

Consultation Document
The Draft Securities and Futures (Professional Investor) Rules
(the “draft Rules”)

Introduction

1. The Securities and Futures Bill (the “Bill”) empowers the SFC to make rules under clause 384 to prescribe requirements in subsidiary legislation. The basis for this approach is that, consistent with modern securities legislation such as the UK Financial Services and Markets Act, effective regulation depends upon the regulator having the flexibility to quickly address changing market practices and global conditions by amending the rules rather than the primary legislation.
2. Besides being subjected to negative vetting by the Legislative Council, the SFC now releases the draft Rules for public consultation.
3. In order to ensure that our proposed rules appropriately balance investor protection and general market needs, the SFC has consulted representatives from the securities and futures industry before formulating the draft Rules. We wish to acknowledge and thank them for their invaluable input.
4. The SFC has used the FinNet communication network to send copies of this consultation document to all registered firms. Copies of the consultation document are available free of charge at the SFC’s office and may also be found on the SFC’s Internet website at <http://www.hksfc.org.hk>.
5. The public is invited to submit comments before close of business on **28 February 2002**. They may be sent to:

By mail: SFC Professional Investor Rules
 12/F, Edinburgh Tower
 The Landmark
 15 Queen’s Road, Central
 Hong Kong

By fax: 2293-5710

By way of on-line: <http://www.hksfc.org.hk>

By e-mail: professional_investor_rules@hksfc.org.hk

Please note that the names of the commentators and the contents of their submissions may be published on the SFC's website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement at Appendix 1.

If you do not wish your name and/or submission to be published by the SFC, please state that you wish your name and/or submission to be withheld from publication when you make your submission.

Background

6. A definition of "professional investor"¹ was introduced in the Bill, published in November 2000. The definition identifies various classes of persons as professional investors, such as intermediaries, authorized financial institutions, insurance companies and recognized exchange companies, etc. The idea is that certain investor protection measures in the Bill imposed upon intermediaries can be dispensed with in the case of "professional investors".
7. To provide flexibility, the definition also empowers the Commission to make rules adding other categories or classes of persons to the definition of "professional investor". These rules may either specify these additional categories or classes of persons as professional investors for the purposes of the entire Ordinance, or only for the purposes of particular provisions in the Ordinance.

¹ "professional investor" is defined in Part 1 of Schedule 1 to the Blue Bill to mean –

- (a) any recognized exchange company, recognized clearing house, recognized exchange controller or recognized investor compensation company;
- (b) any licensed or exempt person, or any other person carrying on the business of the provision of investment services and regulated under the law of any place outside Hong Kong;
- (c) any authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong;
- (d) any insurer authorized under the Insurance Companies Ordinance (Cap. 41), or any other person carrying on insurance business and regulated under the law of any place outside Hong Kong;
- (e) any trust company registered under Part VIII of the Trust Ordinance (Cap. 29);
- (f) any collective investment scheme, or any person by whom a collective investment scheme is operated;
- (g) any pension or provident fund, or any person by whom a pension or provident fund is managed;
- (h) any government (other than a municipal government authority); or
- (i) any person of a class prescribed by rules made under section 384 of this Ordinance for the purposes of this paragraph.

8. Since the publication of the Blue Bill, submissions made by the industry proposed that the Commission should use its rule-making power to add further classes of persons as “professional investor” under appropriate situations.
9. Working on the basis of these submissions, and with the benefit of further dialogues with the market, the Commission now proposes a set of draft rules to be issued under section 384 of the Bill to add three additional categories or classes of persons as “professional investor” for purposes of three provisions in the Bill. This consultation paper is issued to seek the market’s view on these proposals and the draft Rules.

Highlights

10. The proposed draft Rules will expand the definition of “professional investor” in the Bill to include also the following categories or classes of persons:
 - trustee companies that have been entrusted with at least HK\$40 million in assets;
 - high net worth individuals, with a portfolio of at least HK\$16 million; and
 - businesses with either a portfolio of at least HK\$16 million or not less than HK\$40 million in assets.

