

Professional Investors: Hong Kong Relaxes Requirements - At Least For Now

Amendments to the Securities and Futures (Professional Investor) Rules relaxing evidential requirements to establish whether a person qualifies as a non-institutional professional investor will facilitate dealings with persons on the basis of professional investor exemptions. However, the passage of these amendments through the Legislative Council suggests that the legislative climate for the sale of investment products to persons other than institutional professional investors remains hostile, despite a number of measures already taken to raise standards in this regard. A broad review of the professional investor regime would not be unexpected.

Whilst amendments to the Securities and Futures (Professional Investor) Rules (“**Professional Investor Rules**”) relaxing evidential requirements came into effect on December 16, 2011, the passage of these amendments through the Legislative Council highlights political difficulties for the financial industry going forward.

Background

Broadly, the Securities and Futures Ordinance (“**SFO**”) establishes 2 categories of professional investors, namely (i) institutional professional investors, which, in lay terms, includes regulated banks, insurance companies, brokers, asset managers, pension and certain other investment funds and government bodies (other than municipal governments), and (ii) non-institutional professional investors. The Professional Investor Rules prescribe who qualifies as a non-institutional professional investor, setting out 3 classes of persons:

- *High Net Worth Individuals* - any individual (“**high net worth individual**”) who has a portfolio of not less than HK\$8 million (or its

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[A] person who meets the relevant portfolio or asset thresholds will no longer be disqualified from being treated as a non-institutional professional investor on the basis that he fails to produce custodian statements or audited financial statements to evidence compliance with such thresholds.

equivalent in any foreign currency) and any corporation (“**investment holding corporation**”) the sole business of which is to hold investments and which is wholly owned by such an individual, either alone or with any of his associates on a joint account;

- *Substantial Corporations or Partnerships* - any corporation (“**substantial corporation**”) or partnership (“**substantial partnership**”) having a portfolio of not less than HK\$8 million (or its equivalent in any foreign currency) or total assets of not less than HK\$40 million (or its equivalent in any foreign currency); and
- *Trust Corporations* - any trust corporation (“**substantial trust corporation**”) having been entrusted under the trust or trusts of which it acts as a trustee with total assets of not less than HK\$40 million (or its equivalent in any foreign currency).

Securities laws exempt professional investors from a number of regulatory requirements on the basis that such investors are more sophisticated, better able to bear losses or adequately resourced to seek professional advice. Most significantly, offers of securities in Hong Kong to professional investors are exempt from authorization by a Hong Kong regulator.

Amendments

The amendments to the Professional Investor Rules facilitate dealings on the basis of professional investor exemptions, making 2 changes.

First, they dispense with the express requirement for custodian statements or audited financial statements to evidence that a person meets the portfolio or asset thresholds to qualify as a non-institutional professional investor. Consequently, a person who meets the relevant portfolio or asset thresholds will no longer be disqualified

from being treated as a non-institutional professional investor on the basis that he fails to produce custodian statements or audited financial statements to evidence compliance with such thresholds.

Secondly, the amendments include as non-institutional professional investors investment holding corporations wholly owned by substantial corporations, partnerships or trust corporations. Previously, only investment holding corporations wholly owned by high net worth individuals qualified.

Legislative Council Debate

The Securities and Futures Commission (“**SFC**”) has the power to make subsidiary legislation, such as the Professional Investor Rules, but subject to the power of the Legislative Council to amend such subsidiary legislation.

Whilst the amendments to the Professional Investor Rules ultimately passed as originally drafted by the SFC, members of the Legislative Council looked at additional hurdles for a person to qualify as a non-institutional professional investor. In particular:

- *Sophistication Test* - Some members sought to extend to the Professional Investor Rules requirements under the Code of Conduct for Persons Licensed by or Registered with the SFC (“**Code of Conduct**”) to establish a person’s knowledge, expertise and investment experience and to be satisfied as to the person’s knowledge and expertise in the products or markets in which he would deal as a professional investor.
- *Licensing Regime* - Some members canvassed the idea of introducing a licensing regime to accord status as a professional investor.

In light of the debate [over the Professional Investor Rules in the Legislative Council], a further review of the Professional Investor Rules and, possibly, the wider framework for the sale of investment products would not be unexpected.

- *Higher Thresholds* - Some members discussed the possibility of raising the portfolio threshold limit above HK\$8 million on the basis that the original threshold was set and had remain unchanged since it was introduced in 2003.

The Legislative Council debate suggests that even 3 years after the Lehman mini-bond crisis and despite measures taken by the SFC and the Hong Kong Monetary Authority to raise standards in the sale of investment products, the legislative climate for the sale of investment products to anyone other than institutional professional investors remains hostile. In light of the debate, a further review of the Professional Investor Rules and, possibly, the wider framework for the sale of investment products would not be unexpected.