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Briefing note October 2015

MAS to implement proposals to enhance regulatory safeguards for investors

In July 2014 the Monetary Authority of Singapore (MAS) issued a consultation paper setting out its proposals to enhance regulatory safeguards for investors in the capital markets (Consultation Paper).

The MAS released its response to the Consultation Paper in September 2015 (Response to the Consultation Paper) confirming that it will proceed to implement most of its proposals. The MAS aims to table the proposed amendments to the Securities and Futures Act (SFA) in Parliament in 2016.

Regulatory safeguards for investors in non-conventional investment products

In the Response to the Consultation Paper, the MAS indicated that it will extend its capital markets regulatory framework (underpinned by the SFA and Financial Advisors Act (FAA)) to two types of non-conventional investment products, which are, in substance, capital markets products:

- **Precious metals buy-back arrangements,** which involve the sale of precious metals with guaranteed buy-back at an agreed price. The MAS views such arrangements as equivalent to collateralised borrowings and as such should be regulated as debentures under the SFA. The scope of regulation will be limited to arrangements involving gold, silver and platinum, as these are widely regarded as financial assets and are commonly used as collateral for such arrangements.
- **Collectively-managed investment schemes,** which are in substance similar to traditional regulated investment funds but do not pool investors' contributions. The MAS has indicated that such schemes will be regulated as collective investment schemes (CIS) under the SFA. Accordingly, collectively-managed investment schemes that are intended for retail investors will require authorisation from the MAS.

Key changes

- Extension of capital markets regulatory framework to non-conventional investment products which are in substance capital markets products
- Changes to the criteria for an investor to qualify as an accredited investor
- Introduction of an opt-in regime for investors to be eligible as accredited investors
- Expansion of institutional investor definition to include foreign entities carrying out financial services activities, all central governments and central governmental agencies of foreign states, supranational governmental organisations and sovereign wealth funds

Arrangements that exist before the legislative changes come into force will not be affected, unless additional funds are raised from retail investors after the new laws are in place.

Changes to the definition of a CIS

The current CIS definition covers arrangements in respect of property that satisfy the following limbs:

(i) participants have no day-to-day control over management of the property ("***control***" limb);

(ii) property is managed as a whole by or on behalf of the scheme operator ("***management***" limb);

(iii) participants' contributions and profits or income of the scheme from which payments are to be made to the participants are pooled ("***pooling***" limb); and

(iv) purpose or effect (or purported purpose or effect) of the arrangement is to enable participants to participate in profits arising from the scheme property ("***purpose***" limb).

In order to regulate collectively-managed investment schemes under the CIS regime, the MAS will be amending the definition of a CIS such that the "management" limb will be an alternative to the "pooling" limb. The two limbs are to be assessed independently of each other, and the absence of pooling of contributions or profits will not preclude a finding that there is management as a whole.

The MAS clarified (in the Response to the Consultation Paper) that the "purpose" limb does not require investors to derive their returns from pooled profits.

The MAS has expressly clarified in its response that segregated discretionary management accounts (which fall within the regulated activity of fund management under the SFA but do not constitute a CIS), structured notes and exchange traded notes (which are currently regulated as debentures) will be excluded from the CIS regulatory regime. The MAS will consider providing specific exclusions for clarity when finalising the legislative amendments to the CIS definition.

In connection with the proposed changes, the MAS intends to amend the Code on Collective Investment Scheme (CIS Code) to allow for authorised schemes to invest in precious metals that are widely comparable to financial assets. Proposed amendments to the CIS Code will be consulted on separately.

Opt in regime for accredited investors (AIs)

Under the current regulatory regime, investors who meet prescribed wealth or income thresholds are classified as AIs by default. They are accorded a lower level of regulatory protection as they are considered to be better able to protect their own interests.

The MAS will, however, refine the regulatory regime to empower AI eligible investors to choose the level of regulatory safeguards best suited for their individual circumstances.

Under the new regulatory regime, financial institutions (FIs) will have to treat new customers who are AI eligible as retail investors by default, unless the customers choose to "opt in" to AI status.

FIs can continue to treat existing customers who are AI eligible as AIs, unless the customers choose to "opt out" of AI status to benefit from the full range of capital markets regulatory safeguards available to retail investors. FIs will need to arrange for "right to opt out" notifications to be given and for acknowledgement of AI status and implications at the next account review.

