



**IFPHK's Response to the Consultation Paper
Issued by the Securities and Futures Commission on the
Evidential Requirements under the Securities and Futures
(Professional Investor) Rules**

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IFPHK Profile

Background

The Institute of Financial Planners of Hong Kong (“IFPHK”) was established in June 2000 as a non-profit organization for the fast-growing financial industry. It aims to be recognized in the region as the premier professional body representing financial planners who uphold the highest standards that benefit the public.

The Institute is the sole licensing body in Hong Kong authorized by Financial Planning Standards Board Limited¹ to grant the much-coveted and internationally-recognized CFP² certification to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 10,000 financial planning practitioners in Hong Kong from such diverse professional backgrounds as banking, insurance, independent financial advisory, stockbroking, accounting, and legal services.

Currently there are over 126,000 CFP professionals in 23 countries/regions; the majority of whom are in the U.S., Canada, Australia and Japan. There are more than 4,000 CFP professionals in Hong Kong.

To develop and maintain a high professional standard, IFPHK has put in place a vigorous certification process to ensure that all its CFP professionals meet the requisite standards known as the 4Es, namely education, examination, experience and ethics.

The CFP professionals are also required to follow the FPSB 6-step financial planning process in their front-line activities that is designed to provide suitable advice to clients. These include:

Step 1: Establish and define the relationship with the client

Step 2: Collect the client’s information

Step 3: Analyze and assess the client’s financial status



Step 4: Develop the financial planning recommendations and present them to the client

Step 5: Implementing the client’s financial planning recommendations

Step 6: Review the client’s situation

Promotion of professionalism

Since its inception, IFPHK has been striving to raise public awareness of the financial planning industry in Hong Kong and highlight the high standards that CFP professionals adhere to. In addition to consumer seminars, IFPHK has jointly organized with regulators various projects, including developing educational literature and organizing pro bono financial clinics. In 2006, with

¹ FPSB was established in October 2004 by 17 non-profit associations that together certify over 45,000 individuals outside the U.S. to use CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM} and  marks and that have joined FPSB as members. FPSB will protect financial planning consumers and foster professionalism in financial planning through the ongoing development and enforcement of relevant international competency and ethics standards. FPSB will also promote greater global recognition of CFP certification and its related marks as the international hallmarks of financial planning professionals. CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM} and  are certification marks owned outside the U.S. by Financial Planning Standards Board Ltd. (FPSB). The Institute of Financial Planners of Hong Kong is the marks licensing authority for the CFP marks in Hong Kong and Macau, through agreement with FPSB.

² CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM} and  are certification marks owned outside the U.S. by Financial Planning Standards Board Ltd. The Institute of Financial Planners of Hong Kong is the marks licensing authority for the CFP marks in Hong Kong and Macau, through agreement with FPSB.

contributions from our patrons, leading industry practitioners and experts, IFPHK published the *IFPHK Practice Guide for Financial Planners*. The Guide is the first set of guidance materials for financial planners to practise in Hong Kong. To supplement this effort, IFPHK launched the first Guidance Note entitled *Suitability of Advice Obligations: Documenting your Financial Advice* for members. In the near future, we will continue providing more practical support to members and will target to roll out more guidance notes for practitioners' daily references.

Earlier this year, IFPHK had participated in a global job analysis review and international studies that analyzed financial planning job skills. Through this process, IFPHK gained professional insights into core characteristics and practice *vis-à-vis* Hong Kong's financial planning practitioners and international CFP professionals.

IFPHK's interest in this consultation

The global financial crisis and the subsequent investor complaints against the marketing of products such as accumulators by financial institutions have drawn the attention of the regulators to the regulation of financial products sold to high net worth clients known as Professional Investors.

Generally speaking, Professional Investors are perceived to possess the experience, knowledge and financial resources to make their own investment decisions. While Professional Investors are not offered the same level of protection that retail consumers may need, they can access investment opportunities that are not available to retail consumers.

