



SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation Conclusions on the Proposed Amendments to the Securities and Futures (Professional Investor) Rules

May 2018



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Executive summary

1. On 1 March 2017, the Securities and Futures Commission (SFC) issued a consultation paper proposing a number of amendments to the Securities and Futures (Professional Investor) Rules (**PI Rules**) which aim to incorporate modifications the SFC has previously granted under section 134 of the Securities and Futures Ordinance (SFO). The amendments to the PI Rules (**Revised PI Rules**) pertain to the following:
 - (a) allowing portfolios held in joint accounts with persons other than associates¹ and investment corporations owned by individuals to be counted to ascertain whether individuals meet the monetary threshold to qualify as professional investors;
 - (b) expanding the definition of corporations as professional investors; and
 - (c) allowing alternative forms of evidence demonstrating qualification as professional investors.
2. During the consultation period, the SFC received a total of 17 written submissions from market participants and professional bodies. The list of respondents is set out in Appendix A, and the submissions can be viewed on the SFC's website.
3. This paper sets out the SFC's conclusions and its responses to the comments received as well as the way forward after taking public feedback into account. This conclusions paper should be read in conjunction with the 1 March 2017 consultation paper.
4. In general, the respondents were supportive of the proposals to amend the PI Rules, though a number suggested that the SFC should consider relaxing some other requirements and criteria for assessing whether a person qualifies as a professional investor.
5. Having carefully considered all the comments and suggestions received, the SFC is of the view that the proposals in the consultation paper are appropriate for the Hong Kong market. In light of the comments received, the SFC will not take forward the proposal to allow an individual to count the portfolio held by a corporation if he or she partially owns the corporation when determining whether he or she qualifies as a professional investor.
6. The SFC is planning to submit the proposed amendments to the Legislative Council for negative vetting as soon as possible. Subject to the legislative process, we expect the amended PI Rules to come into effect on 13 July 2018.

¹ "Associate" is defined in Rule 2 of the Revised PI Rules as the spouse or any child of the individual.



Comments received and our responses

Section I – General comments

Question 1: Do you agree that the proposed amendments to the PI Rules would introduce appropriate levels of consistency and flexibility, and better serve the interests of both intermediaries and their clients? Please explain your view. Do you have any other suggestions?

Public comments

7. Comments received during the consultation period were generally supportive of the proposed amendments. Some respondents raised other suggestions which mostly pertain to allowing additional forms of evidence, relaxing certain criteria for assessing whether a person meets the monetary threshold to qualify as a professional investor and allowing other types of legal structures such as unincorporated associations to be prescribed as professional investors.

The SFC's response

8. The SFC is of the view that the proposals in the consultation paper are appropriate for the Hong Kong market and will proceed with the proposals.

Section II – Proposed amendments

A. Allowing aggregation of certain assets for individuals

9. In the consultation paper, the SFC proposed to allow an individual to aggregate the following assets when determining whether he or she meets the relevant portfolio threshold to qualify as a professional investor:
 - (a) the share of a portfolio held in an account jointly owned by an individual with persons (including individuals, corporations and partnerships) other than associates of the individual at the relevant date; and
 - (b) the portfolio or share of the portfolio of any corporation the principal business of which is to hold investments and which is wholly or partially owned by the individual at the relevant date.

Share of a portfolio held in a joint account with a non-associate

Question 2(a): Do you agree that an individual's share of a portfolio that is held in a joint account with a non-associate can be counted towards meeting the prescribed threshold to qualify as a professional investor (as outlined in Rule 5(1)(c) in the Revised PI Rules)? Please explain your view.

In determining the share of an individual's portfolio held in a joint account with a non-associate for the purpose of meeting the prescribed threshold, we propose that the individual's share is based on either the share specified in the written agreement between the account holders or an equal share of the portfolio in the absence of a written agreement (as provided for in Rule 5(2) in the Revised PI Rules). Do you agree with our approach? Please explain your view.



