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Submission to Consultation Paper issued by the Securities and Futures Commission on the Proposed Amendments to the Securities and Futures (Professional Investor) Rules (the "Proposal")

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Introduction

The Securities and Futures Commission (the "SFC") has issued a consultation paper on Proposed Amendments to the Securities and Futures (Professional Investor) Rules (the "PI Rules") on 1 March 2017 (the "Consultation Paper").

This submission is made in response to the Consultation Paper with our comments and suggestions set out below. Terms defined or given a particular construction in the Consultation Paper have the same meaning in this Response unless a contrary indication appears.

Question 1

Do you agree that the proposed amendments to the Professional Investor Rules would introduce appropriate levels of consistency and flexibility, and better serve the interests of both intermediaries and their clients? Please explain your view. Do you have any other suggestions?

The Consultation Paper has two major propositions: (1) the extension of the existing definition of Professional Investors ("PI"s) and (2) the introduction of alternative forms of evidence for corporations, trust corporations, partnerships (together, "Corporations") and individuals.

(1) Extension of the definition of PI

We generally agree with the proposition on the extension of the definition of PI save for some parts, which are likely to cause deviation of the PI Rules from the SFC's existing position in enhancing clients' protection.

In the past 3 years, the SFC has been actively revising the laws and regulations to better protect investors' interests and ensure market integrity. Prior to the Consultation Paper, the SFC introduced amendments to the PI Regime that has taken effect on 25 March 2016 ("New PI Regime"), with new client agreement clause that will be effective on 9 June 2017 and the proposals to enhance the regulation of the asset management industry in Hong Kong in November 2016.

In particular, under the New PI regime, the SFC introduced Corporate Professional Investors Assessment ("CPI Assessment") and reinstated the suitability requirement that requires Intermediaries to ensure certain PIs' product suitability as to protect them from the possible event of mis-selling. In short, certain PIs enjoy the same degree of investors' protection as retail investors while they gain access to a wider scope of investment products to both SFC-

authorized and unauthorized investment products such as private funds. The distinction between retail investors and PIs is becoming blurred.

The Consultation Paper extends the scope of PI by widening the definition. Under Rule 7 of the revised PI Rules, if any individuals or Corporations satisfied the relevant threshold, companies wholly or partially owned by the parties as well as their subsidiaries and shareholders will all be deemed PIs. We are of the view that a certain degree of extension of the definition is acceptable. However, the Consultation Paper and the revised PI Rules have been broadened to capture parties who should not be deemed PIs and has failed to maintain the consistency with the SFC's position on investors' protection. This point will be further elaborated in the response to questions 2(b) and 3.

(2) Allowing alternative forms of evidence

We agree with the proposition of allowing public filing and certificates issued by auditors (for Corporations) and custodian as alternative forms of evidence but disagree with the proposition that specific types or categories of documents and the extent of details should be prescribed in the PI Rules. We are of the view that the SFC should defer to Intermediaries the discretion as to which type of evidence is acceptable for satisfying the PI requirement. However, the SFC may provide the guidance in this regard to preserve the flexibility in the PI Rules. This point will be further elaborated in the response to question 4.

Question 2

Do you agree that section 3(b) of the existing Professional Investor Rules in relation to individuals should be extended so that:

a) an individual's share of a portfolio that is held in a joint account with a non-associate can be counted towards meeting the prescribed threshold to qualify as a professional investor (as outlined in paragraph 14(b) above and provided for in Rule 6(1)(c) in Appendix A)? Please explain your view.

We agree with the proposition that an individual's share of a portfolio that is held in a joint account with a non-associate can be counted towards meeting the prescribed monetary threshold to qualify as a professional investor.

Under section 2 of the existing PI Rules, an associate is defined as the spouse or any child of the individual who only covers a very limited group of people. To cater the actual need of the

society and the possibilities of non-associates doing business together, we agree with the SFC's examples of acceptable definitions for non-associates.

