

E nforcement Reporter *Returns*



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Issue No. 5 | March 2025

The *Enforcement Reporter* is back in action to spotlight the SFC's major enforcement efforts to combat corporate misconduct



Highlights of This Issue



A Week in the Life of a Corporate Fraud Investigator: a behind-the-scenes look at how our investigators work to tackle corporate misconduct to protect investors

P.13

New Market Scanning Initiative: our latest effort to identify governance red flags and drive behavioural change in management **P.2**

SFC & AFRC Joint Statement and Enforcement Actions on Dubious Loans: a re-cap of the joint regulators' observations and the subsequent enforcement actions tackling dubious arrangements for channelling funds to related parties **P.3**

Seeking Compensation for Investors: recent cases demonstrating the SFC's resolve to obtain compensation for minority shareholders **P.9**

New Market Scanning Initiative

While enforcement actions serve as a strong deterrent, they are often a lengthy process that can take years to conclude. Recognising that early intervention is key to preventing governance failures, we are leveraging artificial intelligence (AI)-empowered analytics to:

- **Identify red flags** in listed companies in a timely manner, and
- **Engage with boards and audit committees** to strengthen corporate governance and internal controls before concerns escalate into serious misconduct



Our Observations

As a pilot exercise, we analysed listed companies engaged in money-lending activities. Common governance red flags include:

- Granting substantial loans to third parties with little or no due diligence;
- Significant provisions for impairment made shortly after loan disbursements, raising concerns about internal control and oversight; and
- Disclosure of impairment valuation as one of the key audit matters in published financial statements.



Our Actions

Building on this pilot programme, we have launched a Market Scanning Detection Model that employs AI-empowered analytics to assess financial disclosures, market trends, and governance indicators to identify companies with elevated risk profiles.

Instead of waiting to commence enforcement actions, we will proactively engage with company boards and audit committees to highlight key risk areas and governance concerns, as well as to provide an opportunity for directors to address potential weaknesses before they worsen. Responses will be carefully reviewed, and where necessary, further regulatory action may be considered.

By leveraging AI and advanced data analytics, we aim to streamline the detection process, allowing us to focus our resources on formal investigations and other higher risk areas.



Our Goals

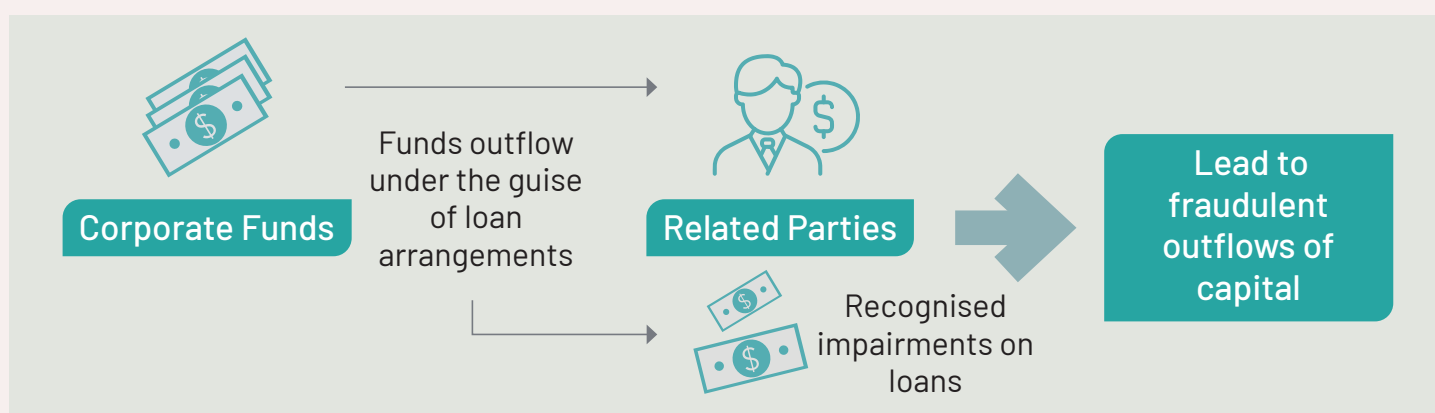
Our goal is **to prevent rather than to discipline**. By nudging market players toward stronger governance practices through early detection and engagement, we aim to achieve the following:

- **Early Intervention:** By identifying and addressing governance and internal control issues in a more timely manner, we aim to identify, prevent or mitigate any corporate misconduct before it worsens.
- **Behavioural Change:** We aim to drive meaningful changes in management behaviour by highlighting potential risks to boards and audit committees, encouraging them to take proactive steps to address these concerns.
- **Market Confidence:** By promoting transparency and accountability, we will enhance investor confidence in the integrity of the market.

