INFORMATION NOTE

Professional investors

1. Background

1.1 Recent investor complaints against the marketing of "Accumulators"[1] by private banks and licensed corporations have brought into focus the regulation of financial products sold to professional investors. The purpose of this information note is to provide the Panel on Financial Affairs with information on the regulatory treatment of professional investors in the United Kingdom (UK) and Singapore, in terms of the regulatory framework, the requirements for qualifying retail clients as professional investors, as well as the business conduct requirements and the exemptions available for financial dealings with professional investors.

1.2 In Singapore, professional investors are defined as those who have satisfied the "asset" or "income" test stipulated in the *Securities and Futures Act*. Meanwhile, in the UK, professional investors can be classified into two broad categories. The first category comprises those institutional investors, such as financial institutions and government bodies, which are defined as professional investors by their status. The second category comprises those high net-worth individuals who are defined as professional investors by their financial position and the fulfilment of other criteria. This information note will only study the regulatory treatment of those high net-worth professional investors. They are known as "elective professional clients" in the UK, "accredited investors" in Singapore, and "professional investors" in Hong Kong. For consistency, the term "professional investors" will be used throughout this information note to represent the high net-worth individual investors who have met the regulatory requirements to be treated as professional investors.

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1 "Accumulators" is one type of structured products which allows an investor to purchase a fixed number of the underlying asset on a daily basis at a strike price in respect of each accumulation period. The strike price is set at a specified percentage (usually between 90% and 98%) of the initial spot price of the underlying asset. If the closing price of the underlying asset is at or above the knock-out price on any day during an accumulation period, a knock-out event occurs. In such an event, the investor will cease to accumulate any further stock of the underlying asset from the knock-out date onwards. The knock-out price is set at a specified percentage (usually between 103% and 108%) of the initial spot price of the underlying asset. While the "Accumulators" allows an investor to enjoy the potential benefit of purchasing the underlying asset at a discount, he or she is subject to the risk of continuously purchasing the underlying asset at a price higher than the prevailing market price if the price of the underlying asset falls below the strike price. See Securities and Futures Commission (2008).

1.3 In the UK and Singapore, professional investors are expected to possess the experience, skills and knowledge to make their own investment decisions, and/or have the financial resources to command the advice of such experience and knowledge. As such, while professional investors are not provided with the same level of protection that retail investors might need, they are eligible for many investment opportunities that retail investors are not allowed to participate in. In particular, many issuers concentrate on marketing financial products to professional investors, as these offers are subject to less stringent regulatory requirements and can be exempted from some of the filing requirements (e.g. prospectus requirements) normally required for offers to retail investors. The same holds for Hong Kong where offers to professional investors are exempted from some of the regulatory requirements applicable to retail clients, such as the lifting of the prohibition against cold-calling and the requirement for submission of offer documents to the Securities and Futures Commission (SFC) for authorization.

Table 1 – Regulatory framework

	The United Kingdom	**Singapore**	**Hong Kong**
Major regulatory authorities	• Financial Services Authority (FSA).	• Monetary Authority of Singapore (MAS).	• SFC and Hong Kong Monetary Authority (HKMA).
Responsibilities	• FSA, being the single statutory regulator of the UK's financial services industry, is responsible for the authorization and regulation of investment firms, banks, building societies and insurance companies.	• MAS serves as Singapore's single statutory regulator for the administration and supervision of the financial system. • MAS is also the licensing authority for conducting regulated investment activities in Singapore.	• SFC is the principal statutory regulator of the securities and futures industry in Hong Kong, with the responsibility for administering the laws governing the securities and futures markets, as well as licensing, supervising and monitoring non-bank intermediaries. • HKMA is responsible for conducting the day-to-day supervision of banks' securities and futures businesses in accordance with the regulatory standards stipulated by SFC.
Principal governing legislation	• The *Financial Services and Markets Act 2000* (FSMA), together with its subordinate legislation.	• The *Securities and Futures Act* (SFA) and its accompanying regulations, orders and notifications.	• The *Securities and Futures Ordinance* (SFO) and the accompanying Rules.

Table 1 – Regulatory framework (cont'd)

	The United Kingdom	Singapore	Hong Kong
Code of conduct	• The securities industry is also governed by the *FSA Handbook*, which comprises a number of themed sourcebooks covering various areas of the financial services industry (e.g. market conducts, conducts of business, training and competence, and dispute resolution). • The sourcebook – *New Code of Business Sourcebook* (COBS) – sets out business conduct requirements for investment firms and their representatives when carrying out regulated investment activities with their clients.	• The securities industry is also governed by the *Financial Advisers Act* (FAA) which contains legal provisions prescribing business conduct requirements for financial advisers with respect to their integrity, objectivity, confidentiality, competence, and due care and diligence.	• The securities industry is also governed by the codes of conduct, guidelines and circulars issued by SFC. • The *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission* (Code of Conduct) offers guidance on the practices and standards for licensed and registered intermediaries and their representatives.

