Application No. 4 of 2020

IN THE SECURITIES AND FUTURES APPEALS TRIBUNAL

IN THE MATTER OF a Decision made by the Securities and Futures Commission under section 194 of the Securities and Futures Ordinance, Cap. 571

AND IN THE MATTER OF section 217 of the Securities and Futures Ordinance, Cap. 571

BETWEEN

YI SHUN DA CAPITAL LIMITED Applicant

and

SECURITIES AND FUTURES COMMISSION Respondent

Tribunal: Mr Michael Hartmann, Chairman

Date of Hearing: 26 April 2021

Date of Determination: 19 October 2021

DETERMINATION

Introduction

1. At all times relevant to this determination, Imperial Sierra Group Holdings Limited ("Imperial Sierra" or "the Group") carried on business as commercial property consultants, its operations being centred in the Pearl River Delta area of the Mainland.

2. The principal revenue of the Company was obtained from advisory services provided on a project-to-project basis to a limited number of customers, its top five customers in 2016 accounting for some 76% of revenue.

3. By contrast, property management services, which provided a regular and recurring income stream, accounted for only 1.1% of its 2016 revenue[1].

4. The founder of Imperial Sierra was Yip Wik, Aric ("Aric Yip") who was Chairman of the Board, an executive director and the controlling shareholder.

5. In December 2016, Imperial Sierra, having resolved to seek a listing on the Main Board of the Stock Exchange of Hong Kong ("the Stock Exchange"), appointed the Applicant in this matter, Yi Shun Da Capital Limited, then known as Zhaobangji International Capital Limited[2], as its 'sole sponsor, global coordinator, bookrunner and lead manager'[3] in order to guide it through the necessary listing procedures.

6. The Applicant was at all relevant times licensed pursuant to the provisions of the Securities and Futures Ordinance, Chapter 571 ("the Ordinance"), to engage in Type 1 and Type 6 regulated activities; Type 1 being dealing in securities, Type 6 being advising on matters of corporate finance.

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[1] This data is taken from the Company's draft prospectus submitted to the Listing Division of the Stock Exchange of Hong Kong in March 2017.

[2] The Applicant was known as Zhaobangji International Capital Limited from November 2015 until December 2017 and as Well Link International Capital Limited from December 2017 to August 2018 when it adopted the present name of Yi Shun Da Capital Limited.

[3] This is taken from the English translation of the contract of appointment between Imperial Sierra and the Applicant.

7. On 30 March 2017, the Applicant, in its role as the sole sponsor, submitted an application (including a draft prospectus and draft accountant's report) for the listing of Imperial Sierra to the Listing Division of the Stock Exchange of Hong Kong.

8. In vetting the listing application, a number of fundamental concerns were raised in respect of 'financial issues', the essence of those concerns being that, in order to show a stronger financial position, there may have been a circular flow of funds.

9. Exchanges then took place in terms of which the Applicant sought – unsuccessfully – to demonstrate that it had had exercised due diligence in respect of those concerns.

10. In January 2020 – by which time Imperial Sierra's application for listing had lapsed – the Respondent in this matter, the Securities and Futures Commission ("the SFC"), informed the Applicant that it proposed to bring disciplinary action against the Applicant for a failure on its part – at the time of submitting the application for listing – to exercise reasonable due diligence in its role as the sole sponsor. The proposed action was based on three areas of contention, each of them to be considered together and each being related to a possible circular flow of funds or similar scheme. The three issues may be broadly summarized as follows –

(a) That over the three-year period before the listing application, a very high percentage of payments to Imperial Sierra had not been made by the debtors themselves but by third parties on their behalf. To give an indication of the extent of this practice, in the first two years of the three-year period, third-party payments in each year exceeded 50% of the Group's total revenue while, in the third year, they came close to 40% of revenue. In this regard, and taking into account the very high value of the third-party payments, it would be fair to say that, in the three-year lead-up period, third-party payments came close to being the dominant payment method. In the view of the SFC, this was, in any set of circumstances, highly unusual and demanding of explanation. As it was put by the SFC, the concern arose out of the fact that substantial third-party payments may have been used "to disguise the original source of funds and facilitate a deceptive or fraudulent

scheme". Despite this, however, it appeared on the evidence that only minimal enquiries had been made by the Applicant's transaction team. For example, none of the major customers of Imperial Sierra who had arranged for third-party payments, or agreed to them, were asked to explain why they had cooperated with the arrangements.

(b) That there had in addition been two 'suspicious sets of transactions' pointing to the possibility of a circular flow of funds. By way of illustration, on 24 June 2015 a company called Guangdong Qitian, acting as a third party, had made a payment of RMB2.3 million to Imperial Sierra on behalf of a major customer, the Wise Group. Two days later, Imperial Sierra remitted RMB2 million back to Guangdong Qitian by way of a personal loan advanced by Aric Yip, Imperial Sierra's Chairman of the Board and controlling shareholder.

(c) That over the same period of time, Aric Yip had entered into concerning financial arrangements with various individuals – termed 'acquaintances' – a number of whom may have had a connection with the third-party payers. In this regard, evidence showed that in the financial years ending 2014, 2015 and 2016, Aric Yip had withdrawn amounts of HK$6.3 million, HK$16.5 million and HK$18.8 million. In addition, as at 31 January 2017, there was evidence of further withdrawals of some HK$35 million. These funds had been used to facilitate a number of financial arrangements (apparently for loan/investment purposes) between Aric Yip and a total of 11 acquaintances. By way of illustrating the potential significance of these financial arrangements –

(i) One of the acquaintances which had been in receipt of funds from Aric Yip, Guangzhou Meijin, had made third-party payments to Imperial Sierra, doing so on behalf of a company called Guanghzou Mingdu.

(ii) Another acquaintance which had been in receipt of funds from Aric Yip. Gaungzhou Chengzhi, had been beneficially owned by a man named Wang Jing who was also the beneficial owner of a company called Foshan Nanfang, that company being a customer of Imperial Sierra.

