

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

**Response to follow-up actions  
arising from the discussion at the meeting on 1 June 2018**

This paper sets out the responses of the Government and the Securities and Futures Commission (“SFC”) to the issues raised by Members in relation to the Securities and Futures (Professional Investor) (Amendment) Rules 2018 (“the Amendment Rules”) at the meeting of the Subcommittee on 1 June 2018.

**Corporate professional investors (“PIs”)**

2. Please refer to the **Annex** for tables and diagrams setting out the circumstances under which a corporation can be qualified as a PI, including a corporation as defined under the existing paragraph (i) of the definition of PI under Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) (“SFO”).

**Assessment of corporate PIs**

3. As part of the know-your-client (“KYC”) procedures, an intermediary should collect information about its clients. Such information should include the financial situation, investment experience, investment objectives and investment knowledge of the clients.<sup>1</sup> An intermediary should be able to ascertain whether a corporation is qualified as a PI based on the financial information it obtained during the KYC procedures.

4. For a client which is a corporation, information about the financial situation, investment objectives and investment experience (e.g. trading history) should be collected and assessed at the company level. An intermediary may determine how to assess the level of investment experience and knowledge of a corporate client by considering, among other things, who the persons authorised to and responsible for making investment decisions are (e.g. the directors and/or officers of an investment committee (for large corporations) or the owners (for small private companies)) and the investment experience and knowledge of such authorised persons.

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<sup>1</sup> Paragraphs 5.1 and 5.1A of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (“Code of Conduct”).

5. An intermediary should adopt a holistic approach and take into account all the relevant information about a client for ensuring the suitability of the recommendation for a client is reasonable in all the circumstances.<sup>2</sup> Further, when an intermediary provides services to a corporate client in derivative products, the intermediary should assure itself that the authorised persons of the corporate client understand the nature and risks of the products and that the corporate client itself has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products.<sup>3</sup>

### **Investment choices of PIs and non-PIs**

6. Under section 103 of the SFO, no person may issue an invitation to the public to invest in any securities unless the issue is authorised by the SFC or an exemption under the SFO applies. In general, products that could be offered to the public include –

- (a) authorised collective investment schemes (i.e. authorised funds);
- (b) listed shares;
- (c) listed structured products (e.g. callable bull/bear contracts and derivative warrants);
- (d) authorised structured products (e.g. equity-linked investments / notes); and
- (e) authorised debentures (e.g. retail bonds)

7. Meanwhile, products offered only to PIs as defined in Schedule 1 to the SFO and the Securities and Futures (Professional Investor) Rules (Cap. 571D) (“the PI Rules”) are exempted from the authorisation requirements. Examples include private placements of unauthorised shares and debentures, which are often offered to groups of non-public investors.

### **Investor protection measures adopted post-Lehman Brothers Minibonds Incident**

8. Following the collapse of Lehman Brothers in September 2008, the SFC has put in place the following key measures which help enhance investor protection –

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<sup>2</sup> Paragraph 5.2 of the Code of Conduct.

<sup>3</sup> Paragraph 5.3 of the Code of Conduct.

*Business conduct of intermediaries*

- (a) following a consultation exercise in 2009, the SFC imposed requirements in relation to the selling of investment products by intermediaries to their clients. Under these requirements, intermediaries need to, among others –
  - (i) assess a client's knowledge of derivatives and characterise the client accordingly before selling him/her derivative products<sup>4</sup>;
  - (ii) disclose transaction-related information to clients prior to or at the point of sale, e.g. the capacity in which an intermediary is acting, affiliation of the intermediary with the product issuer, and benefits received for distributing investment products<sup>5</sup>; and
  - (iii) restrict themselves from offering any gifts other than a discount of fees or charges in promoting a specific investment product to a client<sup>6</sup>;
- (b) in addition, the SFC introduced requirements to enhance product transparency and to set an overall disclosure standard for all offering documents in respect of different investment products being offered to the public in Hong Kong (e.g. introduction of Product Key Facts Statements);
- (c) the SFC also imposed requirements<sup>7</sup> on intermediaries under the Code of Conduct by –
  - (i) requiring intermediaries to incorporate a new clause into client agreements to ensure that the financial products which they solicit the sale of or recommend to clients are reasonably suitable for the clients; and

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<sup>4</sup> Became effective since 4 September 2011.

<sup>5</sup> Became effective since 4 June 2011.

<sup>6</sup> Became effective since 4 September 2010.

<sup>7</sup> Became effective since 9 June 2017.

- (ii) restricting intermediaries from incorporating any clause in the client agreements which is inconsistent with their obligations under the Code of Conduct or mis-describe their services to clients;
- (d) following consultation exercises in 2016 and 2017, the SFC introduced requirements to enhance point-of-sale transparency by –
- (i) governing the use of the term “independent” by intermediaries<sup>8</sup>; and
  - (ii) requiring intermediaries to disclose the maximum percentage of monetary benefits received or receivable that are not quantifiable prior to or at the point of sale<sup>9</sup>; and

*Other measures*

- (e) the Investor Education Centre (“IEC”)<sup>10</sup> was established in November 2012 with the mandate of delivering financial education to the public to improve their financial literacy and equip them with the skills needed to make informed financial decisions.

