
STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined Standard Chartered Securities (Hong Kong) Limited¹ (**Standard Chartered Securities**) \$59.7 million, pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).²
2. The disciplinary action is taken according to an agreement pursuant to section 201 of the SFO dated 13 March 2019 in relation to Standard Chartered Securities' failures in discharging its duties as one of the joint sponsors in relation to the listing application of China Forestry Holdings Company Limited (**China Forestry**) in 2009.

Summary of facts

Background

3. China Forestry first submitted its listing application on 18 April 2008. It submitted a further listing application on 11 November 2008 due to the lapse of more than six months from its first listing application. At that time, Standard Chartered Securities (formerly known as Cazenove Asia Limited) acted as China Forestry's sole sponsor and one of its joint bookrunners. The listing application was then suspended due to market conditions.
4. On 4 September 2009, China Forestry reactivated the listing application process by submitting its third listing application. At that time, Standard Chartered Securities was one of China Forestry's joint global coordinators, joint sponsors, joint bookrunners and joint lead managers.
5. China Forestry was listed on the Main Board of the Stock Exchange of Hong Kong (**SEHK**) on 3 December 2009.
6. Trading in the shares of China Forestry was suspended since 26 January 2011. Subsequently, the company was wound up and the listing of its shares was cancelled on 24 February 2017.

Regulatory requirements³

7. A sponsor is required to conduct reasonable due diligence inquiries so as to put itself into a position to ensure that the disclosure in the listing document and all information provided to the SEHK during the listing application process are true in all material respects and do not omit any material information.
8. Specifically, a sponsor is required by:

¹ Standard Chartered Securities, formerly known as Cazenove Asia Limited (Cazenove), is licensed under the SFO to carry on Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts) and Type 6 (advising on corporate finance) regulated activities. Cazenove changed its name to Standard Chartered Securities on 14 December 2009. With effect from 5 February 2016, for Type 6 regulated activity, Standard Chartered Securities' licence is subject to a condition that it shall not act as sponsor in respect of an application for the listing on the Stock Exchange of Hong Kong.

² The SFC has also banned Mr Joseph Hsu Kar Hing (Hsu), sponsor principal in charge of the supervision of the execution of China Forestry's listing application for Standard Chartered Securities, from re-entering the industry for three years. See the SFC's press release on Hsu dated 17 July 2018.

³ References to codes and guidelines in this Statement of Disciplinary Action are references to the codes and guidelines that were current at the time of the listing of China Forestry.

- (a) General Principle 2 (diligence) of the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**) and paragraph 5.1 (due skill and care) of the Corporate Finance Adviser Code of Conduct (**CFA Code of Conduct**) to act with due skill, care and diligence and observe proper standards of market conduct, in the best interests of the integrity of the market.
- (b) Paragraph 5.8 (standard of documents) of the CFA Code of Conduct to use all reasonable efforts to assist its client in ensuring any document for public dissemination is prepared to the required standard and no relevant information has been omitted.
- (c) Paragraph 2.3 of the CFA Code of Conduct, paragraph IV.6 of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC and paragraph 1.5.2 of the Additional Fit and Proper Guidelines for Corporations and Authorized Financial Institutions applying or continuing to act as Sponsors and Compliance Advisers (**Sponsor Guidelines**⁴), to maintain proper books and records and effective record retention policies which ensure that all relevant legal and regulatory requirements are complied with.
- (d) General Principle 7 (Compliance) and paragraph 12.1 (Compliance: in general) of the Code of Conduct and paragraph 1.5.1(3) of the Sponsor Guidelines to comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of the integrity of the market.

Failure to verify the existence of China Forestry's forestry assets

- 9. According to China Forestry's prospectus dated 19 November 2009, the company and its subsidiaries (**Group**), a plantation forest operator whose main businesses were the management and sustainable development of forests and the harvesting and sale of logs, owned approximately 171,780 hectares of forests in Yunnan and Sichuan Provinces of Mainland China. Around 90% (or 159,333 hectares) of such forests were situated in Yunnan.
- 10. In December 2007, Standard Chartered Securities conducted site inspections to Group's forests in Sichuan and Yunnan in its then capacity as the sole sponsor in relation to China Forestry's listing application⁵. It made the same endeavour in February and May 2008. However, when the SFC compared the forest locations visited by Standard Chartered Securities as recorded in the site visit notes against the forest locations disclosed in the prospectus or the forestry right certificates, material inconsistencies were found such that it was difficult to ascertain which forest locations disclosed in the prospectus Standard Chartered Securities actually visited. Some of the forest locations visited by Standard Chartered Securities appeared not to be situated in the forest areas disclosed in the prospectus.
- 11. Standard Chartered Securities claimed that other professional parties, including lawyers and forestry experts, were involved in some of the site inspections. However, none of them had been instructed to verify the existence of the Group's forestry assets as disclosed in the prospectus.
- 12. Further, despite the fact that the Group acquired 150,000 hectares of forests in Yunnan in 2008 which accounted for over 90% of its forestry assets, there is no evidence to suggest that Standard Chartered Securities had visited the Group's forests in Yunnan after the acquisition or commissioned an assessment of the impact of the earthquake of magnitude

⁴ Appendix I, Fit and Proper Guidelines, September 2006.