11. According to the SFC, these matters (and others) had not been disclosed in the draft prospectus and therefore, if the prospectus had been approved, would not have been known to potential investors. In the result, so it was asserted by the SFC, it appeared that the Applicant had failed to comply with all necessary regulatory requirements applicable to the conduct of a sponsor, particularly those contained in the Code of Conduct[4] and Practice Note 21 of the Listing Rules (Due Diligence by Sponsors in respect of Initial Listing Applications). The SFC was further of the view that it appeared that the Applicant had breached a number of provisions of the Code of Conduct for Persons Licensed by or Registered with the SFC[5] as well as the Code of Conduct applicable to corporate finance advisers.

12. The Applicant's written submissions[6] made in response were not accepted and, by a notice dated 9 June 2020, the SFC gave its final decision which was to the following effect, namely, that the Applicant was found guilty of misconduct and ruled not to be a fit and proper person to remain licensed[7]. That, in addition the Applicant was publicly reprimanded and fined HK$4.5 million pursuant to the provisions of section 194 of the Ordinance.

13. In July 2020, the Applicant sought a review of the SFC decision. It was agreed that the matter would be heard by the Chairman sitting alone.

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[4] Paragraph 17 of the Code sets out the duties of sponsors; paragraphs 17.2 – 17.7 setting out a sponsor's obligations in respect of the exercise of due diligence.

[5] The SFC cited possible breaches of General Principles 2 and 7 and paragraphs 12.1, 17.2(b) ,17.4(a), 17.4(b), 17.6(a), 17.6(b), 17.6(c), 17.6(e) and 17.6(f) of the Code of Conduct.

[6] The written submissions in response were dated 26 March 2020.

[7] The Applicant had, in fact, ceased to accept new sponsor work and therefore accepted a condition on its licence to the effect that "it shall not act as a sponsor in respect of an application for the listing on a recognized stock market of any securities".

The issues defining the SFC case

14. As indicated earlier, the disciplinary sanctions imposed by the SFC have at all times been limited to an alleged failure by the Applicant, as sole sponsor, to perform all reasonable due diligence in respect of its original listing application. This failure of due diligence related to the three areas of concern outlined above which may have indicated a managed circular flow of funds.

15. Imperial Sierra was never successfully listed. The shareholding public suffered no loss. Accordingly, the primary concern of the SFC was at all times limited to the single issue of whether the Applicant, in discharging its duties as sole sponsor and presenting the draft prospectus, had performed all reasonable due diligence in respect of the financial issues that were, on their face, troubling and which, in the exercise of proper due diligence, demanded a more thorough investigation than the one undertaken by the Applicant. The SFC did not suggest that payments had been fictitious. The concern was whether – with all three areas of concern being taken into account – there had been a legitimate risk of some form of circular flow of funds which required a more incisive investigation than the one conducted by the Applicant.

The underlying basis of the application for review

16. It was the Applicant's case on review that it had not failed to conduct due diligence as alleged. While there may have been a significant number of third-party payments made to Imperial Sierra in the three years before its intended listing, payments of that nature did exist in the PRC. A different commercial landscape existed there as evidenced by the fact that a number of earlier listings on the Hong Kong Stock Market had revealed the receipt of third-party payments (although seemingly nothing as extensive as the third-party payments made to Imperial Sierra).

17. Concerning the fact that in this present matter, third-party payments were not an occasional happening but amounted to a dominant practice, counsel for the Applicant emphasised that no allegations had been made by the SFC, nor had any evidence been led to suggest that the third-party payments had been fictitious. There had been no allegation made by the SFC of fraud. Counsel for the Applicant submitted that the SFC

complaint appeared to be based on the contention that the Applicant's transaction team had not investigated *why* the third-party payments had been made. This question, however, was simply not relevant to the exercise of due diligence. The SFC had not suggested, nor was there any logical reason to suggest, that third-party payments to Imperial Sierra were in any way inherently suspicious and ought to have caused concern to the Applicant. What mattered, it was argued, was the fact of receipt of payments and there was no argument as to this defining issue. Any suggestion, therefore, that these third-party payments had been engineered in order to somehow demonstrate that Imperial Sierra's revenues were greater then in fact they were had to be purely speculative and not a matter, therefore, deserving of the sort of exhaustive investigation advanced by the SFC.

18. Similarly, in respect of the two 'suspicious transactions', it was submitted on behalf of the Applicant, that there was nothing inherently suspicious in either of them. If there was a suggestion that in some manner they were part of an engineered flow of funds designed to give the appearance that Imperial Sierra's revenues were greater that in fact they were, any such suggestion was again purely speculative.

19. As to Aric Yip's various finance arrangements with 11 acquaintances, their details were revealed and in addition the Applicant's transaction team had set out details of its due diligence work to the SFC in a PowerPoint presentation. These financial arrangements funded by Aric Yip were not capable of giving rise to any concern so long as the withdrawals had been properly booked in the company accounts: which they were. On the basis that the purpose of due diligence was to ascertain the genuineness, and the existence, of the finance arrangements – and this having been done – the circumstances did not require further investigation by the Applicant's transaction team.

20. The SFC, of course, had not at any time alleged fraud (which would encompass an engineered flow of transactions in order to give a false picture to potential share purchasers) for the simple reason that it had no grounds for doing so. Similarly, the SFC had not alleged that any of the transactions were necessarily fictitious on the basis again that it had no grounds for doing so. The SFC was not the principal investigator. The job of verification lay with the Applicant. As the Tribunal has understood it, it has instead at all times been its position that, in the particular circumstances of this case, with third-party payments being a dominant practice, sufficient areas of concern should have

presented themselves to the Applicant's transaction team during the course of investigations to require it, in the discharge of its due diligence responsibilities, to look deeper into those matters. As it was put by counsel for the SFC, it then became imperative for the Applicant to understand and then critically assess the reasons for the payments. This would have involved an understanding of the relationships between the third-party payers and the Imperial Sierra customers. It was accepted by the SFC that, if it had done so, it may have come to the conclusion, one based on a detailed and rational assessment, that there had been no circular flow of funds or anything of a similar nature to cause concern. Equally, it may have come to the conclusion that the concerns had been justified. The fact is, however, that it had failed to conduct reasonable due diligence in respect of these matters - and in that lay its culpability.

21. It is of course fundamental that, when new shares are listed on the Stock Exchange and presented to the market, material issues that may give rise to concern on the part of potential purchasers should be dealt with in a clear and incisive manner so that potential purchasers know what risks, if any, they face and, if so, the nature and extent of those risks. For a prospectus to do otherwise endangers the integrity of the market.