Since Professional Investors form an important part of our members' clientele, IFPHK as the leading professional institute representing the interests of the financial planning industry shall respond to any consultation paper that may impact our members and their clients. In December 2009, IFPHK provided its views and recommendations on the proposed reforms for the Professional Investor regime as part of the response to Consultation Paper by Securities and Futures Commission ("SFC") entitled *Proposals to Enhance Protection for the Investing Public*. To continue serving the financial planning community, IFPHK has taken a strong interest to express its views on the proposed changes as stipulated in the Consultation Paper.

IFPHK's representation

IFPHK was founded by 30 members (subsequently named Founding Members) to raise the standards of financial planners and highlight the importance of sound financial planning.

IFPHK currently has 64 Corporate Members, including banks, independent financial advisors, insurance companies, and securities brokerages. With our Corporate Members providing a full spectrum of the client services and products, IFPHK is well positioned to understand the needs, concerns and aspirations of the financial planning community. When formulating its response to this consultation, it sought the views of its Corporate Members who are active in the market.

Executive Summary

The SFC issued the Consultation Paper on Evidential Requirements under the Securities and Futures (Professional Investor) Rules (the "Consultation Paper") in October 2010. It then invited comments from market participants and the public on the relevant proposals set out in the Consultation Paper.

The Consultation Paper explains SFC's proposals to refine the evidential requirements under the Securities and Futures (Professional Investor) Rule (Cap.571D) ("Professional Investor Rule"). Evidential requirements refer to the specific methods set out in the Professional Investor Rule to ascertain the relevant assets or portfolio thresholds of different types of Professional Investors.

In considering the proposed changes in the Consultation Paper, IFPHK supported the adoption of a principle-based approach by the SFC to ascertain the asset or portfolio threshold of an investor in order to classify him or her as a Professional Investor. IFPHK believes that this could provide more flexibility to the market participants in principle.

However, IFPHK is concerned over the specific time reference requirement as suggested in the Consultation Paper. This requires institutions to obtain documental evidence about an investor's asset or portfolio threshold at the relevant date. IFPHK felt that implementing the specific time reference requirement can be onerous and costly without substantially enhancing value to the investing public.

In addition, IFPHK also supports the proposal to extend section 3(d) of the Professional Investor. Nonetheless, IFPHK notes that there are market demands to modify section 3(b) of the Professional Rule, which has not been addressed by the SFC in the Consultation Paper.

In conclusion, IFPHK supports most of the proposed changes set out in the Consultation Paper including:

- Adoption of a principle-based approach so that institutions could exercise professional judgment to decide the methods by which they can satisfy themselves that their clients have the required assets or portfolio levels to be Professional Investors
- Preservation of the existing practice as set out in sections 3(a) to 3(c) of the Professional Investor Rule so that market participants can continue requiring accountant's certificate or custodian statements
- Extension of section 3(d) of the Professional Investor Rule to allow any corporation which is wholly owned by one or more individuals or corporations/partnerships where each of those individuals or corporations/partnerships is qualified as a Professional Investor under section 3(b) or section 3(c) (as the case may be) of the Professional Investor Rules, will be qualified as Professional Investor

IFPHK also proposes the following suggestion to improve the proposals in the Consultation Paper:

- Adoption of a more flexible time reference requirement so that the market participants can qualify an investor as a Professional Investor if the investor had the required asset or portfolio threshold within 12 months prior to the relevant date
- Extension of the requirements in section 3(b) of the existing Professional Investor Rule to include the portfolio of an individual's wholly owned corporation whose sole business is to hold investments and a share of portfolio held in a joint account by individuals who are not associates

The statements given in IFPHK's response to the Consultation Paper are based on an objective and independent analysis of the market and consumer needs. To ensure that IFPHK understands the concerns and practicality of the issue, it sought comments from active industry practitioners who deal with this issue on a regular basis. It should also be noted that the views and recommendations outlined herein represents the collective views of both IFPHK management team and selected major industry players.

The SFC Consultation

To address market participants' concerns that specific evidential requirements set out in the Securities and Futures (Professional Investor) Rules (Cap. 571D) ("Professional Investor Rule") makes it difficult in practice to ascertain and treat clients as professional investors, the SFC issued a "Consultation Paper on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules" ("Consultation Paper") in October 2010.

