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# SFC Publishes Consultation Paper On The Evidential Requirements Under The Securities And Futures (Professional Investor) Rules

## Introduction

The Securities and Futures Commission ("**SFC**") has published a consultation paper on a proposal to refine the evidential requirements for evidencing a person's professional investor status ("**Consultation Paper**"). Market participants and interested parties are invited to submit written comments on this proposal.

The SFC proposes a principles-based approach to the classification of high net worth professional investors. While the minimum value of the relevant assets or portfolio under the Securities and Futures (Professional Investor) Rules ("**PI Rules**") will remain unchanged, firms would be able to use any method to ascertain that an investor meets the required assets or portfolio threshold at the relevant date. The SFC believes that this principles-based approach is more flexible and more in line with similar requirements in other leading markets.

The purpose of this note is to provide a summary of the SFC's proposal and how to respond to the consultation.

The Consultation Paper is available [on the SFC website](https://www.sfc.hk/sfcConsultation/EN/sfcConsultFileServlet?name=pirules&type=1&docno=1).

This one-month consultation ends on 5 November 2010. Parties may respond on or before that date by post, fax, online submission or e-mail.

## Background

### The Professional Investor Exemption

The Securities and Futures Ordinance ("SFO") provides an exemption that firms can use in respect of "professional investors" to avoid legal restrictions that the SFO imposes on:

* the issuance of advertisements, invitations or documents in relation to securities, regulated investment agreements and collective investment schemes;
* the making of unsolicited calls; and
* the communication of an offer in relation to securities.

Additionally, the offering of any shares or debentures to professional investors is not subject to the prospectus regime under the Companies Ordinance. That is, an SFC authorised prospectus is not required.

### Definition of "Professional Investor"

There are two types of "professional investors" under the SFO:

* entities set out in paragraphs (a) to (i) of Part 1 of Schedule 1 to the SFO (e.g. banks and insurance companies); and
* high net worth professional investors set out in the PI Rules.

The consultation relates to high net worth professional investors, of which there are four types:

1. any trust corporation with total assets of not less than HK$40 million in any currency;
2. any individual who (either alone or with his/her spouse or children on a joint account) has a portfolio of not less than HK$8 million in any currency;
3. any corporation or partnership with either:
   * a portfolio of not less than HK$8 million in any currency; or
   * total assets of not less than HK$40 million in any currency; and
4. any corporation the sole business of which is to hold investments and which is wholly owned by an individual described in (b).

The PI Rules set out specific evidential requirements to ascertain the relevant assets or portfolio thresholds for the first three types of high net worth professional investors (i.e. (a), (b) and (c) above). Market participants have expressed that these evidential requirements make it difficult in practice to classify clients as professional investors. Consequently, they have been unable to take advantage of the professional investor exemption in respect of such clients.

## The SFC Proposal To Refine The Evidential Requirements

In response to comments from market participants that the current evidential requirements under the PI Rules are difficult to use, the SFC proposes to refine those requirements to allow firms to use any method to establish the different types of high net worth professional investors, including the existing methods set out in the current PI Rules. The Consultation Paper relates only to the method by which the assets or portfolio thresholds in the PI Rules are established, and not to any other element of the professional investor regime.

By taking a principles-based approach, the SFC aims to expand the scope and increase the flexibility of the evidential requirements. The SFC will not prescribe the requirements for ascertaining whether a person meets the relevant assets or portfolio threshold at the relevant date, as it believes it undesirable to try to prescribe all the possible ways to do so. It will be up to firms to exercise their professional judgment to decide the method by which they satisfy themselves that their clients meet the relevant assets or portfolio thresholds. This includes deciding whether it is appropriate/sufficient to rely on a client's self-certification, taking into account all the relevant circumstances. Regardless of what method firms choose to use, the SFC expects firms to keep proper records of their assessment process.

Despite allowing firms to exercise a degree of professional judgment in classifying professional investors, the SFC proposes to retain the time reference that firms use in ascertaining the assets or portfolio thresholds (referred to as the "relevant date" in the current evidential requirements and defined in section 2 of the PI Rules).

The SFC also proposes to expand the definition of high net worth individuals to include any corporation the sole business of which is to hold investments, and which is wholly owned (whether alone or in combination) by individuals or corporations/partnerships, each of which qualifies as a professional investor under the PI Rules.

An indicative draft of the proposed amendments to the PI Rules is set out in Appendix A to the Consultation Paper.

## How To Respond To The Consultation

The Consultation Paper poses five questions to the public in relation to refining the evidential requirements under the PI Rules. These questions are included in the Appendix to this note. Parties that wish to respond should submit their answers or comments to the SFC no later than 5 November 2010 by one of the following methods:

by mail to:

Securities and Futures Commission 8th Floor, Chater House 8 Connaught Road Central Hong Kong Re: Consultation Paper on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules

by tax to:

(852) 2810-5385

by on-line submission at:

<http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/> (or, enter into the subsection "Consultation Papers and Conclusions" under the section "Speeches, Publications and Consultations" on the SFC's website at [http://www.sfc.hk](http://www.sfc.hk/sfc/html/EN/))

by e-mail to:

[PIRules@sfc.hk](mailto:PIRules@sfc.hk)

## Appendix - Consultation Questions

*Question 1:*

Do you agree that the proposed approach is the best way to serve the purpose of providing flexibility? Please explain your view.

Do you have any other suggestions?

*Question 2:*

Do you agree that the existing methods set out in sections 3(a) to 3(c) of the PI Rules (as outlined in paragraph 7 of the Consultation Paper) should be preserved? Please explain your view.

Do you have any other suggestions?

*Question 3:*

Do you agree that the "relevant date" should be used as the time reference for ascertaining whether a high net worth professional investor meets the relevant assets or portfolio threshold? Please explain your view.

Do you have any other suggestions?

*Question 4:*

Do you agree that section 3(d) of the existing PI Rules should be extended so that any corporation which is wholly owned by one or more individuals or corporations/partnerships where each of those individuals or corporations/partnerships would qualify as a professional investor under section 3(b) or section 3(c) (as the case may be) of the PI Rules, will qualify as a professional investor? Please explain your view.

Do you have any other suggestions?

*Question 5:*

Do you have any comments on the indicative draft of the proposed amendments to the PI Rules in Appendix A to the Consultation Paper? Please explain your view.

Do you have any suggestions on alternative wordings for the proposed amendments? If so, please give your suggestions and explain your view.

*This note constitutes a summary only of the SFC's Consultation Paper on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules, which can be viewed on the* [*SFC's website*](https://www.sfc.hk/sfcConsultation/EN/sfcConsultFileServlet?name=pirules&type=1&docno=1)*.*

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