Table 2 – Requirements for qualifying retail clients as professional investors

	The United Kingdom	Singapore	Hong Kong
Qualifying criteria	• Quantitative criteria: a retail client requesting for the professional investor status must fulfil at least two of the following requirements: (a) carrying out transactions at an average frequency of 10 per quarter over the previous four quarters; (b) having an investment portfolio size of more than €500,000 (HK$5.35 million)[1]; and (c) working at least one year in a professional position which requires knowledge of the transactions or services envisaged. • Qualitative requirement: the investment firm must undertake an adequate assessment of the expertise, experience and knowledge of the client to give reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making his or her own investment decisions and understanding the risk involved.	• A professional investor means an individual: (a) whose net personal assets exceed S$2 million (HK$10.36 million)[2] in value (or its equivalent in a foreign currency) or such other amount as MAS may prescribe; or (b) whose income in the preceding 12 months is not less than S$300,000 (HK$1.55 million) in value (or its equivalent in a foreign currency) or such other amount as MAS may prescribe.	• A professional investor (either alone or with his or her spouse or children on a joint account) must have a portfolio of not less than HK$8 million or its equivalent in any foreign currency. • In addition, the market intermediary concerned should assess and be reasonably satisfied that the client requesting for the professional investor status is knowledgeable and has sufficient expertise in the relevant products and markets, having regard to the client's (a) type of products being traded, (b) frequency and size of trades, (c) dealing experience and (d) risk awareness.
Procedural requirement	• Prior to qualifying a retail client as a professional investor, investment firms must issue a written warning to the client explaining the protections he or she may lose. A written declaration from the client acknowledging the above consequence is also required.	• Nil.	• The market intermediaries should issue a written explanation to the client explaining the risks and consequences of accepting the professional investor status, and the right to withdraw from the status. A signed declaration from the client acknowledging the above explanations is also required.

Notes: (1) Based on the average exchange rate of HK$10.7 per Euro in 2007.
(2) Based on the average exchange rate of HK$5.18 per Singaporean dollar in 2007.

Table 3 – Business conduct requirements for financial dealings with professional investors

	The United Kingdom	Singapore	Hong Kong
Applicable business conduct requirements	• Investment firms are governed by the business conduct requirements stipulated in COBS when dealing with their clients. These requirements include: (a) obtaining information in relation to the financial situation and investment objectives of their clients when making personal recommendations or managing their investments; (b) providing appropriate information in a comprehensible form to their clients about the firms and their services, products and investment strategies, and costs and associated charges; (c) acting honestly, fairly and professionally in accordance with the best interests of their clients; (d) providing their clients with a general description of the nature and risks of designated investment; and (e) furnishing their clients with periodic statements.	• Financial advisers are governed by the business conduct requirements set out in the *Guidelines on Standards of Conduct for Financial Advisers* issued by MAS under Section 64 of FAA. When dealing with their clients, financial advisers are required, among other things, to act with integrity, objectivity, competence, due care and diligence.	• Market intermediaries are governed by the business conduct requirements set out in the Code of Conduct when dealing with their clients. These requirements include: (a) avoiding conflicts of interest; (b) assuring themselves that when providing services in derivative products, the client understands the nature and risks of the products and has sufficient net worth to assume the risks and bear the potential losses of trading in the products; and (c) disclosing information on the financial condition of their business upon request.

Table 4 – Exemptions available for financial dealings with professional investors

	The United Kingdom	Singapore	Hong Kong
Exempted business conduct requirements	• COBS allows investment firms to assume professional investors possessing the necessary level of experience and knowledge to understand the products, transaction and services offered to them. Such a provision exempts the investment firms from the requirement of conducting appropriateness test for their professional clients[3]. • COBS does not set out any specific requirement for investment firms to enter into written agreements with their clients. • There is no specific requirement in COBS for investment firms to send professional investors a notice confirming execution of the order as soon as possible.	• The *Financial Advisers (Amendment) Regulation 2005* exempts financial advisers from complying with certain business conducts requirements stipulated in FAA. These include the exemptions from: (a) Section 25 of FAA (requiring the disclosure of material information on collective investment schemes and insurance policies); (b) Section 27 of FAA (prohibiting a financial adviser from making a recommendation with respect to an investment product when it does not have a reasonable basis to do so); and (c) Section 36 of FAA (requiring the disclosure of interests in securities held by a financial adviser when he or she makes recommendations on those securities in a circular or other similar written communication).	• When the client has fulfilled the requirements stipulated in Table 2, some of the obligations of a licensed intermediary under the Code of Conduct can be exempted when dealing with a professional investor. For example, market intermediaries are *not* required to: (a) solicit general information about the client such as the client's financial situation, investment experience and investment objectives; (b) ensure the suitability of a recommendation or solicitation; (c) enter into a written contract or provide risk disclosure statements; and (d) obtain prior authority in writing before effecting transactions.

Note: (3) Appropriate tests are for investment firms to determine whether the services offered are appropriate for their clients.

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