

Author: Yeung Yuen Kin, Lawrence  
Practice Area: Financial Services  
Date: 12<sup>th</sup> April, 2016

## **NEW PROFESSIONAL INVESTOR REGIME**

---

### **EFFECTIVE DATE OF NEW REGIME**

The consultation conclusion of the Securities and Futures Commission (the “SFC”) dated 25<sup>th</sup> September 2014 concluded to replace the entire old paragraph 15 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the “Code”) with a new paragraph 15 of the Code. Thus, professional investor regime has rolled up a new chapter following the commencement of new paragraph 15 of the Code which is effective from 25<sup>th</sup> March 2016.

### **NEW TYPE OF PROFESSIONAL INVESTOR?**

In the first instance, a new type of professional investor known as “Corporate Professional Investor” is created by the new Code and carved out from the retail professional investors. However, it is entirely misconceived when new paragraph 15 of the Code is read verbatim. While the Securities and Futures (Professional Investor) Rules (the “Rules”) remains unchanged at its entirety, the SFC has, merely by virtue of new paragraph 15 of the Code, named a new type of professional investor (i.e. Corporate Professional Investor) falling under sections 3(a), (c) and (d) of the Rules. Thus, the SFC has not created a new type of professional investor at all and only renamed the types of professional investors under the Rules instead and makes types of professional investors more distinctive for compliance purpose. Thus, the term “Corporate Professional Investor” is nothing more than a new terminology but it triggers manifest impact on compliance policies and procedures indeed.

Under new paragraph 15 of the Code, three types of professional investors are comprised of, namely:-

- Institutional Professional Investor (falling under paragraphs (a) to (i) of the definition of professional investor in Section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (the “SFO”) (e.g. recognized exchange company, authorized financial institution and insurer));
- Corporate Professional Investor (i.e. trust corporation, corporation or partnership falling under sections 3(a), (c) and (d) of the Rules); and
- Individual Professional Investor (i.e. individuals falling under section 3(b) of the Rules).

## **ASSESSMENT REQUIREMENTS UNDER OLD PARAGRAPH 15.3 OF THE CODE DISPENSED WITH**

The consultation conclusion summarized that the industry finds it very difficult to obtain waiver under old paragraph 15.5 of the Code given that it has a “Bright line” test under old paragraph 15.3 of the Code (e.g. 40 transactions for 2 years). Therefore, the assessment methodology under old paragraph 15.3 of the Code is entirely removed and substituted with a “Principles-based” assessment approach as prescribed in paragraph 15.3A of Code, which provides more flexibility to the industry but is only relevant to Corporate Professional Investor. It is however anticipated that licensed or registered persons would be more vulnerable to enforcement actions taken by the SFC in the event that the “Principle-based” assessment is not appropriately mastered and applied.

## **NEW ASSESSMENT REQUIREMENTS UNDER PARAGRAPH 15.3A OF THE CODE**

Under new paragraph 15.3A of the Code, the assessment requirements in relation to Corporate Professional Investor are set out as follows:-

- (i) Corporate Professional Investor has the appropriate corporate structure and investment process and control (e.g. how investment decisions are made and whether it has a specialized function responsible for investment decision making);
- (ii) The investment background of the person responsible for making investment decision; and
- (iii) The Corporate Professional Investor is aware of the risk involved which is considered in terms of the person(s) responsible for investment decision making.

Therefore, the assessment should be commenced from a corporation wide perspective (e.g. resources of the corporation) and extended to include the person responsible for making investment decisions (e.g. the relevant person’s dealing experience and knowledge).

In addition, it is mandatorily required that the licensed or registered person should keep audit trail of the assessment and separate assessment for (i) different product types; or (ii) markets should be made. Further, it is also a regulatory requirement that a new assessment should be undertaken for those Corporate Professional Investors who have ceased to trade in the relevant product or market for more than 2 years. All these regulatory requirements are in principal same as those under the old Code.

## **WAIVER UNDER NEW PARAGRAPH 15 OF THE CODE**

Waiver under new paragraph 15 of the Code applies to Corporate Professional Investor and Individual Professional Investor but the extent of waiver is not the same. In the past, the industry is minded to classify clients as professional investor whereby waiver of suitability obligations, which is one of the most significant waivers under old paragraph 15 of the Code, will be sought.

Under the new paragraph 15 of the Code, suitability obligation could be waived if and only if the professional investor is a Corporate Professional Investor as defined under new paragraph 15 of the Code. That is to say, waiver of suitability obligations is no longer applicable to Individual Professional Investor.

### **EXCEPTION UNDER SECTION 103 OF THE SFO**

Since the new professional investor regime does not amend or alter the Rules and the SFO, exception under section 103 (1)(3)(k) of the SFO is still available and licensed or registered person is entitled to invoke exception thereunder to sell unauthorized collective investment scheme to professional investor (whether Corporate Professional Investor or Individual Professional Investor as categorized under new paragraph 15 of the Code) provided that it has honoured suitability obligations. Under that exception, the licensed or registered persons may also sign up a professional investor agreement with the Corporate Professional Investor as prescribed under new paragraph 15.3B(a) of the Code to waive its suitability obligation pursuant to paragraph 15.4 of the Code.

### **CONSEQUENTIAL AMENDMENTS**

Further, consequential amendments to paragraph 5 and paragraph 8 of the Code by deleting the provisions relevant to professional investor therein are also made.

### **CLIENT AGREEMENT REQUIREMENT**

The SFC observed that suitability obligation is only a regulatory obligation under the Code and some licensed or registered persons include clauses in client agreement to waive suitability obligation. Those clauses will prohibit clients from making claim against licensed or registered persons who default in performing suitability obligations. Thus, the SFC has also concluded that amendments be made to the client agreements in the Code and the deadline for amendments falls on 9<sup>th</sup> June 2017. This new client agreement requirements shall be discussed in a separate article to follow.

Kindly note that this article is written for general reference only and shall not be construed as a legal advice. Should you have any query about the new Code, you should seek independent legal advice.

---