Public comments

10. While most respondents considered it appropriate to include a portfolio held in a joint account with non-associates, a few commented that deeming an equal share in the absence of a written agreement may overstate or understate an individual's actual share of a portfolio held in a joint account. One respondent viewed that an individual who failed to provide a written agreement should not be allowed to count his or her share of a portfolio held in a joint account.
11. There were also enquiries about how the proposal would work in practice. A few respondents asked whether a proactive enquiry into the existence of a written agreement was expected, and whether a self-declaration was permitted. There was also a request for more guidance on the form and content of the written agreement, and a question about whether intermediaries were expected to keep a record of the agreement and monitor the terms periodically. One respondent suggested that a written self-declaration made by the joint account holders should be accepted and this should be included in the Revised PI Rules as alternative evidence for the agreed entitlement to the joint account.
12. One respondent suggested reversing the sequence for applying the relevant criteria, such that an individual is deemed to have an equal share of the portfolio in the joint account, unless a written agreement is provided to the intermediary suggesting a different percentage.
13. Separately, a few respondents proposed to expand the definition of "associate" by including other persons such as parents, siblings, grandparents, grandchildren and domestic partners.

The SFC's response

14. The SFC would like to reiterate that the proposal to deem an equal share to a portfolio held in a joint account with non-associates is solely for the purpose of assessing whether an individual meets the portfolio threshold to qualify as a professional investor. This does not necessarily reflect the individual's actual share of the portfolio, because we understand that a joint account holder is usually entitled to all of the proceeds in the joint account.
15. As part of the know-your-client requirements, intermediaries are expected to make a reasonable enquiry about the existence of a written agreement before deeming an equal share of a portfolio in a joint account to avoid overstating or understating the actual share of the portfolio. On the contrary, deeming an equal share in a joint account before enquiring into the existence of the written agreement may overstate or understate the actual share, so we do not propose to reverse the criteria in the Revised PI Rules.
16. The SFC does not intend to set further conditions in the Revised PI Rules in relation to the content of the written agreement. Intermediaries are expected to maintain proper records to substantiate the assessment made of whether a person qualifies as a professional investor.
17. The SFC does not propose to expand the definition of "associate". The existing PI Rules allow an individual to take into account the whole portfolio, and not a share, held in a joint account with associates when determining whether the individual meets the threshold to qualify as a professional investor. The SFC considers that other persons may not have the same right of survivorship as a spouse or child. In view of the above, we are of the view that an individual holding a portfolio in a joint account with non-associates should be taken as having a share, and not the whole, of the portfolio.



Portfolio held by a corporation owned by an individual

Question 2(b): Do you agree that an individual's portfolio or share of a portfolio held by a corporation, the principal business of which is to hold investments and which is wholly or partially owned by the individual, can be counted towards meeting the prescribed threshold to qualify as a professional investor (as outlined in Rule 5(1)(d) and Rule 5(1)(e) in the Revised PI Rules)? Please explain your view.

Public comments

18. In general, respondents support the proposal. Two respondents commented that the portfolio held by a corporation belongs to the corporation, not to its shareholders. Therefore, it is not strictly correct to refer to "his or her share of a portfolio of a corporation" in Rule 5(1)(e). Another respondent made a similar comment and further suggested that the portfolio held by any corporation should only be counted by an individual if he or she wholly owns that corporation.
19. There were also enquiries about the operation of the proposal. One respondent asked whether intermediaries are able to rely on the representation made by an individual in relation to his or her ownership of a corporation. Another respondent suggested that the SFC should consider restricting the number of layers of corporations for the portfolio held by the corporations to be counted by an individual in meeting the portfolio threshold.
20. The majority of the respondents did not have specific comments on the term "principal business". One respondent opined that the term should be given a flexible interpretation and not be defined in an overly rigid way. Another respondent proposed to refine the Revised PI Rules such that the portfolio of a corporation would be counted by an individual in meeting the portfolio threshold if investment holding was only one of the corporation's principal businesses. One respondent suggested that, to avoid any uncertainty, the SFC should provide more guidance on what constitutes "principal business". Alternatively, the phrase "sole business" should be retained in place of "principal business".