22. In the present case, as the Tribunal has understood it, it has been the SFC's position that the Applicant must have known that the issue of third-party payments and other associated transactions would cause concern. Indeed, in its draft prospectus, it set aside several passages in order to deal with the matter. In doing so, however, it failed in an incisive manner to investigate the issues that raised concern, permitting itself too often to rely on generalised statements by representatives of Imperial Sierra. It is on this basis that the SFC came to a finding that the Applicant was culpable, basing this finding in large measure on the due diligence provisions in the Code of Conduct, paragraph 17.6(c) requiring that –

> "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, enquiring 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."

The manner in which this Tribunal must determine this application

23. It is now well settled that the Tribunal must determine the application *de novo*, that is, as a full merits review, acting as if it was the original decision-maker. That being the case, the burden of proof remains on the SFC. That burden is the burden applied in civil proceedings; namely, proof on a balance of probabilities.

Principles guiding the duties of sponsors

24. The role of a sponsor has been considered on a number of occasions by this Tribunal. In *Sun Hung Kai International Limited v SFC*[8], the Tribunal noted that, when a corporate financial adviser takes on the role of sponsor –

> "… it accepts a dual obligation, that is, to the client of course but equally to the Stock Exchange in respect of the application for listing and to investors generally in respect of the prospectus. What must be underscored is that the sponsor is more than a mere servant of an applicant and must act with independent professionalism in ensuring that all information placed before the Stock Exchange and investors generally is *fully, fairly and accurately presented.*" [emphasis added]

25. That is why, in undertaking its role, a sponsor must examine the accuracy and completeness of representations made to it by the representatives of the company seeking listing and do so with the necessary degree of professional scepticism. The requirement to adopt an attitude of professional scepticism places on the shoulders of a sponsor the requirement to make a critical assessment of relevant information, doing so with a questioning mind and – of central importance in the present case – being alert to information that brings into question the reliability of relevant statements and representations.

[8] Application No. 3 of 2013.

26. Where a sponsor becomes aware of circumstances that may cast doubt on information provided to it or otherwise indicate a potential problem or risk, the sponsor is then obliged to undertake additional due diligence in order, hopefully, to arrive at an accurate understanding.

27. As indicated earlier, when seeking to verify information that on its face may be problematic, undue reliance on management representations, especially those that are bland and without detail, cannot be regarded as a proper discharge of reasonable due diligence.

28. This is not to suggest that a sponsor is required to provide counsel of perfection. The method by which a sponsor discharges its dual obligation is by employing due skill and care, tempered always with a healthy but rational degree of scepticism, doing so in the best interests of its client and – importantly – the integrity of the market.

Were the SFC concerns unfounded in that they were 'speculative'?

29. It has been fundamental to the Applicant's case for review that in the present case any suggestion that there may have been a circular flow of funds, no doubt engineered to try and show a greater revenue stream than was in fact the case, was purely speculative on the part of the SFC. It has been submitted on behalf of the Applicant that the exercise of a rational degree of scepticism does not mean that every 'speculated' risk, no matter how immaterial, must be chased down every hole. Accordingly, the Applicant was not culpable of any failure of due diligence.

30. It is not disputed that in the three years leading up to the listing application – this period being known as the 'track record period' – a significant number of customers of Imperial Sierra had chosen not to make payment themselves of amounts owing to the company but had instead directed third parties to make those payments on their behalf. Manifestly, on the evidence, this practice of making third-party payments constituted not simply a common practice in the track record period but for two of those years was *the* dominant practice and in the third year remained *a* dominant practice.

31. In the draft prospectus, the Applicant asserted that third-party payments were 'not uncommon' in the PRC – an assertion which it was later forced to modify. However, that being said, the Tribunal has noted that the Applicant itself – at the time the draft prospectus was lodged - clearly considered the issue of third-party payments to be of sufficient concern to devote space to it under the heading of 'Risk Factors', the sub-heading being: "We are subject to various risks relating to third party payments" -

> "During the track record period, some of our customers settled our payments through third-party payers… third party payments may be subject to various risks, such as (i) possible claims from third-party payers for return of funds as they were not contractually indebted to our Group; (ii) possible claims from liquidators of the third-party payers, and (iii) money-laundering risk. In the event of any claim from third-party payers or their liquidators or legal proceedings (whether criminal or civil) instituted or brought against us in respect of the third-party payments or for violation or non-compliance of laws and regulations in Hong Kong or elsewhere, we will have to spend significant financial and managerial resources to defend against such claims and legal proceedings, the financial, operational and liquidity of our business may as a result be adversely affected. Moreover, if we are involved in criminal proceedings for money-laundering charges, our reputation may be adversely affected and we may face difficulty in maintaining our existing customers or attracting new customers, which may cause a decrease in our operating profit. There can be no assurance that our business, financial condition, will not be materially and adversely all affected by a successful claim or prosecution against us."

32. If the Applicant itself, acting through its transaction team, considered the issue of third-party payments to be of sufficient importance to be identified in the draft prospectus, it must follow that it considered the matter to be sufficiently important to require due verification.

33. In the view of the Tribunal, it would surely have been the case that, if the listing had gone ahead, there would have been a real risk of concern in the market as to the fact that this indirect form of payment, rather than being an occasional form of payment dictated by its own particular facts, appeared to constitute the dominant form of payment. When this practice was considered in the context of Aric Yip's various advances to business acquaintances, and to the two suspicious transactions detailed in this determination, this concern would have been heightened. And this surely would have led

to questions as to why, without full and clear explanation, the listing had been permitted to go ahead.

34. In this regard, this Tribunal's statement of principle given in its report in *Sun Hung Kai International* is applicable –

> "In an orderly and transparent market investors must be able to place trust, first, in the fact that the listing of a company has been founded by the Stock Exchange on the consideration of full and accurate information and, second, that the information contained in the prospectus is also full and accurate. The route to ensuring such trust must rest principally on the sponsor, the party responsible for the management of the listing. It must rest principally on the conduct of an objective, professional and scrupulous investigation of all material relevant to the listing and the initial public offering; in short, on the conduct of due diligence."

