



香港財經分析師學會

THE HONG KONG SOCIETY OF FINANCIAL ANALYSTS

14th August 2013

Sent by Email and by Post

Intermediaries Supervision Department
Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

Dear Sirs,

Re: Consultation Paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements

The Hong Kong Society of Financial Analysts ("HK SFA") appreciates the opportunity to participate in the Securities and Futures Commission (SFC)'s consultation paper regarding the amendments to the professional investor regime and the client agreement requirements.

The HK SFA welcomes the proposed measures to enhance the existing professional investor regime and the client agreement requirements. We understand that the SFC has not proposed any change to the current private placement regime which is considered to be well established and consistent with the stance taken in other major overseas jurisdictions. But instead the focus is on whether individuals and corporate professional investors should continue to be allowed to participate in private placements and whether the monetary thresholds should be increased. All in all, HK SFA believes that increasing the minimum threshold alone will not give extra protection to professional investors. Exemption should only be granted if there is good rationale for taking the investment on a portfolio basis for an individual professional investor. For corporate professional investors, exemption should be granted only if there is good rationale for taking the investment from the business perspective. The SFC's proposal is generally in line with the HK SFA's mission of raising the standard of practice as well as the ethical standard of the financial professionals in Hong Kong.

Based on our positions, we state our comments to the specific questions as set out in the Consultation Paper as follows :

Q1. Should Corporate and Individual Professional Investors continue to be allowed to participate in private placement activities?

Private Placements are necessary to facilitate capital raising on an accelerated basis. Professional investors regularly participate in private placements and rely on the listing obligations of the company when making the investment. It would not be appropriate to apply a binary approach to exclude corporate and individual investors as investment expertise and experience will differ between investors within these groups.

If additional suitability assessments are required, then further guidance or checklist should be provided by the SFC on how to administer the rules. The process needs to be time sensitive and easy to administer. If lengthy suitability assessments are required each time there is a private placement, then this will likely result in intermediaries excluding individual and corporate professional investors from the deal as there is only a very limited window of time for investors to respond to private placement deals – most deals are announced at 4-5 pm HK time and deals are closed within 2 hours and allocations announced by 7 pm HK time. Any suitability requirements in the form of additional documentation requirements may not be effective as investors may just provide confirmation if they want to participate in the deal.

Corporate and Individual Professional Investors should continue to be allowed to participate in private placement activities which align with other major overseas jurisdictions.

Q2. Do you think that the minimum monetary thresholds for Corporate and Individual Professional Investors should be increased?

We believe the current minimum thresholds for corporate & individual professional investors are adequate. Further increasing the minimum thresholds may not create extra protection to investor. Indeed, the focus should be on type of professional investors that need extra protection.

A high net worth individual is not always a professional investor. Increasing the monetary thresholds does not address investment experience and expertise.

Q3. Do you agree that intermediaries should observe the Code without exception when they deal with individuals?

Yes. We agree that intermediaries should observe the Code without exception when dealing with individuals. For individual professional investors, our view is extra protection is necessary even they met the minimum monetary thresholds. Intermediaries can judge the suitability from a combination of factors including knowledge, dealing experience, net worth to withstand potential risk, etc. to form a recommendation.

Intermediaries should ensure the suitability of the recommendation or solicitation for an individual is reasonable in all circumstances based on the investor's investment experience and risk objectives. This fiduciary duty should always apply regardless of the net worth of the individual.

Q4. Do you agree that investment vehicles wholly owned by individuals and by family trusts should be treated on the same basis as individuals under the Code?

Yes. Investment vehicles wholly owned by individuals and by family trusts should be treated as individuals and offered the same level of protection.

Exemption as professional investors can be entertained if the investment or hedging products match their business need. For example, commodity related company entering contracts to hedge commodity price or manufacturer entering contracts to hedge FX exposure. It should be acknowledged by the investor and filed for documentation. Intermediaries should also exercise due diligence and understand the business nature of the corporates in order to exercise second level of control.

