

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

**Response to follow-up actions
arising from the discussion at the meeting on 12 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 12 June 2018.

Holding companies of corporate professional investors (“PIs”)

2. A corporation’s governance structure should determine (a) who is responsible for making the investment decisions for the corporation, (b) under what circumstances its shareholders should be informed of a decision made, and (c) under what circumstances consent from shareholders is necessary. While the SFC is not in a position to intervene in a corporation’s governance, the SFC understands the view that the shareholders should be properly informed as appropriate, if and when a holding company becomes a PI under the Amendment Rules because its wholly-owned subsidiary is a PI.

3. In view of the above, the SFC has committed in the consultation conclusions of May 2018¹ to remind directors and shareholders of a corporation to review the corporate governance structure. This is to ensure that the shareholders of a corporation are properly informed and are aware of the implications when the corporation becomes a PI pursuant to 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.

4. After the discussion at the 12 June 2018 Subcommittee meeting, the SFC has further reviewed the situation. Apart from the measures mentioned in paragraph 3 above, the SFC will issue a circular requiring intermediaries to obtain confirmation from the authorised person(s) of the

¹ Copy available at:
<http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=17CP1>

holding company of a corporate PI², prior to providing services, that the shareholders of that holding company have been informed of its corporate PI status. The circular will be issued once the Amendment Rules become effective.

Inclusion of real property in monetary thresholds

5. At present, a corporation having a portfolio (“投資組合” in Chinese) of not less than \$8 million *or* total assets (“總資產” in Chinese) of not less than \$40 million can qualify as a PI under the Securities and Futures (Professional Investor) Rules (Cap. 571D) (“PI Rules”).³ A “portfolio” is defined under the PI Rules to basically include securities and cash. Meanwhile, “assets” includes real property. An intermediary may refer to the audited financial statements or statements issued by custodians in ascertaining the value of assets (including real property) for PI qualification. The Amendment Rules have not introduced changes in these aspects. Under the Amendment Rules, an intermediary may also refer to public filing or certificates issued by a custodian, auditor or Certified Public Accountant in ascertaining PI qualification.

6. The monetary threshold test is put in place so that there is a simple and easy-to-interpret method for evaluating whether a person qualifies as a PI. Apart from Hong Kong, there are other jurisdictions (e.g. the UK and the US) which use different asset classes for the different monetary thresholds for individuals and corporations. As we have explained in our note of 11 June 2018 (Ref: LC Paper No. CB(1)1104/17-18(02)), PIs, like other investors, are further subject to the know-your-client procedure, suitability requirement, etc. before being sold a product.

Reviewing the PI regime

7. The SFC has been keeping in close view the operation of the PI regime and would review, amongst other things, the monetary thresholds

² Persons authorised to make investment decisions for a corporation are commonly the directors and/or officers of an investment committee for large corporations, and the owners for smaller companies.

³ Meanwhile, an individual having a portfolio of not less than \$8 million will qualify as a PI. “Portfolio” has the same definition, which basically includes securities and cash.

for qualification as PIs from time to time. We take note of Members' comments that the monetary thresholds adopted under the PI regime should be reviewed to ensure that the levels can keep up with market changes and that the protection for the investors can be maintained. Any alterations to the existing regime will have considerable impact on the investors and the operation of the industry, and must be considered holistically (including to study the implementation, and if applicable, transitional details) and after a due consultation process. Otherwise, changes made in haste may cause market confusion. This would compromise the protection for the investors. The Amendment Rules that we have tabled for the Legislative Council's scrutiny is to standardise the modifications granted by the SFC to individual intermediaries under section 134 of the Securities and Futures Ordinance (Cap. 571) over the years. The purpose is to ensure consistency in the application of the PI Rules and provide a level playing field for the market. The preceding consultation was on the standardisation proposal only.

8. The above notwithstanding, we understand Members' concern over the PI regime, particularly the monetary thresholds adopted under the regime. We, together with the SFC, will actively consider the suggestion to carry out a review on the thresholds.

Assessment of the risks of investment products

9. The suggestion to rate investment products would fall outside the remit of the PI regime. Under the current regulatory regime, when conducting the suitability assessment, an intermediary should not merely match a product's risk rating with a client's risk tolerance level as assessed by the intermediary. Rather, the intermediary should carry out due diligence on and develop a thorough understanding of the investment product and ensure the product that it recommends to a client are suitable for him/her under all circumstances. An intermediary should exercise its professional judgement to assess whether the characteristics and risk exposures of a recommended product are suitable for a client after taking into account the client's relevant circumstances. These include the client's investment objectives, investment horizon, investment knowledge and experience, risk tolerance, and financial situation. The SFC has no plans to change this arrangement.

Evidential requirements

10. Bank statements are allowable evidence in ascertaining PI

qualification as set out in the new section 8 of the PI Rules (added by virtue of the Amendment Rules) and by virtue of the definition of “custodian” in section 2. In addition to statements or certificates issued by custodians, certificates issued by auditors or certified public accountants and audited financial statements, which are already allowable evidence under the PI Rules, public filings will be accepted as permissible evidence pursuant to the new section 8.

11. As an alternative to ascertaining PI qualification in accordance with the new section 8, an intermediary may satisfy itself that an investor meets the relevant monetary threshold at the “relevant date” (as defined in section 2) to qualify as a PI by relying upon methods that are appropriate in the circumstances (see the new sections 4 to 7 of the PI Rules, which are added by virtue of the Amendment Rules and adapted from the existing section 3). Accordingly, an intermediary may refer to certificates issued by lawyers in determining whether a person meets the relevant monetary threshold at the relevant date to qualify as a PI. The SFC considers that the PI Rules as amended will be sufficiently flexible to address most situations.

12. An intermediary is expected to keep proper records of its assessment process to demonstrate that professional judgement has been duly exercised and that a reasonable conclusion has been drawn that its clients have indeed met the relevant monetary thresholds.

Financial Services and the Treasury Bureau
The Securities and Futures Commission
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