



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

Consultation Conclusions on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules

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Executive Summary

1. On 4 October 2010, the Securities and Futures Commission (**SFC**) issued a Consultation Paper on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules (**Consultation Paper**) for a one-month consultation period ending on 5 November 2010. The Consultation Paper invited comments on the proposals to refine the evidential requirements for ascertaining whether a person meets the relevant assets or portfolio threshold so as to qualify as a professional investor under the Securities and Futures (Professional Investor) Rules (Cap. 571D) (**Professional Investor Rules**).
2. The purpose of the proposals is to create more flexibility by adopting a principles-based approach whereby firms may use methods that are appropriate in the circumstances to satisfy themselves that an investor meets the relevant assets or portfolio threshold at the relevant date to qualify as a professional investor and firms that wish to continue with the existing practices may use the existing methods set out in sections 3(a) to 3(c) of the current Professional Investor Rules.
3. The SFC received a total of 16 written submissions, mainly from market participants and professional bodies. Most respondents supported, in principle, the adoption of a principles-based approach, subject to comments on specific proposals. Comments revolved around the following main areas:
 - (a) whilst respondents generally supported the proposal to adopt a principles-based approach for evidencing an investor's status as a professional investor, they requested for:
 - (i) additional guidance on the standard and methods that should be taken in assessing the assets and portfolio levels;
 - (ii) additional guidance on circumstances under which it would be appropriate to accept self-certification from investors and provision of a sample statement or information checklist for self-certification; and
 - (iii) incorporation of the modifications (**Modifications**) to the requirements under the Professional Investor Rules that have been previously granted by the SFC pursuant to section 134 of the Securities and Futures Ordinance (**SFO**);
 - (b) most respondents agreed to the use of "relevant date" as the time reference for ascertaining whether an investor meets the relevant assets or portfolio threshold to qualify as a professional investor. However, some respondents commented that it is logistically impracticable to obtain evidence to ascertain an investor's assets or portfolio value on a specific date and called for relaxation of this requirement; and
 - (c) whilst respondents agreed with the proposed extension of the scope of section 3(d) of the Professional Investor Rules, they called for further extensions by including additional types of corporations as professional investors.
4. The SFC has considered all responses and comments received in detail and has decided to proceed with the proposed amendments to the Professional Investor Rules on the following basis:



- (a) to proceed with the proposals in the Consultation Paper:
 - (i) to adopt a principles-based approach so that firms may use methods that are appropriate in the circumstances to satisfy themselves that an investor meets the relevant assets or portfolio threshold at the relevant date to qualify as a professional investor;
 - (ii) to preserve the existing methods set out in sections 3(a) to 3(c) of the current Professional Investor Rules;
 - (iii) to use “relevant date” as the time reference for ascertaining whether an investor meets the relevant assets or portfolio threshold to qualify as a high net worth professional investor; and
- (b) to further extend the scope of section 3(d) of the existing Professional Investor Rules by extending its application to all three types of high net worth professional investors under sections 3(a) to 3(c), namely trust corporations, individuals and corporations/partnerships.

5. Changes will be made to the indicative draft of the amendment rules to reflect the above. The revised amendment rules will be gazetted in due course following review by the Department of Justice.
6. With regards to the respondents’ requests for additional guidance and further relaxation of the requirements under the Professional Investor Rules, the SFC is of the view that it is not necessary/appropriate to adopt such suggestions.
7. The main comments and concerns raised, together with the SFC’s responses to these, are discussed in greater detail below. A list of the respondents who sent in submissions is at **Appendix A** to this paper, and the full text of the submissions can be viewed at the SFC’s website at www.sfc.hk. Of the 16 respondents who made submissions, two requested that their submissions be published without disclosing their names.



Comments received and the SFC's responses

Proposed principles-based approach

The SFC's proposal in the Consultation Paper:

8. The existing Professional Investor Rules set out specific evidential requirements for ascertaining the relevant assets or portfolio threshold for high net worth professional investors. In view of the comments from market participants that such evidential requirements are limited in scope and provide little flexibility, the SFC proposed to amend the Professional Investor Rules to create more flexibility.
9. The SFC proposed to adopt a principles-based approach so that firms may use methods that are appropriate to satisfy themselves that an investor meets the relevant assets or portfolio threshold at the relevant date to qualify as a professional investor. The SFC will not specify the methods by which firms can satisfy themselves that their clients have the required assets or portfolio levels at the relevant date. The SFC expects firms to keep proper records of their assessment process so as to demonstrate that they have exercised professional judgement and have reached a reasonable conclusion that their clients meet the relevant thresholds.