The reasoning is that these persons should be sufficiently sophisticated that investor protection requirements imposed upon intermediaries under these three provisions could be disappplied. Releasing intermediaries from compliance with such requirements when dealing with such persons will facilitate the provision of investment services to their clients.

11. The proposed expanded definition of "professional investor" however will only apply to clauses 102, 108 (which, in the latest version of the Bill, has been moved to Part VII as clause 169A) and 169 of the Bill. The rationale for this partial relaxation is that while these investors should be sufficiently sophisticated to merit a relaxation of the provisions specified, they may not be so experienced that they should be regarded as "professional investors" for all purposes under the Bill.
12. In essence, clauses 102, 108 and 169² prohibit intermediaries from engaging in certain conduct, except (among other exemptions) in relation to professional investors. Briefly, clause 102 prohibits the issuance of unauthorized advertisements, invitations or documents relating to investments. Section 108

² Section 102 is derived from section 4 of the Protection of Investors Ordinance (Cap. 335).
Section 108 is derived from section 72 of the Securities Ordinance (Cap. 333).
Section 169 is derived from sections 73 and 74 of the Securities Ordinance, section 60A of the Commodities Trading Ordinance (Cap. 250) and section 39 of the Leveraged Foreign Exchange Trading Ordinance (Cap. 451).

generally prohibits the offer of securities not accompanied by an offering document containing relevant information. Section 169 essentially prohibits cold calling. For easy reference, these sections are set out in Appendix 2.

13. The effect of the draft Rules will be that intermediaries will be able to conduct the activities prohibited under clauses 102, 108 and 169 in relation to the three categories of persons set out in the draft Rules (see paragraph 10, above), in addition to other “professional investors” as defined under the Bill.
14. It should be noted, in conjunction, that the SFC has also proposed that the definition of “professional investor” in the Bill be amended so as to include, among others, holding companies and wholly owned subsidiaries of regulated intermediaries, authorized financial institutions and banks for the purposes of sections 102, 108 and 169. A marked-up version of the proposed amended definition is in Appendix 3.
15. We have prepared the draft Rules with the aim of facilitating the provision of investment services by intermediaries while maintaining a sufficient degree of investor protection and preserving market integrity. The SFC believes that the classes of professional investors so prescribed should be in a position to protect their own interests in the contexts of sections 102, 108 and 169 of the Bill, and have the resources to do so.
16. The above approach is also broadly in line with that of other major jurisdictions. In the United Kingdom, the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 provides (under certain conditions) an exemption from financial promotion restrictions in respect of relevant communications made to a “certified high net worth individual”³. In the United States, pursuant to Regulation D (promulgated under the Securities Act of 1933), certain exemptions from rules governing the limited offer and sale of

³ Under the Order, “certified high net worth individual” means any individual –

- (a) who has a current certificate of high net worth; and
- (b) who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in prescribed terms.

For the above purposes, a certificate of high net worth –

- (a) must be in writing or other legible form;
- (b) is current if it is signed and dated within the period of twelve months ending with the day on which the communication is made;
- (c) must state that in the opinion of the person signing the certificate, the person to whom the certificate relates either –
 - (i) had, during the financial year immediately preceding the date on which the certificate is signed, an annual income of not less than GB£100,000; or
 - (ii) held, throughout the financial year immediately preceding the date on which the certificate is signed, net assets to the value of not less than GB£250,000;
- (d) must be signed by the recipient’s accountant or by the recipient’s employer.

securities without registration are also available in respect of communications to sell securities made to “accredited investors”⁴

