

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined TC Capital International Limited (**TC Capital**)¹ \$3 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in respect of TC Capital's failure to discharge its duties as the sponsor in the listing application (**Listing Application**) of China Candy Holdings Limited (**China Candy**) on the Growth Enterprise Market (**GEM**) of The Stock Exchange of Hong Kong Limited (**SEHK**), in that TC Capital has failed to:
 - (a) conduct reasonable due diligence on the third party payments made on behalf of two top customers of China Candy; and
 - (b) maintain proper records of the due diligence work allegedly done in relation to the Listing Application.
3. The SFC has also suspended the licence of Mr Edward Wu Wen Guang (**Wu**) for seven months from 29 July 2022 to 28 February 2023 for failing to discharge his duties as a responsible officer and sponsor principal of TC Capital in charge of the Listing Application.

Summary of facts

Background

4. China Candy was a candies manufacturer in Mainland China. It sold candies to customers mainly in Mainland China and overseas countries in South East Asia, North America, Europe and the Middle East.
5. On 13 February 2015, TC Capital submitted the Listing Application to the SEHK on behalf of China Candy. On 4 September 2015, TC Capital re-submitted the Listing Application due to the lapse of more than six months from its first application. On 11 November 2015, China Candy was listed on GEM.
6. At the request of China Candy, trading in the shares of China Candy had been suspended since 12 December 2017. China Candy explained that the suspension was due to its inability to confirm the authenticity of certain bank information and it was conducting investigation into the matter. The SEHK cancelled China Candy's listing with effect from 31 December 2019.

¹ TC Capital, formerly known as TC Capital Asia Limited, is licensed under the SFO to carry on Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities.

Failure to conduct reasonable due diligence on the third party payments made on behalf of two top customers of China Candy

7. Customer A and Customer B were two top customers (collectively, **Customers**)² which contributed to a significant portion of China Candy's revenue³ during the track record period (ie, the years ended 31 December 2013 and 2014 and the six months ended 30 June 2015), and they settled most of their payments to China Candy through third party payers:
 - (a) Customer A used 18 different third party payers to settle around 93% of its payments to China Candy. The third party payments made on behalf of Customer A accounted for around 22% of China Candy's revenue; and
 - (b) Customer B used 14 different third party payers to settle around 85% of its payments to China Candy. The third party payments made on behalf of Customer B accounted for around 23% of China Candy's revenue.
8. Third party payments by a customer, in particular by a top customer, is an apparent red flag, as third party payments might be used to disguise the original source of funds and/or facilitate a fraudulent scheme. It was therefore imperative for TC Capital to conduct proper due diligence to understand the reasons behind the third party payments as well as the third parties' background and their relationship with China Candy (and its associated entities, customers and suppliers), and critically assess the legitimacy and veracity of the third party payments.
9. Although Wu stated that he was aware of the third party payments at the time, and the walkthrough which TC Capital conducted on a sample transaction for each Customer (**Walkthrough**)⁴ also shows that the Customers used third party payers to settle payments to China Candy, TC Capital's transaction team members (**Transaction Team**) did not turn their mind to the question of whether further enquiries were necessary and/or assess with a questioning mind as to whether such payment method was legitimate. No further follow-up due diligence was conducted by TC Capital to ascertain the extent of the third party payments and the rationale for using this payment method:
 - (a) The issue of third party payments was not a matter that TC Capital had considered at all at the time:
 - (i) Apart from Wu who claimed to be aware of the third party payments from the Customers, all the other Transaction Team members who were involved in the due diligence work relating to the Listing Application stated that they were not aware of the third party payments.

² The Customers were incorporated in the Philippines and were principally engaged in the wholesale of snack products and trading business including trading of candies and dried fruits.

³ During the track record period, the percentage of revenue contributed by Customer A and Customer B was around 23% and 25%.

