IFPHK's Response to the Securities and Futures Commission Consultation Paper on the Proposed Amendments to the Securities and Futures (Professional Investor) Rules

March 2017

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Institute of Financial Planners of Hong Kong (IFPHK) - Profile

<u>Background</u>

The 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 those financial planners that uphold the highest standards for the benefit of the public.

The IFPHK is the sole licensing body in Hong Kong authorized by Financial Planning Standards Board Limited to grant the much-coveted and internationally-recognized CFP^{CM} certification and AFP^{TM} certification to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 6,800 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 more than 147,000 CFP certificants in 24 countries/regions; the majority of these professionals are in the U.S., Canada, China, Australia and Japan, with more than 4,700 CFP certificants in Hong Kong.

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<u>IFPHK's interest in this consultation</u>

Since its inception, the IFPHK has been striving to raise public awareness of the financial planning industry in Hong Kong and highlight the high standards to which CFP professionals adhere. In 2006, with contributions from our patrons, leading industry practitioners and experts, the IFPHK published the *IFPHK Practice Guide for Financial Planners*. The Guide is the first set of guidance materials for financial planners practicing in Hong Kong. To supplement this effort, the IFPHK launched the Guidance Note entitled *Suitability of Advice Obligations: Documenting your Financial Advice* for its members.

Since Professional Investors form an important part of our members' clientele, the IFPHK, as the leading professional body 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, the IFPHK provided its views and recommendations on the proposed reforms for the Professional Investor regime as part of the response to the Consultation Paper by the Securities and Futures Commission ("SFC") entitled *Proposals to Enhance Protection for the Investing Public*. In October 2010, the SFC issued a "Consultation Paper on the Evidential Requirements under the Securities and Futures (Professional Investor) Rules" and the IFPHK provided its views. On 30 May 2011, the IFPHK also provided a response to the Questionnaire on Suitability as initiated by the IOSCO Standing Committee 3. In 2013, the IFPHK also responded to the

Consultation Paper on proposed amendments to the Professional Investor Regime and Client Agreement Requirements.

To continue serving the financial planning community, the IFPHK has taken a strong interest in expressing its views on the proposed changes as stipulated in the Consultation Paper.

IFPHK's representation

The IFPHK was founded by 30 members (the 'Founding Members') in order to raise the standards of financial planners and highlight the importance of sound financial planning.

The IFPHK currently has 32 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, the IFPHK is well positioned to understand the needs, concerns and aspirations of the financial planning community.

Executive Summary

The Securities and Futures Commission (the "SFC") issued the Consultation Paper on the proposed amendments to the Securities and Futures (Professional Investor) Rules (the "Consultation Paper") in March 2017. It then invited comments from market participants and the public on the relevant proposals set out in the Consultation Paper. The submission deadline is 3 April 2017.

The proposed amendments allow joint accounts with non-associates and assets held in investment vehicles owned by individuals to be counted in ascertaining whether individuals meet the monetary threshold to qualify as professional investors. In addition, the categories of professional investors would be expanded to include corporations having investment holdings as their principal business and are wholly owned by one or more professional investors, as well as corporations which wholly own another corporation that is a qualified professional investor. Alternative forms of evidence would also be allowed to demonstrate qualification as a professional investor.

Under the proposals, the SFC envisages that more persons will qualify as professional investors. Nevertheless, intermediaries remain subject to the suitability and other fundamental requirements when serving them.

In considering various proposals as set out in the Consultation Paper, the IFPHK's views are based on the following principles and beliefs:

- The Professional Investor Regime is important in providing a quicker and lower cost channel to investors who possess the knowledge, financial resources and skills to make their investment decisions.
- Suitability is the cornerstone of financial planning. The six-step financial planning process that the IFPHK has promulgated helps clients take a holistic approach to assessing their financial situation.
- The professional standards of intermediaries should be enhanced to keep up with the demands of the market.
- A responsible investing attitude by consumers should be promoted through widespread investor education.

In principle, the IFPHK has no major concerns over the proposals in the Consultation Paper. Firstly, the proposals are minor adjustments to the Professional Investors Rules, and the changes will not lower investor protection. Secondly, we agree with the SFC's approach in embedding industry practices.

The statements given in the IFPHK's response to the Consultation Paper are based on an objective and independent analysis of market and consumer needs. To ensure that the 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.

The SFC Consultation

On 2 March 2017, the Securities and Futures Commission (the "SFC") issued a "Consultation Paper on Proposed Amendments to the Securities and Futures (Professional Investor) Rules" ("Consultation Paper"). The Consultation Paper was intended to enhance the existing professional investor regime and client agreement requirements as stated in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the "Code of Conduct").