In determining the share of an individual's portfolio held in a joint account with a non-associate for the purpose of meeting the prescribed threshold, we propose that the individual's share is either based on the share specified in the written agreement between the account holders or an equal share of the portfolio in the absence of a written agreement (as provided for in Rule 6(2) in Appendix A). Do you agree with our approach? Please explain your view.

We agree with the proposition that the individual's share of the portfolio is based on the share specified in the written agreement between the account holders. However, we disagree that the share of the portfolio is deemed to be on an equal share in the absence of a written agreement between the account holders, which we believe is likely to be abused.

The written agreement between the holders of the joint account ("Joint Account Holders") is privately concluded and the Intermediaries have no right of access to the agreement without the express consent of the Joint Account Holders. Under the current proposal, if one of the Joint Account Holders refuses access by the Intermediaries, the share of the portfolio between the account holders will be considered as equal share in the absence of a written agreement. Under such presumption, the share of the majority Joint Account Holder will be understated for his share being considered equal to his counterpart minority Joint Account Holder. As such, minority Joint Account Holders may have strong incentive to refuse Intermediaries in access the agreement in order to overstate their shares. As a result, the purpose of this asset requirement assessment may be defeated and the mechanism may be easily manipulated and abused.

Due to the private nature of the information, the individual who requests for the inclusion of joint account as asset has the burden of proof to illustrate his share in the joint account. Not only that Intermediaries do not have the professional knowledge as an auditor and/or a court to decide the respective entitlement of one of the Joint Account Holders, they should also independently assess an individual's financial status. As a result, if an individual cannot provide written agreement of the joint account, the individual's asset in the joint account should be accounted for 0%.

We understand that some joint accounts are held in a social context where no written agreement has been prepared at the time of opening. Hence, we suggest that the individual can provide a written declaration made by the holders of the joint account to evident the agreed entitlement to the joint account. Further, the evidential requirement should be further revised to include this document as an alternative form of evidence.

b) an individual's portfolio or share of a portfolio held by a corporation, the principal business of which is to hold investments and which is wholly or partially owned by the individual, can be counted towards meeting the prescribed threshold to qualify as a professional investor (as outlined in paragraph 14(a) above and Rule 6(1)(d) and Rule 6(1)(e) in Appendix A)? Please explain your view. Do you have any other suggestions?

We agree with the proposition that an individual's portfolio or share of a portfolio that is held by an investment vehicle can be counted towards meeting the prescribed monetary threshold to qualify as a professional investor to the extent that the concerned corporation is wholly owned by one individual but not partially owned.

We would like to remind the SFC that the proposition would in substance go against the established principles of Company Law that companies have separate legal personalities. As a fundamental principle of Company Law, a company has an independent legal existence separate from its shareholders, directors and officers. Both the legal title and beneficial interest of assets held by a company thus lies with the company itself instead of its shareholders, directors or officers, unless stipulated by a separate agreement. In order to consider the portfolio held by a corporation as assets of its individual shareholder(s), it would in substance lift the corporate veil of the corporation.

Accordingly, the SFC should ensure that the proposed aggregation of an individual's portfolio or share of a portfolio that is held by an investment vehicle shall only be limited to the sole purpose of assessing the PI status of investors and not applicable in the case of liability considerations. The SFC is advised to keep in mind any legal implications that may be invoked in light of the present proposition.

In another aspect, the interpretation as to when would a corporation be determined as having a principal business of holding investments is blurred which the SFC must further clarify. Obviously, the burden of proof shall be on the individual who seeks aggregation of the assets held by the investment vehicle. The question is what kind of proof or to what extent does the SFC expects from the individual. It has been mentioned in the consultation paper that a corporation may be considered a qualified investment vehicle even if it is involved in other businesses which it may not materially affect or detract from their principal business of investment holding. We found this statement somehow confusing as it has not provided Intermediaries with clear guidance in determining what satisfy as principal. To avoid uncertainty, we suggest that the SFC should only accept companies that are set up solely for investment purposes in this respect. Accordingly, the SFC can provide further elaboration and in particular suggest some advice for Intermediaries to consider when making such decisions.