The SFC's response

21. Having considered the comments raised by the industry (as mentioned in paragraph 18), the SFC will not take forward the proposal to allow an individual to count the portfolio held by a corporation if he or she partially owns the corporation. The SFC views that this could address the legal concerns that an individual who does not wholly own a corporation may not have the control over the corporation, so the portfolio held by the corporation may not be the legitimate property of the individual. The SFC has made the change to the Revised PI Rules accordingly.
22. For an individual wholly owns a corporation, our proposal remains to allow the individual to count the portfolio held by the wholly-owned corporation when determining whether he or she meets the monetary threshold to qualify as a professional investor. Intermediaries should take reasonable steps, which may include obtaining necessary evidence from the individual, to substantiate his or her sole ownership of the corporation.
23. The SFC is of the view that the term "principal business" is generic and should not be defined in the Revised PI Rules. Determination of "principal business" should be principles-based and flexibility should be provided to intermediaries. Intermediaries are expected to maintain proper records of the assessment made. The SFC considers that the current proposal allows adequate flexibility and does not propose to change the language in the Revised PI Rules.



B. Expanding the definition of corporations to qualify as professional investors

Question 3: Do you agree that the scope of the existing PI Rules should be extended so that:

(a) any corporation, the principal business² of which at the relevant date is to hold investments and which is wholly owned by one or more of the persons where each of them is qualified as a professional investor³, will qualify as a professional investor (as outlined in Rule 6(b) in the Revised PI Rules)? Please explain your view.

(b) any corporation, which wholly owns another corporation which has been qualified as a professional investor under the Revised PI Rules by meeting the asset or portfolio threshold, will qualify as a professional investor (as outlined in Rule 6(c) in the Revised PI Rules)? Please explain your view.

Do you have any other suggestions?

Public comments

24. Most respondents agreed with our proposals. One respondent suggested expanding the definition by allowing a corporation to qualify as a professional investor if it is a fellow subsidiary of another corporation which qualifies as a professional investor and both corporations are wholly owned by the same holding company.
25. Two respondents believed that our proposal in Rule 6(c) of the revised PI Rules, to allow a corporation to qualify as a professional investor if it wholly owns another corporation which qualifies as a professional investor, only expands the category of professional investors to the extent that the wholly owned corporation qualifies by meeting the portfolio threshold of \$8 million under Rule 6(a)(i). For the wholly-owned corporation that meets the total assets threshold of \$40 million under Rule 6(a)(ii), its holding company, by consolidating the full accounts of the wholly-owned corporation, should have total assets exceeding \$40 million. In view of the above, the holding company is able to qualify as a professional investor in its own right under Rule 6(a)(ii) and not necessarily under Rule 6(c).

The SFC's response

26. We consider that the Revised PI Rules should be able to cover the most common types of corporation set up for investment holding purposes. We do not propose to expand the definition of corporation at this stage.
27. We propose including a corporation as a professional investor if it wholly owns another corporation fulfilling the monetary threshold, as we understand from the industry that, in practice, the holding company may be an offshore investment holding company which is not necessarily required to prepare consolidated annual audited financial statements. In this regard, intermediaries may have difficulties ascertaining whether the holding company meets the monetary threshold under Rule 6(a). We consider that the Rule 6(c) is a sensible extension to allow the holding company to qualify as a professional investor if it wholly owns another corporation which fulfils the monetary requirements (regardless of whether the consolidated annual audited financial statements are in place for the holding company), and this will provide intermediaries with operational flexibility.

² The term "principal business" is proposed instead of "sole business" in the existing PI Rules.

³ Specifically, professional investors include those qualified under the "professional investor" definition in Part 1 of Schedule 1 to the SFO (eg, banks and insurance companies), in addition to those professional investors qualified under the PI Rules.



28. The SFC envisages that more corporations will qualify as professional investors in this regard. The SFC would also like to take this opportunity to remind directors or shareholders of a corporation to review its corporate governance structure, so as to ensure their shareholders are properly informed of the consequences and the impacts on them when the corporation they own is being qualified as a professional investor under the amended PI Rules.

