



Hong Kong

June 2018

SECURITIES AND FUTURES (PROFESSIONAL INVESTOR) RULES AMENDMENTS TARGETED TO TAKE EFFECT ON 13 JULY 2018

The Securities and Futures (Professional Investor) Rules (**PI Rules**) will be amended to implement modifications previously granted by the Securities and Futures Commission (**SFC**)¹ with effect from 13 July 2018, subject to the legislative process. The SFC published its consultation conclusions² to its March 2017 consultation paper³ on 18 May 2018, details of which are provided in Charltons' March 2017 Newsletter.⁴ The following provides a summary of the changes to the PI Rules.

1. Aggregation of Certain Assets for Individuals

The amendments allow portfolios held in joint accounts with non-associates and in investment corporations wholly-owned by an individual to count towards meeting the threshold to qualify as an individual professional investor.

"Portfolio" is defined in the PI Rules as a portfolio comprising securities, certificates of deposit issued by banks or money held by custodians for a person. The PI Rules define "associate" as an individual's spouse or child.

Portfolio held by a corporation owned by an individual

The consultation paper originally proposed allowing an individual to aggregate the portfolio or share of the portfolio

of any corporation (with a principal business of holding investments) wholly or partially owned by the individual in meeting the portfolio threshold for an individual professional investor. In response to comments received, the SFC decided not to allow the portfolio of a partially-owned corporation to be included, due to legal concerns that if an individual does not wholly own a corporation, he/she may not control it, so that its portfolio could not be considered to be the individual's property. Thus, only the portfolio of a wholly-owned corporation can be aggregated.

The term "principal business" will not be defined, to allow flexibility to intermediaries. Intermediaries will be expected to take reasonable steps to ascertain an individual's ownership of a corporation, including obtaining evidence necessary to substantiate this.

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

The PI Rule amendments will allow an individual's share of a portfolio held in an account jointly owned by the individual with non-associates – individuals, corporations and partnerships – to be aggregated for the purposes of meeting the professional investor threshold.

Whereas a joint account with associates permits the portfolio to be considered in full for the purpose of meeting the threshold, a joint account with non-associates will mean the individual is considered as holding a share in the portfolio, but not the whole portfolio. The PI Rules currently define "associate" as the spouse or a child of the individual, and the SFC will not be expanding this definition.

1 Under section 134 of the Securities and Futures Ordinance.
2 <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=17CP1>
3 <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=17CP1>
4 <https://www.charltonslaw.com/sfc-publishes-consultation-on-amendments-to-the-professional-investor-rules/>

Intermediaries will be expected to make reasonable enquiries about the existence of a written agreement before considering the equal share of a portfolio in a joint account, in order to avoid miscounting the actual share of the portfolio. No conditions will be imposed by the SFC on the content of the written agreement.

2. Expanded definition of corporations which qualify as professional investors

The categories of professional investors will be expanded to include:

- a) corporations whose principal business is investment holding, which are wholly-owned by one or more persons all of whom are professional investors (under the PI Rules or Schedule 1 to the Securities and Futures Ordinance (**SFO**)); and
- b) corporations that own another corporation which is a professional investor by virtue of satisfying the asset or portfolio test. This would cover a holding company which may be an offshore investment holding company which is not necessarily required to prepare consolidated annual audited financial statements causing difficulties for intermediaries in ascertaining whether the holding company meets the monetary threshold under Rule 6(a). The revised rule allows 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), which is intended to provide operational flexibility for intermediaries.

The SFC also reminds directors or shareholders of corporations to review their corporate governance structure, to ensure their shareholders are properly informed of the consequences and the impacts on them when the corporation they own qualifies as a professional investor under the amended PI Rules.

3. Allowing alternative forms of evidence

The evidential requirements of sections 3(a) to (c) of the PI Rules will be amended to permit investors to use alternative forms of evidence to demonstrate the satisfaction of the applicable assets or portfolio threshold for qualifying as a professional investor. Investors will be allowed to rely on public

filings made pursuant to legal or regulatory requirements in Hong Kong or in a place outside Hong Kong, and certificates issued by custodians, auditors or certified public accountants.

It will be a condition that public filings can be relied upon only if they were submitted within 12 months before the relevant date.

Existing modifications granted under Section 134 of the SFO will be revoked due to overlap with the revised PI Rules.

4. Relevant Date

Some respondents to the consultation paper suggested removing the term “relevant date”, which is the time reference for assessing whether a person meets the relevant assets or portfolio threshold to qualify as a professional investor, and whether a corporation has a principal business of investment holding. The SFC declined to remove the term on the basis that the requirement to assess an investor’s status on a specific date is a key element in the PI Regime and the foundation for establishing suitability requirements and investor protection.

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