



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

**WRITTEN RESPONSE TO THE QUESTION RAISED
BY THE SUBCOMMITTEE ON 29 MAY 2009**

10 June 2009



Please explain in writing how an individual will come within the meaning of "professional investor" under the Securities and Futures Ordinance (Cap. 571) and under the relevant Code(s)/guideline(s) issued by the Securities and Futures Commission (SFC), with clarification on how para 15.3 of the Code of Conduct for Persons Licensed by or Registered with the SFC would be applicable when dealings with a professional investor have been excluded from the definitions of "dealings in securities" and "dealings in futures contract" in Schedule 5 to Cap. 571.

The SFO

1. The term "professional investor" is defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) ("SFO").
2. Paragraph (j) of the definition of "professional investor" enables the SFC to prescribe additional classes of persons to be professional investors in rules which are subsidiary legislation and subject to negative vetting by the Legislative Council. The SFC did so in the Securities and Futures (Professional Investor) Rules (Cap. 571D) ("PI Rules"). Among the additional classes of persons prescribed by the SFC as professional investors under the PI Rules is the following:

"(b) any individual, either alone or with any of his associates on a joint account, having a portfolio of not less than HK\$ 8 million or its equivalent in any foreign currency -

- (i) as stated in a certificate issued by an auditor or a certified public accountant of the individual within 12 months before the relevant date; or
- (ii) as ascertained by referring to one or more custodian statements issued to the individual (either alone or with the associate) within 12 months before the relevant date;"

3. The term "portfolio" is defined as follows –

"portfolio" (投資組合) means a portfolio comprising any of the following-

- (a) securities;
- (b) a certificate of deposit issued by-
 - (i) an authorized financial institution; or
 - (ii) a bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong;
- (c) in relation to an individual, corporation or partnership, money held by a custodian for the individual, corporation or partnership;

The Code of Conduct

4. The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("Code") applies to all licensed or registered persons when they are carrying on any regulated activities as defined under the SFO. When an intermediary serves an individual



professional investor, it may only "treat" the investor as a "Professional Investor" under the Code (and thereby as exempt from certain regulatory requirements as set out under paragraph 15.5 of the Code) if the intermediary has conducted an assessment of the person's investment experience as required under paragraph 15.3 of the Code and, having done so, is reasonably satisfied that the investor is knowledgeable and has sufficient expertise in relevant products and markets. In conducting this assessment the intermediary should have regard to the following factors:

- (a) the type of products in which the person has traded;
 - (b) the frequency and size of trades (a Professional Investor would be expected to have traded not less than 40 transactions per annum);
 - (c) the person's dealing experience (a Professional Investor would be expected to have been active in the relevant market for at least 2 years); and
 - (d) his awareness of the risks involved in trading the relevant markets.
5. Under paragraph 15.4(b) of the Code, an intermediary should obtain a written signed declaration from the person confirming that the intermediary has explained to him the consequences of consenting to being treated as a Professional Investor (*under the Code*), that the person has given consent to being so treated, and that he has been informed that he may withdraw from being treated as a professional investor at any time. Under paragraph 15.4(c) of the Code, the intermediary should also have in place procedures to carry out a confirmation annually that the person continues to fulfil the requisite requirements under the PI Rules.
6. It should also be highlighted that notwithstanding that there are "professional investor" exemptions in certain sections under the SFO, for instance, a person may issue an advertisement made in respect of securities which are intended to be disposed of only to professional investors (otherwise it would be an offence under section 103, SFO), the intermediaries are still required to comply with the Code when they carry on any regulated activities and serve their "professional investor" clients.
7. Furthermore, paragraph 5.3 of the Code applies to all intermediaries providing services to clients in derivative products, whether the clients are professional investors or not.
8. Paragraph 5.3 of the Code of Conduct provides –

"5.3 Know your client: derivative products

A licensed or registered person providing services to a client in derivative products, including futures contracts or options, or any leveraged transaction should assure itself that the client understands the nature and risks of the products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products."

9. Minibonds and the other Lehman-related structured products incorporate derivatives and paragraph 5.3 would have applied to require that any intermediary selling these products should have assured itself that the client understood the nature and risks of the products and had sufficient net worth to be able to assume the risks and bear the potential losses of trading in the



products – regardless of whether the person was a professional investor or an ordinary investor.

10. Accordingly, the distinction between professional investors and ordinary investors appears to be of little significance in the context of the matters under consideration by the Subcommittee.

“Professional investor” exemption in “dealing in securities” and “dealing in futures contracts”

11. Both “dealing in securities” and “dealing in futures contracts” are regulated activities and are defined in Part 2 of Schedule 5 to the SFO.
12. Subject to the important limitation mentioned in paragraph 13 herein, an intermediary may rely on the exemptions in the definitions of “dealing in securities” and “dealing in futures contracts” (please refer to the definitions in Part 2 of Schedule 5 to the SFO) such that the intermediary’s activities fall outside the ambit of those regulated activities where it, as principal, deals with a person who is a professional investor.
13. The exemptions referred to in the previous paragraph do not extend to the classes of persons specified in the PI Rules (please refer to section 3 of the PI Rules) such as the class of individuals referred to in paragraph 2 above. Accordingly, an intermediary cannot rely on the exemptions if he is dealing with an individual professional investor. In such circumstances, the relevant activities are “regulated activities” and the intermediary should observe the relevant legal and regulatory requirements under the SFO and the Code of Conduct in the usual way.