The Draft Rules

17. In the draft Rules, the SFC proposes to prescribe simple tests for ascertaining whether a person meets the assets or portfolio values requirement so as to qualify as a professional investor for the purposes of clauses 102, 108 and 169. These are -
- (a) any trustee company having been entrusted with total assets of not less than HK\$40 million (or equivalent) as stated in its audited financial statements for the financial year ended within the previous 16 months;
 - (b) any individual having a portfolio of not less than HK\$16 million (or equivalent) in securities and/or currency deposits as certified by his auditor or as stated in the current statement of account issued by his custodian; and
 - (c) any corporation or partnership having a portfolio of not less than HK\$16 million (or equivalent) in securities and/or currency deposits, or total assets of not less than HK\$40 million (or equivalent) as stated in its audited financial statements for the financial year ended within the previous 16 months or in the current statement of account issued by its custodian.
18. These tests are designed to make the evaluation of whether the person qualifies as a member of the class specified simple and straightforward. The reference to audited financial statements for the financial year ended within the previous 16 months is intended to refer to the previous year's audited financial statements whilst allowing a period of time for those statements to be produced during the current year.

⁴ “Accredited investors” include, amongst others, –

- (a) a corporation, not formed for the purpose of acquiring the securities offered, with total assets in excess of US\$5 million;
- (b) a natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds US\$1 million;
- (c) a natural person who had an individual income in excess of US\$200,000 in each of the two most recent years or joint income with that person's spouse in excess of US\$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;
- (d) a trust, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of US\$5 million whose purchase is directed by a sophisticated person; and
- (e) an entity in which all of the equity owners are accredited investors.

19. It will be noted that the individual referred to in paragraph (b), above, is defined in section 2 of the draft Rules to include the person's spouse and their children. The threshold requirement can be met where the individual alone has a portfolio of not less than HK\$16 million, or, where the spouse and/or children are included, the portfolio is held in their joint names. It is considered that in the absence of joint portfolios, individuals should be considered separately. These thresholds of assets or portfolio values are considered more user-friendly to intermediaries and easier to ascertain than, for example, a combination of net worth and experience as an investor.
20. A copy of the draft Rules, to be made pursuant to section 384 of the Bill, is attached as Appendix 4.

Consultation

21. The SFC welcomes any comment industry practitioners and members of the investing public may have on the draft Rules. In particular, the SFC would appreciate discussion as to whether:
 - the proposed three classes of persons are suitable to be regarded as professional investors;
 - the proposed monetary thresholds for the three classes of persons are appropriate;
 - the proposed means of ascertaining the monetary thresholds are practicable; and
 - any further classes of persons should be so prescribed.

– End –

Personal Information Collection Statement

1. This Personal Information Collection Statement (“PICS”) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data¹ will be used following collection, what you are agreeing to with respect to the SFC’s use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (“PDPO”).

Purpose of Collection

2. The Personal Data provided in your submission to the SFC in response to the Consultation Document on the Draft Securities and Futures (Professional Investor) Rules (“the Consultation Document”) may be used by the SFC for one or more of the following purposes:
 - to administer the relevant Ordinances, rules, regulations, codes and guidelines made or promulgated pursuant to the powers vested in the SFC
 - for the purposes of performing the SFC’s statutory functions under the relevant Ordinances
 - for research and statistical purposes
 - other purposes permitted by law

Transfer of Personal Data

3. Personal Data may be disclosed by the SFC to the members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Document. The names of persons who submit comments on the Consultation Document together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC web site and in documents to be published by the SFC throughout and at the conclusion of the consultation period.

Access to Data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on the Consultation Document. The SFC has the right to charge a reasonable fee for processing any data access request.

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486 (“PDPO”)

Enquiries

5. Any enquiries regarding the Personal Data provided in your submission on the Consultation Document, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer
The Securities and Futures Commission
12/F, Edinburgh Tower
The Landmark
15 Queen's Road
Central
Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

Section 102 of the Bill

1. Section 102(1), subject to certain exceptions, provides that a person commits an offence if he issues, or has in his possession for the purposes of issue, an advertisement, invitation or document which to his knowledge is or contains an invitation to the public –
 - (a) to enter into or to offer to enter into –
 - (i) an agreement to acquire, dispose of, subscribe for or underwrite securities; or
 - (ii) a regulated investment agreement; or
 - (b) to acquire an interest in or participate in, or offer to acquire an interest in or participate in, a collective investment scheme,unless the issue is authorized by the SFC.
2. Various exceptions to the general prohibition are provided under subsections (2), (3) and (5) to (9) of section 102. The more significant exceptions include–
 - (a) the issue of such materials by licensed or exempt intermediaries in relation to their corresponding regulated activities except in respect of unauthorized collective investment schemes; and
 - (b) the issue of such materials made in respect of securities or interests in any collective investment scheme or regulated investment agreement, which are or are intended to be disposed of only to professional investors.

