

1. The Administration/Securities and Futures Commission (SFC) is requested to:-

- (a) consider making it an explicit requirement in the Securities and Futures (Professional Investor) Amendment Rules 2011 (the Amendment Rules) or relevant legislation requiring intermediaries to comply with the relevant requirement under the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct) in dealing with/serving professional investors;**
- (b) consider making it an explicit requirement in the Amendment Rules or relevant legislation requiring the intermediaries to assess an investor's knowledge, expertise and investment experience prior to treating an investor as a Professional Investor;**

The current legal and regulatory regime in Hong Kong has a 3-level structure -

The first level is the primary legislation, Securities and Futures Ordinance (Cap 571) ("SFO"), which mainly sets out the key provisions governing the securities and futures industry.

The second level is the rules made under the SFO that prescribe requirements in subsidiary legislation.

The third level is the codes of conduct made under the SFO relating to the practices and standards with which intermediaries and their representatives are ordinarily expected to comply with in carrying on their regulated activities.

As the first and second levels are in the law and breaches of the law may lead to criminal sanctions, these provisions are carefully crafted and in statutory language. The third level, the Code of Conduct, is written in more layman language to facilitate intermediaries in understanding the requirements in their day-to-day operations.

In the context of the PI, the first level is the PI definition is in Schedule 1 to the SFO. This definition sets out specific types of

entities that are professional investors and empowers the SFC to make rules to prescribe persons as professional investors for the purpose of this definition.

The second level is the PI Rules which prescribe high net worth investors who meet specified monetary thresholds to be professional investors.

The third level is the Code. The Code does not provide a further legal definition of PI but it provides specific actions that an intermediary must go through when the intermediary wishes to waive certain Code requirements when it deals with a PI client (as defined under the PI Rules).

When breaches of the SFO and the Rules may lead to criminal sanctions, the Code of Conduct is underpinned by the disciplinary regime set out in Part IX of the SFO. Thus, in considering whether or not an intermediary has committed misconduct the SFC is required to have regard to applicable provisions of the Code of Conduct (section 193(3) of the SFO). Furthermore, a failure on the part of an intermediary to comply with the provisions of the Code of Conduct may be taken into account by the SFC in assessing whether the intermediary is a fit and proper person to be or remain licensed or registered (section 169(4) of the SFO). Disciplinary sanctions are set out under Part IX of the SFO, ranging from a public reprimand, through fines of up to \$10 million (or up to three times the profit made or loss avoided, whichever is greater), to suspension or revocation of the intermediary's license or registration.

Extracting certain elements from the Code of Conduct without the surrounding provisions may affect the totality of the regulatory requirements in the Code and disturb the existing balance of the regulatory regime and render it more difficult to administer. Also, such an amendment may necessitate consequential amendments to other parts of the SFO or subsidiary legislations, and the language to be used must be drafted very carefully to provide a high level of legal certainty as it would result in potential criminal sanctions.

Nevertheless, in view of Members' comments and concerns raised, we will review the PI regime with a view to consulting the market in 2012.

- (c) including in the Amendment Rules or relevant legislation the assessment/qualifying criteria similar to the “elective professional clients” adopted in the United Kingdom; and**

The criteria for “elective professional clients” in the United Kingdom were developed in accordance with the EU Markets in Financial Instruments Directive. They are specified in the Conduct of Business Sourcebook of the UK Financial Services Authority. As such, they are similar in effect to the provisions on professional investors as specified in the Code of Conduct here in Hong Kong.

- (d) introducing, in the long run, a licence regime for professional investors in respect of different financial products and markets by way of the issue of a licence or certificate to accord an investor with the status of a professional investor.**

This is a major proposal involving fundamental changes to the role of SFC as well as the existing market practice. We would need to study the proposal carefully before making any response. At this moment, we are not aware that any major overseas regulator makes an assessment of individual investors and grants a licence if they qualify as a professional investor.