The Consultation Paper offers proposals to refine the evidential requirements for ascertaining whether a person meets the relevant assets or portfolio threshold to be qualified as a Professional Investor under the Professional Investor Rules (hereafter referred as "asset test" in this submission paper).

As such, the SFC will no longer prescribe the evidential requirements of the asset test. Going forward, the SFC will rely on market participant's professional judgment in performing the asset test and retain all the associated documents at the relevant date³. The SFC also expects the market participants to put in place proper procedures and retain records on the assessment process. Moreover, the Consultation Paper highlights SFC's intention to preserve the existing methods set out in section 3(a) to 3(c) of the current Professional Investor Rules so that market participants can continue using the existing practice.

In addition, the Consultation paper stipulates the proposal to extend section 3(d) of the Professional Investor Rule so that any corporation which is wholly owned by one or more individuals or corporations/partnerships would qualify as Professional Investor given that each of those individuals or corporations/partnerships is qualify as Professional Investor under section 3(b) or section 3(c) (as the case may be) of the Professional Investor Rules.

The Consultation Paper contains five questions relating to the aforementioned proposals on the Professional Investor Rule for market participants and public to provide comments.

³ Relevant date is defined in section 2 of the Professional Investor Rules, that:
(a) in the case of an advertisement, invitation or document described in section 103(3)(k) of the Ordinance, means the date on which advertisement, invitation or document is issued, or possessed for the purposes of the issues;
(b) in the case of a call described in section 174(2)(a) of the Ordinance, means the date on which the call is made;
(c) in the case of an offer described in section 175(5)(d) of the Ordinance, means the date on which the offer is made; or
(d) in any other case which, by virtue of any rules made under the Ordinance, requires compliance with an obligation, means the day by or on which the obligation is required to be complied with.

IFPHK Response Methodology

IFPHK is a professional body that seeks to promote higher professional standards in the financial planning industry. It feels that it is important to respond to consultation and policy papers that significantly impact the financial planning sector. When formulating its response to such papers, it takes a systematic approach that includes:

1. An independent and objective study of the proposals on the overall impact, both positive and negative, on the industry and consumers based on theoretical and practical analysis.
2. Study of international practices of markets that are either more developed or similar to Hong Kong to understand how similar proposals may have succeeded or failed and the reasons why that happened.
3. Collection of comments and opinions from the industry players including legal and compliance professionals whose business practices may be impacted by the proposals in the Consultation Paper.

IFPHK also invited comments from individual members on the various proposals set out in the Consultation Paper. The changes proposed in the Consultation Paper were highlighted to each individual member. They were then invited to provide feedback directly to IFPHK.

After collecting and consolidating the industry views, IFPHK analyzed the information obtained together with its own research in markets deemed relevant to the situation of Hong Kong, such as Australia, the United Kingdom and Singapore. IFPHK then came up with the responses to the various questions raised in the Consultation Paper as well as the recommendations on the practical application and effectiveness of the relevant proposals that take into account the likely impact on the industry.

The views expressed in this submission paper are not necessarily summaries of views from the industry but one which had undergone more independent and critical analysis and consideration by IFPHK as a professional body. As a result, not all the views collected by IFPHK are recorded in this submission paper and neither have all the views expressed in this submission paper been directly endorsed by the industry representatives or members who were consulted.

IFPHK's Submission

The submission below is the result of IFPHK's process to seek views from its Members in addition to its own independent internal analysis. IFPHK considers the practical implication of the proposed changes on the business of the financial planners who advise and provide professional services to Professional Investors as its top most priorities.

Consultation Questions raised in the Consultation Paper

- 1) ***Do you agree that the proposed approach is the best way to serve the purpose of providing flexibility? Please explain your view.***

Do you have any other suggestions?