However, we are aware that some investment vehicles owned by individuals and family trusts to be treated as individuals under the Code may hire an investment professional to run the investment vehicle on their behalf.

Q5. Do you agree that a principles-based Knowledge and Experience Assessment should dispense with bright line tests concerning dealing experience?

Yes. We support a principles-based Knowledge and Experience Assessment to ensure that corporate professional investors are sufficiently sophisticated to dis-apply those specified Code protections. The assessment should be "principles-based" covering factors such as the corporate structure, the investment process, how investment decisions are made, and the background of the relevant person responsible for making investment decisions on behalf of the corporation.

The “bright-line” tests serve as a practical guideline and can be further simplified once the principle-based Knowledge and Experience Assessment framework is well established.

Having that said, the current assessment criteria for corporate professionals are easy to administer and measure. Although a principles-based approach would be more meaningful, a lengthy suitability assessment would be highly administrative and counter-productive. An extreme example would be the account opening process in India which may require more than 3-6 months to complete for foreign investors. As a result, the Securities and Exchange Board of India (SEBI) has recently accepted recommendations from the market to simplify foreign investors market entry requirements into a new category and abolishing SEBI registration.

Q6. Do you have any views on the Suitability Requirement?

We opine that the Suitability Requirement in general should be applied by Intermediaries to all the investors to ensure a fair selling process with right level of investor protection. However, specific occasions such as the cases below warrant a further look into potential dispensation.

With regards to limiting the ability of intermediaries to dis-apply any Code requirements including the Suitability Requirement for individual professional investors, investment vehicles wholly owned by individual professional investors and family trusts, we would urge the SFC to carefully consider the need for this in light of actual cases of mis-selling for these categories and to balance this with the effect it could have on local start-up investment managers. New investment managers commit their own funds and often other funds they may have access to, for instance so-called “friends and family”. It would be detrimental to Hong Kong’s competitiveness as a financial market to hamper the development of start-up businesses.

In United States, accommodation could be made to allow for ‘knowledgeable employees’ to participate in investments (in funds) alongside investors. This would allow a greater alignment of incentives with investors and give fund managers additional scope for rewarding employees by allowing access to more investment opportunities in which the employees have an expert understanding. Having said that, the definition of “knowledgeable employees” would require further guidance by the regulators.

Q7. Do you agree with the above proposals in relation to the client agreement?

Inclusion of the suitability as contractual undertaking:

Disagree. The Suitability Requirement should NOT be incorporated into client agreements as a contractual term. The suitability test could be subjective and vary significantly across a wide range of product offerings. We opine that investor protection would be better facilitated by regulations protecting investors. Mandating suitability requirements to be included in the client agreement would likely increase volume of litigation where the parties dispute on the application of the suitability requirements. This would result in the court taking a larger role in matters which it may not be well placed to judge on. In addition, it would not be an efficient use of the court’s expertise and resources.

If the SFC is minded to pursue this proposal, the HKSFA would ask the SFC to consider differentiating the extent and depth of suitability obligations in terms of solicitation and recommendation. For instance, there should be distinction between a general solicitation of an asset class versus an active solicitation and recommendation on a specific investment based on client’s unique circumstances, and whether or how an intermediary is being remunerated.



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No inclusion of clauses that are inconsistent with the Code or which mis-describe the actual services provided to clients:

Agree. The client agreements should not contain terms which are inconsistent with the Code and should accurately set out in clear terms the actual services to be provided to the client.

HKSFA appreciates the opportunity to comment on SFC's consultation paper on the amendments to the professional investor regime and the client agreement requirements. We trust you find our comments useful and constructive.

Yours Sincerely,
For and on behalf of
The Board of The Hong Kong Society of Financial Analysts

Advocacy Chair :
Jimmy Jim, CFA / Ashley Khoo, CFA

Chief Executive Officer :
Cheri Wong, CFA