SFC & AFRC Joint Statement Addressing Dubious Loans

In recent years, we have observed a concerning trend in corporate fraud. Corporate executives at listed companies may use loan arrangements as a means to divert corporate funds to related parties. These loans are structured to appear legitimate, but they lack genuine commercial purpose and are later impaired, effectively masking the fraudulent outflow of funds.

This tactic not only reveals a growing audacity among corporate executives but also underscores the urgent need for vigilance and robust oversight by key stakeholders to protect shareholders' interests and maintain market integrity.



As a result of these observations, the Securities and Futures Commission (SFC) and the Accounting and Financial Reporting Council (AFRC) issued our [joint statement](#) in July 2023, marking a significant collaboration in addressing this growing trend in Hong Kong's capital market. The statement highlighted an observed increase in suspected misconduct by listed issuers using dubious loans, advances, and prepayments to divert funds. It emphasised the need for proper conduct and governance among management, audit committees, and auditors.



Red flags: dubious loans to related parties

Transaction Types:

- Loans
- Advances
- Prepayments
- Deposits
- Artificial circulation of funds

Key Concerns:

- **Lack of Commercial Rationale:** Loans often granted without sound business reasons.
- **Poor Due Diligence:** Insufficient risk assessments and lack of documentation.
- **Weak Internal Controls:** Inadequate systems for managing loan approvals and monitoring repayments.

SFC & AFRC Joint Statement Addressing Dubious Loans

Expectations on Management



Effective Vetting of Loans:

- Ensure that material loans undergo effective vetting, risk assessments, and due diligence processes.

Duty of Good Faith:

- Act in the company's best interests when evaluating loan proposals and ensure they are beneficial to the company as a whole.

Proper Documentation:

- Ensure proper documentation of due diligence and credit assessments, as well as approvals and collateral details.

Report Material Issues:

- Establish procedures for reporting defaults or other significant issues to the board promptly.

Expectations on Audit Committees



Oversight of Internal Controls:

- Establish and maintain effective risk management and internal control systems for loans, particularly to related parties.

Accurate Financial Reporting:

- Ensure that loans to related parties are completely identified and disclosed in financial statements.

Engagement with Auditors:

- Ensure auditors conduct a robust audit on loans granted to related parties and report on concerns, if any.

Expectations on Auditors



Design Responsive Audit Procedures:

- Design audit procedures to evaluate the effectiveness of internal controls over loans and identify dubious loan arrangements, if any.

Heightened Scepticism:

- Apply heightened professional scepticism when evaluating loans to related parties, particularly those lacking commercial rationale or proper documentation.

Report Irregularities:

- Timely report any observed or suspected fraud to the audit committee and the appropriate authorities.



Consequences of Non-Compliance

- Disclosure of false or misleading information concerning loans may result in criminal prosecution under section 298 or section 384 of the Securities and Futures Ordinance (SFO), carrying substantial penalties including fines and imprisonment.
- The SFC may pursue civil actions under section 214 of the SFO against directors implicated in dubious loan practices, seeking disqualification or compensation.
- The AFRC will investigate accounting non-compliance related to these practices and may impose sanctions under section 37CA of the Accounting and Financial Reporting Council Ordinance on certified public accountants responsible for such failures.

Enforcement Actions on Dubious Loans

Following the release of the [joint statement](#), the SFC has initiated various enforcement actions to combat problematic loans and achieved tangible results.



FingerTango Inc. (FingerTango)

FingerTango is involved in legal proceedings for alleged misconduct involving 20 loans totalling over \$500 million granted to 15 borrowers. The company subsequently recorded a related **impairment loss of approximately \$424 million, indicating that over 80% of the loans have been defaulted.**

Key Insights

The investigation revealed significant lapses in due diligence. Only four loans were secured, and the securities were vaguely recorded as account receivables without identifiable debtors. Proceeds from eight loans were disbursed to unrelated private companies and at least three loans lacked CEO approval, violating internal policies.

The SFC had previously [initiated](#) legal proceedings against FingerTango, seeking disqualification and compensation orders against the company and its former directors for failing to exercise due care in making two investments. Due to the similar nature of misconduct, the findings from both cases have recently been [consolidated](#) into a single petition. Proceedings are ongoing.

Enforcement Actions on Dubious Loans



3DG Holdings (International) Limited (formerly known as Hong Kong Resources Holdings Company Limited) (HK Resources)

HK Resources is embroiled in misconduct related to its money lending operations. Its subsidiary granted loans to borrowers totalling \$74.4 million with interest receivable amounting to approximately \$11.6 million. Many of the loans were linked to individuals and entities closely associated with HK Resources.