IFPHK's Response

IFPHK agrees that the proposed approach provides more flexibility for market participants to choose the appropriate methods to ascertain whether an investor meets the asset or portfolio threshold to be a Professional Investor. The proposed principle-based approach is also in line with the practice of other leading markets. IFPHK compares similar requirements in Singapore, Australia and the United Kingdom⁴. Except for Australia, both Singapore and the United Kingdom do not prescribe the ways the market participants use to qualify an investor in order to classify him or her as a Professional Investor.

Most of the industry players who were interviewed also shared the same view as IFPHK. They believed that the proposed approach could provide additional options to the existing practice that is stipulated sections 3(a) to 3(c) of the current Professional Investor Rule. However, some industry players raised their concerns over the use of relevant date as the time reference. The concerns will be further discussed in Question (3) below.

- 2) ***Do you agree that the existing methods set out in sections 3(a) to 3(c) of the Professional Investor Rules (as outlined in paragraph 7 above) should be preserved? Please explain your view.***

Do you have any other suggestions?

IFPHK's Response

IFPHK agrees that the existing methods should be preserved so that the market participants can continue using the current practice. Most of the industry players who were interviewed also shared the same view as IFPHK. As mentioned previously, some industry players were uncertain about the specific time reference requirement proposed in the Consultation Paper, and preferred to use the existing practice that they considered to be less ambiguous. In view of the industry's concerns, IFPHK strongly recommends the SFC to keep the existing methods set out in section 3(a) to 3(c) of the Professional Investor Rule.

⁴ IFPHK studies the regulatory treatment of high net-worth individuals in Singapore, the United Kingdom and Australia. This class of investors is known as "accredited investors" in Singapore, "elective professional clients" in the UK and "wholesale clients" in Australia. For consistency, the term "professional investors" will be used in this submission paper.

- 3) ***Do you agree that the “relevant date” should be used as the time reference for ascertaining whether a high net worth professional investor meets the relevant assets or portfolio threshold? Please explain your view.***

Do you have any other suggestions?

IFPHK’s Response

As aforementioned, some of the industry players whom IFPHK interviewed were concerned over the use of relevant date as a time reference. Relevant date is defined in section 2 of the Professional Investor Rule. Under the existing rule depending on the type of Professional Investor and the type of document, market participants determining whether an investor is qualified to be a Professional Investor are required to obtain documental proof of an investor’s asset or portfolio level that is dated within a certain time period (either 12 or 16 months) **before the relevant date**; whereas it is interpreted that under the proposed amendments the asset test has to be performed with documental evidence **at the relevant date**. As such, some market participants were uncertain on the practical implementation of the new approach and considered that the process of obtaining documents from an investor on the relevant date can be costly and burdensome without substantially strengthening the protection of investors.

IFPHK studied the practice in other jurisdictions with similar requirements, including Singapore, the United Kingdom and Australia. Only Australia has prescriptive requirements on the methods to ascertain the asset or portfolio of an investor prior to qualifying him or her as a Professional Investor. Nonetheless, the date reference used in Australia is 2 years prior to the relevant date⁵.

In view of the above, IFPHK recommends the SFC to consider adopting a time reference that is practically feasible and consistent with the international practice. IFPHK proposes that an investor can be qualified as a Professional Investor if the institution is reasonably satisfied that he or she had the required asset or portfolio threshold within 12 months prior to the relevant date.

- 4) ***Do you agree that section 3(d) of the existing Professional Investor Rules should be extended so that any corporation which is wholly owned by one or more individuals or corporations/partnerships where each of those individuals or corporations/partnerships would qualify as a professional investor under section 3(b) or section 3(c) (as the case may be) of the Professional Investor Rules, will qualify as a professional investor? Please explain your view.***

Do you have any other suggestions?

