

Direct Line (852) 2842 4187
Direct Fax (852) 2810 8133
E-mail david.clark@linklaters.com

Our Ref DCC/052000
Your Ref

28 February 2002

**By Hand and
By e-mail: professional_investor_rules@hksfc.org.hk**

The Securities and Futures Committee
12/F, Edinburgh Tower
The Landmark
Central
Hong Kong

Dear Sirs

Securities and Futures Bill - Definition of "Professional Investor"

I am a solicitor who practices in the area of retirement schemes. I have been asked to give you my comments on the proposed definition of professional investor from this perspective.

I have the following comments in relation to the proposed definition:

- 1** The reference to "collective investment scheme" in paragraph (f) does not cover Hong Kong collective investment schemes other than those authorised under Section 103. Large Hong Kong pension schemes may sometimes establish unauthorised unit trusts consisting of, say, an equity fund and a bond fund. The members of the pension scheme may be offered the choice of different investment strategies according to different allocations of units in each of the equities and bond fund. The actual investment management, however, takes place at the level of the unit trust. Since the only investor in such unit trusts is the trustee of the pension scheme, such arrangements are not public, and so are not normally authorised under Section 15 of the

A01871006/0.1/28 Feb 2002

SOLICITORS

Resident Partners

Pauline Ashall, A.J. Carmichael, Steven A. Christopher, David Clark, James Douglass, Patrick Fontaine, Marc Harvey, Elaine S.M. Kwee, Celia C.L. Lam, Rebecca Lo, Andrew Malcolm, Nick Rees, Zili Shao, Beryl Sze, Peter Treacy, Dominic Tsun, C.J. Walker

Consultants

Alison J. Fidler, K.M. Teresa Ma, Vanessa K.L. Poon

REGISTERED FOREIGN LAWYERS

Lawrence Vranka, Jr. (*Partner, Linklaters New York, Resident in Hong Kong*)

Richard Lucchese (*Partner, Linklaters New York, Resident in Hong Kong*)

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Securities Ordinance (“SO”) (or under Section 4 of the Protection of Investors Ordinance (“PIO”)). The retirement schemes themselves are occupational retirement schemes which are regulated under the Occupational Retirement Schemes Ordinance, but do not require SFC authorisation (except in the case of “pooled retirement funds”, to which a separate SFC Code applies). Underlying unit trusts of this type therefore presumably also would not be authorised under Section 103 of the Bill. They are therefore not professional investors within the meaning of the definition. A reference to such unauthorised funds should be added, either in this paragraph or in paragraph (ga).

Comparable structures may exist overseas (in the UK, they are often called “common investment funds”), but (f)(ii) of the definition seems wide enough to cover these.

- 2** A similar concept also applies in relation to MPF schemes, where the underlying vehicle is referred to as an approved pooled investment fund (“APIF”). APIFs may be unit trusts (and, theoretically, but not in practice, mutual funds) or insurance policies.

2.1 Where an APIF is constituted as a unit trust (or mutual fund), Schedule 1, paragraph 17(2)(a) requires it to be authorised by the SFC as an investment arrangement within the PIO, rather than as a fund authorised under Section 15 of the SO (although the SFC’s code on MPF products refers to such APIF as being approved under Section 15 of the SO). In order for such APIFs to qualify as professional investors, it would be necessary to ensure that they fall within the category of collective investment schemes authorised under Section 103 or to include a specific reference in the definition of professional investor.

2.2 APIFs which are constituted as insurance policies are regarded for the purposes of the MPF legislation as being “pooled investment funds” (similar in concept to a collective investment scheme), although the rights of the investor are strictly contractual rights against the insurance company, since those rights are linked to the separate investment fund maintained by the insurance company for this purpose (see Section 6 and Schedule 1, paragraph 19(1)(c) of the Mandatory Provident Fund Schemes (General) Regulation). This type of investment vehicle seems covered by paragraph (d). However, there is potential for confusion which could be clarified (see suggestion at paragraph 5 below).

Please note that in some cases there may be a one-on-one correlation between a constituent fund and an underlying APIF, but in other cases, two or more APIFs may underlie the constituent fund. Even where there is a one-on-one correlation between the constituent fund and the APIF, it is also possible for the same APIF to be available as an investment for another MPF scheme.

