

MAS publishes proposals to enhance regulatory safeguards for investors

The Monetary Authority of Singapore (MAS) has issued a consultation paper seeking feedback on its proposals to enhance regulatory safeguards for investors in the capital markets.

The MAS's main proposals are to: (i) extend its regulatory oversight to non-conventional investment products which share characteristics with capital markets products; (ii) establish a framework to rate all investment products for their complexity; and (iii) refine the investor classes under the Securities and Futures Act (SFA) and Financial Advisers Act (FAA).

Non-conventional investment products

The MAS proposes to extend its regulatory perimeters to the following:

- buy-back arrangements involving gold, silver and platinum (precious metals); and
- collectively-managed investment schemes which have all the characteristics of a regulated collective investment scheme (CIS) save for the pooling of investors' contributions.

The MAS's rationale for regulating such arrangements and investment schemes is that these products are being offered to consumers as alternative investments (as opposed to personal consumption) and these products share the same characteristics with other capital markets products which are currently regulated by the MAS.

Buy-back arrangements

Currently, buy-back arrangements involving precious metals are not regarded as financial assets and fall outside the regulation of the SFA.

The MAS intends to regulate buy-back arrangements involving precious metals which are, in effect, debt financing arrangements.

A key element that will need to be established for a buy-back arrangement involving precious metals to be considered as a debt financing arrangement is the right for the investor to receive a financial benefit from the entity offering the arrangement as part of the arrangement. The MAS will consider a financial benefit as present if the

Key proposals

- Regulation of buy-back arrangements involving precious metals with such arrangements to fall under the SFA regulatory regime for debentures.
- Regulation of collectively-managed investment schemes which are similar to collective investment schemes with such schemes to fall under the SFA regulatory regime for CISs.
- Establishing a complexity-risk ratings framework and requiring ratings to be disclosed to investors.
- Refining definitions of investor classes under the SFA and FAA.

effective repurchase price is higher than the initial purchase price.

Buy-back arrangements involving precious metals which the MAS regards as akin to debt financing arrangements will be subject to the following regulatory requirements which are applicable to debentures:

1. there must be a registered prospectus which complies with prescribed disclosure requirements;
2. a MAS-approved trustee must be appointed; and
3. intermediaries who deal in or advise on debentures will need to be licensed by the MAS.

Collectively-managed investment schemes

At present, CISs are arrangements in respect of any property which exhibit all of the following characteristics:

1. participants have no day-to-day control over the management of the property;
2. the property is managed as a whole by or on behalf of the scheme operator;
3. participants' contributions are pooled;
4. profits or income of the scheme from which payments are to be made to the participants are pooled; and
5. the purpose or effect of the arrangement is to enable participants to participate in profits arising from the scheme property.

CISs are regulated under the SFA. One key element of the current definition of a CIS is that the contributions of the investors must be pooled together for the purpose of enabling investors to participate in, or receive profits through, their investment.

A CIS must be authorised (if it is established in Singapore) or recognised (if it is established outside Singapore) before it may be offered to the retail public in Singapore.

Currently, for a CIS to be authorised for a retail offer, a CIS must *inter alia* (i) comply with the Code on Collective Investment Schemes (CIS Code); and (ii) be managed by a licensed fund manager or real-estate investment trust (REIT) manager who is fit and proper.

In response to the MAS's observation that a number of arrangements are currently offered to retail investors without compliance with the CIS regulatory regime by offering investors direct interests in the underlying physical assets, the MAS intends to amend the regulatory regime by regulating arrangements which present all the elements of a CIS except for the pooling of contributions. Such arrangements will be subject to the same regulatory regime as CISs.

In this regard, the MAS proposes to amend the definition of a CIS under the SFA to remove the requirement for the pooling of investors' contributions to be present for an arrangement to be regarded as a CIS.

The MAS also proposes to develop specific rules in the CIS Code for such schemes so that they will be eligible for authorisation by the MAS for retail offer.

