

LEGISLATIVE COUNCIL BRIEF

SECURITIES AND FUTURES ORDINANCE (CAP. 571)

SECURITIES AND FUTURES (PROFESSIONAL INVESTOR) (AMENDMENT) RULES 2011

INTRODUCTION

1. At its meeting on 22 August 2011, pursuant to section 397(1) of the Securities and Futures Ordinance (Cap. 571) ("SFO"), the Securities and Futures Commission ("Commission") made the Securities and Futures (Professional Investor) (Amendment) Rules 2011 ("Amendment Rules") at the Annex. The Commission proposes to prescribe additional methods of ascertaining whether an investor is a professional investor under section 3(a), (b) and (c) of the Securities and Futures (Professional Investor) Rules (Cap. 571D) ("Rules") and to prescribe additional types of corporations as professional investors under section 3(d) of the Rules.

BACKGROUND

2. There are two types of professional investors under the SFO. The first type are specified entities set out in paragraphs (a) to (i) of the definition of "professional investor" in Part 1 of Schedule 1 to the SFO. The second type are persons belonging to a class which is prescribed under the Rules ("high net worth professional investors").
3. There are four types of high net worth professional investors under the Rules, namely:-
 - (a) a trust corporation having been entrusted with total assets of not less than \$40 million (or the equivalent in foreign currency)¹;
 - (b) an individual (either alone or with his or her associates on a joint account) having a portfolio comprising securities, certificate of deposit issued by a bank and/or money held by a custodian ("portfolio") of not less than \$8 million (or the equivalent in foreign currency)²;
 - (c) a corporation or partnership having either a portfolio of not less than \$8 million (or the equivalent in foreign currency) or total assets of not less than \$40 million (or the equivalent in foreign currency)³; and
 - (d) a corporation the sole business of which is to hold investments and which is wholly owned by an individual (either alone or with his or her associates on a joint account) having a portfolio of not less than \$8 million (or the equivalent in foreign currency)⁴.
4. The Rules set out specific evidential requirements to ascertain whether an investor has the required assets or portfolio. For example, evidence of an individual investor's portfolio must be in the form of a certificate issued by an auditor or a certified public accountant within 12 months before the relevant date⁵, or by referring to one or more custodian statements issued within 12 months

¹ Section 3(a) of the Rules.

² Section 3(b) of the Rules.

³ Section 3(c) of the Rules.

⁴ Section 3(d) of the Rules.

⁵ As defined by section 2 of the Rules.

before the relevant date.

5. Market participants have expressed that the evidential requirements under the Rules are very specific and provide little flexibility. Therefore, while the required assets and portfolio thresholds prescribed under the Rules will remain unchanged, the Commission proposes to refine the evidential requirements to create more flexibility.
6. The current proposal to refine the evidential requirements under the Rules does not seek to revisit the review of the professional investor regime under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("Code of Conduct") and the minimum portfolio threshold for an individual investor to be a professional investor both of which were the subjects of a separate consultation exercise concluded in May 2010. Having considered all the public comments received in response to that consultation exercise, the Commission revised the assessment criteria for an investor to be a "professional investor" under the Code of Conduct and concluded that it is in the best interests of the investing public to maintain the existing minimum portfolio threshold under the Rules.

SUMMARY OF THE PROPOSED AMENDMENTS

7. In addition to using the existing methods to ascertain whether an investor has the required assets or portfolio prescribed under the Rules, the Amendment Rules will allow market participants to use other methods that are appropriate in the circumstances. The Commission expects market participants to keep proper records of their assessment process so as to demonstrate that they have exercised professional judgment to reach a reasonable conclusion that each particular high net worth professional investor has the required assets or portfolio prescribed under the Rules.⁶
8. Section 3(d) of the Rules will prescribe additional types of corporations as high net worth professional investors so that any corporation the sole business of which at the relevant date is to hold investments and which at the relevant date is wholly owned by one or more high net worth professional investors as provided in section 3(a), (b) or (c) of the Rules will be a high net worth professional investor.

THE AMENDMENT RULES

9. The Amendment Rules are attached at the Annex. The main provisions of the Amendment Rules are:-
 - (a) Clause 3(1) extends section 3(a) of the Rules to prescribe that a trust corporation is a professional investor if it has been entrusted with the required assets at the relevant date, whilst preserving the existing methods of evidencing such assets.
 - (b) Clause 3(3) extends section 3(b) of the Rules to prescribe that an individual is a professional investor if he or she (either alone or with his or her associates on a joint account) has the required portfolio at the relevant

⁶ Pursuant to section 3(2)(a) of, and paragraph 4(a) of the Schedule to, the Securities and Futures (Keeping of Records) Rules (Cap. 571O), in respect of a client who is a professional investor, an intermediary shall (in relation to the businesses which constitute any regulated activities for which it is licensed or registered) keep records showing particulars sufficient to establish that the client is a professional investor.

date, whilst preserving the existing methods of evidencing such portfolio.

- (c) Clause 3(4) extends section 3(c) of the Rules to prescribe that a corporation or partnership is a professional investor if it has the required assets or portfolio (as the case may be) at the relevant date, whilst preserving the existing methods of evidencing such assets or portfolio (as the case may be).
- (d) Clause 3(5) extends section 3(d) of the Rules to prescribe as a professional investor any corporation the sole business of which at the relevant date is to hold investments and which at the relevant date is wholly owned by one or more trust corporations, individuals (either alone or with any of their associates), corporations or partnerships (where they are prescribed as professional investors within the scope of section 3(a), (b) or (c) of the Rules (as the case may be)).

PUBLIC CONSULTATION

- 10. On 4 October 2010, the Commission issued a Consultation Paper on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules. The Commission published the consultation conclusions on 23 February 2011. There were a total of 16 responses, mainly from market participants and professional bodies. Most respondents supported, in principle, the proposed amendments to the Rules, subject to comments on specific proposals.

FINANCIAL AND STAFFING IMPLICATIONS

- 11. There are no financial or staffing implications for the Commission.

LEGISLATIVE TIMETABLE

- 12. The legislative timetable is as follows:

Publication in the Gazette	9 September 2011
Tabling in the Legislative Council	12 October 2011

COMMENCEMENT

- 13. The Amendment Rules will come into operation on 16 December 2011.

PUBLICITY

- 14. A press release was issued upon gazettal of the Amendment Rules on 9 September 2011. A spokesman is available to handle media enquiries.

ENQUIRIES

- 15. Any enquiries on this brief may be addressed to Ms Alexandra Yeong, Director (at 2840 9247) or Ms Joanne Lam, Manager (at 2840 9536), both of the Corporate Finance Division of the Commission.

The Securities and Futures Commission

14 September 2011