

**For discussion on
15 May 2018**

Legislative Council Panel on Financial Affairs

**Proposed amendments to standardise the rules for prescribing
professional investors in Hong Kong**

PURPOSE

This paper sets out the amendments proposed by the Securities and Futures Commission (“SFC”) to standardise the rules for prescribing certain categories of persons – both natural and legal persons – as professional investors in Hong Kong.

BACKGROUND

2. The Securities and Futures (Professional Investor) Rules (Cap. 571D, “the PI Rules”), first promulgated in 2003 pursuant to section 397 of the Securities and Futures Ordinance (Cap. 571, “SFO”), prescribe certain categories of persons as professional investors, in addition to those falling within the definition of “professional investor”¹ in the SFO. Under the professional investor regime, certain requirements under the SFO imposed upon intermediaries may be dis-applied when they are serving professional investors.²

¹ “Professional investor” is defined in Part 1 of Schedule 1 to the SFO. “Professional investors” include intermediaries, authorised financial institutions, insurance companies, etc. as per paragraph (a) to (i) of the definition, as well as any person of a class as prescribed by rules made under section 397 of the SFO as per paragraph (j) of the definition.

² This is because professional investors are generally regarded as more sophisticated investors who are generally more capable of protecting their interests. The requirements that may be dis-applied include an offer should not be made unless the issue is authorised by the SFC (section 103(1) of the SFO), certain agreements should not be made in an unsolicited call (section 174(1) of the SFO) and an offer should be accompanied by an offering document containing specified information (section 175(1) of the SFO). Yet, the suitability requirement is still applicable.

3. Under the current exercise, the SFC proposes to amend and refine the PI Rules.³ Professional investors as prescribed under the PI Rules are high net worth investors with wealth meeting the monetary thresholds as set under the same rules. These investors are –

- (a) any trust corporation having been entrusted with total assets of not less than \$40 million;
- (b) any individual who (either alone or with his/her spouse and children on a joint account) has a portfolio of not less than \$8 million;
- (c) any corporation or partnership having (i) a portfolio of not less than \$8 million; or (ii) total assets of not less than \$40 million; or
- (d) any corporation the sole business of which is to hold investments and is wholly owned by any one or more of (a), (b) or (c) above.

4. The PI Rules specify the kinds of documents that can be relied upon as evidence in ascertaining compliance with the relevant monetary threshold. These documents are –

- (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

³ The SFC does not seek to review the professional investor regime or other relevant provisions in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, which were the subject of a separate consultation exercise concluded in September 2014. The relevant papers on that consultation exercise (i.e. Consultation Conclusions on the Proposed Amendments to the Professional Investor Regime and Further Consultation on the Client Agreement Requirements and Consultation Conclusions on the Client Agreement Requirements) are available at – <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=13CP1>; and <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=14CP7>.

- (c) custodian statements issued within 12 months before the relevant date for trust corporations, corporations, partnerships or individuals.

5. Over the years, there have been calls from intermediaries for relaxing some requirements of the PI Rules, including the types of assets permissible to be counted by an individual towards meeting the relevant monetary threshold, the definition of a corporation as a professional investor and other allowable alternative evidence, etc.

6. The SFC considers these calls for greater flexibility reasonable. Pursuant to section 134 of the SFO, the SFC, on request by intermediaries, has granted a number of modifications to improve operational efficiency without compromising investor protection. Currently, there are around 40 such modifications in place, all of which are published on the SFC's website for public information.

7. The SFC considers it timely and appropriate to update the PI Rules by incorporating the modifications granted. These modifications are considered suitable for standardisation and their general application to the market would not deviate from the policy intent or erode the essential protection for the investors. The opportunity is also taken to make further changes to the PI Rules having regard to the views and comments made by market participants in response to a soft consultation carried out from December 2015 to June 2016. The SFC considers that the proposed amendments would ensure consistency in the application of the PI Rules and provide a level playing field for all intermediaries.

THE SFC'S PROPOSALS TO STANDARDISE RULES FOR PRESCRIBING PROFESSIONAL INVESTORS

8. On 1 March 2017, the SFC issued a public consultation paper on the proposed amendments to the PI Rules. Respondents were invited to provide views by 3 April 2017. The proposed amendments fall under the following three areas –

- (a) allowing the aggregation of certain assets by individuals towards meeting the portfolio threshold to qualify as professional investors;

- (b) expanding the definition of corporations as professional investors; and
- (c) allowing the use of alternative forms of evidence to demonstrate qualification as professional investors.

Details are set out in paragraphs 9 to 18 below.

Allowing aggregation of certain assets for individuals

Portfolio held in a joint account with non-associates

9. At present, an individual who, either alone or with any of his or her associate on a joint account, has a portfolio of not less than \$8 million at the relevant date will qualify as a professional investor under the PI Rules. The existing PI Rules define the term “associate” as the spouse or any child of an individual. Some intermediaries have pointed out that it is quite common for family members other than associates, such as siblings, parents or grandparents, and for business partners (which are corporations or partnerships) to set up a joint account together. They have suggested that the PI Rules should be suitably revised to cater for this situation.

