

LEGISLATIVE COUNCIL BRIEF

SECURITIES AND FUTURES ORDINANCE (CAP.571)

SECURITIES AND FUTURES (PROFESSIONAL INVESTOR) (AMENDMENT) RULES 2018

INTRODUCTION

Pursuant to section 397 of the Securities and Futures Ordinance (Cap. 571) (“SFO”), the Securities and Futures Commission (“SFC”) made the Securities and Futures (Professional Investor) (Amendment) Rules 2018 (“the Amendment Rules”) at the Annex on 14 May 2018.

BACKGROUND AND ARGUMENT

The Professional Investor Regime

2. The Securities and Futures (Professional Investor) Rules (Cap. 571D, “the PI Rules”), first promulgated in 2003 pursuant to section 397 of the 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 investors².

3. Professional investors as prescribed under the PI Rules are 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;

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.

- (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 also 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
- (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.

CHANGES TO THE PI RULES

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 amendments would ensure consistency in the application of the PI Rules and provide a level playing field for all intermediaries. The amendments to the PI Rules 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 8 to 17 below.

Allowing aggregation of certain assets for individuals

Portfolio held in a joint account with non-associates

8. 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.

9. The SFC concurs with these observations and will allow the inclusion of 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 will specify in the PI Rules 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.

10. 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.³ 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

11. 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.

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

³ 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.

Expanding the definition of corporations as professional investors

13. 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.

14. 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 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. investors with wealth meeting the relevant monetary thresholds). The SFC considers it a natural extension of the existing categories of professional investors in keeping with the spirit of the PI Rules.

15. 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 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

16. 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 will include them in the PI Rules as allowable forms of evidence. Public filings will 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.

17. 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 will extend them to corporations, trust corporations and partnerships for the purpose of ascertaining professional investor qualification.

THE AMENDMENT RULES

18. The main object of the Amendment Rules is 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 ascertaining whether a person is a professional investor. The Amendment Rules will also restructure section 3 of the PI Rules (“existing section 3”) for better presentation. The main provisions of the Amendment Rules are as follows –

- (a) section 3 amends section 2 of the PI Rules to repeal the definition of “custodian statement” and to add a new definition of “public filing” which is used in the new section 8 of the PI Rules;
- (b) section 4 adds a new section 2A to the PI Rules, which consolidates the references to amounts in foreign currency in paragraphs (a), (b) and (c) of the existing section 3; and
- (c) sections 5 and 6 amend the existing section 3 to restructure it into separate sections for better presentation, and to expand the types of individuals and corporations that are to be regarded as professional investors and the records which may be considered in ascertaining whether a person is a professional investor, as follows—
 - (i) the existing section 3 is amended to replace its paragraphs (a), (b), (c) and (d) with cross-references to the new sections 4, 5, 6 and 7 of the PI Rules;
 - (ii) the circumstances in which trust corporations are prescribed as professional investors are moved from paragraph (a) of the existing section 3 to the new section 4 of the PI Rules;
 - (iii) the circumstances in which individuals are prescribed as professional investors are moved from paragraph (b) of the existing section 3 to the new section 5 of the PI Rules, and are expanded by allowing interests in joint accounts

- with non-associates and in certain corporations to be taken into account;
- (iv) the circumstances in which corporations are prescribed as professional investors are moved from paragraphs (c) and (d) of the existing section 3 to the new section 6 of the PI Rules, and are expanded by including corporations which have a principal (rather than sole) business of holding investments, and corporations which wholly own another corporation which is a professional investor;
 - (v) the circumstances in which partnerships are prescribed as professional investors are moved from paragraph (c) of the existing section 3 to the new section 7 of the PI Rules; and
 - (vi) matters relating to the documents by reference to which a person's total assets or portfolio are to be ascertained are moved from paragraphs (a)(i), (ii) and (iii), (b)(i) and (ii) and (c)(iii) and (iv) of the existing section 3 to the new section 8 of the PI Rules, and are expanded by allowing, in respect of all types of persons, reference to be made to documents which are public filings or certificates issued by custodians, auditors or CPAs.