35. The Tribunal notes that no mention was made in the draft prospectus of the possibility that extensive third-party payments may indicate the existence of some form of circular cash flow, a pattern designed to give the appearance of a higher turnover in business activity than in fact was the case. It is puzzling that, on examination, this became the central concern of the SFC – in the view of the Tribunal, a logical enough concern - but appears to have been of no concern to the Applicant's transaction team.

36. Clearly, however, in the opinion of the Tribunal, an exercise of verification, that is, an exercise of reasonable due diligence, was required by the Applicant. The concerns raised by the SFC were not, therefore, focused on purely speculative matters.

(A) SFC concern as to the size (in number and value) of third-party payments

37. Mention has already been made of the fact that the Applicant itself considered it necessary in the draft prospectus to deal with the issue of third-party payments. As to the extent of these payments (in number and value) the following was written in the draft prospectus -

> "During the Track Record Period, some of our customers ('relevant customers') settled our payments ('third party payments') through third parties ('third party payers'). These third-party payments were either made

> to Yufeng Guangdong in the PRC or to Imperial Sierra HK in Hong Kong. There were a total of 14, 8 and 4 third-party payers [for the years] 2014, 2015 and 2016. To the best information and knowledge of our directors, all the third-party payers are independent third parties. No discounts or benefits were provided to third-party payers when third-party payments were undertaken. The aggregate corresponding revenue settled through third-party payers [for the years] 2014, 2015 and 2016 were HK$12.2 million, HK$31.5 million and HK$22.4 million respectively, representing 55.5%, 68.9% and 39.1% of our total revenue for the corresponding periods."

38. The draft prospectus therefore revealed that in the first two years of the track record period third-party payments represented more than 50% of Imperial Sierra's total revenue. Even the payment in the third year came close to representing 40% of total revenue for that year. Third-party payments were therefore highly significant and, on their face, without clear explanation, highly unusual. This is especially so when taking into account the nature of Imperial Sierra's predominant business, namely, that of providing advisory services in respect of commercial property projects.

39. The passage cited above (paragraph 36) went on to explain –

> "To the best information and knowledge of our directors, out of the third-party payments made during the track record period, HK$1.4 million, HK$22.5 million and HK$22.4 million, representing 11.5%, 71.6% and 100% of the total third-party payments were from parties that have a connection with the relevant customers to the extent that they are either a legal representative, shareholder, director or employee of the relevant customer."

40. As to how third-party payments were received and recorded, the draft prospectus said –

> "Upon being informed by a customer that we would be expecting a certain sum to be paid into our bank accounts by a third party for the settlement of our service fees, we would check our bank accounts for such sum and request a remittance advice from our customer. A copy of such remittance advice would be passed from our sales department to our accounts department. We would check and reconcile to ensure our accounts with our customers were properly recorded. During the track record period, we did not experience any difficulty in reconciling the amounts we received in our bank accounts with our customers. Our directors confirm that there had been no dispute as to the amount settled by the relevant customers during a track

> record. And no request from any third-party payers or relevant customers for the repayment…"

41. As to the central issue of the circumstances that would give rise to such a large number of third-party payments, the draft prospectus continued –

> "To the best information and knowledge of our directors, the practice of accepting third-party payments when dealing with customers based in the PRC *is not uncommon in the PRC as well as within the commercial property consultancy industry in the PRC.* During the Track Record Period, all relevant customers were entities established in the PRC or residents in the PRC. Most of the third parties who settled payments on behalf of the relevant customers [were requested] to effect such payments… because they were either a legal representative, a shareholder, a director or an employee of the relevant customers, representing 11.5%, 71.6% and 100% of the total third-party payments." [emphasis added]

42. As earlier indicated, what must be underscored in respect of the assertion that third-party payments were "not uncommon" in the PRC is that this assertion was later qualified by the Applicant when it was admitted that it may not have been appropriate given that it was difficult to gather accurate statistics and to perform a statistical analysis at an industry level. Accordingly, the assertion that third-party payments were "not uncommon" was revised to read that third-party payments "existed" within the commercial property consultancy industry in the PRC. In the opinion of the Tribunal, the difference in terminology was substantive. It indicated that, with hindsight, the Applicant accepted that the original terminology, one that suggested that third-party payments were common in the PRC, was an overstatement; an important overstatement too in the sense that it must have been intended to help lull any potential concern on the part of the market as to the existence of so many third-party settlements.

43. The draft prospectus went on to say that there were occasions – the number of those occasions not being given an estimate – when third-party payments were made in order to avoid the difficulties presented in making payments from the PRC to Hong Kong.

44. It then went on to say that there were also occasions when third-party payments were simply a matter of 'expediency'. That may be so; no doubt from time to time third-party payments are a convenient way of settling matters. But the Tribunal does

not see how 'expediency' on its own can explain such a dominant practice. If any transparency was to be obtained, the obvious question to be asked was: why was it expedient?

45. As indicated earlier, it was said in the draft prospectus that a material number of the third-party payers were connected to customers of the Applicant, being shareholders, directors, employees or other representatives of those customers. In 2014, payments by such connected persons equalled 11.5% of payments received from third parties. In 2015, they represented 71.6% of payments received from third parties and in 2016 they represented 100% of the total third-party payment. Of course, some connection was bound to be the case. Such parties would be more approachable, more amenable generally: at least in theory. But the circumstances in which they had made such payments remained an open question.

46. It was further submitted by the Applicant in its written response, that there had been earlier – successful – listings on the Hong Kong Exchange despite the fact that the applicant companies in those cases had declared the receipt of third-party payments. Several examples were provided, one being Guangdong Adway Construction (Group) Holdings Company Limited, a building decoration company, in respect of which it was said that in its prospectus of November 2016 it had declared that a number of its customers had settled debts due to it through third parties.

47. That may be so. As the Tribunal understands it, it was never the SFC case that third-party payments, by their very nature, were always to be viewed with suspicion. It was rather the SFC position that, on its face, this dominant practice in respect of Imperial Sierra clearly constituted more than random commercial happenstance. There was a pattern of people asking other people to make these third-party payments. But why?