Public comments:

10. Most respondents welcomed and supported the SFC's proposal to adopt a principles-based approach so that firms may use methods that are appropriate in the circumstances to establish the different types of high net worth professional investors at the relevant date. However, some respondents requested additional guidance on the proposed requirements or incorporation of the Modifications into the Professional Investor Rules.

Assessment methods

11. Some respondents sought the SFC's guidance on the standard and methods that should be used in assessing the assets and portfolio levels. They also sought the SFC's confirmation on whether certain types of documents or information (such as company search on corporate client) are acceptable evidence to ascertain an investor's status as a professional investor and suggested that non-exhaustive examples of acceptable documents should be provided.

Self-certification

12. Some respondents sought the SFC's guidance on the circumstances under which self-certification by a client would be an acceptable means to establish the relevant assets or portfolio level of such client at the relevant date.
13. One respondent suggested that the SFC should issue a sample statement for self-certified professional investor or provide a checklist of information to be included in such statement.
14. There was also a suggestion that the investors should give an undertaking to notify the firms promptly whenever he ceases to meet the relevant assets or portfolio threshold to be a professional investor.



Incorporation of Modifications

15. Over the past years, the SFC has received applications for and has granted a number of Modifications to the requirements under the Professional Investor Rules to individual market participants at their request pursuant to section 134 of the SFO (e.g., allowing the portfolio of a corporation that is wholly owned by an individual and the principal businesses of which include the holding of investments to be taken into account for the purpose of ascertaining whether such individual investor has the required portfolio under section 3(b) of the Professional Investor Rules). Some respondents commented that the Modifications that are of general application to the market should be incorporated into the Professional Investor Rules. One respondent expressed that the incorporation of the Modifications into the Professional Investor Rules would standardise the Modifications previously sought by market participants and thus increase consistency in the market.

The SFC's response:

16. Based on the general support for this proposal, the SFC intends to proceed with its proposal to adopt a principles-based approach so that firms may use methods that are appropriate in the circumstances to establish the different types of high net worth professional investors at the relevant date.

Assessment methods

17. Whilst the SFC believes that the issue of guidance on the standard and methods to assess the assets and portfolio levels may provide more certainty to the market, the prescription of examples of acceptable documents/assessment methods goes against the philosophy of a principles-based approach underlying the proposed amendments to the Professional Investor Rules. The SFC intends to leave the flexibility to market participants to decide on what methods to use to establish an investor's status as long as those methods are appropriate in the circumstances and proper records of the assessment process are kept.

Self-certification

18. The SFC understands market participants' concern as to the circumstances under which self-certification by a client would be an acceptable means to establish the relevant assets or portfolio level of such client to qualify as a professional investor. However, the SFC believes that firms should have sufficient knowledge about their clients for making such decision after having complied with the "know your client" requirements under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission. Therefore, the SFC takes the view that additional guidance in this regard is not necessary.
19. The SFC wishes to stress that whilst the SFC will not rule out the possibility of accepting investors' declaration as one of the assessing methods, it should be restricted only to occasions that are appropriate in the circumstances.



Incorporation of Modifications

20. In respect of the suggestion to incorporate the Modifications that are of general application to the market into the Professional Investor Rules, the SFC considers it inappropriate to do so for the following reasons:
- (a) all previously granted Modifications were considered upon application by firms under section 134 of the SFO, and were granted with regard to the specific circumstances provided in each application. The SFC has no intention to change the current practice of handling applications for Modifications; and
 - (b) the SFC believes that the flexibility provided by the proposed principles-based approach has effectively addressed market participants' concerns with the practical difficulties in ascertaining their clients as professional investors under the Professional Investor Rules.



Preservation of existing methods

The SFC's proposal in the Consultation Paper:

21. To enable firms that wish to continue with the existing practices to do so, the SFC proposed to preserve the existing methods set out in sections 3(a) to 3(c) of the current Professional Investor Rules.