PUBLIC CONSULTATION

19. On 1 March 2017, the SFC issued a public consultation paper on its proposed amendments to the PI Rules. The public consultation period ended on 3 April of the same year. In general, the respondents were supportive of the proposals to amend the PI Rules, though a number of them suggested that the SFC should consider relaxing some other requirements and criteria for assessing whether a person qualifies as a professional investor. Having carefully considered all the comments and suggestions put forward, the SFC considered that the proposed amendments are appropriate. In the light of comments received during the consultation, the SFC will not take forward the proposal to allow an individual to count the portfolio held by a corporation when determining whether he or she qualifies as a professional investor if he or she only partially owns the corporation. The other proposals have remained unchanged.

20. On 15 May 2018, the SFC briefed the Legislative Council Panel on Financial Affairs on the proposed amendments to the PI Rules. Panel members were generally supportive of the SFC's proposals.

FINANCIAL AND STAFFING IMPLICATIONS

21. There are no financial or staffing implications for the Government or the SFC.

COMMENCEMENT

22. The Amendment Rules will come into operation on 13 July 2018.

PUBLICITY

23. The SFC will publish the consultation conclusions and issue a press release on 18 May 2018. The Amendment Rules will be published in the Gazette on the same date.

ENQUIRIES

24. Any enquiries on this brief may be addressed to Mr. Keith Choy, Senior Director, or Ms. Joanne Li, Director, of the Intermediaries Supervision of Intermediaries Division of the SFC at 2231 1670 and 2231 1107 respectively.

The Securities and Futures Commission
16 May 2018

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

(Made by the Securities and Futures Commission under section 397(1) of the Securities and Futures Ordinance (Cap. 571))

1. **Commencement**
These Rules come into operation on 13 July 2018.
2. **Securities and Futures (Professional Investor) Rules amended**
The Securities and Futures (Professional Investor) Rules (Cap. 571 sub. leg. D) are amended as set out in sections 3 to 6.
3. **Section 2 amended (interpretation)**
 - (1) Section 2, definition of *custodian*, paragraph (b)—
 - (a) English text, after “the following persons”—
Add
“whose business includes acting as a custodian of securities or other property for another person, whether on trust or by contract”;
 - (b) **Repeal**
everything after “investment services”
Substitute
“and regulated under the law of any place outside Hong Kong;”.
 - (2) Section 2—
Repeal the definition of *custodian statement*.
 - (3) Section 2—

Add in alphabetical order

“*public filing* (公開檔案) means a document that, pursuant to the legal or regulatory requirements in Hong Kong or in a place outside Hong Kong, has been submitted to a person or body that is under a duty to publish the document to, or otherwise make the document available for inspection by, members of the public in Hong Kong or in a place outside Hong Kong, by or on behalf of—

- (a) a trust corporation (whether on its own behalf or in respect of a trust of which it acts as a trustee);
- (b) an individual;
- (c) a corporation (other than a trust corporation referred to in paragraph (a)); or
- (d) a partnership;”.

4. Section 2A added

After section 2—

Add

“2A. Amount in Hong Kong dollars includes its equivalent in any foreign currency

In these Rules, a reference to an amount expressed in Hong Kong dollars includes its equivalent in any foreign currency.”.

5. Section 3 amended (persons prescribed as professional investors)

Section 3—

Repeal

everything after “other than Schedule 5”

Substitute

“—

- (a) a trust corporation specified in section 4;
- (b) an individual specified in section 5(1);
- (c) a corporation (other than a trust corporation referred to in paragraph (a)) specified in section 6;
- (d) a partnership specified in section 7.”.

6. Sections 4 to 8 added

After section 3—

Add

“4. Trust corporations

A trust corporation specified for the purposes of section 3(a) is a trust corporation having been entrusted under one or more trusts of which it acts as a trustee with total assets of not less than \$40 million at the relevant date or as ascertained in accordance with section 8.

5. Individuals

- (1) An individual specified for the purposes of section 3(b) is an individual having a portfolio of not less than \$8 million at the relevant date or as ascertained in accordance with section 8, when any one or more of the following are taken into account—
 - (a) a portfolio on the individual’s own account;
 - (b) a portfolio on a joint account with the individual’s associate;
 - (c) the individual’s share of a portfolio on a joint account with one or more persons other than the individual’s associate;

- (d) a portfolio of a corporation which, at the relevant date, has as its principal business the holding of investments and is wholly owned by the individual.
- (2) For the purposes of subsection (1)(c), an individual’s share of a portfolio on a joint account with one or more persons other than the individual’s associate is—
 - (a) the individual’s share of the portfolio as specified in a written agreement among the account holders; or
 - (b) in the absence of an agreement referred to in paragraph (a), an equal share of the portfolio.