48. Accordingly, merely stating the fact that such payments had been made was insufficient. What reasonable due diligence demanded in the circumstances was an explanation of the circumstances which gave rise to those payment. The question had to be asked: 'why were so many payments made, why did the practice arise?'

49. As indicated earlier, counsel for the Applicant argued that the question 'why?' was not relevant, not when the fact of payment had been verified. The Tribunal must reject this submission. Bearing in mind that Imperial Sierra was seeking a listing on the Hong Kong Exchange, and bearing in mind that for two of the lead-up years third-party payments constituted more than 50% of Imperial Sierra's receipt of revenue, the full circumstances of this highly unusual practice demanded to be understood.

50. It was further submitted on behalf of the Applicant that it had been entitled to rely on the accountant's report annexed to the draft prospectus, that report saying that the financial statements gave a true and fair view of Imperial Sierra's financial affairs. That report, of course, did not seek to explain how it was that, to a substantial degree, those financial affairs had come into being. Nor could the sponsor wash its hands of the matter on the basis that the reporting accountant had found nothing that required it to qualify its report.

51. The draft prospectus went on to say the following –

> "Our directors have confirmed that, (i) the practice of accepting third-party payments is based on genuine legal transactions as a result of services provided by our Group and the information and records relating to those transactions are accurate and complete…"

52. That may be the case. As the Tribunal has understood it, it was rather the SFC case that otherwise legitimate payments may have been engineered in such a manner as to create a circular flow of funds in order to misrepresent the true financial position of Imperial Sierra.

53. During the track record period, all 23 third-party payers had made payments to Imperial Sierra on behalf of 18 customers, including major customers[9]. Of these third-party payers, two had made payments on behalf of more than one of Imperial Sierra's major customers.

[9] For ease of reference the Tribunal has referred to Imperial Sierra's 'major customers' rather than 'top ten five customers' which, for the purposes of this determination may be confusing.

54. The evidence obtained by the SFC showed that the Applicant's transaction team had interviewed 10 of the major customers which had made payments to Imperial Sierra through third parties. However, on the evidence of the transaction team's due diligence records, none of these 10 major customers had been questioned as to the third-party payments. No explanation had been sought from any of the parties on behalf of which the payments had been made, this in spite of the fact that such payments had been a dominant payment practice.

55. As to the third-party payers themselves, the evidence obtained by the SFC revealed that the Applicant had interviewed just seven such payers out of a total of 23, asking why it had been necessary to make the third-party payments. The payments of these seven over the track-record period had constituted 42%, 80% and 72% of the total amount of third-party payments made to Imperial Sierra. Four of the seven third-party payers[10], however, had professed personal ignorance of why the payments had been made, each of them giving explanations to the effect that it had been arranged by their company and they knew no more.

56. In later confirmation letters provided by these four interviewees, they sought to amplify their answers by saying the following –

(a) The representative of Guangzhou Chaoting (the third-party payer) said that it had made one payment to Imperial Sierra on behalf of a company to which it was related, namely, Guangzhou Fengxian, and had made a second payment on behalf of a company with which it had been cooperating in some form of commercial project, that company being Zhuhai Qiaosheng. However, no details were given as to the circumstances that made it necessary or convenient to make the third-party payments at the time.

(b) The representative of Guangzhou Meijin (the third-party payer) said that payment to Imperial Sierra had been made on behalf of a 'related company', Guangzhou Mingdu. Again, however, no details were given as to why it had been necessary or convenient to make the third-party payments at the time.

[10]These four payers represented 40% or higher of the payments made each year of the track record period.

(c) A person by the name of Gan Lu said that he had made payment to Imperial Sierra on behalf of another individual, Lu Zhenyan, because he was on the staff of that person. Again no details were given of the circumstances that made it necessary or convenient for a subordinate to make payment.

(d) A person by the name of Yang Aidi said that he made payment on behalf of a customer named Guangzhou Xiongyian because he was the 'legal person' behind that enterprise; in other words, for all practical purposes, he was paying on behalf of himself. If so, and it was not demonstrated otherwise, that payment would not have constituted a 'third-party' payment.

57. Records of interview of a senior member of the Applicant, Fabian Shin, revealed that, as he best understood it, the major concern of the Applicant in its role of sponsor had been to confirm that third-party payments had indeed been made, that being considered more important than seeking to discover why there had been such a significant number of third-party payments. If so, in the opinion of the Tribunal, Mr Shin had misdirected the work of his transaction team.

58. As it was, the Applicant's sponsor team failed to interview 16 of the 23 third-party payers – 10 of these payers making third-party payments on behalf of one or more of Imperial Sierra's major customers. It was the Applicant's assertion that it had attempted to contact 13 of these 16 entities, doing so through Imperial Sierra, but without success. In this regard, as the Applicant best understood it, eight of the third parties had expressed an unwillingness to be interviewed.

59. Unwillingness to disclose commercially sensitive information may not itself be unusual but, as the Tribunal understands it, there was no real attempt to understand the cause and nature of the resistance or any attempt made to find a way around that resistance.[11] As to the remaining third-party payers, four were not known to Imperial Sierra while apparently one could not be contacted because it had already been deregistered.

[11] In this regard, see paragraph 45 of the Report on Sponsor Theme Inspection Findings published in March 2011 by the SFC.

60. On the information that was available via Imperial Sierra, six of the third-party payers said that the payments had been made because it was 'convenient'. But why this was the case was never explored. Such payments indeed may have been more inconvenient – after all, they now involved three parties in respect of a single payment when originally there were just two.

61. On the information available via Imperial Sierra, seven third-party payments were made pursuant to 'private arrangements'. But, absent further explanation, that description too gave no better understanding. It still left open the very obvious questions: 'what sort of private arrangement and why was it necessary?' Regrettably, such questions do not appear to have been asked.

62. Counsel for the SFC also laid emphasis on the fact that the background search reports revealed a number of possible anomalies which, he submitted, constituted 'red flags' demanding further examination. These anomalies opened up the possibility that four of the companies – which made substantial third-party payments in 2014 – may not have been conducting genuine business. On a view of the issues surrounding these entities, the Tribunal is of the view that, viewing the anomalies in the light of all the circumstances, some further investigation was required. Again, regrettably, that further investigation appears not to have been undertaken.