Key Insights

The investigation revealed significant lapses in due diligence. Credit assessments were superficial, requiring only basic identification documents and lacking verification of borrowers' financial health. Most loans were unsecured, reflecting the inadequate financial scrutiny applied during the approval process. Moreover, key executives failed to fulfil their fiduciary duties by not acting in the company's best interests. Internal controls were deficient, with no written policies governing loan approvals, allowing directors excessive power without board oversight. Their actions led to a complete default on all 12 loans and **an impairment loss of approximately \$86 million.**

The SFC has [commenced](#) legal proceedings in the Court of First Instance (CFI) against eight former directors, including independent non-executive directors (INEDs), seeking disqualification and compensation orders for their alleged failure to prevent the misappropriation of corporate funds. This case highlights the importance of all directors, including INEDs, fulfilling their fiduciary duties and being held accountable for their conduct. The SFC's actions underscore that INEDs are not merely symbolic appointments but are expected to exercise independent judgment and proactive oversight. Independent directors play a crucial role in ensuring proper corporate governance, and their failure to act with adequate skill, care, and diligence can have severe consequences.

Enforcement Actions on Dubious Loans

Key Insights

During the tenure of the CFO, Fuguiniao or its subsidiaries executed 87 undisclosed deposit pledge arrangements totalling approximately RMB5.3 billion. These arrangements were used as collateral for credit facilities or loans extended to external parties with no apparent relationship to the company, and therefore provided no benefit to Fuguiniao whose deposits were pledged.

Chan failed in some critical areas:

1. **Abdication of Responsibilities:** He lacked an understanding of his role and responsibilities as CFO of a listed company, failing to monitor the financial affairs of the group effectively and allowing material transactions and significant deposit pledges to occur without proper oversight.
2. **Failure to Act on Auditor Concerns:** Despite being alerted by the company's auditor KPMG about potential undisclosed transactions, Chan did not take appropriate steps to investigate or rectify the situation. Instead, he accepted representations from conflicted parties without independent verification.
3. **Lack of Familiarity with Financial Affairs:** Chan was not adequately familiar with Fuguiniao's financial matters in Mainland China, where most of the business activities occurred.

Proceedings involving three former directors linked to these governance failures are ongoing.



Fuguiniao Co., Ltd (Fuguiniao)

The SFC successfully obtained a disqualification order in the CFI against Chan Wai Shing (Chan), former Chief Financial Officer (CFO) and company secretary of Fuguiniao. The order prohibits him from serving as a director or being involved in the management of any listed corporation in Hong Kong for a period of two years.



Enforcement Actions on Dubious Loans



China Ecotourism Group Limited (China Ecotourism)

The [case](#) highlights corporate governance issues related to loans granted by China Ecotourism that totalled more than \$460 million. The loans in question consisted of 13 separate transactions involving nine borrowers. Notably, **a substantial portion of these loans – amounting to \$407 million – was impaired in 2019.**

Key Insights

SFC investigations revealed that loan proceeds were paid to individuals and entities related to former directors. The SFC uncovered suspicious fund movements related to loans issued by the company; in one instance, a licensed junket operator received \$50 million but quickly transferred the funds to an intermediary, who then funnelled most of it to another company connected to key individuals involved in approving the loans. These findings reveal complex layers of financial transfers among related parties.

Additionally, the SFC identified serious deficiencies in the group's practices. There was insufficient credit assessment for borrowers, with no evidence of financial capability or repayment capability documented. The group's internal controls were inadequate, relying on vague policies that did not provide detailed guidelines for loan approval. Moreover, the group failed to take timely and effective actions to recover overdue loans.

We shared the investigation findings with the Stock Exchange of Hong Kong Limited (SEHK), and this collaboration led to the imposition of disciplinary actions against the relevant directors.

Seeking Compensation for Investors

Compensating investors harmed by corporate governance failures is essential for maintaining market integrity and investor confidence. The SFC employs various approaches to achieve restoration, as demonstrated in the cases below. The SFC seeks compensation mechanisms that provide viable exit opportunities and ensure direct compensation to minority shareholders. This underscores the importance of developing targeted, case-specific strategies that prioritise the protection of minority shareholders to reinforce market trust.

Combest Holdings Limited (Combest)

The SFC's investigation found that two Executive Directors (Liu Tin Lap and Lee Man To) and a shadow director (Ng Kwok Fai) of Combest had caused the company to enter into **two overpriced acquisitions in 2016-17 for a total consideration of \$240 million**. The targets acquired were in fact companies controlled by Ng. By including the fictitious income "contributed" by these companies in Combest's financial statements, **its revenue had been overstated by 84%-99% from 2016 to 2019**.