In line with the proposal to regulate collectively-managed schemes as CISs, the MAS proposes to require operators of such schemes that are offered to retail investors to be regulated as licensed fund managers. Existing operators will be required to obtain a licence if they wish to take on new investors or offer additional units of the scheme to existing investors.

The expansion of the CIS regime will likely catch the following investment schemes in respect of real estate:

1. arrangements in which investors are offered fractional interests in undeveloped land and are required to use the scheme operator's services in obtaining planning permission for, or disposing of, the land as a whole (or both);
2. an investment into land for forestry or harvesting purposes, where investors acquire fractional interest in a plantation plot or individual trees on a plantation plot, but with the day-to-day control of the plantation plot left in the general management and control of the scheme operator; and
3. a buy-to-let scheme in which: (i) investors are offered units in real estate on the understanding that the investor will be entitled to participate in rental income generated; (ii) the scheme operator will have control over the rental of the property; and (iii) the rental income is pooled and allocated to scheme participants on a proportional basis to their interests in the scheme.

Complexity-risk ratings framework

The current regulatory regime governing the sale and marketing of more complex products to retail investors judges product complexity based on whether it is a derivative or embeds a derivative.

The MAS proposes to introduce a complexity-risk ratings framework for investment products, where each investment product will be rated according to: (i) complexity (i.e. the difficulty in understanding the risk/reward profile of a product); and (ii) risk (i.e. the likelihood of losing the principal investment amount).

The MAS proposes to confine the complexity risk-ratings framework to products which: (i) are for investment purposes only; and (ii) are made available to retail investors.

Complexity

The MAS proposes to derive the complexity rating of an investment product based on four factors:

1. the number of structural layers which the investment product has;
2. the investment product's expansiveness in the use of derivatives;
3. the availability of, and usage of, a known valuation model; and
4. the number of scenarios determining return outcomes.

An example of how the complexity-rating methodology would work is as follows:

Complexity-rating methodology

Factor		Low	Medium	High
Number of structural layers	Threshold	One layer	Two layers	Above 2 layers
	Score	1	3	5
Usage of derivatives	Threshold	None	Up to two	Above two
	Score	1	3	5
Known valuation models	Threshold	Publicly available	Generic	Proprietary models
	Score	1	2	3
Number of return outcome scenarios	Threshold	One	Two	More than two
	Score	1	3	5

Complexity Rating			
Low	Medium	High	Very High
4-5	6-7	8-14	15-18

Risk

Additionally, each investment product will be subject to a "bucket-based" approach to risk rating, based on the likelihood of the investor losing some or all of, or even more than, his principal investment amount.

Disclosure of complexity-risk ratings

The MAS further proposes to require ratings to be disclosed in product offering documents for new and ongoing offers of investments to retail investors. Issuers who seek to have their products listed on an approved exchange (AE) will be required to inform the relevant AE of the rating and the AE should indicate this information on its trading platform

accordingly. Intermediaries will also be required to ensure that this information is made available to investors.

Classification and treatment of investors

The MAS's key proposals to refine the existing rules on classification and treatment of investors are as follows:

1. introduce an "opt-in" approach for an investor who is classified as an "Accredited Investor" (AI) under the SFA;
2. extend the AI eligibility criteria to any individual who holds a joint account at a financial institution with an AI, but only in respect of transactions entered into with or through the financial institution, using the joint account; and
3. refine the definitions of "Accredited Investor" and "Institutional Investor" under the SFA; and
4. remove the "Expert Investor" class of investors from the SFA.

Opt-in regime for AIs

Currently, if an investor qualifies as an AI, the financial institution will automatically classify and treat the investor as an AI and the financial institution will be exempt from various regulatory requirements when dealing with the AI.

The AI investor would, in turn, automatically be deprived of certain regulatory protection not available to AIs (but available to retail investors).