10. The SFC concurs with these observations and proposes to include an individual’s share of a portfolio held in an account jointly owned by the individual with other persons (including individuals, corporations and partnerships), who are not associates of that individual at the relevant date, when determining whether the individual meets the portfolio threshold to qualify as a professional investor. In determining the share of an individual’s portfolio held in a joint account with non-associates, the SFC proposes that the individual’s share should be based on his/her share as specified in a written agreement among all account holders. In the absence of a written agreement, all account holders, including the individual concerned, should be deemed to have an equal share of the portfolio.

11. The SFC considers that the proposal of deeming an equal share to a portfolio held in a joint account with non-associates in the absence of a written agreement is solely for the purpose of assessing if an individual meets the portfolio threshold to qualify as a professional investor. This does not necessarily represent the individual’s actual right to the portfolio, because the SFC understands that a joint account holder is usually

entitled to all of the proceeds in the joint account, instead of a share of it.⁴ Intermediaries are expected to make reasonable enquiries into the existence of a written agreement before deeming an equal share in a joint account to avoid over-stating or under-stating the actual share of the portfolio.

Portfolio held by a corporation owned by an individual

12. Some intermediaries have indicated that some investors may use investment corporations to hold their portfolios. A portfolio held by an investment corporation attributable to an individual should be aggregated with the individual's portfolio in assessing whether the individual meets the portfolio threshold. The SFC considers that this is a natural extension of the existing categories of professional investors and is consistent with the spirit of the PI Rules.

13. In view of the above, the SFC proposes to include the portfolio of any corporation, the principal business of which is to hold investments, and the corporation is owned by the individual at the relevant date, when determining if the individual qualifies as a professional investor.

Expanding the definition of corporations as professional investors

14. Currently, a corporation will qualify as a professional investor under the PI Rules if it has a portfolio of not less than \$8 million or total assets of not less than \$40 million. A corporation will also qualify as a professional investor if it has the sole business to hold investments and is wholly owned by one or more of the professional investors prescribed under the PI Rules.

15. Some intermediaries have indicated that the term "sole business" lacks flexibility as an investment vehicle involved in other businesses may not materially affect or detract from its principal business of investment holding. The SFC accepts the industry view and proposes to include any corporation 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 the SFO (e.g. banks and insurance companies), or the PI Rules (e.g. high net worth investors). The SFC considers it a

⁴ This means, for example, a person holding a joint bank account with his/her spouse is entitled to withdrawing any amount from the bank account, instead of just half of it.

natural extension of the existing categories of professional investors in keeping with the spirit of the PI Rules.

16. Some intermediaries have also indicated that a corporation should be able to qualify as a professional investor if it wholly owns another corporation which has been ascertained to have met the asset or portfolio threshold to qualify as a professional investor. The SFC accepts the industry view and proposes to expand the categories of professional investor to include these corporations. The SFC believes that the expansion of the definition of corporations as professional investors will facilitate and encourage the participation of corporations in private placement activities.

Allowing alternative forms of evidence

17. Currently, the PI Rules specify certain evidential requirement (see paragraph 4 above) in ascertaining if a person meets the relevant monetary threshold to qualify as a professional investor. The SFC understands that alternative forms of evidence, namely public filings and certificates issued by custodians, are used in practice and proposes to include them in the PI Rules as allowable forms of evidence. Public filings are proposed to be defined in the PI Rules as documents made pursuant to legal or regulatory requirements in Hong Kong or in a place outside Hong Kong.

18. The existing PI Rules only allow individuals to use certificates issued by auditors or CPAs in ascertaining professional investor qualification. As such certificates should generally be applicable to other types of persons, the SFC proposes to extend them to corporations, trust corporations and partnerships for the purpose of ascertaining professional investor qualification.

BENEFITS OF THE PROPOSALS

19. The SFC considers that the proposed amendments to the PI Rules will enhance market transparency and ensure consistency in the application of the PI Rules. The proposals will provide facilitation to both intermediaries and their clients without compromising investor protection.

20. The SFC envisages that more persons will qualify as professional investors upon the implementation of the proposals. The intermediaries,

among others, remain subject to the suitability requirement and other fundamental requirements as stipulated by the SFC when serving the professional investors.

COMMENTS FROM THE PUBLIC

21. Respondents to the consultation paper mentioned in paragraph 8 above generally supported the proposed amendments to the PI Rules.

WAY FORWARD

22. The SFC aims to issue the consultation conclusions and table the proposed amendments to the PI Rules before the Legislative Council for negative vetting in May 2018.

ADVICE SOUGHT

23. Members are invited to note and provide views on the proposed amendments to the PI Rules.

Financial Services and the Treasury Bureau
The Securities and Futures Commission
7 May 2018