C. Evidential requirements

Question 4: Do you agree that the evidential requirements set out in section 3(a) to (c) of the existing PI Rules should be extended to include public filings and certificates issued by auditors, certified public accountants or custodians (as outlined in Rule 8 in the Revised PI Rules)? Are these alternative forms of evidence commonly used by intermediaries as proof of clients meeting the stipulated monetary thresholds? Please explain your view.

Do you also agree that the Revised PI Rules should prescribe the types or categories of documents that could be regarded as “public filings” and the details to be included in the content of “certificates” issued by auditors, certified public accountants or custodians? Please explain your view.

In particular, which documents are used in practice as “public filings” and “certificates” issued by auditors, certified public accountants or custodians? Please provide examples.

Do you consider that the Revised PI Rules should impose conditions for the use of these alternative forms of evidence? Please explain your view.

Do you have any other suggestions?

29. In the consultation paper, the SFC proposed allowing certain alternative forms of evidence, namely public filings and certificates issued by custodians, to ascertain whether a person meets the monetary threshold to qualify as a professional investor. The SFC also proposed allowing the use of certificates issued by auditors or certified public accountants for ascertaining the professional investor qualification for corporations, trust corporations and partnerships.

Public comments

30. The industry generally welcomed the proposals to introduce public filings as an alternative form of evidence. Two respondents also viewed that the use of audited financial statements as evidence for private companies is not a common practice.
31. One respondent proposed accepting public filings which were submitted more than 12 months before the relevant date as valid evidence. A few respondents requested the SFC to provide more guidance on what types of documents would be considered “public filings”. A few respondents held the view that an exhaustive list of examples of public filings might not be practical.
32. A few respondents suggested allowing certificates and statements issued by other persons, such as fund administrators, registrars, transfer agents, trustees and auditors as well as certified public accountants registered in other jurisdictions, as evidence to ascertain if a person meets the monetary threshold to qualify as a professional investor. There were also requests that a broader range of permissible types of evidence be introduced, such as valuation reports for real estate and art.



33. One respondent suggested imposing other conditions, for example, public filings or certificates would only be accepted if they were submitted or issued pursuant to the requirements of designated regulatory bodies or countries. Other respondents requested that overly prescriptive requirements and conditions on types or categories of evidence should be avoided.

The SFC's response

34. The SFC considers that the types of evidence proposed could address most situations. We also consider that allowing public filings submitted within 12 months before the relevant date is appropriate and consistent with the requirement for other types of evidence. In view of the above, we do not propose to introduce other types of evidence or impose other conditions in the Revised PI Rules.

D. Other comments

Question 5: Do you have any other comments on the Revised PI Rules? Please explain your view.

Do you suggest any alternative wording for the Revised PI Rules? If so, please give your suggestions and explain your view.

Public comments

Other legal structures or individuals

35. Some respondents suggested expanding the definition of professional investor to cover foundations, unincorporated associations and other legal structures.
36. A few respondents proposed allowing certain individuals such as directors of a licensed fund manager and their spouses and other licensed individuals to qualify as professional investors without ascertaining whether they meet the portfolio threshold. For example, other jurisdictions (eg, Australia and US) may consider licensed individuals as professional investors if they are assessed to have investment knowledge based on their work or experience. In addition, one respondent suggested that individual trustees should also qualify as professional investors if the assets held by them meet the monetary threshold.

Counting other asset types

37. A few respondents requested that the definition of “portfolio⁴” be expanded to include non-securities, such as investment-linked assurance schemes (ILAS), other bank products (such as structured deposits) whose value is linked to securities or wealth management products developed and designed by Mainland banks. One respondent suggested using the term “assets” rather than “a portfolio” in the definition of “portfolio” in the Revised PI Rules.
38. Two respondents proposed allowing portfolios held in partnerships or trusts to be counted by individuals towards meeting the portfolio threshold to qualify as professional investors.

⁴ “Portfolio” is defined in Rule 2 of the Revised PI Rules as a portfolio comprising securities, certificates of deposit issued by banks or money held by custodians for a person.



