

Corporate & Commercial

Another Lesson for the Sponsors – the ICBCI Case

Background

On 21 May 2014, the Securities and Futures Commission (“**SFC**”) announced that it has reprimanded ICBC International Capital Limited (“**ICBCI Capital**”) and ICBC International Securities Limited (“**ICBCI Securities**”) and fined each of them HK\$12.5 million in relation to their roles in the listing of Powerlong Real Estate Holdings Limited (“**Powerlong**”) (Stock code: 1238) in 2009. In this article, we will summarize the facts and SFC’s findings of the case and highlight the points to note for the sponsors.

Facts

ICBCI Capital was one of the joint sponsors and bookrunners and ICBCI Securities was one of the joint lead managers of Powerlong’s listing in 2009. During the listing process, Powerlong referred certain placees (“**Placees**”) to ICBCI Capital, which in turn referred them to ICBCI Securities to open accounts for subscription of Powerlong’s offer shares (“**Offer Shares**”).

Subsequently, due to insufficient demand, the offer price was lowered from HK\$4.9 per share to HK\$2.75 per share. Upon Powerlong’s request and liaison, ICBCI Capital increased the orders of some Placees and informed ICBCI Securities to extend extensive margin financing to certain Placees so as to boost their subscription sizes. As a result, subscription of 4 Placees increased by as much as tenfold. Although subscription of certain Placees far exceeded their declared net worth, ICBCI Capital nonetheless allotted the Offer Shares to them, which triggered massive debit balances to their accounts. Further, margin financing of as much as 50% was then extended by ICBCI Securities to certain Placees.

SFC's Findings

Failing to conduct customer due diligence and perform ongoing scrutiny

Pursuant to General Principle 4 and paragraph 5.1 of the Code of Conduct for Persons Licensed by or Registered with the SFC (the “**Code of Conduct**”), a licensed corporation should take all reasonable steps to seek information and establish from its client their financial situation, investment experience and investment objectives. ICBCI Group Compliance Manual also contained relevant provisions regarding the obtaining of such information from clients.

However, ICBCI Securities accepted the Placees' subscriptions without conducting know-your-client (KYC) checks. Further, none of ICBCI Securities' responsible account executives were aware of the regulatory requirements or the requirements set out in the Compliance Manual to obtain client's financial situation, investment experience and investment objectives, and thus no such information was obtained.

Also, while subscription far exceeded the declared net worth of some Placees and some Placees turned out to have been allocated with Offer Shares in an amount of up to 127 times their declared net worth, ICBCI Securities failed to perform ongoing scrutiny of the transactions in the Placees' accounts.

Turning a blind eye to the lack of independence and extending margin financing
SFC found that both ICBCI Securities and ICBCI Capital turned a blind eye to the Placees' lack of independence and facilitated Powerlong's listing by extending margin financing.

It was apparent that some Placees lacked the financial capability to settle their allocation of Offer Shares since their subscriptions and allocations were greater than their declared net worth. None of the then staff of ICBCI Securities questioned the source of funds of the Placees and even at times advised the Placees to pay by cash or cashier orders so that the identity of the third party depositors could not be traced.

Various telephone recordings indicated that some of the Placees were suspected to be financially dependent on Powerlong and/or its management/controlling shareholders. However, no inquiry as to their independence was made. Upon request of ICBCI Capital, ICBCI Securities extended high levels of margin financing to certain Placees, which were not generally available to clients in international primary placings, without approval from senior management.

Failing to ensure that all independence confirmations were received
ICBCI Securities filed the Marketing Statement and vouched Placee independence as required by Rule 9.11(35) of the Listing Rules without receiving all the independence confirmations from the Placees at the time, in breach of General Principle 2 of the Code of Conduct.

Failing to ensure that submissions were true, accurate and not misleading
ICBCI Capital filed a Sponsor's Declaration without making any reasonable enquires that the Offer Shares in public hands would satisfy the 25% requirement prescribed by Rule 8.08 of the Listing Rules. A former responsible officer of ICBCI Capital admitted that he merely relied on the clearance of the allotment results announcement by the SEHK, which stated that the minimum public float requirement had been met, before signing off the declaration to confirm the same.

ICBCI Capital therefore failed to use reasonable efforts to ensure that submissions to the SEHK were true, accurate and not misleading.

Lessons to Learn for the Sponsors

In light of the ICBCI case, there are a few points to note for the sponsors:

1. Make sure that due diligence on placees' independence, financial situation and investment experience are properly conducted, whether by itself or other related parties in the listing.
2. When in doubt of the placees' independence, especially financial independence, make reasonable enquires and take necessary actions to ascertain the relationship between the issuer and the placees, especially with regard to the source of funds.
3. Before signing the Sponsor's Declaration, make reasonable enquiries with regard to each item on the declaration, so as to ensure that the information and representations provided to the Stock Exchange of Hong Kong Limited are true, accurate and not misleading.

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Important: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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