Section 108 (169A) of the Bill

3. Section 108(1) of the Bill prohibits, subject to certain exceptions, a licensed or exempt securities dealer or adviser from communicating an offer to acquire or dispose of any securities of, or issued by, a body unless (amongst others) the offer is contained, or if communicated verbally, reduced to writing, in a document in an official language and contains the required information. Subsection (5) states that the section does not apply to, amongst others, an offer made –
 - (a) to a professional investor;
 - (b) to a solicitor or a professional accountant acting in his professional capacity; or

- (c) by an exchange participant in the ordinary course of trading on a recognized stock market.

Section 169 of the Bill

4. Section 169(1) of the Bill provides, subject to certain exceptions, that a licensed or exempt person shall not, as principal or agent, during or as a consequence of an unsolicited call made by him –

- (a) make or offer to make with another person –
 - (i) an agreement for that other person to sell or purchase, or with a view to having that other person sell or purchase, any securities, futures contract or leveraged foreign exchange contract;
 - (ii) an agreement for him to provide, or with a view to having him provide, to that other person securities margin financing; or
 - (iii) an agreement the purpose or effect, or pretended purpose or effect, of which is to provide, whether conditionally or unconditionally, to that other person a profit, income or other returns –
 - (A) from any securities, futures contract or leveraged foreign exchange contract; or
 - (B) calculated by reference to changes in the value of any securities, futures contract or leveraged foreign exchange contract; or
- (b) induce or attempt to induce another person to enter into an agreement referred to in paragraph (a),

whether or not in making the unsolicited call he does any other act or thing.

5. Similarly, various exceptions to the general prohibition are provided under subsections (2) and (3) of section 169. Subsection (2) provides, amongst others, that an intermediary shall not be regarded as contravening subsection (1) by reason only that he -

- (a) makes a call on another person who is a solicitor or professional accountant acting in his professional capacity, or a licensed person, exempt person, money lender, existing client, or professional investor; and

- (b) whether as principal or agent, makes or offers to make with that other person an agreement referred to in subsection (1)(a), or induces or attempts to induce that other person to enter into such an agreement.

"professional investor" () means -

- (a) any recognized exchange company, recognized clearing house, recognized exchange controller or recognized investor compensation company, or any person authorized to provide automated trading services under section 95(2) of this Ordinance;
- (b) any intermediary ~~licensed or exempt person~~, or any other person carrying on the business of the provision of investment services and regulated under the law of any place outside Hong Kong;
- (c) any authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong;
- (d) any insurer authorized under the Insurance Companies Ordinance (Cap. 41), or any other person carrying on insurance business and regulated under the law of any place outside Hong Kong;
- ~~(e) any trust company registered under Part VIII of the Trustee Ordinance (Cap. 29);~~

(f) ~~any collective investment scheme, or any person by whom a collective investment scheme is operated,~~

any scheme which -

(i) is a collective investment scheme authorized under section 103 of this Ordinance; or

(ii) is similarly constituted under the law of any place outside Hong Kong and, if it is regulated under the law of such place, is permitted to be operated under the law of such place,

or any person by whom any such scheme is operated;

(g) ~~any pension or provident fund, or any person by whom a pension or provident fund is managed;~~

any registered scheme as defined in section 2(1) of the Mandatory Provident Fund Schemes Ordinance (Cap. 485), or its constituent fund as defined in section 2 of the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485 sub. Leg.), or any person who, in relation to any such registered scheme, is an approved trustee or service provider as defined in section 2(1) of that Ordinance or who is an

investment manager of any such registered scheme or constituent fund;