IFPHK’s Response

IFPHK supports the extension of section 3(d) of the existing Professional Investor Rules so that more investors will benefit from the Professional Investor exemption. The extension reflects the market needs that are evidenced in the number of institutions applying for modifications or waivers to modify section 3(d) of the Professional Investors Rule. Currently, market participants are required to apply for modification or waiver under section 134(1) (xiv) if they wish to modify some of the requirements of any provision of rules made by the SFC under the Securities and Futures Ordinance. As at 4 October 2010, approximately 35 institutions have been approved by

⁵ Pursuant to the Corporations Act 2001 of Australia, a “wholesale client” can exempt from the disclosure requirements if he or she provides a certificate from a qualified account certifying he or she has a prescribed net asset or gross income level. The certificate should be dated and it is less than 2 years since it was issued at the time an institution offer securities or financial product to a “wholesale client”.

the SFC to modify the requirements under section 3(d) of the Professional Investor Rules allowing a corporation, which is wholly owned by one or more individuals or corporations/partnerships where each of those individuals or corporations/partnerships is qualified as a Professional Investor, to be a Professional Investor.

IFPHK notes that there are other modifications or waivers to the Professional Investor Rules that market participants have commonly applied for SFC approval. Some commonly applied modifications or waivers are shown in the table below:

Relevant SFO Section	Details of the Modification to the requirements in the Professional Rule	Approximate number of institutions which the SFC has granted approval to modify the requirements in the Professional Rule as at 4 October 2010
3(b) of the Professional Investor Rule	Modification of the requirements of section 3(b) of the Rules that for the purposes of assessing whether an individual's portfolio is not less than \$8 million, only portfolio of an individual, held either alone or with any of his associates on a joint account, will be taken into account is modified to permit the portfolio of a corporation whose sole business is to hold investments and which is wholly owned by the individual also to be taken into account.	35
3(b) of the Professional Investor Rule	Modification of the requirement of section 3(b) of the Rules that for the purposes of assessing whether an individual portfolio is not less than \$8 million, only the portfolio of an individual, held either alone or with any of his associates on a joint account, will be taken into account is modified to permit a share of a portfolio held in a joint account by individuals who are not associates also to be taken into account where the institution is reasonably satisfied that each of the individuals is beneficially entitled to a share of the portfolio of not less than \$8 million	32

Taking into account the number of modifications or waivers granted to modify section 3(b) of the Professional Investor Rule, IFPHK recommends the SFC to consider widening the extensions to cover section (b) of the Professional Investor Rules so that more investors can meet the professional investor qualifying criteria. IFPHK suggests the following portfolio types are to be taken into account for the purpose of assessing whether an individual's portfolio is not less than \$8 million:

- An individual's portfolio of a corporation whose sole business is to hold investments and that is wholly owned by the individual, and
- A share of a portfolio held in a joint account by individuals who are not associates where each individual is beneficially entitled to a share of the portfolio of not less than \$8 million.

- 5) *Do you have any comments on the indicative draft of the proposed amendments to the Professional Investor Rules in Appendix A? Please explain your view.*

Do you have any suggestions on alternative wordings for the proposed amendments? If so, please give your suggestions and explain your view.

IFPHK's Response

As mentioned in question (1), (2) and (3) above, IFPHK and the industry players whom IFPHK interviewed felt that the use of time reference "at the relevant date" maybe difficult to implement in practice. As a result, IFPHK suggests to replace the phrase "at relevant date" by "**within 12 months before the relevant date**" on the indicative draft of the proposed amendments to the Professional Investor Rules in Appendix A of the Consultation Paper.

Conclusion

In principle, IFPHK welcomes the adoption of a principle-based approach on evidential requirements in the Professional Investor Rules and the extension of section 3(d) of the Professional Investor Rule. The aim of having these proposals is to provide more flexibility to the market participants so that more investors are able to utilize the Professional Investor exemptions.

To this end, IFPHK recommends the SFC to adopt a pragmatic and flexible approach on the time reference used in the proposed amendments. IFPHK suggests a time reference of 12 months before the relevant date.

IFPHK also urges the SFC to consider extending section 3(b) of the Professional Investor Rules to cover more portfolio types for the purpose of assessing whether an individual's portfolio meets the portfolio threshold stipulated in the Professional Investor Rules.

IFPHK believes that the combined initiatives as discussed in this submission paper can provide more options to market participants, and thus enhance the overall efficiency of the Professional Investor Regime and provide benefits to the financial planning community as a whole.