⁴ According to Wu, the purpose of the Walkthrough was to understand the sale process from China Candy to the Customers and to verify that the sales to the Customers were genuine transactions.

- (ii) Wu was not aware of the significant number of third party payments involved in settling China Candy's sales.
 - (iii) The Walkthrough documents show that the Customers used third parties, Company X and Company Y, to make payments to China Candy in the selected sample sale transactions. However, the two Transaction Team members who were primarily responsible for reviewing the Walkthrough documents according to TC Capital denied being involved in the Walkthrough or had no recollection who conducted the Walkthrough.
 - (iv) The due diligence plan⁵ did not set out any due diligence work on how the Transaction Team reviewed and enquired about the third party payments and the relationship between the third parties, the Customers and China Candy.
- (b) The Transaction Team did not make proper enquiries about the third party payments:
- (i) Wu accepted that the Transaction Team only made general enquiries and did not carry out detailed due diligence on the third party payments.
 - (ii) Wu claimed that Company X and Company Y were companies designated by the respective Customers to settle payments on their behalf. This differed from the understanding of a staff of China Candy's auditor and reporting accountant, who stated that the third party payers were "ending customers".
 - (iii) The records of the interviews with the Customers show that the Transaction Team did not enquire about the third party payments, their relationship with the third party payers and the reasons for using a number of third party payers to settle payments with China Candy.
 - (iv) There were no background searches on the third party payers or interviews with the third party payers to enquire about the third party payments.
- (c) TC Capital submitted that there was no basis to conduct rigorous due diligence on the third party payments as it was a common practice for Philippines business to use third party payment agents. However, there was no evidence to show that this was indeed the reason that led to the decision not to conduct due diligence on the third party payments at the time.
10. Based on the matters set out in paragraphs 7 to 9 above, TC Capital failed to conduct all reasonable due diligence and exercise professional scepticism when conducting due diligence work in relation to the Listing Application. Without conducting reasonable due diligence on the third party payments, TC

⁵ The due diligence plan was to identify work which the Transaction Team undertook in order to assess and co-ordinate the overall due diligence exercise in relation to the Listing Application.

Capital could not properly assess whether the use of third party payers by two top customers was material information that should be disclosed in the China Candy's prospectus. TC Capital was in breach of:

- (a) General Principle 2 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) and paragraph 5.1 of the Corporate Finance Adviser Code of Conduct (**CFA Code of Conduct**) which require a licensed corporation to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.
- (b) Paragraphs 17.2(b) and 17.4(a) of the Code of Conduct which require a sponsor to perform all reasonable due diligence on the listing applicant before submitting the listing application.
- (c) Paragraph 17.6(a) of the Code of Conduct which requires a sponsor to exercise reasonable judgement on the nature and extent of due diligence work needed in relation to the listing application having regard to all relevant facts and circumstances.
- (d) Paragraph 17.6(b) of the Code of Conduct and paragraphs 2 and 3 of PN2⁶ which require a sponsor to examine the information provided by the listing applicant with professional scepticism and be alert to information which contradicts or brings into question the reliability of that information.
- (e) Paragraph 17.6(c) of the Code of Conduct which requires a sponsor to undertake additional due diligence to ascertain the truth and completeness of the information provided by a listing applicant when it becomes aware of circumstances that may cast doubt on the information provided to it or otherwise indicated a potential problem or risk.

Failure to maintain proper records of the due diligence work allegedly done in relation to the Listing Application

- 11. A sponsor is required to maintain proper and accurate records and be able to provide a proper trail of work done upon request by the SFC. It should record the results of due diligence performed together with its assessments of these results and be in a position to demonstrate that it has turned its mind to the question of what enquiries are necessary and reasonably practicable in the context and circumstances of the case.
- 12. In a situation where the matter bears some significance, even if a conclusion has been reached that the matter is not sufficiently material to warrant disclosure, the sponsor is expected to maintain documentation showing how such a conclusion has been reached. Only then would a sponsor be able to demonstrate that it has turned its mind to the question of what due diligence inquiries were necessary in the circumstances⁷.