AI status will be held on a per FI basis. Investors will have the flexibility to choose their AI status with each FI. Investors will also be able to move between investor classifications at any time, although any change in status would not impact the investor classification of past transactions.

Joint account holders

In the Consultation Paper, the MAS proposed to allow for any individual, who holds a joint account at an FI with an individual who is an AI, to be AI eligible, but only in respect of transactions entered into, with or through the FI using the joint account (joint account limb).

In the Response to the Consultation Paper, the MAS indicated that it will proceed with the above proposal and, for a non-AI to be eligible to opt in for AI status in respect of a joint account, (i) at least one joint account holder must be an AI, and (ii) all joint account holders must opt in to be treated as AIs in respect of the joint account.

If the AI joint account holder ceases to be eligible as an AI, or any joint account holder ceases to opt in to be treated as an AI, the non-AI account holder will also cease to be eligible to opt in for AI status in respect of the joint account.

"Private bank exemption"

The joint account limb replicates the flexibility currently given to private

banks (PB) to service non-AI clients who are “connected” to the PBs’ main AI client through exemptions granted pursuant to section 100(2) of the FAA (PB exemptions).

The MAS has accordingly indicated its intent to remove the PB exemptions with the introduction of the joint account limb. PBs would continue to be able to rely on AI exemptions when serving clients who are AI eligible and have opted in to AI status.

AI eligibility criteria

Individuals

Currently, an individual qualifies as an AI if his net personal assets exceed S$2 million (net personal assets test), or his income in the preceding 12 months is not less than S$300,000 (income test).

In the Consultation Paper, the MAS proposed modification such that net equity of an individual's primary residence can only contribute up to S$1 million (S$1 million cap) of the S$2 million threshold. "Primary residence" refers to the home where the investor lives in most of the time and can be located in Singapore or overseas.

In the Response to the Consultation Paper, the MAS indicated that it will proceed to introduce the S$1 million cap for the net personal assets test.

For existing AI clients who would no longer be AI eligible (e.g. due to the S$1 million cap modification to the net personal assets test), FIs can continue to treat them as AIs only in respect of existing investments predicated on their AI status.

Corporations

Currently, the AI definition includes investment holding corporations where the entire share capital of such a corporation is owned by one or more persons, each of whom is an AI.

In the Consultation Paper, the MAS recognised 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. The MAS proposed 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.

In the Response to the Consultation Paper, the MAS indicated that it will proceed to remove the investment holding company criterion but clarified that nominee shareholders will only be regarded as AIs if the beneficial owner is an AI.

Trustees of a trust

In the Consultation Paper, the MAS also proposed that AI eligibility will be extended to the trustee of any trust in which all beneficiaries are AIs.

In the Response to the Consultation Paper, the MAS has indicated that it will proceed to extend AI eligibility to the trustee of any trust in which all the beneficiaries are AIs.

The MAS noted, however, that there are certain trust structures where a settlor retains some equitable interest in the trust assets after the constitution of the trust, such as a trust where the settlor has

(i) reserved investment powers over declared trust assets (settlor reserved powers); or (ii) powers to revoke the trust, in which case all trust property would go back to the settlor (revocation powers). The MAS recognised that in such a trust, the settlor continues to have interest over the management of the trust assets and as such it would be appropriate to look to the settlor’s AI status to determine the AI eligibility status of the trustee of such a trust.

Institutional investors (II)

In the Consultation Paper, the MAS proposed to expand the definition of II to include:

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

In the Response to the Consultation Paper, the MAS indicated that it will proceed to implement these changes to widen the definition of an II.

The MAS will, however, exclude statutory bodies, other than statutory boards, from the II definition.

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 proposed (in the Consultation Paper) to remove the EI class of investors.

However, in light of feedback received by the MAS that the EI class continues to be relevant for FIs, the MAS will retain the EI class for now.

Complexity risk-ratings framework

MAS is still reviewing feedback on the proposal to introduce a complexity-risk ratings framework for investment products and will issue a separate public response later.

Next Steps

Implementation of the changes outlined above will require amendments to the SFA and supporting regulations. The MAS aims to table the proposed SFA amendments in Parliament in 2016.

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