

Investment Management Alert

November 3, 2014

Conclusion of Consultation Paper on Proposed Amendments to Hong Kong Professional Investor Regime

Summary

The Hong Kong Securities and Futures Commission (SFC) issued a consultation paper titled “Consultation Paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements on 15 May 2013” (the Consultation).

On 25 September 2014, the SFC released its conclusions (the Consultation Conclusions), which detail a number of significant amendments to the Code of Conduct for Persons Licensed By or Registered with the Securities and Futures Commission (the Code) with respect to the treatment of certain categories of professional investors, and a further consultation on the client agreement requirements.

The Consultation Conclusions, including the impending amendments to the Code and the further consultation on client agreement requirements, are available in full [here](#).

The amendments to the Code, which are summarized below, will become effective 18 months from the date of the Consultation Conclusions, being 25 March 2016:

- the introduction of a requirement that all category B professional investors (as defined below) who are individuals be treated as non-professional investors for the purposes of the Code. (The current position, which is outlined in the attached appendix, is that category B professional investors may be treated as professional investors for the purposes of the Code if they meet certain requirements as to their level of sophistication and understanding of the product sold).
- that category B professional investors that are corporations may continue to be treated as professional investors for the purposes of the Code where they satisfy a principles-based assessment of knowledge and investment experience and have given their consent to be treated as a professional investor.

The Consultation had identified the possible amendment of the current monetary thresholds outlined in the attached appendix but the Consultation Conclusions confirmed that the current position would remain unchanged.

Revocation of Right to Waive Certain Provisions of the Code in respect of High Net Worth Individuals

Currently category B professional investors that meet the requirements of a sophistication test, may be treated as professional investors for the purposes of the Code, which allows certain requirements of the

Code to be dispensed with by intermediaries, for example, the obligation to conduct a suitability test and enter into a client agreement.

From 25 March 2016, the more substantive of these requirements may no longer be dispensed with in respect of high net worth individuals, notwithstanding any levels of sophistication.

A sophistication test will remain applicable for corporate professional investors but the current, rather prescriptive, sophistication test, which, briefly, requires an assessment of the investor's experience in the type of product, frequency of trading by the relevant investor, dealing experience, knowledge and expertise in relevant products and awareness of risks in trading in relevant products or markets, will be replaced by a principles-based test. The SFC acknowledged in the Consultation Conclusions that these bright-line tests were not rigidly applied in practice and, as a result, a principles-based test would be more appropriate.

The new principles-based test, as applied to corporate category B professional investors, including investment vehicles that are wholly owned by individual professional investors and family trusts, will have three requirements which are as follows: (i) appropriate corporate structure and investment process and controls; (ii) the person(s) responsible for making investment decisions having sufficient investment background; and (iii) awareness of the risks involved.

The amendments represent a significant departure from the current position, in particular in respect of the treatment of high net worth individuals.

Client on-boarding processes will be required to be reviewed and updated so as to ensure compliance with the changes to the Code by 25 March 2016.

Proposed Changes to the Client Agreement

The Consultation proposed that the Code suitability requirements be incorporated into client agreements as a contractual term and that intermediaries be prohibited from putting terms in client agreements that are inconsistent with the provisions of the Code. Whilst the Consultation Conclusions did not implement any changes in respect of client agreement, a further consultation was initiated, which proposes certain amendments to the Code (the proposed amendments are available in full [here](#)), including that the clause below be inserted into client agreements:

"If we [the intermediary] solicit the sale of or recommend any financial product to you [the client], the financial product must be reasonably suitable for you having regard to your financial situation, investment experience and investment objectives. No other provision of this agreement or any other document we may ask you to sign and no statement we may ask you to make derogates from this clause."

Industry participants have been invited to submit comments by 24 December 2014.

Client agreements will be required to be reviewed and, potentially, updated, if new requirements in respect of same are implemented following the conclusion of the further consultation on client agreements.

Any such amendment to client agreements would necessitate a review of, and if necessary an update to, investment fund subscription forms, in particular in relation to intermediaries and high net worth individuals.

Suitability Requirements

The SFC have confirmed that they will conduct a detailed internal study of the Suitability Requirement (i.e. the need to ensure the suitability of a recommendation or solicitation), which will include the gathering of industry views on this issue.

Contact Information

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