The proposed amendments pertain to the following:

(a) Allowing the portfolio held in joint account(s) with persons other than associates (i.e. the spouse or any child of the individual) and investment vehicle(s) owned by individuals to be counted in ascertaining if the individuals meet the monetary threshold to qualify as professional investors;

(b) Expanding the definition of corporations as professional investors; and

(c) Allowing alternative forms of evidence demonstrating qualification as a professional investor.

The Consultation Paper contains three parts with 5 questions relating to the aforementioned proposals concerning the Securities and Futures (Professional Investor) Rules on which market participants and the public can comment.

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?***

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) in Appendix A)? Please explain your view.***
>
> ***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.***

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?

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 in Rule 7(b) in Appendix A)? Please explain your view.

(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?

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.

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 provide examples.

Do you consider that the Professional Investor Rules should impose conditions for the use of these alternative forms of evidence?

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.

IFPHK's Submission

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

The IFPHK considers the practical implication of the proposed changes on the business of those financial planners who consider advising and providing professional services to investors as its utmost priority.

In considering the various proposals of the Consultation Paper, the IFPHK's comments are based upon the following principles and beliefs:

Importance of having a Professional Investor Regime

The principle of the Professional Investor regime is to allow investors, who presumably possess the knowledge and have the financial resources and skills to make their decision, to participate in the markets without facing unnecessary barriers or incurring unnecessary transaction costs. Therefore, by proper information disclosure, the professional investors are able to make their own investment decisions. As long as the Professional Investor is properly categorised and properly informed of their status and have the option to opt for greater protection, they should be held responsible for the consequences of their investment decisions. Mis-selling claims in the past were mostly related to investors investing in products that are inconsistent with their objectives and needs, regardless of whether they are Professional Investors or retail investors. If clients are properly identified and classified based on all relevant parameters[1] which enable the financial planners and advisers to make recommendations that are suitable to the clients, the IFPHK thinks the regime is already sufficient.

Advocating the six-steps financial planning process

It is the IFPHK's mission to promote the importance of financial planning. For the IFPHK and other affiliates of the Financial Planning Standard Board ("FPSB"), the financial planning process consists of six steps that help clients take a holistic approach to assessing their financial situation. The process involves gathering relevant financial information, setting life goals, examining a client's current financial status and coming up with a strategy or plan for how clients can meet their goals given their current situation and future plans. As a result, suitability requirements are already embedded in the six-steps of the IFPHK's financial planning process with which financial planning professionals are required to be familiar.

Enhancement of professional standards of intermediaries

The IFPHK has always believed that qualified intermediaries and well-informed and educated consumers, together with a robust framework for regulating sales processes, should form the core pillars for protecting the investing public. If the professional standards of financial intermediaries do not keep up with the demands of the market, even if all the protection measures proposed are

[1] These parameters include but are not limited to knowledge, experience, worth, means, etc.

implemented, Hong Kong would not be able to maintain its reputation as an international financial centre and therefore grow its financial services industry.

The IFPHK highlights that having a regular monitoring process as well as competent staff is vital in a sound suitability framework. Equally important is the need to engage and empower investors with regard to suitability assessment. While investors should be adequately informed in order to make sound investment decisions, they shall be held responsible for their own investment decisions. Intermediaries shall remind investors of the risk and limitation in cases where the investors refuse to provide sufficient information for assessment, or insist in investing in products that do not match with their profiles.

Promoting responsible investing attitudes through financial education

As aforementioned, well-informed and educated consumers are the core elements in a healthy regulatory system. For a market to perform effectively and consumers to be protected properly, a fundamental understanding of how financial products work is essential. It is the IFPHK's view that improved financial literacy levels will not only allow consumers to make more informed investment decisions, but also result in greater consumer appreciation for the planning of a long-term financial future – a concept the IFPHK continuously promulgates. Given the high degree of participation of Hong Kong people in financial markets, it is important for people to adopt and apply responsible attitudes towards investing and money management when it comes to making financial decisions.[2] Rather than imposing prescriptive and rigid requirements on intermediaries to protect investors, the IFPHK considers it more effective and appropriate to empower and improve investors through other means such as investor education or raising the professional standard of intermediaries.

Questions raised in the Consultation Paper

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?