6. Corporations

A corporation specified for the purposes of section 3(c) is—

- (a) a corporation having—
 - (i) a portfolio of not less than \$8 million; or
 - (ii) total assets of not less than \$40 million, at the relevant date or as ascertained in accordance with section 8;
- (b) a corporation which, at the relevant date, has as its principal business the holding of investments and is wholly owned by any one or more of the following persons—
 - (i) a trust corporation specified in section 4;
 - (ii) an individual specified in section 5(1);
 - (iii) a corporation specified in this paragraph or paragraph (a);
 - (iv) a partnership specified in section 7;
 - (v) a professional investor within the meaning of paragraph (a), (d), (e), (f), (g) or (h) of the

definition of *professional investor* in section 1 of Part 1 of Schedule 1 to the Ordinance; or

- (c) a corporation which, at the relevant date, wholly owns a corporation referred to in paragraph (a).

7. Partnerships

A partnership specified for the purposes of section 3(d) is a partnership having—

- (a) a portfolio of not less than \$8 million; or
 (b) total assets of not less than \$40 million,

at the relevant date or as ascertained in accordance with section 8.

8. Ascertaining total assets or portfolio

For the purposes of section 4, 5(1), 6(a) or 7, the total assets entrusted to a trust corporation, the portfolio of an individual, or the portfolio or total assets of a corporation or partnership, are to be ascertained by referring to any one or more of the following—

- (a) for a trust corporation, corporation or partnership, the most recent audited financial statement prepared within 16 months before the relevant date in respect of the trust corporation (or a trust of which it acts as a trustee), corporation or partnership;
- (b) for a trust corporation, individual, corporation or partnership, any one or more of the following documents issued or submitted within 12 months before the relevant date—
- (i) a statement of account or a certificate issued by a custodian;

- (ii) a certificate issued by an auditor or a certified public accountant;
- (iii) a public filing submitted by or on behalf of the trust corporation (whether on its own behalf or in respect of a trust of which it acts as a trustee), individual, corporation or partnership.”.



Ashley Alder

Chief Executive Officer,
 Securities and Futures Commission

14 May 2018



Explanatory Note

The main object of these Rules is to amend the Securities and Futures (Professional Investors) Rules (Cap. 571 sub. leg. D) (*principal 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 ascertaining whether a person is a professional investor, and to restructure section 3 of the principal Rules (*existing section 3*).

2. Section 1 provides for commencement.
3. Section 3 amends section 2 of the principal Rules to repeal the definition of *custodian statement* and to add a new definition of *public filing* which is used in the new section 8 of the principal Rules.
4. Section 4 adds a new section 2A to the principal Rules, which consolidates the references to amounts in foreign currency in paragraphs (a), (b) and (c) of the existing section 3.
5. Sections 5 and 6 amend the existing section 3 to restructure it into separate sections for better presentation, and to expand the types of individuals and corporations that are to be regarded as professional investors and the records which may be considered in ascertaining whether a person is a professional investor, as follows—
 - (a) the existing section 3 is amended to replace its paragraphs (a), (b), (c) and (d) with cross-references to the new sections 4, 5, 6 and 7 of the principal Rules;
 - (b) the circumstances in which trust corporations are prescribed as professional investors are moved from paragraph (a) of the existing section 3 to the new section 4 of the principal Rules;
 - (c) the circumstances in which individuals are prescribed as professional investors are moved from paragraph (b) of

the existing section 3 to the new section 5 of the principal Rules, and are expanded by allowing interests in joint accounts with non-associates and in certain corporations to be taken into account;

- (d) the circumstances in which corporations are prescribed as professional investors are moved from paragraphs (c) and (d) of the existing section 3 to the new section 6 of the principal Rules, and are expanded by including corporations which have a principal (rather than sole) business of holding investments, and corporations which wholly own another corporation which is a professional investor;
- (e) the circumstances in which partnerships are prescribed as professional investors are moved from paragraph (c) of the existing section 3 to the new section 7 of the principal Rules;
- (f) matters relating to the documents by reference to which a person's total assets or portfolio are to be ascertained are moved from paragraphs (a)(i), (ii) and (iii), (b)(i) and (ii) and (c)(iii) and (iv) of the existing section 3 to the new section 8 of the principal Rules, and are expanded by allowing, in respect of all types of persons, reference to be made to documents which are public filings or certificates issued by custodians, auditors or certified public accountants.