Public comments:

22. Most respondents supported the preservation of the existing methods in the current Professional Investor Rules.

The SFC's response:

23. In view of the general support, the SFC will pursue this proposal. Although market participants may use methods that are appropriate in the circumstances to ascertain the relevant assets or portfolio threshold for high net worth professional investors under the proposed principles-based approach, the SFC believes that it is desirable to preserve the existing methods in the current Professional Investor Rules as some market participants find the existing methods satisfactory and would want to continue using them.



Use of “relevant date” as the time reference for ascertaining whether an investor meets the relevant assets or portfolio threshold to qualify as a professional investor

The SFC’s proposal in the Consultation Paper:

24. The SFC proposed to use “relevant date” as the time reference for ascertaining whether a high net worth professional investor meets the relevant assets or portfolio threshold. The term “relevant date” is defined in section 2 of the current Professional Investor Rules.

Public comments:

25. Most respondents agreed to the use of “relevant date” as the time reference for ascertaining whether an investor meets the relevant assets or portfolio threshold to qualify as a professional investor. However, some respondents commented that it is logistically impracticable to obtain evidence to ascertain an investor’s assets or portfolio value on a specific date and called for relaxation of this requirement, such as:
- (a) allowing supporting evidence to be dated prior to the relevant date (e.g., within a reasonable period of time before the relevant date);
 - (b) changing the time reference to “any time within 12 months before the relevant date”; and
 - (c) including “securities account opening date” in the definition of the “relevant date”.

The SFC’s response:

26. The SFC wishes to clarify the general requirement under the proposal – an investor will have to meet the relevant assets or portfolio threshold at the relevant date in order to qualify as a professional investor. The proposed principles-based approach does not prescribe the process or evidence that market participants must take or obtain on any specific date. Instead, it will create more flexibility for market participants to take steps that are appropriate in the circumstances to satisfy themselves that their clients have the requisite assets or portfolio levels at the relevant date to be treated as professional investors.
27. In the event that a market participant finds it difficult to ascertain an investor’s status on the relevant date, the market participant can always resort to using the existing methods (which allows specific documentary evidence to be collected prior to the relevant date) to establish whether an investor qualifies as a professional investor under the Professional Investor Rules.
28. In light of the above, the SFC will proceed with the original proposal to use the “relevant date” as the time reference for ascertaining whether an investor meets the relevant assets or portfolio threshold.



Extension of the scope of section 3(d) of the existing Professional Investor Rules

The SFC's proposal in the Consultation Paper:

29. The SFC proposed to extend the scope of section 3(d) of the existing Professional Investor Rules so that any corporation which is wholly owned by one or more individuals or corporations/partnerships where each of those individuals or corporations/partnerships would qualify as a professional investor under section 3(b) or section 3(c) (as the case may be) of the Professional Investor Rules, will qualify as a professional investor.

Public comments:

30. Whilst most respondents agreed with the proposed extension of the scope of section 3(d) of the Professional Investor Rules, some respondents called for further extensions by including additional types of corporations as professional investors. These corporations include:
- (a) a corporation whose principal business is to hold investments and that is owned by a high net worth individual together with associates and other broader family members (such as a sibling and/or a parent);
 - (b) a corporation that is wholly or beneficially owned by one or more person, each of whom falls within the definition of "professional investor" under paragraphs (a) to (i) of section 1 in Part 1 of Schedule 1 to the SFO;
 - (c) a corporation that is wholly or beneficially owned by: (i) a trust corporation that falls within the description in section 3(a) of the Professional Investor Rules; or (ii) a trust, the trustee of which satisfies the requirements of a professional investor corporation or partnership, as described in section 3(c) of the Professional Investor Rules;
 - (d) a corporation that is wholly owned by qualifying individuals and the "primary purpose" (as opposed to "sole business") of which is to hold investments;
 - (e) a corporation wholly owned by a professional investor that also engages in financial service business; and
 - (f) a corporation which is indirectly (and wholly) owned by any qualifying individual or corporation/partnership.

The SFC's response:

31. Having considered the responses received, the SFC believes that it is logical and fair to extend the application of section 3(d) of the Professional Investor Rules to all three types of high net worth investors under sections 3(a) to 3(c), namely trust corporations, individuals and corporations/partnerships. In other words, the scope of section 3(d) of the Professional Investor Rules will be further extended so that any corporation which is wholly owned by one or more trust corporations, individuals or corporations/partnerships where each of those trust corporations, individuals or corporations/partnerships would qualify as a professional investor under section 3(a), section 3(b) or section 3(c) (as the case may be) of the Professional Investor Rules, will qualify as a professional investor.



