

Comments on the Draft Securities and Futures (Professional Investor) Rules

1 Introduction

The draft Securities and Futures (Professional Investor) Rules (the “draft Rules”) are to be issued under Section 384 of the Securities and Futures Bill (the “Bill”) and add three additional categories of professional investor to the definition contained in the Bill.

The group of financial institutions referred to below (the “Group”) welcomes the opportunity to comment on the draft Rules. As a general comment the Group is supportive of the approach taken by the SFC to extend the category of persons that will be treated as professional investors under the Bill.

Attached to this paper is a copy of the draft Rules marked up with suggested amendments to reflect the comments of the Group. In addition, the Group would like to make the following comments.

2 Definition of Custodian

“Custodian” is defined as “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”.

This definition of custodian is rather narrow as it appears that a bank or broker/dealer that provides custodian services would not be included as its “principal business” is not to act as a custodian. The Group therefore suggests that the definition is revised as follows:

“means a corporation whose business includes acting as a custodian of securities or other property for another person, whether on trust or by contract.”

3 Definition of Individual

The Group supports the concept that the definition of “individual” should be expanded to include joint accounts. However, we suggest that the definition of “individual” is too narrow and should be expanded to include brothers, sisters, parents and grandparents. We assume that, in this situation, the permitted class of family members is treated as one individual and therefore is only required to satisfy the portfolio test on a group basis.

We also assume that even if joint account holders do not fall within the definition of “individual”, if each joint account holder satisfies the portfolio test set out in Rule 3(1)(b) (without double counting the assets in the particular joint account), then that joint account may be treated as a professional investor account.

4 Definition of Portfolio

The Group suggests that this is expanded to include precious metals, which are from time to time included within the investment portfolio of individuals.

5 Rule 3(1)(a) - Trustee companies

In order to be treated as a professional investor a trustee company must be entrusted with total assets of not less than HK\$40 million, as stated in its most recent audited accounts (provided these are not more than 16 months old). The accounts of a trustee company

may not actually show the value of assets under trust since the assets do not belong to the trustee. Also, in some jurisdictions there may not be a requirement to provide audited accounts. We suggest, therefore, that it should also be sufficient in determining whether a trustee company can be treated as a professional investor to rely on custodian statements and bank statements (for further comments on these see Section 6).

It is suggested that the audited accounts should not be more than 24 months old. This is because trustee companies are often incorporated in jurisdictions where the requirement to deliver audited accounts within a particular time frame is less stringent than in Hong Kong.

6 Rule 3(1)(b) - Individuals

It is a requirement under the draft Rules for an individual to hold a portfolio of not less than HK\$16 million. This is double the current requirement under the SFC's Code of Conduct for Registered Persons (the "Code"), and more than is required in the United Kingdom (net assets of not less than £250,000 (@HK\$2.8 million)) or the United States (net worth of more than US\$1 million (@HK\$8 million)) or in Australia (assets of A\$2.5 million (@HK\$10 million)). The Group suggests that the value of HK\$8 million currently in the Code is followed. To have different thresholds in the Code and the Bill is confusing and would be difficult to monitor in practice. Given the various definitions of "professionals" that will exist once the Bill is passed, we suggest that the tests be streamlined as far as possible to minimise confusion and error in treatment of clients as professionals.

The value of the portfolio must be certified by the individual's auditor or be stated in the current statement of account issued by his custodian.

This raises a few issues:

- (a) It is unlikely that an individual would have an auditor. Therefore we suggest the reference here should be to accountant rather than auditor.
- (b) As "portfolio" is defined to include both securities and currency deposits, it is probable that currency deposits will be kept at a bank, even if securities are, separately, held with a custodian. Therefore, it should be possible to rely on both custodian statements and bank statements.
- (c) Investors may not keep their assets with just one custodian or in one bank account. It should be possible to rely on more than one relevant statement.
- (d) The rule refers to a "current" statement of account, which suggests that an individual would have to provide a new statement each time a financial institution wanted to treat the individual as a professional investor. This would be cumbersome in practice and is not required under the Code, where an annual confirmation is sufficient. We suggest that custodian/bank statements should not be more than 12 months old and therefore we assume that if a financial institution obtained current statements upon opening the account it would only be necessary to review the position annually.

7 Rule 3(1)(c) - Corporations or Partnerships

The comments made above in relation to the value of the portfolio, audited financial statements and statements of account apply equally to corporations and partnerships.

8 Other matters

- 8.1** The draft Rules in Appendix 3 contain a revised draft of the definition of “professional investor”. Paragraph (h) refers to “any government (other than a municipal government authority), any institution which performs the functions of a central bank, or any multilateral agency. The Group seeks confirmation that this paragraph would include governmental controlled agencies/entities such as GIC and BIA, which are clearly “professionals”.
- 8.2** Whilst these new categories of “professional investor” are welcome, they will mean little in practice for primary issues because of the prospectus requirements currently in the Companies Ordinance, and the narrow definition of professionals contained in Section 343(2) of that Ordinance. We hope that the provisions on prospectuses in the Companies Ordinance will be reviewed at the earliest possible opportunity.

If you would like to discuss any of the above issues with the Group collectively, please contact Alison J Fidler at Linklaters, 10th Floor, Alexandra House, Chater Road, Central, Hong Kong (Direct Line: 2842 4811, Email: alison.fidler@linklaters.com).

List of Submitting Group Members

Credit Suisse First Boston (Hong Kong) Limited
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J.P. Morgan
Morgan Stanley Dean Witter Asia Limited
Salomon Smith Barney Hong Kong Limited
UBS Warburg

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 "bank statements" () means a statement or statements issued by any authorized financial institution or any bank which is not an authorized institution but is regulated under the law of any place outside Hong Kong, provided any such statement is not more than 12 months old;

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

"custodian statements" () means a statement or statements issued by any custodian, provided any such statement is not more than 12 months old;

"individual" () means a natural person, and includes the person's spouse ~~and~~ children, siblings, parents and grandparents 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 ~~;~~ or
- (c) precious metals.

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 ~~16-24~~ months old or as stated in custodian statements and/or bank statements;

(b) any individual having a portfolio of not less than HK\$~~16-8~~ million, or its equivalent in any other currency, as certified by his ~~auditor-accountant~~ or as stated ~~in the current statement of account issued by his custodian in custodian statements and/or bank statements~~; and

(c) any corporation or partnership having -

(i) a portfolio of not less than HK\$~~16-8~~ 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 ~~16-24~~ months old or ~~in the~~
~~current statement of account issued by its~~
~~custodian as stated in custodian~~
~~statements and/or bank statements.~~

(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.