To protect the interest of the investing public, the SFC directed the SEHK to suspend the trading of the company's shares on 29 May 2019. In 2020, the SFC filed a petition to the CFI pursuant to section 212 and section 214 of the SFO seeking to wind up the company, to disqualify Liu, Lee, and Ng and to ensure that the three respondents pay compensation to the company.

In September 2024, the SFC announced that a settlement had been reached whereby **Liu, Lee, and Ng agreed to pay \$192 million in compensation to Combest**, for distribution to independent public shareholders in the form of special dividends.



Key Takeaways

- The SFC can hold "shadow directors" or *de facto* controllers of listed companies accountable for their misconduct towards the companies even if they do not hold "official" titles on the board.
- The SFC will explore all available options for investor compensation. In the case of Combest, its listing had been cancelled since 2020, and its operations were based on fictitious businesses which generated artificially inflated revenue. Given the circumstances, distributing compensation from the wrongdoing directors to minority shareholders would be the most reasonable and efficient way to restore the positions of affected shareholders.

Seeking Compensation for Investors

Sound Global Ltd. (Sound Global)

The SFC's investigation revealed that the bank balances of subsidiaries of Sound Global had been inflated by RMB2.18 billion and RMB2.72 billion for the years ended 31 December 2012 and 2013, respectively, as a result of a scheme orchestrated by the company's then chairman Wen Yibo (Wen) that involved falsification of bank balances and fabrication of bank statements and bank balance confirmations. The SFC filed a petition under section 214 of the SFO and sought, among others, a disqualification order and a share buy-out order against Wen.

In September 2022, affirming the SFC's findings, the Court ordered Wen to purchase shares held by the other shareholders of Sound Global. This order was the first of its kind made under section 214 of the SFO.



Key Takeaways

A share buy-out order **does not require proving and quantifying financial gain or loss, nor does it necessitate establishing a causal link between the misconduct and any financial impact.**

In ordering Wen to make an offer to purchase shares from the other shareholders, the Court cited the following reasons:

- 1. Unclear Financial State:** The schemes had left Sound Global's financial state unclear; the disappearance of relevant personnel and documents made it impossible to determine the full extent of the wrongs committed and losses suffered. This situation prevented the company from seeking compensation.
- 2. Substantial and Irreversible Prejudice:** The prejudice suffered by Sound Global and its shareholders was substantial and irreversible. The discrepancies and prolonged suspension of trading had eroded investor confidence. Trading in the company's shares had been suspended for over six years, with no indication that it could meet the conditions for resumption.
- 3. No Other Remedy Available:** There was no other remedy that could adequately redress the discrepancies. An order for the company to appoint independent auditors to review its internal control would be futile, as previous investigations conducted by the company had been inconclusive.
- 4. Financial Capability of Wen:** The Court highlighted the fact that Wen had previously indicated his intention to privatise Sound Global, suggesting he had the necessary resources to make the share purchase.

Again, the case demonstrates that the SFC will seek the most appropriate mechanism for investor compensation, depending on the circumstances of each case.

Seeking Compensation for Investors

Changgang Dunxin Enterprise Company Limited (Changgang Dunxin)

The SFC's investigation revealed that proceeds totalling \$163 million from two exercises of share and bond placements of Changgang Dunxin had been routed to its then chairman and executive director Zheng Dunmu (Zheng). Chen Ruomao (Chen), an executive director and the CFO of the company at the time, was found to have allowed the proceeds to be misappropriated by Zheng, taking steps to conceal the misappropriation from the auditors and audit committee by providing falsified records purporting to show that Zheng had returned the funds to the company. In March 2024, the CFI ordered Chen to pay a sum of \$163 million with interest as compensation to the company.

Key Takeaways

The Court's decision highlights that those who commit or assist in corporate misconduct can be and will be held accountable, even if they may not have personally received the illegal proceeds. **The absence of personal financial benefits does not absolve one from being held liable for complicity in the misconduct.**



Seeking Compensation for Investors

SMI Culture & Travel Group Holdings Limited (formerly known as Qin Jia Yuan Media Services Company Limited) (QJY)

The SFC's investigation found that three former executive directors of QJY, namely, Anita Leung, Philip Wong, and Tsiang Hoi Fong orchestrated a scheme to misappropriate corporate funds from QJY through fictitious purchases of broadcasting rights for TV dramas that involved a total consideration of \$327.5 million. A portion of these funds, estimated between \$35.2 million to \$74.3 million, was routed to Leung and/or her related companies. These "rights" were substantially overpriced, resulting in **an estimated loss of around \$235.36 million** for the company.

