

## STATEMENT OF DISCIPLINARY ACTION

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### The disciplinary action

1. The Securities and Futures Commission (**SFC**) has reprimanded and fined CES Capital International (Hong Kong) Co., Limited (**CESHK**)<sup>1</sup> HK\$3.2 million pursuant to section 194 of the Securities and Futures Ordinance (**SFO**).
2. The disciplinary action is taken in respect of CESHK's failure to discharge its duties as an investment manager of two funds between February 2015 and July 2017 (**Relevant Period**), in that CESHK has failed to:
  - (a) perform sufficient due diligence and monitoring on the funds' underlying investments and undertake satisfactory risk management measures to identify, quantify and manage the risks to which the funds were exposed; and
  - (b) keep proper audit trail of the due diligence and monitoring allegedly performed on the funds and their underlying investments.

### Summary of facts

#### *Background*

3. **CESHK was appointed by Worldwide Opportunities Fund SPC (WOF) as the investment manager of the following Funds (collectively, Funds):**
  - (a) **Evergreen Growth Saver SP (EGSSP, formerly known as Real Estate and Finance Fund SP)** from 16 February 2015 to 31 January 2018; and
  - (b) **Hong Kong Investment Fund SP (HKIFSP)** from 1 March 2016 to 31 January 2018.
4. WOF was an open-ended investment fund established as an exempted company limited by shares under the laws of the Cayman Islands on 23 February 2015. EGSSP and HKIFSP were segregated portfolios of WOF<sup>2</sup>.

#### *The Funds' investment mandate*

5. Pursuant to the respective initial private placement memorandum (**PPM**) of EGSSP and HKIFSP dated 6 July 2015 and 9 February 2016, the Funds' investment objective was to provide shareholders with a structured investment return by investing substantially all its assets in acquiring the participating shares of a **Cayman incorporated underlying company, "Real Estate and Finance Fund" (REFF)**. REFF was the underlying company for both Funds **initially** and according to the investment objective set out in the initial PPM of

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<sup>1</sup> CESHK is licensed under the Securities and Futures Ordinance to carry on business in Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 3 (leveraged foreign exchange trading), Type 4 (advising on securities), Type 5 (advising on futures contracts) and Type 9 (asset management) regulated activities under the SFO. CESHK has ceased business of regulated activities.

<sup>2</sup> On 16 May 2019, WOF was wound up by an order of the Grand Court of the Cayman Islands and the Funds have been in liquidation since then.

each of the Funds, the underlying company derived income **mainly from real estate properties and loans to licensed money lenders in Hong Kong.**

6. On 11 March 2016, WOF's directors passed a resolution to issue a revised PPM for EGSSP dated 11 March 2016 to, among other things:
  - (a) change the underlying company for EGSSP from REFF to another Cayman incorporated underlying company, "Evergreen Growth Saver" (**EGS**) (REFF and EGS each a **UC** and collectively, the **UCs**); and
  - (b) stipulate that the UC (ie, **EGS**) **might also invest in, among other things, derivatives and listed/unlisted equities.**
7. The initial PPM for HKIFSP was similarly amended by a revised PPM for HKIFSP dated 2 August 2016 to allow REFF to also invest in, among other things, derivatives and listed/unlisted equities. The amended mandates for EGS and REFF are collectively referred to as the **Mandate Change**.

*CESHK's failure to discharge its duties as the investment manager*

8. Pursuant to the PPMs and the investment management agreement between WOF and CESHK applicable during the Relevant Period, CESHK was vested with the duties to manage and invest the Funds' assets and investments on a discretionary basis. CESHK was also responsible for monitoring the performance of the Funds' investments and performing analysis of the progress of all investments and assets of the Funds.
9. As the Funds' assets were invested exclusively in the UCs, the values of the Funds were almost entirely dependent on the performance of the UCs and ultimately subject to the risks associated with the UCs' investments. In the circumstances, CESHK's duties to manage the Funds' assets and monitor the performance of their investments must include the performance of due diligence on the UCs to understand their background, business and underlying investments and assets, and ongoing monitoring of the UCs' performance and risk exposure.
10. However:
  - (a) According to CESHK, WOF made the final decision on when to invest for the Funds, and it entered into the sales and purchase agreements with UCs' shareholders for the UC shares without CESHK's involvement.
  - (b) CESHK considered that its main role was to ensure that the Funds' assets were invested substantially in the UCs in accordance with the investment objective stated in the PPMs, and it did not have the obligation or right to obtain information to ascertain the UCs' underlying investments and assets.
  - (c) CESHK had performed minimal due diligence on the UCs, and it had limited or no information about the UCs' underlying investments and assets and their respective holdings in them.