Similar to the case concerning the shares held by respective holders of a joint account, the present proposal also calls into question the proportion of share that each individual may be

entitled to in the case where the investment vehicle is held by more than one individual. Unless further elaboration is offered by the SFC, we are of the view that the proposition of aggregating an individual's portfolio or share of a portfolio that is held by an investment vehicle should only be limited to wholly-owned corporations but not applicable if the corporation is jointly owned.

Question 3

Do you agree that the scope of the existing Professional Investor Rules should be extended so that:

a) any corporation, the principal business of which at the relevant date is to hold investments and which is wholly owned by one or more of the persons where each of them is qualified as a professional investor, will qualify as a professional investor (as outlined in paragraph 14(c) above and provided for in Rule 7(b) in Appendix A)? Please explain your view.

We agree with the proposition that any corporation, the principal business of which at the relevant date is to hold investments and which is wholly owned by one or more of the persons where each of them is qualified as a professional investor, will qualify as a professional investor. Other than Rule 7(b)(v), Rule 7(b) of the revised PI Rules is equivalent to the existing Rule 3(d).

In essence, Rule 7(b)(v), which includes subsidiaries of the Institutional PI as PIs, is consistent with the meaning prescribed in the Consultation Paper.

b) any corporation, which wholly owns another corporation which has been qualified as a professional investor under the Professional Investor Rules by meeting the asset or portfolio threshold, will qualify as a professional investor (as outlined in paragraph 14(c) above and provided for in Rule 7(c) in Appendix A)? Please explain your view. Do you have any other suggestions?

We agree with the proposition of any corporation, which wholly owns another corporation which has been qualified as a professional investor (the "CPI") under the PI Rules by meeting the asset or portfolio threshold, will qualify as a PI.

Question 4

Do you agree that the evidential requirements set out in section 3(a) to (c) of the existing Professional Investor Rules (as outlined in paragraph 11(b) above) should be extended to

include public filings and certificates issued by auditors, certified public accountants or custodians (as outlined in paragraph 14(d) above and provided for in Rule 9 in Appendix A)? Are these alternative forms of evidence used commonly by intermediaries as proof of clients meeting the stipulated monetary thresholds? Please explain your view.

We agree in principle with the proposition introduced in the Consultation Paper that the evidential requirements should be extended to include certificates issued by auditors, certified public accountants or custodians (together, the "certifications"). At first sight, the proposal appears to allow greater flexibility from a client perspective. However, in practice, the effectiveness and feasibility of potential PIs using public filings to prove their financial status remain doubtful.

We acknowledge that the SFC currently adopts a dual approach for Intermediaries to ascertain the relevant assets or portfolio thresholds for high-net-worth professional investors. The two approaches are namely a principles-based approach which in essence allows self-certification by clients and in the alternative a more prescriptive approach where Intermediaries may obtain certain evidential documents from clients as set out under the existing PI Rules.

The concept of allowing clients to establish their fulfillment of the relevant assets or portfolio requirements through self-declaration stems from the SFC's Consultation Conclusions on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules published in February 2011. In that consultation conclusion, the SFC also emphasized that this approach is based on the presumption that Intermediaries should have sufficient knowledge about their clients for making such decision after having complied with the "know-your-client" requirements under the Code of Conduct. In this sense, Intermediaries have the flexibility to decide on using what methods to establish an investor's status as long as those methods are appropriate in the circumstances and proper records of the assessment process are kept.

As an alternative to the principles-based approach, Rule 3 of the existing PI Rules provides that certain evidential documents such as audited financial statements, custodian statements and certificates issued by an auditor or a certified public accountant could be accepted by intermediaries as proof for the relevant assets or portfolio thresholds.

Although audited financial statements have been a prescribed mean under the existing PI Rules, it has proven to cause inconvenience to the applicable corporations, trust corporations and partnerships. On one hand, unlike public companies, private companies in Hong Kong are not required to publish their financial documents through filing with the Companies Registry. As such, these documents are private in nature to the applicable parties. On the other hand, audited financial statements contain income statement which may be unnecessary for the purpose of confirming the PI status of corporations, trust corporations and partnerships. As such, audited financial statements tend not to be a popular mean of evidence in actual practice.