63. A further concern raised by counsel for the SFC focused on a payment of RMB2.5 million made to Imperial Sierra by Gan Lu, the wife of Imperial Sierra's deputy general manager. The payment was apparently made on behalf of Gan Lu's employer, Lu Zhenyan. When asked about this payment by the Applicant's transaction team, Gan Lu simply said that she had been instructed to make the payment and gave no further explanation. Again, in the view of the Tribunal, the obvious question arose: 'what was it that led to the payment in this manner and why would it have been more convenient?' In the opinion of the Tribunal, in light of the special circumstances of the broader practice of third-party payments, this payment by the wife of a senior manager of Imperial Sierra to that company required some further explanation. On the evidence, however, no such explanation was sought.

64. By way of an overview of the issue of third-party payments, when considering whether the SFC has demonstrated a lack of reasonable due diligence on the part of the Applicant, the Tribunal has been drawn to the following findings –

(a) In light of the fact that third-party payments made through a variety of third parties (including by the wife of a senior manager of Imperial Sierra) constituted such a dominant practice in the three years leading up to the filing of the draft prospectus, and in light of the further fact that this was on its face a highly unusual practice, certainly one which, by reason of its magnitude alone, appeared to go far beyond mere happenstance, the Applicant's transaction team was left with no option other than to conduct a suitable investigation into the matter, doing so in order, if possible, to explain how the practice had arisen, why it had prevailed over the three years and why it was a legitimate practice, not one designed perhaps to give a false impression to the market.

(b) A suitable investigation into the matter, however, if it was to seek an answer as to the legitimacy of the practice, demanded more than answers which, while superficially they appeared to give an answer, in reality gave no answer at all, at least no answer which advanced the investigation. The Applicant's transaction team was clearly aware of the fact that the issue of third-party payments would be of concern to the market: hence the passages in the draft prospectus to which reference has been made earlier. The members of the transaction team must therefore have understood that the market would wish to understand the true dynamics of the practice. Answers to the effect that such payments were convenient when, in fact, without further explanation, they could equally be very inconvenient or answers to the effect that such payments were made by way of private arrangements were, for all rational purposes, of no real value at all. Such answers demanded more questions. In addition, the fact that a number of third parties were simply unwilling to explain why they had made third-party payments would have added to the concerns of the market. In the opinion of the Tribunal, as set out above, due diligence demanded further and more

incisive investigation. There was, however, a failure to conduct that investigation.

(c) While the good faith of the transaction team in the execution of its obligations is not in any way doubted by this Tribunal, the fact remains that, in the circumstances, a failure to look more deeply into the dynamics of the third-party payment practice clearly amounted to a failure to exercise reasonable due diligence, indeed a failure that may well have given the impression to the market that the sponsor's loyalty has been to the company seeking listing to the detriment of market integrity.

65. For the reasons set out above, the Tribunal is satisfied that there was a failure on the part of the Applicant to exercise reasonable due diligence.

(B) Failure to exercise due diligence in respect 'suspicious transactions'

66. In this regard, there were two transactions which the SFC found to be of particular concern. Both, it was said, on their face at least, and without further investigation – especially when considered in the broader context of the dominant practice of third-party payments – added to the concern regarding a circular flow of funds. The two transactions may be summarized as follows –

(a) On 24 June 2014, Guangdong Qitian made a third-party payment to Imperial Sierra in a sum of RMB2.3 million. This payment was made on behalf of one of Imperial Sierra's major customers, Wise Group. Two days later, Imperial Sierra itself remitted RMB2 million back to Guangdong Qitian by way of a personal loan advanced to it by Aric Yip (the "Guangdong Qitian transactions"), Aric Yip, of course, being the Chairman of Imperial Sierra and controlling shareholder.

(b) On 23 August 2016, Imperial Sierra remitted a sum of RMB2.2 million to Guangzhou Chengzhi by way of a personal loan advanced to it by Aric Yip. On that same day, Foshan Nanfang, a major customer of Imperial Sierra, made a payment of RMB2.7 million to Imperial Sierra. Both Guangzhou

Chengzhi and Foshan Nanfang were beneficially owned by the same person: Wang Ting (the "Guangzhou Chengzhi transactions").

67. In respect of the Guangdong Qitian transactions, it was the SFC assertion that the Applicant's sponsor team had failed to make any enquiries with Guangdong Qitian as to the two transactions (the third-party payment followed within 48 hours by the loan), this being compounded by a failure to review underlying documents. In addition, although the Wise Group was interviewed, there was no record of any questions being put related to the third-party payment made on its behalf by Guangdong Qitian. In blunt terms, there had been no effective enquiry.

68. In respect of the Guangzhou Chengzhi transactions, it was the SFC assertion that the Applicant's sponsor team had failed to exercise due diligence in essentially the same manner; namely, there had been a failure to make enquiries direct with Guangzhou Chengzhi and Foshan Nanfang, this being compounded by a failure to review underlying documentation.

69. On behalf of the Applicant, it was submitted that, as with the issue of third-party payments, any allegation that there had been a circular flow of funds in respect of either set of transactions had been purely speculative.

70. In respect of the Guangdong Qitian transactions, it was submitted that there was nothing inherently suspicious in the transactions despite the proximity in time. The reason why the third-party payment had been made was because of private arrangements reached between the Wise Group and Guangdong Qitian. Aric Yip himself had confirmed that there was no correlation between the loan agreement and the third-party payment. They were, therefore, on any reasonable assessment, entirely independent of each other and, as such, had not required the level of due diligence suggested by the SFC.

71. The Tribunal is satisfied that, considered in the broader context of the third-party payments, these transactions demanded further investigation. There was, therefore, a failure on the part of the Applicant to exercise due diligence.

(C) Payments made by Aric Yip to 'acquaintances'

72. There was evidence of a substantial withdrawal of funds over the track record period by Aric Yip. These withdrawals were made apparently to facilitate various loan and investment arrangements between Aric Yip and 'acquaintances' of his.

73. The evidence showed that in the financial years ended 2014, 2015 and 2016 Aric Yip had withdrawn amounts of HK$6.3 million, HK$16.5 million and HK$18.8 million. As at 31 January 2017, there was evidence of further withdrawals of HK$35.1 million. In the draft prospectus and its accompanying papers, however, while these withdrawals were recorded, no further details were provided, particularly as to their purpose. It was only in response to queries from the listing authorities that the purpose of the funds was revealed.