The SFC initiated proceedings under section 214 of the SFO against Leung, Wong, and Tsiang, seeking disqualification orders and a compensation order for \$235.36 million. To ensure the efficacy of these orders, we obtained an interim Mareva injunction order from the CFI against Leung in May 2024, prohibiting her from disposing of assets in Hong Kong and elsewhere, up to the value of \$235.36 million. This Mareva injunction ensures that there will be funds available to satisfy any compensation orders granted by the court. Additionally, we cooperated with the British Columbia Securities Commission in Canada through the International Organization of Securities Commissions (IOSCO) infrastructure and obtained preservation orders against Leung, restraining her and her banks from disposing of assets in British Columbia, Canada.

Key Takeaways

Not only will the SFC seek compensation orders against culpable management of listed companies, but **we will also take steps to ensure the efficacy of such orders.**

This includes obtaining Mareva injunctions to prevent defendants from dissipating their assets. Making use of the IOSCO infrastructure, **we can take action to preserve the respondents' assets, even if such assets are located outside Hong Kong.**



A WEEK IN THE LIFE OF A CORPORATE FRAUD INVESTIGATOR

Behind the scenes at the SFC, our investigators work tirelessly to uncover complex financial crime and protect investor interests. This is a glimpse into the busy work week of one of our dedicated investigators, Melody Chiu, where every day presents fresh challenges and new opportunities to drive regulatory enforcement. As a Senior Manager in the Enforcement Division, Melody leads investigations into corporate misconduct, leveraging her expertise to protect the interests of investors.

MONDAY

AM: Weekly meeting with management to discuss case progress

This is a critical moment for my team to align efforts, brainstorm solutions, and drive investigations forward.

PM: Briefing on Tuesday's search operation

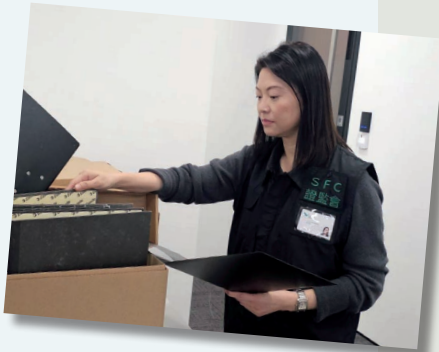
This sets the stage for a high-stakes search operation, where every detail counts. I work with my team to discuss strategies and review logistics, ensuring that all elements are in place for a seamless and effective execution of the search, which will be crucial in uncovering key evidence.



TUESDAY

AM: Search operation

The search operation kicks off, a carefully coordinated effort to gather crucial evidence and advance the investigation.



PM: Review seizures and evidence

This is critical to any investigation, where we scrutinise and analyse all seized evidence to uncover potential leads and build a robust case. It's a meticulous process that requires a keen eye for detail and a deep understanding of the significance of the evidence.



WEDNESDAY

AM: Attend court hearing and give evidence

This is one of my key duties, involving extensive preparation that includes gathering evidence, interviewing witnesses, and compiling filings to support our legal actions. It's a thrilling challenge to bring clarity to complex cases, and I find it incredibly rewarding to see our efforts make a tangible impact in the courtroom.

PM: Conduct interview

This is a formal interview that requires skilful questioning, keen observation, and a deep understanding of case material to extract vital information. Experience makes a difference, as it sharpens instincts and yields better results.





THURSDAY

AM: Inspection at audit firm

I am here to review audit working papers and gather evidence in relation to accounting fraud and misstatements in relation to one of our ongoing investigations. Should we uncover auditors' misconduct, we may refer them to the AFRC.



PM: Conduct training at a fellow law enforcement agency for its induction programme

In this strategic initiative, I provide training to new recruits to equip them with the latest insights and techniques in our enforcement and investigative powers, so as to facilitate future cooperation between the two enforcement agencies.



FRIDAY

AM: I review draft s.183 notices issued to listed companies, banks, witnesses, and other professional parties

This powerful tool allows the SFC to compel key stakeholders to provide essential information and testimony, helping to uncover crucial evidence and advance complex investigations into potential misconduct.

PM: Presentation at an industry association on "Directors' Duties and Responsibilities"

I give a presentation that offers helpful guidance on the roles and responsibilities of directors in Hong Kong, emphasising the importance of effective governance. This is a platform for professionals to discuss challenges, share experiences, and develop strategies for improved compliance and oversight. TGIF!