By broadening the acceptable evidential documents, the applicable parties can preserve the privacy of their financial information while providing reliable information for Intermediaries to rely on. In addition, this amendment will eliminate the difference between the evidential requirement for individual and the applicable parties. Hence, in long run, this introduction can improve the business efficiency when the Intermediaries deal with a corporation, trust corporation or a partnership.

In addition, by stipulating a same set of acceptable evidential documents for different PIs, the proposed arrangement could facilitate the adoption of the extended definition of PI and could reduce the ambiguity of the existing rules which apply different evidential requirements to different categories of PIs.

However, the effectiveness of the adoption of the public filing appears to be doubtful since the types of relevant public filings in Hong Kong are limited as the Companies Registry, the Land Registry and the HKEx News being the few public registry or database that keeps relevant records. In the case of HKEx News announcements, only listed companies' substantial shareholders may be identifiable, i.e. anyone possessing more than 10% of shareholding of a listed company, but it is not clear if the relevant shares are subject to any incumbency. In reality, this only applies to a very limited population. Adding to the uncertainty is that records available on the Companies Registry may not always be updated and proven as the registrar adopts a trust mechanism relying on self-declaration made by companies.

If so, do you also agree that the Professional Investor Rules should prescribe the types or categories of documents that could be regarded as "public filings" and the extent of details to be included in the content of "certificates" issued by auditors, certified public accountants or custodians? Please explain your view. In particular, which documents are used in practice as "public filings" and "certificates" issued by auditors, certified public accountants or custodians? Please provide examples.

We are of the view that the SFC should defer the discretion as to the content of the public filing and Certificates to Intermediaries in order to cater to different needs of investors. By prescribing the types or categories of documents that could be regarded as "public filings" and the extent of details to be included in the content of "certificates", this creates more confusion than assistance to Intermediaries.

We note that under Rule 2 (Interpretation) of the revised PI Rules, "public filing" has been given a rather broad definition. We envisage that possible examples public filings may cover records from the Companies Registry, the Land Registry and the HKEx News. In this respect, we would like the SFC to provide a non-exhaustive list of examples for Intermediaries to consider as a

general guidance, while using terms such as “including but not limited to” to demonstrate that the examples shall not be prescriptive in nature but only as reference for Intermediaries.

Question 5

Do you have any other comments on the indicative draft of the proposed Professional Investor Rules in Appendix A? Please explain your view. Do you suggest any alternative wording for the proposed rules? If so, please give your suggestions and explain your view.

We welcome the SFC’s move in giving each category of professional investors under separate headings. We believe that by doing so it would be easier for readers to find the applicable requirements to a specific class of PIs.

It is also welcomed that the SFC has not altered the definition of institutional investors as well as the monetary thresholds and the scope of portfolio that currently apply. We also observed that the definition of “custodian statement” has been removed from the existing PI Rules which we agree since the term is self-explanatory and that it has been covered under Rule 9(b)(i) of the revised PI Rules.

Conclusion

In respect of the above questions, we are of the view that the proposed amendment in questions 2 and 3(a) are reasonable but the benefits that can be brought to the efficiency of the industry is minor. Meanwhile, the amendments in question 3(b) and 4 would likely pose practical challenges to Intermediaries. Hence, we are of the view that the respective PI Rules shall maintain status quo at this stage.

Intermediaries have already been continuously amending their internal policy in order to cater for the changes on the PI Rules as introduced by the SFC in recent years. For the present proposal to be implemented, Intermediaries will be required to further amend documents, such as compliance manual, PI declaration forms, subscription form and client agreement for the third time within 3 years. This will definitely add compliance costs and administrative burdens to Intermediaries such as Independent Financial Advisors, brokerage houses, private banks and fund managers. We suggest the SFC to offer an 18-month to 24-month transitional period to the industry.

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