74. As it was put by counsel for the SFC, given that some of the acquaintances were third-party payers or entities with connections to Imperial Sierra's customers – which inflated the risk of a circular flow of funds between Imperial Sierra and its customers – it was especially important that the true nature and purpose of the transactions be verified.

75. In respect of its due diligence work, it was the Applicant's case that it had interviewed six of the 11 acquaintances, obtaining confirmation of the reasons for each transaction, the amounts involved and the fact of their independence from Imperial Sierra and its customers.

76. In an interview with the representative of one of the companies that received funding, Guangdong Junfeng, it was said that the money had been obtained for 'business needs'. The same reason was given by the representative of Guangzhou Meijin: the funds had been obtained for 'business needs'. Again, answers were given in the very broadest of terms: effectively saying nothing.

77. In addition, as part of the due diligence process, the Applicant had arranged for background searches to be conducted related to ten of the acquaintances. In respect of these searches, it accepted that there had been discrepancies in two of the interviews but these were considered to be trivial. Counsel for the SFC disagreed, saying that the

discrepancies had related to the 'primary nature of the finance arrangements'. As such, they demanded a follow-up.

78. One of the difficulties facing the Applicant was that, in the course of an interview, Michael Wong, one of the Applicant's senior members at the time, accepted that the transaction team should have had a clearer picture of the nature and extent of the loans being advanced to acquaintances. He further accepted that, in order to obtain that clearer picture, there should have been steps taken to look at source material; for example, to confirm whether loans have been repaid or not. Mr Wong accepted that the transaction team had not obtained even basic underlying documentation such as bank-in the slips. In the result, he admitted, matters had been left more opaque than they should have been.

79. On behalf of the Applicant, support was also sought from the fact that the draft accountant's report confirmed that no impropriety or irregularity had been detected and that, in its view, the financial statements provided a true and fair picture of Imperial Sierra's financial affairs. That was further evidence, it was submitted, to demonstrate that the sort of in-depth investigation required by the SFC had never been necessary.

80. As to the importance of the accountant's report in respect of the Applicant's obligation to conduct due diligence, the Tribunal has made reference to this earlier in this report: see paragraph 50.

81. It was submitted on behalf of the Applicant that the fact that finance arrangements had been funded by Aric Yip did not, and should not, have given rise to any concern so long as the withdrawals were properly booked in the necessary accounts and there was no concern, therefore, as to their genuineness. That being the case, whether the acquaintances were all able to explain fully the reasons or purposes of the relevant arrangements should not have given rise to any concern or require further investigation. As it was said by counsel for the Applicant: "it was unnecessary for the Applicant to conduct a microscopic examination of all relevant documents and to conduct enquiries just because certain names were the same and/or similar. Such burden was unduly onerous. Such unsubstantiated speculation did not need to be [set out] in the draft prospectus."

82. The Tribunal does not agree. If, looking at the overall picture, there was legitimate reason for concern that there may have been a circular flow of funds – as there was - then all relevant matters had to be considered and that included the substantial loan/investment transactions between Aric Yip, the controlling shareholder of Imperial Sierra, and various acquaintances who themselves had, or may have had, some connection to the parties involved in the possible circular flow of funds. In such circumstances, the true issue to be determined was not whether payments out and payments received were duly recorded but what was effect of this flow of finance.

83. It was the SFC finding, that there had been a failure to obtain and review the agreements themselves and relevant bank records; there had been a failure to follow up on unsatisfactory or incorrect responses provided by acquaintances and, of importance, there had been a failure to state in the draft prospectus that four of the acquaintances were either third-party payers or were connected with the top five customers of Imperial Sierra. By way of illustration –

(a) One of the acquaintances, Guangzhou Meijin, which had been in receipt of funds from Aric Yip, had made third-party payments to Imperial Sierra on behalf of one of Imperial Sierra's customers, Guangzhou Mingdu.

(b) Another acquaintance which had been in receipt of funds from Aric Yip, Guangzhou Chengzhi, was beneficially owned by a man named Wang Jing who was also the beneficial owner of Foshan Nanfang, a customer of Imperial Sierra.

84. Again, the Tribunal is satisfied that there was a failure to exercise due diligence on the part of the Applicant.

The findings of the Tribunal

85. By way of a general determination, therefore, the Tribunal is satisfied to the

required standard that in respect of the three areas of concern outlined by the SFC, there was a failure to exercise reasonable due diligence on the part of the Applicant[12].

The issue of sanctions

(A) The objection to identifying the Applicant by the name 'Well Link'

86. Unusually, in respect of sanctions, the first matter raised by the Applicant was concerned with the wording of the SFC draft press release, more particularly, with the fact that the press release cited the three names by which the Applicant has been known since late 2015 through until the present time, one of those names being 'Well Link International Capital'.

87. As indicated in the second footnote to this determination, the Applicant was known as 'Zhaobangji International Capital' until mid-December 2017. It then changed its name to 'Well Link International Capital', the name being changed to 'Yi Shun Da Capital' – its present name – in August 2018.

88. On behalf of the Applicant, counsel said that no objection was taken to the inclusion in the press release of the name 'Zhaobangji International Capital' as that was the name by which the Applicant was known when the sponsorship work was undertaken. Similarly, because that was the Applicant's current name, no objection was taken to the inclusion in the press release of the name, 'Yi Shun Da Capital'.

89. However, objection was taken to the citation of the name 'Well Link International Capital' on the basis that this was the name by which the Applicant was known after the impugned sponsorship had been completed and was, in addition, a name abandoned before the present SFC proceedings.

90. In the opinion of the Tribunal, the Applicant's contention is misconceived.

[12] Although the Tribunal has not set out in detail its analysis of the various schedules/tables presented to it during the hearing, that analysis has backed its findings as to culpability.