- 3** The reference to MPF schemes in paragraph (g) refers to an MPF scheme or its constituent fund. In practice, the majority of MPF schemes hold only units in APIFs at the constituent fund level (other than cash for operational purposes etc.). Normally the assets themselves (and the investment management) is conducted at APIF level. Therefore, the reference in this paragraph to a constituent fund will not assist with the problems referred to above in relation to APIFs.
- 4** The reference to “service provider” in paragraph (g) seems too wide. This can include persons who are not involved in securities dealing or investment advice (e.g. the administrator of an MPF scheme, responsible for record keeping). There seems no reason why a service provider who has no involvement in investment issues should be regarded as a professional investor.

- 5** In order to deal with the above points about APIFs, I suggest that paragraph (g) should be redrafted as follows:

“In relation to:

- (a) any registered scheme as defined in Section 2(1) of the Mandatory Provident Schemes Ordinance (Cap.483), the approved trustee, custodian or investment manager of the registered scheme, or any of its constituent funds as defined in Section 2 of the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485 Sub. Leg.); and
- (b) any approved pooled investment fund as defined in Section 2 of the Mandatory Provident Fund Schemes (General) Regulation (Cap.485 Sub. Leg.), the approved trustee (or if the approved pooled investment fund is constituted as insurance policy, the authorised insurer), custodian or investment manager of the approved pooled investment fund,

or any person to whom any of the approved trustee (or authorised insurer), custodian or investment manager has delegated any of its functions relating to the custody or investment management of the assets of the registered scheme or approved pooled investment fund.”

I am not sure if the references to custodian in the above wording are relevant - this depends on how “professional investor” is used in the bill.

- 6** There are a number of omissions from paragraph (ga):

- In addition to a scheme which is registered under ORSO, it is necessary to deal with a scheme which is exempted from registration. Although such schemes are commonly established overseas and may therefore be covered by (ii), this will not invariably be the case. It is possible to have an exempted scheme which is established in Hong Kong (if the number of permanent ID cardholders is less than 10% of the members of the scheme), or it could be possible to have an offshore scheme which does not fall within the requirements of paragraph (ii). Such schemes may often be quite small, but could include large foreign schemes with small numbers of permanent ID card holders.
- Schemes which are not required to be registered or exempted under ORSO (e.g. a scheme contained in or otherwise established by any ordinance - see Section 3(1b) of ORSO. Significant schemes such as the Hong Kong civil service pension scheme may fall in this category.
- Not all retirement schemes will fall within the definition of “occupational retirement scheme” within ORSO e.g. because they are not linked to specific employments (similar to the participation of the self-employed in MPF schemes in Hong Kong). It is possible that some very significant overseas schemes (such as the new stakeholder pensions in the UK, French “caisses de retraite” or possibly certain US multi-employer plans) could fall in this category.

- 7** The exemption for offshore schemes in paragraph (ga)(ii) refers to such schemes as being “regulated” under the law of the place in which the schemes is domiciled. The reference quite correctly recognises that not all schemes are required to be regulated (see the words “if it is regulated ...”). However, even where a scheme is not under the supervision of a regulator, it will of course be subject to the control of the laws of that place (e.g. a trust scheme will always be subject to the supervision of the court of that jurisdiction). For the sake of clarity, I suggest that the phrase “if it is regulated” is replaced by “if it is subject to the supervision of any regulatory authority”.

- 8** The reference in paragraph (ga)(ii) to an offshore scheme which is regulated being “permitted to be operated under the law of such place” is imprecise, since it is not clear what “operated” may mean. For instance, there is a class of pension scheme established in Jersey which is approved under the Jersey income tax (and therefore regulated by the Jersey tax authority), which as part of the conditions of such approval must not include Jersey residents. It is not clear whether such schemes can be said to be “permitted to be operated under the law of [Jersey]”. A similar position may arise with schemes established in other offshore jurisdictions, and therefore the meaning of “operated” should be clarified.
- 9** The reference in paragraph (ga) to “any person who, in relation to any such scheme, is an administrator as defined in Section 2(1) of [ORSO]” does not catch the investment manager of a scheme established under trust (see the definition in Section 2(1) of ORSO, which refers solely to the trustee of a scheme established under trust). Although in practice it is likely that in most cases such an investment manager would be caught by another limb of the definition, this might not always be the case. I suggest that the reference to “administrator” should be replaced simply by a reference to investment manager (or its delegate).
- 10** The definition does not cover other employee benefit arrangements e.g. a trust established in connection with an employees share ownership plans (ESOPs).

I trust you may find these comments helpful.

Yours sincerely

David Clark