11. With respect to CESHK's due diligence on the UCs:
- (a) The responsible officer of CESHK (**RO**) claimed that CESHK had requested WOF to provide information about the UCs' underlying investments but his claim is not supported by any records.
  - (b) While CESHK has been provided with valuation reports in respect of some real properties, one of which appeared to be indirectly owned by REFF, there is no evidence that CESHK has taken any steps to ascertain the relationships between the properties and the UCs. There is also no evidence that CESHK has taken any steps to ascertain the remaining assets, investments and liabilities in the UCs' portfolios.
  - (c) CESHK asserted that it had requested WOF for information about the UCs' underlying investments after the Mandate Change and became aware in around mid-2017 that the UCs had invested in an unlisted stock traded in the OTCQB market<sup>3</sup>, but again, CESHK has not been able to produce any record to support this assertion and specify when such enquiries were made.
12. In terms of monitoring the performance of the Funds:
- (a) CESHK claimed that after receiving the draft fund valuation reports (**NAV Report**) prepared by the funds' administrator, its Asset Management Department would take steps to monitor the valuation of the Funds. However, according to the RO, CESHK's role was to simply (i) check whether the figures stated in the NAV Reports were consistent with the Funds' subscription/redemption and share transfer records and (ii) re-calculate the valuations therein to ensure they were correct arithmetically. CESHK did not know the basis on which the UCs were valued.
  - (b) CESHK has not been able to produce any record of the alleged regular meetings held within its Asset Management Department to review the performance of the Funds, or the discussions in the alleged meetings.
  - (c) The monthly reports prepared by CESHK from May 2016 to March 2017 only set out some data and/or views on the Hong Kong property market generally. They do not provide any analysis or explanation on how such data and/or views would impact the UCs and/or the Funds.
  - (d) **CESHK claimed that it learnt about the 75.7% drop in the net asset value (NAV) per share of EGSSP from HK\$2,251.987 on 30 September 2016 to HK\$546.872 on 30 November 2016 in mid-December 2016.** It then made enquiries with WOF's directors who explained that the drastic drop in the NAV per share of EGSSP was due to a price drop in the UC's portfolio. CESHK did not find it necessary to take any further action at that point as the price of the

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<sup>3</sup> According to CESHK, the UCs have invested in the shares of First Asia Holdings Limited traded on the OTCQB market after the Mandate Change. The OTCQB is a venture market operated by the OTC Markets Group, Inc. in the United States for over-the-counter securities.

portfolio had already rebounded by mid-December 2016<sup>4</sup>. CESHK has not maintained any record of its alleged discussions with WOF's directors and the basis of its decision to take no further action in respect of the drastic price drop.

13. It was not until August 2017, ie, after the SFC conducted a limited review of CESHK's business activities and raised concerns about its conduct in acting as the Funds' investment manager, that CESHK began to take active steps to make enquiries with WOF and the UCs' management about the UCs' underlying investments and price fluctuation.

## **Conclusion**

14. The SFC is of the view that CESHK has failed to (i) perform sufficient due diligence and monitoring on the funds' underlying investments and undertake satisfactory risk management measures to identify, quantify and manage the risks to which the funds were exposed, and (ii) keep proper audit trail of the due diligence and monitoring allegedly performed on the Funds and their underlying investments, in breach of:
  - (a) paragraph 1.2(d) of the Fund Manager Code of Conduct (the second edition dated January 2014) which requires a fund manager to maintain satisfactory risk management procedures commensurate with its business; and
  - (b) section VIII of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission which requires a licensed person to establish and maintain effective policies and procedures to ensure the proper management of risks to which the firm and, if applicable, its clients are exposed, particularly with regard to their identification and quantification, whether financial or otherwise.
15. CESHK's failures set out above cast doubt on its ability to carry on regulated activities competently and call into question its fitness and properness to remain licensed.
16. In reaching the decision to take the disciplinary action set out in paragraph 1 above, the SFC has taken into account all relevant circumstances of this case, including:
  - (a) CESHK's remedial actions taken following the SFC's limited review, including the termination of its investment management services to the Funds with effect from 1 February 2018 in light of the Funds' directors' failure to provide the information necessary for CESHK to discharge its duties; and
  - (b) CESHK cooperated with the SFC in resolving the SFC's concerns.

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<sup>4</sup> The NAV per share of EGSSP increased 269.5% from HK\$546.872 on 30 November 2016 to HK\$2,020.822 on 31 December 2016.