Over the years, the SFC has received comments from the market to the effect that modifications made to section 134 of the Securities and Futures Ordinance (SFO) should be incorporated into the provisions of the Professional Investor Rules. Following the recent reform of the professional investor regime to enhance investor protection, the SFC should take this opportunity to incorporate this reform into the Professional Investor Rules.

The proposed amendments to the Professional Investor Rules include expanding the categories of persons who will qualify as professional investors and allowing the aggregation of certain assets and alternative forms of evidence for determining and ascertaining whether a person meets the relevant asset or portfolio thresholds to qualify as a professional investor under the Professional Investor Rules.

[2] Investor Education Council, press release on 23 July 2013.

The SFC believes that the proposed amendments will cater for the business needs of intermediaries and their clients and enhance consistency in the application of the Professional Investor Rules.

<u>IFPHK's Response</u>

On the basis of the principles mentioned above, the IFPHK has no major concerns with regard to the proposed amendments.

As discussed above, mis-selling claims are mostly related to investors investing in products that are inconsistent with their objectives and needs. As mentioned previously, the IFPHK promotes the concept of financial planning and suitability being performed as part of the financial planning process. To the IFPHK, financial planning is the process of developing strategies to assist clients in managing their financial affairs to meet life goals or objectives. It is envisaged that both retail and Professional Investors will have their own investment objectives and goals. The financial planning process, as well as the suitability assessment process, shall therefore be no different for retail or Professional Investors. Since the current proposals would not lower suitability requirements, the IFPHK concurs with the proposals.

We consider the proposals to be an attempt to embed the existing industry approach. We also agree with the general comments that the proposals should be welcomed by asset managers and private banks, since there will be more flexibility and scope for treating individuals as professional investors.

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) in Appendix A)? Please explain your view.

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.

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?

<u>IFPHK's Response</u>

The IFPHK has no objections on the proposals to expand the definitions of joint account holders.

As enunciated in our previous submission of amendments to the Professional Investor Regime, the change may increase difficulty in acting as an intermediary for large-scale product offerings to investors who have significant financial means and investment experience, as well as a loss in efficiency due to the protection and disclosure mechanisms that would need to be extended to investors who were formerly classified as Professional Investors[3]. Indeed, there is a group of Professional Investors who are ultra high net worth clients that are sophisticated in terms of wealth and investment experience. It may not be efficient and could be onerous to request for them to go through a lengthy assessment and risk disclosure process. The SFC should recognize that there are ultra high net worth clients who are capable, and sophisticated in means and knowledge, and are therefore responsible for their own investment decisions. Investment vehicles and family trusts are useful common tools for these ultra high net worth individuals to use for tax planning purposes or other investment purposes. They may even hire experts to assist them with regard to their investment management. As such, these investment vehicles operate more like Corporate Professional Investors.

The IFPHK considers that the proposed changes to joint accounts have incorporated the industry comments. The IFPHK concurs with the general comments that the proposals are designed to regularize the position in relation to the categorization of professional investors and level the playing field for all intermediaries, and will increase certainty in the market by codifying existing practices by some market participants.

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 in Rule 7(b) in Appendix A)? Please explain your view.***

- ***(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?

[3] Australian Government, Wholesale and Retail Clients Future of Financial Advice, Options Paper, January 2011.

IFPHK's Response

In the previous consultation paper on the amendments to the Professional Investor Regime, the SFC delineated Professional Investors into three different classes. The category of Corporate Professional Investor includes trust corporations, corporations or partnerships that qualify as professional investors under the Professional Investor Rules. We stated in our previous submission that the SFC should recognize that there are ultra high net worth clients who are capable, and sophisticated in means and knowledge, and are therefore responsible for their own investment decisions. Investment vehicles and family trusts are useful common tools for these ultra high net worth individuals to use for tax planning purposes or other investment purposes. They may even hire experts to assist them on investment management. As such, these investment vehicles operate more like a Corporate Professional Investor.

As such, we welcome the new proposal of expanding the definition of Corporate Professional Investor. The amendments proposed do not radically change the PI Rules or the categories of professional investors under them. However, they regularize the position in relation to the categorization of professional investors and level the playing field for all intermediaries, and will increase certainty in the market by codifying the existing practices of some market participants.

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.

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 provide examples.

Do you consider that the Professional Investor Rules should impose conditions for the use of these alternative forms of evidence?

IFPHK's Response

The IFPHK supports the proposed changes of allowing alternative forms of evidence. The current proposals appear to make it easier for intermediaries to be more effective in their assessment and identification of professional investors.

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.

IFPHK's Response

The IFPHK has no further comments.