It is to be remembered that sanctions permitted under the Ordinance are defensive in nature and not penal. Their purpose is to defend the integrity of the market and, by use of appropriate sanctions, to ensure that the particular harm is not repeated either by the offender in question or by any other operators in the market. A threat to the market can only effectively be countered if the source of that threat is clearly identified. Fundamental to this purpose is the requirement that in each case the offender in question is fully and accurately identified. It must follow that, for that to be done, the name – or names – by which the offender is, or has been, known must be made known to the market. If an offender has changed the name by which it is known then, for the offender itself to be identified, that change of name must also be made known. It is to be emphasised that those persons who did business with the Applicant when it was known as Well Link were dealing with the same corporation now known as Yi Shun Da.

(B) The sufficiency of a public reprimand

91. It was Applicant's contention that a public reprimand constituted a sufficient sanction in the circumstances of this case and that a fine was unwarranted. In this regard, it was submitted that, as a matter of principle, a public reprimand was appropriate when, as in the present case, the misconduct had not affected the market, indeed would not have been generally even known to the market, and when adequate measures had been taken to address the identified failings.

92. It was further urged on the Tribunal that the Applicant had relied heavily upon the expertise and experience of its transaction team, that team being led by a person with more than 25 years' relevant experience.

93. That said, as the Tribunal sees it, it is inevitable that sponsors will set up an operational team in order to bring a listing application to fruition. It does not mean that the sponsor can wash its hands of responsibility. No matter how experienced the operational team may be, it remains the responsibility of the sponsor throughout to ensure that the team fully undertakes its duties and complies with its responsibilities. It is also to be emphasised that, on the face of it, the failings were broader 'team' failings. This is not a case in which one 'rogue' member failed to live up to his or her obligations.

94. During the course of submissions, it was accepted by counsel for the Applicant that the question of whether a public reprimand alone was sufficient turned very much on this Tribunal's view of the Applicant's culpability. That must be correct.

95. In the opinion of the Tribunal, that culpability must first be put into the context of the duties imposed on a sponsor in a listing application. Mention has been made earlier in this determination of the importance of the sponsor's role in listing applications. In this regard, in the Tribunal's report in *Sun Hung Kai International Limited,* the following was said –

> "It is clear to us that the regulatory framework insisting on the exercise of due diligence by each and every sponsor is critical to the orderly and transparent working of the market. That is why emphasis is placed on the dual obligation of a sponsor, an obligation not only to the client but, equally importantly, to the integrity of the market."

96. The passage in *Sun Hung Kai* just quoted went on to state that investors must be able to assess the risk in buying shares in an initial public offering (and thereafter in day-to-day trading) by relying on accurate and relevant information contained in the listing documents. If they are unable to do that then trust in the market is undermined. In the present case, as stated earlier, if the regulators had not raised concern as to the possible circular flow of funds, that concern may well have been reflected in the marketplace and may well have led to concerns as to the integrity not only of the of the listing but of the listing process itself.

97. For this reason, in the opinion of the Tribunal, evidence of material culpability on the part of a sponsor in the listing process will almost inevitably demand more than a public reprimand.

(C) The fine

98. While recognising that the Applicant had not been found culpable of any prior breach of regulatory conduct, the SFC nevertheless originally proposed a fine of HK$14 million. In its final decision, this was reduced to HK$4.5 million, the reduction, it appears, being made in light of the Applicant's difficult financial circumstances.

99. On behalf of the Applicant, it was submitted that this fine too was manifestly excessive. What had to be given more emphasis was the Applicant's clear record, the fact that it had now ceased its sponsor business and, in particular, the dire circumstances of its finances at the relevant time, that is, in 2019.

100. It was further said that, in light of the fees that had been earned[13], if the amount of the fine was not materially reduced, it would mean that the Applicant would suffer a significant loss in respect of the work it had done. In this regard, it was said that it had to be borne in mind that the findings of culpability related to one aspect only of the extensive due diligence work carried out by the Applicant. The Tribunal has difficulty accepting this submission. While all relevant circumstances must be taken into account, including issues of financial jeopardy, it cannot be the case that a sponsor is entitled to make a profit in respect of work undertaken by it even though that work has been undermined by its own culpability.

101. As to the quantum of the fine to be imposed in this case, the Tribunal recognises that, while it is important to have regard to earlier cases in order to maintain some consistency of approach, it must be recognised that each case turns on its own particular circumstances. It must also be recognised that, in respect of sanctions too, the Tribunal must approach the matter as if it is the original decision-maker.

102. In the particular circumstances of this case, on a consideration of all the evidence, the Tribunal has concluded that the Applicant's essential culpability lay in its failure to look to the broader picture; to recognise that the dominant practice of third-party payments was, on its face at least, so unusual as to raise concern, a concern that was compounded when Aric Yip's very substantial advance of funds to acquaintances for purposes of loans and/or investments was integrated into the overall picture. If sponsors are to fulfil their dual obligation to represent the interests of an applicant for listing and at the same time to protect the integrity of the market, the ability to adopt a fully objective view, that is, to step back and view matters as market participants may well view them, is a necessary part of their professional skills.

[13] It was said that the total sponsor fee was HK$5 million, this fee being reduced by 50% because the listing ultimately lapsed, and what remained was significantly taken up with meeting salaries and administrative expenses.

103. The Tribunal accepts that the dominant practice of third-party payments should have been seen as a major 'red flag' by the Applicant's transaction team. It is puzzling that it was not. Its other failings are not all to be measured at the same level of culpability. In the view of the Tribunal, accepting that the sanction of a public reprimand is appropriate, and not neglecting its financial straits, an appropriate fine is assessed to be one of HK$3 million.

Determination of the Application for Review

104. For the reasons given, other than the reduction of the fine from HK$4.5 million to HK$3 million, the application for review is dismissed.

Legal costs

105. As to costs, there will be an order *nisi* that costs are awarded to the SFC with a certificate for two counsel. While the principal issues were easy enough to define, they were supported by a considerable complexity of factual matters. This order will be made final if the Applicant does not give notice within 30 days that it seeks a different order.

Michael Hartmann
(Chairman)

APPEALS TRIBUNAL THE SECURITIES AND FUTURES 證券及期貨事務上訴審裁處

Dated: 19 October 2021

Mr Jonathan Chang, SC leading Mr Victor T.S. Lui, instructed by Li & Partners
for the Applicant

Mr Abraham Chan, SC leading Mr Norman S.P. Nip, instructed by the SFC
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