2. The Administration/SFC is requested to explain the reasons and practical difficulties, if any, for not considering the suggestion in item 1 above; and advise whether any comparable jurisdictions have adopted the practice suggested in 1(d) above.

As mentioned in our response to (1) above, we consider it necessary to consider the implications carefully and consult the market before making a decision. We are prepared to study the proposal.

3. The Administration/SFC is requested to provide information on the different sanctions, criminal and/or civil liabilities for:

- (a) non-compliance with/breach of the legal requirements**

under the PI Rules or relevant legislation, including an intermediary treating an investor who has not met the minimum portfolio requirement under the Professional Investor Rules (PI Rules) as a Professional Investor; and

The PI Rules themselves contain no penalty provision. Rather, there are certain exemptions from compliance with particular provisions of the SFO and the Companies Ordinance when dealing with professional investors. These are, if an investor is a “professional investor”, the legal restrictions on issuance of advertisements in relation to investments (section 103 of the SFO), the making of unsolicited calls (section 174 of the SFO) and the communication of an offer in relation to securities (section 175 of the SFO) do not apply. In addition, the offering of any shares in (or debentures of) a company to professional investors is not subject to the prospectus regime under the Companies Ordinance. The failure to properly assess an investor as a professional investor under any of these provisions may result in criminal prosecution (e.g. a breach of section 103(1) of the SFO attracts a fine of up to \$500,000 and imprisonment for up to 3 years for conviction on indictment or a fine at level 6 and imprisonment for up to 6 months for summary conviction).

(b) non-compliance with/breach of the requirements set out in the Code of Conduct for dealing with/serving professional investors.

As indicated in the response to question 1, disciplinary sanctions are set out under Part IX of the SFO, ranging from a public reprimand, through fines of up to \$10 million (or up to three times the profit made or loss avoided, whichever is greater), to suspension or revocation of the intermediary’s licence or registration.

4. The Administration/SFC is requested to explain why qualifying criteria such as the assessment on the investor’s knowledge, expertise and investment experience and the written consent requirement as set out in the Code of Practice are not included in the definition of “Professional Investor” under the PI Rules.

As mentioned in (1) above, we would study Members’ suggestions of statutory codification of some of the requirements currently

contained in the Code of Conduct.

5. In relation to A2(d) in CB(1)313/11-12(01), the Administration's response to the list of follow-up actions arising from the meeting on 1 November 2011, advise: -

- (a) the disciplinary actions to be taken by the Hong Kong Monetary Authority (HKMA) where major breaches and non-compliances with regulatory requirements are identified;**
 - (b) under what circumstances would HKMA take disciplinary action against persons registered for conducting regulated activities; and**
 - (c) under what circumstances and on what grounds would HKMA refer cases of major breaches or non-compliance to SFC for enforcement action.**
- (a) The Monetary Authority ("MA") has the power to take disciplinary action against an executive officer ("EO") and/or a relevant individual ("Rel") of a registered institution, by withdrawing or suspending his consent for a person to be an EO or removing or suspending some or all of a Rel's relevant particulars from the MA's register.
- (b) The MA may initiate an investigation on the basis of information obtained from various sources, including complaints, enquiries, internal referrals from staff of the MA or registered institutions and external referrals from other regulators, including the Securities and Futures Commission ("SFC"). When an investigation has been completed, the MA will consider whether or not there is sufficient evidence to support a finding that an EO or a Rel is guilty of misconduct and/or is not a fit and proper person.

The MA would commence his disciplinary process when he considers that the evidence supports a finding that the EO or Rel is guilty of misconduct and/or is not a fit and proper person and, after considering all the circumstances of the case concerned, considered that there are sufficient grounds to take disciplinary action against that person.

- (c) The MA would refer a case to the SFC for disciplinary actions when, after investigation, if he considers that the evidence supports a finding that the EO or Rel is guilty of misconduct and/or is not a fit and proper person and, after taking into account all the circumstances of the case concerned, considers that there are sufficient grounds to take disciplinary action against that person and the sanctions available to the SFC, including reprimand, fine and/or prohibition order, are appropriate.