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<sup>8</sup> With effect from 17 August 2018, an intermediary will be restricted from representing itself as “independent” or using any term(s) with a similar inference when distributing an investment product if the intermediary receives commission or other monetary benefits in relation to distributing such investment product; or if it receives any non-monetary benefits from any party or has close links or other legal or economic relationships with product issuers which are likely to impair its independence.

<sup>9</sup> To become effective on 17 August 2018.

<sup>10</sup> The IEC is a wholly owned subsidiary of the SFC. It is governed by an Executive Committee comprising a Chairman (who is a Non-Executive Director of the SFC), representatives of the four financial regulators (namely the Hong Kong Monetary Authority, the Mandatory Provident Fund Schemes Authority, the Insurance Authority and the SFC), as well as a representative of the financial industry and of the Education Bureau, and the General Manager of the IEC.

## **Investment-linked assurance schemes (“ILAS”)**

9. “Portfolio” is defined in section 2 of the PI Rules as a portfolio comprising securities, certificates of deposit issued by banks or money held by custodians for a person. ILAS are excluded from the definition of “securities” under the SFO. Hence, ILAS are not counted towards the portfolio threshold to determine whether an individual qualifies as a PI.

## **Holding companies to be regarded as PIs**

10. A holding company has control over the assets or portfolios held by a wholly-owned subsidiary. Hence, a holding company which wholly owns another corporation meeting the relevant monetary threshold should also be regarded as having met the relevant monetary threshold to qualify as a PI. The proposal will facilitate participation of corporations in private placement activities in Hong Kong, while providing flexibilities to the holding company in allocating investments amongst different entities it wholly owns, without necessarily having to concentrate their investments in one single entity.

11. A corporation should have an adequate and proper governance structure over its investment decision-making process. An authorised person should be bound by the governance structure to make investment decisions in accordance with the corporation’s investment objective.

12. To alleviate the concern that the shareholders of the holding company may not be aware that the corporation has become a PI under the Amendment Rules, the SFC has made a statement in the consultation conclusions of May 2018 to remind directors and shareholders of a corporation to review its corporate governance structure. This is to ensure the shareholders of a corporation are properly informed of the consequences and impacts on them when the corporation they own is being qualified as a PI under the Amendment Rules. The SFC will also issue a press release to remind the public of the same when the Amendment Rules become effective in July 2018 and will provide more investor education in this regard.

**Illustration of corporate professional investors (“PIs”)**

**A. Definition of a corporation as a PI under the Securities and Futures (Professional Investor) Rules (Cap. 571D) (“PI Rules”)**

(a) Scenario 1: Corporation which fulfills the monetary threshold to qualify as a PI (section 6(a) of the PI Rules)

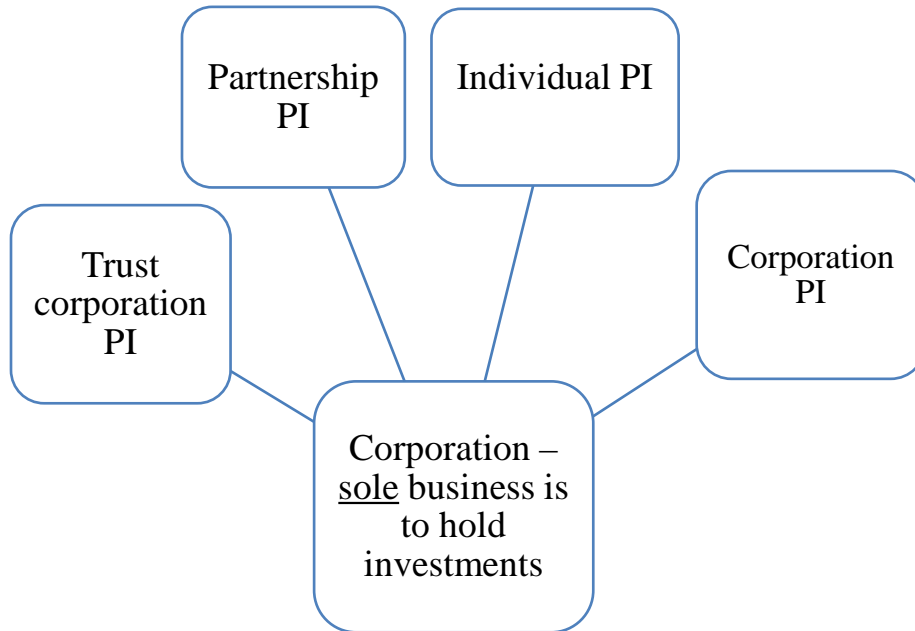
<b>Existing Rules</b>	<b>Amended Rules</b>
A corporation which is ascertained to have –  (i) a portfolio of not less than \$8 million; or (ii) total assets of not less than \$40 million,  is qualified as a PI.	Unchanged.

