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**Subcommittee on Securities and Futures (Professional Investor)
(Amendment) Rules 2018**

Background Brief

Purpose

This paper provides background information on the Securities and Futures (Professional Investor) (Amendment) Rules 2018 ("the Amendment Rules"). It also summarizes the views and concerns expressed by members when the Panel on Financial Affairs ("FA Panel") was consulted on the legislative proposals at the meeting on 15 May 2018.

Background

2. "Professional investor" is defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) ("SFO") to include any intermediary, authorized financial institution, insurer, collective investment scheme, registered provident fund, retirement scheme, etc., and any person of a class prescribed by rules under section 397 of SFO (i.e. the Securities and Futures (Professional Investor) Rules (Cap. 571D) ("the PI Rules")). Under the professional investor regime, certain requirements of SFO imposed on intermediaries may be dis-applied when intermediaries are serving professional investors as such investors are generally regarded as more sophisticated who are generally more capable of protecting their interests.

3. The PI Rules prescribe the following persons as professional investors under SFO:

- (a) any trust corporation with total assets of not less than \$40 million;

- (b) any individual, either alone or with any of his/her associates¹ on a joint account, having a portfolio of not less than \$8 million;
- (c) any corporation or partnership having a portfolio of not less than \$8 million or total assets of not less than \$40 million; and
- (d) any corporation whose sole business is to hold investments and which is wholly owned by (a), (b) and/or (c) above.

4. The PI Rules also specify the kinds of documents that can be relied upon as evidence in ascertaining compliance with the relevant monetary threshold, which include:

- (a) the most recent audited financial statement prepared within 16 months before the relevant date for trust corporations, corporations or partnerships;
- (b) certificates issued by auditors or Certified Public Accountants ("CPAs") within 12 months before the relevant date for individuals; and
- (c) custodian statements issued within 12 months before the relevant date for trust corporations, corporations, partnerships or individuals.

5. Over the years, the Securities and Futures Commission ("SFC"), on request by intermediaries, has granted around 40 modifications to relax some requirements of the PI Rules with a view to improving the operational efficiency of the professional investor regime without compromising investor protection. SFC considers it timely and appropriate to update the PI Rules by incorporating the modifications granted. SFC issued a public consultation paper on its proposed amendments to the PI Rules on 1 March 2017. According to SFC, the respondents were generally supportive of the proposals.

The Securities and Futures (Professional Investor) (Amendment) Rules 2018

6. The Amendment Rules are made by SFC under section 397(1) of SFO to amend the PI Rules to expand the types of individuals and corporations that are to be regarded as professional investors, and the records which may be considered in

¹ The existing Securities and Futures (Professional Investor) Rules (Cap. 571D) define the term "associate" as the spouse or any child of an individual.

ascertaining whether a person is a professional investor. The main provisions are summarized as follows:

- (a) in determining whether an individual qualifies as a professional investor, an individual's share² of a portfolio jointly held with persons other than his/her associate, and the portfolio of an investment holding corporation wholly owned by the individual, may also be taken into account in calculating the individual's portfolio;
- (b) a corporation qualifies as a professional investor if its principal business is investment holding and it is wholly owned by one or more professional investors qualified either under the "professional investor" definition in Part 1 of Schedule 1 to SFO, or the PI Rules; and
- (c) in ascertaining the size of the portfolio or total assets of individuals, corporations, trust corporations or partnerships, one may refer to the public filings³ submitted by them or on their behalf, or certificates issued by custodians, in addition to other forms of acceptable evidence.⁴

7. The Amendment Rules were gazetted on 18 May 2018 and tabled at the Legislative Council meeting of 23 May 2018 for negative vetting. The Amendment Rules will come into operation on 13 July 2018.

Major views and concerns expressed by Members

8. FA Panel was briefed by the Administration on the proposed amendments to the PI Rules at the meeting on 15 May 2018. The views and concerns expressed by members at the meeting are summarized in the ensuing paragraphs.

9. Panel members asked about the details of enquiries intermediaries were expected to make in ascertaining an individual's share of a portfolio held in a joint

² An individual's share of a portfolio on a joint account with persons other than his/her associate is the individual's share as specified in a written agreement among the account holders or, in the absence of such agreement, an equal share of the portfolio.

³ Under section 3 of the Securities and Futures (Professional Investor) (Amendment) Rules 2018, "public filing" means a document submitted under the legal or regulatory requirements in Hong Kong or elsewhere to a person or body who has a duty to publish the document to, or make it available for inspection by, members of the public.

⁴ Audited financial statements, custodian statements, and an auditor/accountant's certificates.

account with non-associates when determining whether the individual met the monetary threshold as a professional investor.

10. SFC advised that according to the Code of Conduct for Persons Licensed by or Registered with SFC ("Code of Conduct"), a licensed or registered person should take all reasonable steps to establish a client's financial situation. When determining whether an individual could meet the threshold as a professional investor, intermediaries could apply the reasonable steps as appropriate including making enquiries or requiring a client to fill in a questionnaire regarding his/her financial situation, etc., to ascertain the individual's share of a portfolio held in a joint account with non-associates.

11. Some Panel members called on the Administration to strengthen investor education with a view to enhancing investors' understanding of the rights and obligations of professional investors. SFC responded that professional investors were allowed to participate in private placement activities and according to the Code of Conduct, intermediaries should remind professional investors of the risks involved. SFC would continue to cooperate with the Investor Education Centre in strengthening investor education in this regard.

12. Under the existing professional investor regime, intermediaries could dis-apply certain requirements when they served professional investors because the latter were considered to be more sophisticated investors and could better protect themselves. As more people would qualify as professional investors upon implementation of the proposals, Panel members asked if SFC would conduct regular review of the professional investor regime to ensure its healthy development. Regarding the proposal to expand the definition of corporations as professional investors to include a corporation if its principal business was investment holding, members enquired about the details on "principal business", and whether there would be any specific timeframe set for holding investments as a corporation's principal business.

13. SFC responded that it would conduct on-site inspections to intermediaries on a continuous basis to ensure their compliance with the relevant regulatory requirements, and had been undertaking regular reviews of the PI Rules since its first promulgation in 2003. Regarding a corporation's principal business under the proposed amendments, SFC advised that a corporation would qualify as a professional investor if its principal business was investment holding at the relevant date on which the offer was made and was wholly owned by one or more professional investors.

Latest development

14. At the House Committee meeting on 25 May 2018, Members agreed to form a subcommittee to study the Amendment Rules.

References

15. A list of relevant papers is in the **Appendix**.

Council Business Division 1
Legislative Council Secretariat
31 May 2018

List of relevant papers

Date	Event	Paper
1 March 2017	Consultation paper on the proposed amendments to the Securities and Futures (Professional Investor) Rules issued by the Securities and Futures Commission	Consultation paper Consultation conclusions
15 May 2018	Meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)926/17-18(06))
23 May 2018	The Securities and Futures (Professional Investor) (Amendment) Rules 2018 were tabled in the Legislative Council	The Rules Legal Service Division Report (LC Paper No. LS61/17-18)