⁵ Standard Chartered commenced its due diligence on China Forestry since late 2007. In its capacity as a sole sponsor of China Forestry, Standard Chartered submitted China Forestry's first and second listing applications to the SEHK in April 2008 and November 2008 respectively.

6.0 on the Richter scale that hit Yunnan on 9 July 2009 (**Yunnan Earthquake**) on the Group's forestry assets.

Failure to verify the Group's forestry rights

13. According to the prospectus, the Group had the necessary legal rights over its forests and the relevant forestry right certificates to evidence its ownership of the trees, and rights to use the forest land. While Standard Chartered Securities claimed to have inspected the original certificates, it did not identify certain apparent anomalies (for example, a mismatch between the name of the location of a forest as disclosed in the prospectus and as stated in the corresponding certificates) that should have called for further inquiries.
14. Standard Chartered Securities also claimed that its Mainland Chinese lawyers had verified and checked the certificates, but it was not aware of what steps had been taken by the Mainland Chinese lawyers to check the certificates. Further, the relevant legal opinions did not state that the certificates had been verified and checked. In fact, the legal opinions contain express assumptions as to the genuineness and accuracy of documents China Forestry provided to the lawyers.
15. The SFC has instructed a Mainland Chinese law firm to verify the certificates allegedly held by the Group in support of its forestry rights in Yunnan and Sichuan as disclosed in the prospectus:
 - (a) The forestry bureaus in Yunnan confirmed that all the 18 certificates purportedly held by China Forestry in relation to 18 parcels of forests in Yunnan had no corresponding records with the relevant forestry bureaus.
 - (b) The forestry bureaus in Sichuan confirmed that 22 of the 28 certificates purportedly held by China Forestry in relation to 21 parcels of forests in Sichuan had no corresponding records with the relevant forestry bureaus.
 - (c) For the remaining 6 certificates purportedly held by China Forestry in relation to 6 parcels of forests in Sichuan, the relevant forestry bureaus were unable to confirm their authenticity due to an ongoing criminal investigation relating to China Forestry.
16. The 18 certificates mentioned in paragraph 15(a) above account for over 90% of China Forestry's forestry assets as disclosed in the prospectus.

Failure to verify China Forestry's compliance with relevant forestry laws and regulations

17. The prospectus describes the means by which China Forestry undertook its logging activities in compliance with relevant forestry and environmental laws and regulations.
18. Standard Chartered Securities relied on written confirmations purportedly issued by the relevant forestry bureaus that China Forestry had provided for it⁶ to confirm that the business and logging activities of China Forestry were in compliance with the relevant Mainland Chinese forestry and environmental laws. There is, however, no evidence that Standard Chartered Securities had verified whether the written confirmations were issued by the relevant forestry bureaus, or whether the information recorded therein was accurate.
19. Standard Chartered Securities claimed that it relied on its Mainland Chinese lawyers' due diligence on the written confirmations, but there is no evidence that it had requested the Mainland Chinese lawyers to check or verify the authenticity of the written confirmations. In fact, the legal opinions contain express assumptions as to the genuineness and accuracy of documents China Forestry provided to the lawyers.

⁶ Standard Chartered Securities did not know how China Forestry had obtained the written confirmations.

Inadequate due diligence on the insurance coverage for the Group's forestry assets

20. Having sufficient insurance coverage for the Group's forestry assets, which were pivotal to its business operation, was of fundamental importance. Standard Chartered Securities relied on insurance documents provided by China Forestry as evidence of such insurance coverage without independently verifying the authenticity of the insurance documents.
21. Although Standard Chartered Securities claimed that its deal team members and Mainland Chinese lawyers had reviewed the insurance documents, it did not identify a number of issues (for example, an inconsistency between the location of a forest as stated in the insurance document and as stated in the forestry right certificate) that should have called for further inquiries.
22. The SFC has made inquiries with the insurer which has allegedly insured all the forests of the Group. The insurer confirmed with the SFC that that none of the insurance contracts that China Forestry provided to Standard Chartered Securities was issued by it.