Removal of the term “at the relevant date”

39. One respondent proposed removing “at the relevant date” from Rule 5 of the Revised PI Rules so that intermediaries can take into account the information which is valid as of the assessment date. Another respondent specifically proposed removing “at the relevant date” from Rule 5(1)(d)&(e) and Rule 6(b) in the Revised PI Rules so that an intermediary is not bound by the relevant date when ascertaining whether the principal business of a corporation is investment holding.

The SFC’s response

40. We consider that the Revised PI Rules should be able to cover the legal structures most commonly used for the purpose of investment holding. At this stage, we do not propose to expand the definition of professional investor to include other persons, in particular individuals who are unable to meet the portfolio threshold. We are of the view that qualifying individuals as professional investors without assessing their personal net worth has considerable implications for the existing PI Regime and the Code of Conduct requirements. In view of the above, we do not propose to include them but will keep this comment in view for possible further study and may consult the industry on this matter again in the future.
41. We also consider that the Revised PI Rules should have covered the ownership structures most often used by individuals to hold investments. In view of the above, we do not propose to expand the scope in this regard to include portfolios held in partnerships or trusts to be counted by an individual in meeting the portfolio threshold to qualify as a professional investor. In particular, for portfolios held in trusts, since the grantor, beneficiary or trustee (who manage the trusts) are not the “owners” of the trusts, the SFC is not convinced that portfolios held in trusts should be allowed to be counted toward meeting the portfolio threshold for an individual.
42. We consider that the current definition of “portfolio” is sufficiently wide and do not propose to expand it at this stage. The SFC will keep this in view and consult the industry again should we consider the current definition inadequate to cater for future market development. We also do not propose to use the word “assets” in the definition of “portfolio”, as assets could include other property.
43. We do not propose to remove the term “at the relevant date”⁵ in the Revised PI Rules. The requirement to assess an investor’s status on a specific date is a key element in the PI Regime and this is the foundation for establishing suitability requirements and investor protection.

⁵ The term “at the relevant date” is a time reference in assessing whether a person meets the relevant assets or portfolio threshold to qualify as a professional investor, and whether a corporation has principal business of investment holding.



Section III – Implementation

Other comments on the implementation of the Revised PI Rules

Public comments

44. One respondent requested that any modifications granted under section 134 of the SFO be preserved. One respondent requested a transitional period of 18 to 24 months to allow sufficient time for implementation. One respondent requested the SFC to publicise any future modifications through industry associations and to formally codify them in a timely manner to ensure a level-playing field for all participants.

The SFC's response

45. The SFC considers that the Revised PI Rules should have covered the modifications previously granted under section 134 of the SFO. We will revoke all the subsisting modifications when the Revised PI Rules become effective.

Conclusion and way forward

46. The SFC is of the view that implementation of the Revised PI Rules is in the best interest of the industry to ensure a level-playing field and consistent application of the PI Rules. After considering all the comments and suggestions, the SFC will not take forward the proposal to allow an individual to count the portfolio held by a corporation if he or she partially owns the corporation. Other proposals as set out in the consultation paper will be adopted.
47. The SFC has today gazetted the proposed amendments to the PI Rules and will submit the amendments to the Legislative Council for negative vetting. Subject to the legislative process, the SFC expects the amended rules to come into effect on 13 July 2018.
48. The SFC will revoke all the modifications previously granted under section 134 of the SFO when the rules become effective. The SFC will update the cross-references in the Code of Conduct where necessary to conform with the restructuring of the rules.



Appendix A

List of respondents

(in alphabetical order)

1. Alternative Investment Management Association Limited (Hong Kong Branch), The
2. Boswell Capital Management Limited
3. CompliancePlus Consulting Limited
4. Complyport (HK) Limited
5. Deacons
6. Eversheds
7. Hong Kong Association of Banks, The
8. Hong Kong Society of Financial Analysts, The
9. Institute of Financial Planners of Hong Kong
10. Law Society of Hong Kong, The
11. Mr Sean Croucher
12. Private Wealth Management Association
13. Simmons & Simmons
14. Anonymous – four respondents requested not to publish their identities