The proposed amendments to the Professional Investor Rules will be revised accordingly to reflect such change.

32. Other than the one additional amendment referred to in paragraph 31 above, the SFC considers it appropriate to maintain the proposed scope of extension of section 3(d) of the Professional Investor Rules as set out in the Consultation Paper. The other extensions suggested by respondents are not necessary and go beyond the scope of the current consultation. The SFC believes that the flexibility provided by the proposed principles-based approach has effectively addressed market participants' concerns with the practical difficulties in ascertaining their clients as professional investors under the current Professional Investor Rules.



Drafting comments on the indicative draft of the proposed amendments to the Professional Investor Rules in Appendix A to the Consultation Paper

33. A number of specific drafting suggestions were provided.
34. To the extent that the suggestions would better reflect the policy intentions (as set out above), they will be reflected in the revised draft of the amendments to the Professional Investor Rules. In particular, section 3(d) will be amended to clarify that the time for ascertaining whether the corporation qualifies as a professional investor should be at the “relevant date”.
35. The SFC will adopt the proposed amendments to the Professional Investor Rules as set out in the Consultation Paper, with revisions as discussed in paragraphs 31 and 34. The revised amendment rules will be gazetted in due course following review by the Department of Justice.



Other matters

Other suggestions relating to the professional investor regime

36. Respondents have raised suggestions in relation to elements other than the evidential requirements under the professional investor regime (e.g., the inclusion of any parent of an individual in the definition of “associate”). Since the current consultation exercise is meant to be a review of the evidential requirements under the Professional Investor Rules only, such suggestions go beyond the scope of this consultation exercise and will not be adopted.

Status of existing Modifications / Future applications for Modification

37. One respondent asked whether (i) Modifications that have been granted as of the date of amendment to the Professional Investor Rules will continue to apply after such amendment; and (ii) an application for a Modification or waiver of the requirements of the Professional Investor Rules under section 134 of the SFO will continue to be permissible after the amendment to the Professional Investor Rules.
38. The SFC wishes to clarify that the revised Professional Investor Rules would not affect the status of Modifications previously granted.
39. Market participants should note that if a modification application is in relation to sources/types of information and the requested treatment is in fact consistent with the amended Professional Investor Rules, it is not necessary or appropriate for a market participant to make such an application. However, the SFC will continue to consider granting modifications in relation to other requirements of the Professional Investor Rules under section 134 of the SFO.¹

¹ See paragraph 20 of this conclusions paper.



Conclusion and way forward

40. Having considered the responses received and the regulatory objectives of the proposals, the SFC will implement the proposals and adopt the proposed amendments to the Professional Investor Rules as set out in the Consultation Paper, with revisions as discussed in paragraphs 31 and 34 above. The revised amendment rules will be gazetted in due course following review by the Department of Justice.
41. The SFC would like to take this opportunity to thank all respondents who have sent in submissions for their time, effort and contribution.



Appendix A

List of respondents

(in alphabetical order)

1. Allen & Overy
2. Clifford Chance
3. CompliancePlus Consulting Limited
4. Corporate Support (HK) Limited
5. Hong Kong Institute of Certified Public Accountants
6. Hong Kong Investment Funds Association
7. Hong Kong Securities Professionals Association
8. Institute of Financial Planners of Hong Kong
9. ipac financial planning Hong Kong Limited
10. Linklaters responded on behalf of 12 institutions:
 - (a) Bank of America Merrill Lynch
 - (b) Barclays Capital Asia Limited
 - (c) Citigroup Global Markets Asia Limited
 - (d) Credit Suisse (Hong Kong) Limited
 - (e) Goldman Sachs (Asia) LLC
 - (f) Hong Kong and Shanghai Banking Corporation Limited
 - (g) J. P. Morgan Chase
 - (h) Macquarie Capital Securities Limited
 - (i) Morgan Stanley Asia Limited
 - (j) Nomura International (Hong Kong) Limited
 - (k) The Royal Bank of Scotland plc
 - (l) UBS AG
11. Managed Funds Association
12. Suen Chi Wai



13. The Hong Kong Association of Banks
14. The Law Society of Hong Kong
15. Two respondents have requested that their submissions be published without disclosing their names