Inadequate due diligence on China Forestry's customers

23. According to the prospectus, for the year ended 31 December 2008 and the 6 months ended 30 June 2009, approximately 70.5% and 81.4% respectively of China Forestry's customers by revenue were located in Yunnan.
24. Standard Chartered Securities had planned to conduct face-to-face interviews with some of China Forestry's customers in Yunnan, but subsequently decided to postpone the face-to-face interviews because of the Yunnan Earthquake. Standard Chartered Securities only conducted telephone interviews with them.
25. Conducting interviews with customers via telephone means that the sponsor is not able to verify the existence of the customers and the identity of their representatives at their place of business. With respect to China Forestry's customers in Yunnan in particular, conducting telephone interviews with them meant that Standard Chartered Securities was not able to assess the impact of the Yunnan Earthquake on them at their place of business post-earthquake. As such, it is reasonable to expect that Standard Chartered Securities would have taken steps to mitigate the limitations of conducting interviews with customers via telephone.
26. The SFC found that certain practices that Standard Chartered Securities adopted in conducting due diligence enquiries with the Group's customers were inadequate:

(a) No independent searches

There is no evidence that Standard Chartered Securities had conducted any company, address or background searches on any of the Group's customers to confirm their identity. While Standard Chartered Securities claimed that it had performed internet searches on the Group's customers, the relevant search records were not retained. There is no evidence that Standard Chartered Securities attempted to confirm the existence of the Group's major customers through other means.

(b) No verification of identity and contact detail of interviewees

Information such as the name and telephone number of the customer, the key contact person and his position were obtained from China Forestry. Standard Chartered Securities arranged the telephone interviews by calling either the fixed line or mobile phone number of the customers that China Forestry provided to it. There is no evidence that Standard Chartered Securities took any steps to independently verify the customer's telephone number and/or the identity of the individual to be interviewed.

27. The SFC also found that important information about the interviews were not recorded in the telephone interview records provided by Standard Chartered Securities. For example, the interview records did not in every case record the full name of any of the interviewees (the interviewees were only identified by surname), the identity of the interviewer(s) and other persons attending the interview, and the telephone number of any of the customers interviewed.
28. The interviewees were not asked to confirm whether the Yunnan Earthquake had affected their factories, production or sales, etc. Instead, the interviewees were asked to confirm whether their orders with the Group would be affected by factors such as the Sichuan earthquake⁷.

Breaches and reasons for action

29. In light of the matters set out above, the SFC considers that Standard Chartered Securities had failed to discharge its due diligence obligations as one of the joint sponsors in relation to China Forestry's listing application, in that it had:
 - (a) failed to conduct adequate and reasonable due diligence inquiries to ensure that the information and representations provided in the prospectus were true, accurate and not misleading, in that it had:
 - (i) failed to verify the existence of the forests in respect of which China Forestry represented in the prospectus that it possessed forestry rights;
 - (ii) failed to verify that the forestry rights as disclosed in the prospectus were appropriately held by China Forestry;
 - (iii) failed to verify the written confirmations purportedly issued by relevant local forestry bureaus, which confirmed that China Forestry's business and logging activities were in compliance with the relevant Mainland Chinese forestry and environmental laws;
 - (iv) failed to properly review the insurance documents provided by China Forestry as evidence that it had insurance coverage for all of its forests disclosed in the prospectus; and
 - (v) failed to take reasonable steps to verify the identity and existence of China Forestry's customers and their relationship with China Forestry;
 - (b) failed to keep a proper audit trail/written record of the work done in relation to the due diligence for China Forestry's listing application;
 - (c) breached the sponsor's undertaking to the SEHK and/or filed untrue statements in the sponsor's declaration to the SEHK; and
 - (d) failed to comply with all regulatory requirements applicable to the conduct of a sponsor, including the **Rules Governing the Listing of Securities on the SEHK (Listing Rules)** and Practice Note 21 to the Listing Rules (Due Diligence by Sponsors in respect of Initial Listing Applications).

⁷ This was an earthquake that hit Sichuan, China on 12 May 2008.

Conclusion

30. Having considered all the circumstances, the SFC is of the view that Standard Chartered Securities have breached the regulatory requirements as set out in paragraph 8 above.
31. In deciding the appropriate sanction, the SFC has taken into account all relevant considerations, including:
 - (a) the deficiencies in the due diligence conducted by Standard Chartered Securities are significant, i.e. it had failed to properly examine and verify crucial aspects of China Forestry's business, i.e. its forestry asset, logging activities, insurance coverage and customers;
 - (b) substandard due diligence work of sponsors could facilitate the listing of companies that are, in fact, not suitable for listing. When companies listed in such circumstances fail, their failure may cause significant loss to public investors and jeopardise their confidence in Hong Kong financial markets. As such, deterrent penalties for sponsor failures are warranted; and
 - (c) Standard Chartered Securities cooperated with the SFC in accepting the disciplinary actions and the SFC's findings and regulatory concerns.