(b) Scenario 2: Corporation as a subsidiary wholly-owned by a PI (which can be a PI prescribed under the Securities and Futures Ordinance (Cap. 571) (“SFO”) or the PI Rules) (section 6(b) of the PI Rules)

<b>Existing Rules</b>	<b>Amended Rules</b>
A corporation the <u>sole business</u> of which is to hold investments and is wholly owned by one or more of the following –  (i) a trust corporation PI; (ii) an individual PI; (iii) a corporation PI; (iv) a partnership PI,  is qualified as a PI.	Include any corporation the <u>principal business</u> of which is to hold investments and is wholly owned by one or more of the following –  (i) a trust corporation PI; (ii) an individual PI; (iii) a corporation PI; (iv) a partnership PI; (v) PIs as defined under paragraph (a), (d), (e), (f), (g) or (h) in Part 1 of Schedule 1 to the SFO.

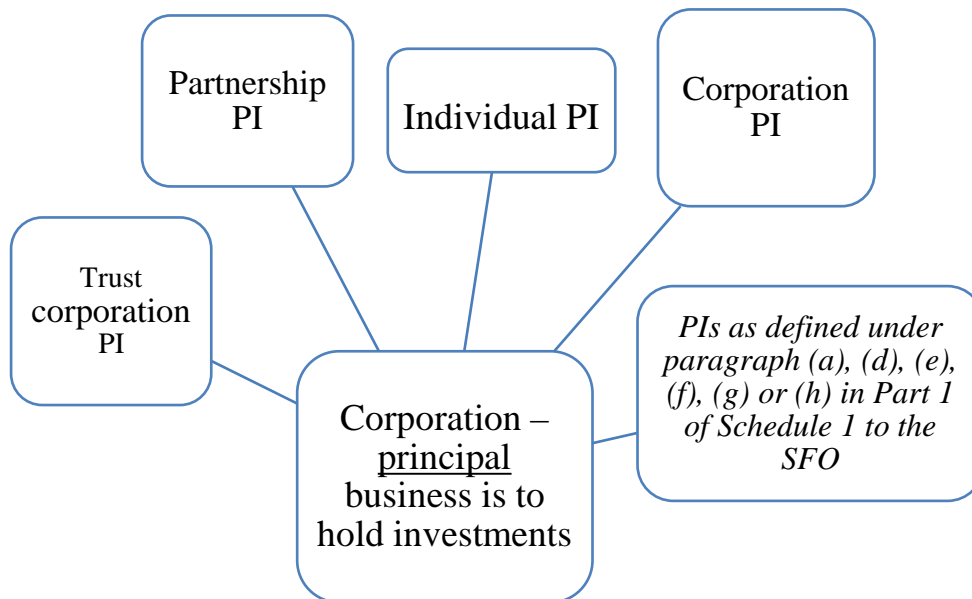
The following are two diagrams illustrating what corporations can qualify as PIs under scenario 2.

Existing Rules



Corporation can qualify as a PI if it is wholly owned by one or more of the PIs above.

Amended Rules



Corporation can qualify as a PI if it is wholly owned by one or more of the PIs above.

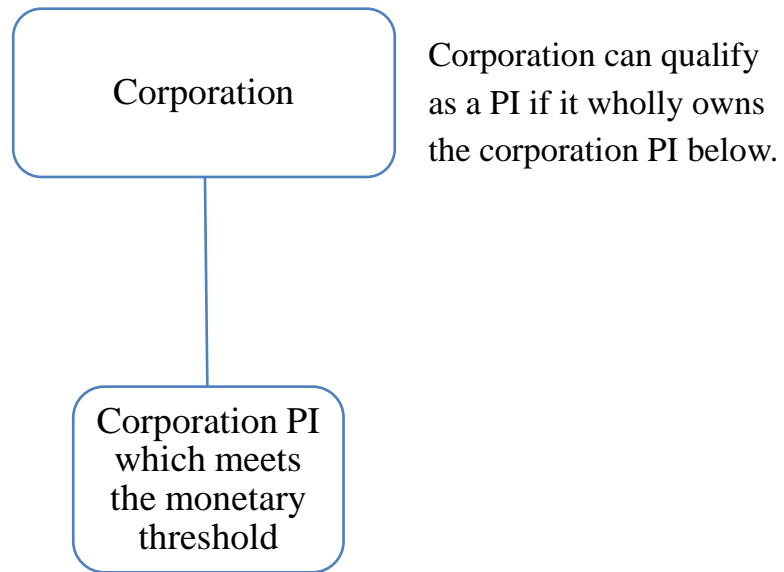
- (c) Scenario 3: Corporation which wholly owns another corporation that is a PI which has been ascertained to have met the monetary threshold under the PI Rules (section 6(c) of the PI Rules)

Existing Rules	Amended Rules
Not applicable.	Any corporation which wholly owns a corporation that meets the monetary threshold under the PI Rules can qualify as a PI.

The following is a diagram illustrating what corporations can qualify as PIs under scenario 3.



Amended Rules



**B. Definition of a corporation as a PI under paragraph (i) of the “professional investor” definition in the SFO**

- (a) Group companies of an intermediary or authorised financial institution (i.e. bank) are qualified as PIs.

