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Dear Sirs

"Professional Investor" definition

We are writing on behalf of the Alternative Investment Management Association (AIMA) in connection with a recently proposed motion to amend the definition of "professional investor" in the Securities & Futures Ordinance ("**SFO**") as it relates to high net worth investors as defined in the Securities and Futures (Professional Investor) Rules ("**PI Rules**").

Currently, certain high net worth investor are or can be characterized as "professional investors" under the PI Rules provided they satisfy certain minimum portfolio (HK\$8 million) or total asset (HK\$40 million) tests. The PI Rules then set out specific methods or evidential requirements to ascertain whether an investor does indeed have the required portfolio or assets to be classified as a professional investor.

Following a public consultation exercise, the Securities and Futures (Professional Investor) (Amendment) Rules 2011 (the "**Amendment Rules**") was made which allows market participants to use alternative methods (in addition to those prescribed in the PI Rules) to ascertain whether an investor is a professional investor for the purposes of the PI Rules. These Amendment Rules will come into operation on 16 December 2011 and are welcome.

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It is worth noting that by treating an investor as a professional investor under the PI Rules for the purposes of the SFO, the strict legal prohibitions on offering, marketing or issuing advertisements in relation to investments that are not SFC authorized, and the prospectus requirements under the Companies Ordinance in relation to the offer of shares or debentures in a company, cease to apply. (This is commonly referred to as the professional investor private placement safe harbour). Hedge funds like many other investment products are offered in Hong Kong in reliance on this professional investor private placement safe harbour, whether directly or via other distribution channels such as private banks. Without this safe harbour most unauthorized investment products cannot be offered or sold in Hong Kong.

However, and importantly, unless the intermediary offering or marketing an investment product in reliance on the professional investor private placement safe harbour follows the knowledge, expertise and investment experience procedural requirements as set out in Chapters 15.3 and 15.4 of the SFC Code of Conduct for Persons Licensed by or Registered with the SFC (the "**Code of Conduct**") in relation to a "professional investor" under the PI Rules, the relevant intermediary remains subject to the Code of Conduct requirements for "know your client" (or KYC) and ensuring suitability when giving advice or recommendations to clients or when soliciting clients to make an investment. The relevant intermediary must also comply with the new requirements, contained in Chapter 5.1A of the Code of Conduct, with respect to derivatives knowledge. In this respect, the Amendment Rules make no change to the levels of investor protection afforded to professional investors under the SFC's conduct of business rules, as set out in the Code of Conduct.

We would also note that the professional investor private placement safe harbour has been a key feature of the Hong Kong regulatory framework for many years. In fact, its significance has increased following the recent amendments to the SFO and Companies Ordinance relating to "structured products", which effectively removed the minimum allotment/subscription safe harbour and the statutory 50 persons safe harbour for all investments other than shares or debentures in companies. It is noteworthy that these recent reforms were only introduced following an extensive public consultation.

We understand that the current motion proposes to amend the definition of "professional investor" in the PI Rules to impose:

- a 40 transactions per year test
- two years experience in relevant markets test
- a requirement for an investor's knowledge and experience to be assessed, such that he/she can make his/her own investment decision.

We would comment:

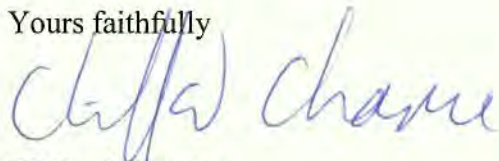
1. There has been no public consultation process on these proposed amendments, which have far reaching undesirable consequences for the financial services industry and investors alike, as discussed below. We also note that section 378 of the SFO would require the SFC to consult publicly on any such proposed amendments.
2. Technically, revising the definition of professional investor to incorporate a process, as suggested, does not actually work as a matter of interpretation.
3. There are a number of undesirable consequences that would flow from this amendment including:
 - (i) There would be a significant restriction on the ability of investors to buy investment products. As an investor, unless you satisfy the proposed expertise and investment experience tests, you will not be a professional investor by definition. Accordingly, your investment universe would be limited to SFC authorized investment products and shares/debentures for which a Companies Ordinance compliant prospectus has been registered with the Companies Registry; this includes, for example, any investor who has only entered into up to 39 transactions in the last year, regardless of their knowledge and expertise.
 - (ii) In practice, while many intermediaries do rely heavily on the professional investor private placement safe harbour to be able to offer and actually sell investment products to their clients, those same intermediaries do not classify their clients as professional investors for the purposes of Chapter 15.3 of the Code of Conduct. Instead they carry out KYC and ensure suitability of an investment product recommended for the client. The reasons for this are many. The reasons include (a) few clients do actually satisfy the requirements set out in Chapter 15.3 of the Code of Conduct, for example, few clients actually carry out 40 transactions a year; (b) clients want to have the freedom to purchase a wide range of products relying on the professional investor private placement safe harbour, but also want to ensure they are treated like a retail client for the purposes of the KYC and suitability requirements under the Code of Conduct; and (c) clients want to keep their transaction history confidential. If the proposals were implemented, intermediaries would simply not be able to rely on the professional investor private placement safe harbour to offer and sell a wide range of investment products to their clients wishing to have access to such products.

- (iii) Taking (i) and (ii) together, it would be virtually impossible to offer hedge funds in Hong Kong if these proposals were implemented, other than to a very small segment of the Hong Kong investor base (regardless of their wealth).
4. The failures relating to Lehman mini bonds and accumulators largely arose because the KYC and suitability requirements contained in the Code of Conduct had not been sufficiently rigorously applied. They did not arise because of any failure in the "professional investor" definition and compliance with the professional investor private placement safe harbour.

For the reasons outlined above, the proposed amendment to the definition of professional investor as contained in the PI Rules would not only be highly undesirable for Hong Kong investors as it restricts their freedom to invest in alternative investment products, as well as Hong Kong as a financial centre, it adds no additional investor protection over and above what is already contained in the Code of Conduct.

In the event that there is appetite to revisit the definition of "professional investor" in the PI Rules, then we would urge a wide public consultation beforehand consistent with section 378 of the SFO.

Yours faithfully



Clifford Chance