(ga) any scheme which -

(i) is a registered scheme as defined in section 2(1) of the Occupational Retirement Schemes Ordinance (Cap. 426);

or

(ii) is an offshore scheme as defined in section 2(1) of that Ordinance and, if it is regulated under the law of the place in which it is domiciled, is permitted to be operated under the law of such place,

or any person who, in relation to any such scheme, is an administrator as defined in section 2(1) of that Ordinance;

(h) any government (other than a municipal government authority), any institution which performs the functions of a central bank, or any multilateral agency; ~~or~~

(ha) except for the purposes of Schedule 6 to this Ordinance, any corporation which is -

(i) a wholly owned subsidiary of -

(A) an intermediary, or any other person carrying on the business of the provision of investment

services and regulated under the law of any place outside Hong Kong; or

(B) an authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong;

(ii) a holding company which holds all the issued share capital of -

(A) an intermediary, or any other person carrying on the business of the provision of investment services and regulated under the law of any place outside Hong Kong; or

(B) an authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong; or

(iii) any other wholly owned subsidiary of
a holding company referred to in sub-
subparagraph (ii); or

(i) any person of a class which is prescribed by
rules made under section 384 of this Ordinance
for the purposes of this paragraph as within
the meaning of this definition for the purposes
of the provisions of this Ordinance, or to the
extent that it is prescribed by rules so made
as within the meaning of this definition for
the purposes of any provision of this
Ordinance;

SECURITIES AND FUTURES (PROFESSIONAL INVESTOR) RULES

(Made by the Securities and Futures Commission under
section 384(1) of the Securities and Futures
Ordinance (of 2002))

1. Commencement

These Rules shall come into operation on the day
appointed for the commencement of Part XVI of the
Securities and Futures Ordinance (of 2002).

2. Interpretation

In these Rules, unless the context otherwise requires -

"custodian" () means a corporation the principal
business of which is to act as a custodian of securities or
other property for another person, whether on trust or by
contract;

"individual" () means a natural person, and
includes the person's spouse and children where a
portfolio is held jointly with them;

"partnership" () means the relation which subsists between persons carrying on a business in common with a view to profit;

"portfolio" () means a portfolio comprising -

- (a) securities; or
- (b) currency deposits.

3. Persons that are professional investors

(1) Subject to subsection (2), for the purposes of paragraph (i) of the definition of "professional investor" in Part 1 of Schedule 1 to the Ordinance, the following persons are professional investors -

- (a) any trustee company having been entrusted with total assets of not less than HK\$40 million, or its equivalent in any other currency, as stated in its most recent audited financial statements provided they are not more than 16 months old;
- (b) any individual having a portfolio of not less than HK\$16 million, or its equivalent

in any other currency, as certified by his auditor or as stated in the current statement of account issued by his custodian; and

(c) any corporation or partnership having -

(i) a portfolio of not less than HK\$16 million, or its equivalent in any other currency; or

(ii) total assets of not less than HK\$40 million, or its equivalent in any other currency,

as stated in its most recent audited financial statements provided they are not more than 16 months old or in the current statement of account issued by its custodian.

(2) These Rules do not apply for the purposes of Schedule 6 to the Ordinance.

Chairman,
Securities and Futures Commission

February 2002

Explanatory Note

These Rules are made by the Securities and Futures Commission under section 384(1) of the Securities and Futures Ordinance (of 2002) for the purposes of paragraph (i) of the definition of "professional investor" in Part 1 of Schedule 1 to the Ordinance. This means that such persons attract exemptions from certain prohibitions as set out in sections 102(3)(j) (issuing advertisements, invitations or documents relating to certain investments), 169(2)(a) (unsolicited calls) and 169A(5)(d)(i) (communication of offers to acquire or dispose of securities) of the Ordinance. However, such persons are not regarded as professional investors for the purposes of the definitions of regulated activities in Part 2 of Schedule 6 to the Ordinance.