The MAS is, however, now proposing that the classification of an investor as an AI should not be automatic. Instead, an investor who is eligible to be an AI must opt-in to be treated as an AI. This regime would allow the investor to determine the level of regulatory protection he/she wants to be afforded.

Under this new opt-in regime, all investors other than institutional investors would, by default, be treated as retail investors.

The opt-in process involves the financial institution having to inform the client in writing that he/she has been assessed to be eligible to be an AI, and to provide a clear written description and warning of the regulatory safeguards which may be disappplied if he/she opts in to AI status. Alternatively, an investor who qualifies as an AI could, of his own accord, approach a financial institution to indicate that he/she wishes to be classified and treated as an AI.

The MAS has clarified that AI status will be held on a per financial institution basis (i.e. an investor can choose to be classified and treated differently by different financial institutions).

Joint-account holders

Currently, each joint account holder is treated according to his/her individual investor status.

The MAS proposes to provide that any individual who holds a joint account with an AI (at a financial institution) will himself/herself be AI eligible, but only in respect of transactions entered into with or through that financial institution, using the joint account.

As such, if an investor is a joint account holder with an AI, he/she will be AI eligible and may opt-in to AI status and avail himself/herself of the full suite of private banking services and product offerings available to AIs.

Refining investor classes

Accredited Investors

An individual whose net personal assets exceed in value S\$2 million (or its equivalent in a foreign currency) is considered an "Accredited Investor" under the SFA.

The MAS proposes to refine the definition of an "Accredited Investor" to modify the net assets eligibility criterion such that net equity in an individual's primary residence can only contribute up to S\$1 million of the minimum net assets threshold of S\$2 million.

A corporation whose sole business is to hold investments and the entire share capital of which is owned by one or more persons, each of whom is an accredited investor, is also considered an "Accredited Investor" under the SFA.

The MAS recognises that it would be restrictive to insist that a corporation owned entirely by AIs can only be an AI if it is a pure investment holding company and cannot carry on any other business.

Accordingly, the MAS proposes to do away with the investment holding company criterion, such that any corporation which is owned entirely by AIs would become eligible to be an AI.

AI eligibility will also be extended to the trustee of any trust in which all beneficiaries are AIs.

Institutional Investors (II)

Currently, an II is narrowly defined and limited to the Singapore government and MAS-regulated financial institutions carrying out capital markets services activities in Singapore.

Foreign financial institutions that do not have a regulated presence in Singapore and foreign governments and sovereign wealth funds are currently excluded, although most would separately have qualified as AIs and thus still be treated as non-retail clients.

Accordingly, the MAS proposes to expand the II definition to include:

1. foreign entities carrying out financial services activities and that are authorised, licensed and/or regulated in one or more foreign jurisdictions; and
2. all central governments and central governmental agencies of foreign states, supranational governmental organisations and sovereign wealth funds.

The MAS, however, proposes to limit the II definition in relation to statutory bodies to include only statutory boards.

Expert Investors (EI)

Under the SFA, an EI is *inter alia* a person whose business involves the acquisition and disposal, or the holding, of capital markets products (whether as principal or agent).

The main category of persons who fall within the current EI definition consists of individuals who work for financial institutions as traders, in respect of those individuals' own personal trading.

In order to simplify the SFA and FAA regulatory framework, the MAS proposes to remove the EI class of investors. Investors who are affected by this proposal can opt-in to be AIs if they are eligible investors or, alternatively, assume retail status.

Closing date for the public consultation

The MAS consultation paper is available from the MAS website and the closing date for the public to submit comments and feedback is **1 September 2014**. We will be submitting comments to the MAS. If you have any comments to include in our submission, please contact us before **18 August 2014**.

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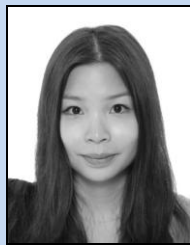


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