BIAL did not disclose the existence of the Connected Guarantees until its filing of the Post AP5 Prospectus on 7 September 2015 (see paragraph 23 below).

*Failure to ensure that all information provided to the regulators is accurate and not misleading*

20. Paragraph 17.9(a) of the Code of Conduct requires a sponsor to reasonably satisfy itself that all information provided to the SEHK and the SFC during the listing application process is accurate and complete in all material respects and not misleading in any material respect and, if it becomes aware that the information provided does not meet this requirement, the sponsor should inform the Stock Exchange and the SFC (as the case may be) promptly.
21. After reviewing the AP Prospectus, the SFC/SEHK questioned whether any of the loans granted by the Company to its customers were guaranteed by the Company or any of its related party. In response, BIAL disclosed in the Post AP1 Prospectus that, during the TRP, there was no loan granted by the Company to its customers which were guaranteed by the Company or any of its related party.

22. When asked whether all of the short term loans granted by the Company are guaranteed by independent third parties unrelated to the Group, BIAL disclosed in the Post AP4 Prospectus that a certain percentage of Guaranteed Loans were guaranteed by the Company's related parties.
23. When the SFC/SEHK drew BIAL's attention to the inconsistency between the Post AP1 and the Post AP4 Prospectuses, BIAL submitted that there was a clerical mistake in the relevant sentence of the Post AP4 Prospectus: a certain percentage of Guaranteed Loans was guaranteed by "connected persons" and not "related parties"<sup>2</sup>. Then BIAL submitted the Post AP5 Prospectus on 7 September 2015 which disclosed the information on the Connected Guarantees. This was the first time the SFC/SEHK had been informed of the existence of the Connected Guarantees since the filing of the Application Proof on 10 November 2014.
24. As well as the inconsistent disclosure in the Post AP1 Prospectus and the Post AP4 Prospectus about the granting of guarantees by related parties of the Company, the SFC finds that, due to the negligence on the part of BIAL's transaction team, certain information disclosed in the Post AP5 Prospectus in respect of the identity of the guarantors, percentage of the Connected Guarantees to the total amount of loans granted by the Company etc. was inaccurate or misleading.

## Conclusion

25. Having considered all the circumstances, the SFC is of the view that BIAL 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 BIAL was therefore guilty of misconduct.
26. In deciding the appropriate sanction, the SFC has taken into account all relevant considerations, including:
  - we need to send a strong message to the industry and the market that sponsor failures will not be tolerated;
  - the SFC, SEHK and the investing public rely on the competence and integrity of the sponsor in assisting the issuer to prepare and present the listing application and listing documents, which is essential to the orderly and transparent working of the market. Before submitting a listing application on behalf of a listing applicant, BIAL should have performed all reasonable diligence and ensured that all information material to the listing applicant has been included in the Application Proof;

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<sup>2</sup> "Connected persons" are defined in the Listing Rule (see footnote 1). "Related parties" are defined in the the Accountants' Report attached to the AP Prospectus as "a person, or a close member of that person's family, is related to the Group if that person: (i) has control or joint control over the Group; (ii) has significant influence over the Group; or (iii) is a member of the key management personnel of the Group or the Group's parent". The Group refers to the Company and all of its subsidiaries.



- the degree of BIAL's failures is such that it failed to conduct follow-up due diligence on the Company after it became aware of the potential problem or risk revealed by its own due diligence;
- as the concerned listing application was returned by the SEHK, no harm has been caused to members of the investing public;
- BIAL cooperated with the SFC in accepting the disciplinary action and not disputing the SFC's findings and regulatory concerns;
- there is no evidence to suggest a systemic failure in BIAL's policies, procedures and practices relating to its sponsorship work;
- the senior management of BIAL agreed to review and enhance its 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; and
- BIAL has an otherwise clean disciplinary record.