⁶ Practice Note 2 to the Rules Governing the Listing of Securities on GEM of the SEHK.

⁷ The SFC summarised its findings of a special review on sponsors in the Report on Sponsor Theme Inspection Findings (published in March 2011), and provided guidance on sponsors' obligations in the listing application process. See paragraphs 59 to 63 of the report regarding the SFC's guidance on sponsors' duty to maintain proper documentation of due diligence.

13. TC Capital failed to maintain proper records of the due diligence work which it claimed to have performed in relation to the Listing Application:
 - (a) There were no records showing how TC Capital enquired about the third party payments and/or came to the conclusion that the third party payments were immaterial to warrant disclosure in China Candy's prospectus.
 - (b) There was a lack of audit trail demonstrating that TC Capital had turned its mind to the discrepancies as to the identity of the buyer, consignee and payer in the Walkthrough documents and concluded that despite such discrepancies, it had no concerns that these were not genuine transactions.
 - (c) There was inconsistent information as to who owned the Customers⁸ and some of the Transaction Team members were aware of such discrepancy. However there were no records demonstrating that TC Capital had properly considered, and concluded that it had no concerns about, the discrepancy.
14. Based on the matters set out in paragraph 13 above, TC Capital failed to maintain proper records of the due diligence work allegedly done in relation to the Listing Application and to demonstrate that it had conducted reasonable due diligence and had properly considered the third party payments and the discrepancies of information from the due diligence documents. TC Capital was in breach of:
 - (a) General Principle 2 of the Code of Conduct.
 - (b) Paragraphs 17.2(e) and 17.10 of the Code of Conduct and paragraph 2.3 of the CFA Code of Conduct which require a sponsor to maintain adequate records so as to demonstrate to the SFC its compliance with the Code of Conduct.
15. In light of TC Capital's failure to comply with the regulatory requirements set out in paragraphs 10 and 14 above, TC Capital was also in breach of General Principle 7 and paragraph 12.1 of the Code of Conduct which require a licensed corporation to comply with all regulatory requirement applicable to the conduct of its business activities.

Wu's failures

16. Wu was the sponsor principal in charge of the Listing Application and the supervision of the Transaction Team.
17. The SFC considers that TC Capital's failures are attributable to Wu's failure to discharge his duties as a sponsor principal, a responsible officer and a member of the senior management of TC Capital, in that he failed to:
 - (a) exercise due skill, care and diligence in handling the Listing Application;

⁸ The ownership information provided by the Customers to TC Capital was inconsistent with the results of company searches conducted by a third party service provider.

- (b) diligently supervise the Transaction Team to carry out the sponsor work; and
 - (c) ensure the maintenance of appropriate standards of conduct by TC Capital.
18. Wu's failures were in breach of:
- (a) General Principle 2 of the Code of Conduct.
 - (b) Paragraph 4.2 of the Code of Conduct and 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 which require a sponsor principal to diligently supervise the transaction team to carry out the sponsor work and be involved in the making of the key decisions relating to the work carried out by the transaction team and must be aware of the key risks in such work and responsible for the measures to address them.
 - (c) General Principle 9 and paragraph 14.1 of the Code of Conduct which provide that the senior management of a licensed person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm.

Conclusion

19. In deciding the disciplinary sanction set out in paragraphs 1 and 3 above, the SFC has had regard to its Disciplinary Fining Guidelines and has taken into account all relevant considerations, including:
- (a) the need to send a strong deterrent message to the industry and market that sponsor failures will not be tolerated;
 - (b) TC Capital's financial position – but for the firm's financial position, the SFC would have imposed a heavier fine against it;
 - (c) TC Capital and Wu have no previous disciplinary record with the SFC; and
 - (d) TC Capital and Wu co-operated with the SFC in resolving the SFC's concerns.