

## SINGAPORE VARIABLE CAPITAL COMPANY – POWERING FURTHER GROWTH IN THE FUNDS INDUSTRY

On 10 September 2018, the Monetary Authority of Singapore (MAS) published its response to feedback (the Response Paper) on its public consultation on the proposed framework for variable capital companies (VCCs), which was issued on 23 March 2017. MAS also moved the Variable Capital Companies Bill (the Bill) for its first reading in Parliament.

Once the Bill is passed and comes into effect, fund managers in Singapore will have the option of establishing funds using a new corporate vehicle with access to Singapore's network of Avoidance of Double Taxation Agreements (DTAs) with other jurisdictions.

This briefing analyses several key features of the VCC that were announced by MAS in the Response Paper:

### Administration of VCCs

The Accounting and Corporate Regulatory Authority (the Registrar) will act as the registrar of VCCs and administer the new Bill, except for the AML/CFT obligations of VCCs, which will be overseen by MAS.

### Permitted use of VCCs

The VCC may only be used as a vehicle for collective investment schemes (CIS), although MAS has stated that it may consider widening the permitted scope of use in the future.

MAS also announced that it would remove the requirement for VCCs to have at least two members, clarifying that MAS does not intend to prevent VCCs from being used in master-feeder structures or funds of one.

### Open-ended and Closed-end Funds

Unlike shares in companies incorporated under the Companies Act (Chapter 50) of Singapore (the CA), shares in VCCs may be freely redeemed subject to the terms of redemption of shares set out in the constitution of the VCC. MAS has also clarified that an umbrella VCC may consist of sub-funds that are both open-ended and closed-end, and have the flexibility to use liquidity

### Key updates

- A new corporate vehicle, the VCC, has been proposed by MAS.
- VCCs will be able to issue and redeem shares without shareholders' approval (enabling investors to exit investments) and pay dividends using its capital.
- VCCs may have several sub-funds, each with segregated assets and liabilities, and cross sub-fund investment is permitted.
- MAS will not administer the new VCC Bill, except for the AML/CFT obligations of VCCs.
- VCCs may have only one member.

management tools, provided that any rights or limits to redemption are clearly set out in the VCC's constitution.

## **Cellular Structure**

Similar to the approach taken in other jurisdictions, MAS confirmed that an umbrella VCC will be a single legal entity with sub-funds that have segregated assets and liabilities, but each sub-fund will not have its own separate legal personality. The VCC Bill provides for certain disclosure requirements for umbrella VCCs, allows for cross sub-fund investment, and for each sub-fund to be wound up as if it were a separate legal person.

MAS also announced its intention to proceed with the original proposal on additional safeguards against the risk of cross-cell contagion, which will be set out in amendments to the Securities and Futures Act (the SFA), its subsidiary legislation, and the Code on Collective Investment Schemes (CIS Code). One additional safeguard announced is that the manager of a scheme authorised by MAS for offer to retail investors structured as a VCC (Authorised VCC) may only invest in assets located in a jurisdiction that does not have a cellular structure after taking steps to reasonably mitigate any cross-cell contagion risk. This obligation will require careful analysis by managers of Authorised VCCs.

## **Shares and Share Capital**

The VCC Bill provides that the requirement for shares in a VCC to be issued or redeemed at a price equal to the proportion of the NAV of the VCC represented by each share will be implied in the constitution of every VCC. However, VCCs will have flexibility to adjust the price for fees and charges in accordance with the constitution. In-kind subscriptions or redemptions are not prohibited by the VCC Bill.

In addition, VCCs will be able to issue different classes of shares with different rights and dividend payment policies, although the rights attaching to each share must be set out in the VCC's constitution.

## **Confidentiality**

A VCC must maintain an up-to-date register of members at its registered office or at the office of a service provider whose office is in Singapore and must disclose this information to the necessary regulatory and law enforcement authorities upon request, although neither this, nor the constitution of the VCC, need to be made available to the public. Also, information on share allotments and redemptions will not be required to be lodged with the Registrar.

## **Corporate Governance**

A VCC must appoint a Singapore-based fund manager that is regulated by MAS (a Permissible Fund Manager) — either licensed or registered — to retain overall responsibility for the fund management duties and to mitigate any conflicts of interests. At least one director of a VCC must be a representative or director of the Permissible Fund Manager. This means that while Venture Capital Fund Managers may manage VCCs, fund managers that are exempt from MAS regulation (such as certain real estate fund managers) will not be permitted to manage VCCs. However, MAS has noted that it may reconsider this requirement in the future.

Directors of VCCs must be fit and proper persons, and the board of directors of Authorised VCCs must have at least three directors, including one

independent director. VCCs must at all times have at least one director who is ordinarily resident in Singapore.

## **Custodial Arrangements**

Authorised VCCs are required to appoint a custodian that is a trustee approved by MAS (an Approved Trustee). Such custodian will not have a general obligation to safeguard the rights and interests of the VCC's members, which will instead be imposed on the board of directors of the VCC.

MAS also announced that the requirement to appoint an Approved Trustee would not be imposed on restricted schemes structured as VCCs. Such schemes will instead be required to maintain their assets in trust or custody accounts with a prescribed entity (e.g., licensed/approved banks, custodians or financial institutions, etc). However, this requirement will not apply to restricted schemes that are private equity or venture capital funds, provided, that investors have both been informed of the absence of custodial arrangements and that their acknowledgement has been obtained.

## **Financial Statements**

VCCs that are not Authorised VCCs may prepare their financial statements using IFRS, an applicable ASC Standard or US GAAP. All sub-funds in a VCC will also be required to prepare financial statements using the same accounting standards as their VCC, and which must be audited.

## **Winding-up of VCCs**

MAS announced that VCCs may be wound up voluntarily by a members' resolution, similar to companies incorporated under the CA. The Court may also wind up a VCC on the same grounds on which CA-incorporated companies may be wound up, or where the VCC has conducted business outside its permitted use as a vehicle for CIS only, where the VCC does not have a Permissible Fund Manager for the period prescribed, or where the VCC breaches its AML obligations.

## **Re-domiciliation and Restructuring**

MAS announced that the re-domiciliation regime under the CA will be adopted for VCCs, except that certain requirements under the CA to have total assets, annual revenue or employee headcount below a prescribed threshold will not be applicable to otherwise eligible foreign corporations seeking to re-domicile as VCCs.

However, MAS has decided against adopting the mechanisms for arrangements, reconstructions or amalgamations under the CA for VCCs. MAS explained that its approach would accord flexibility in allowing VCCs and sub-funds to restructure under the terms of each VCC's constitution. MAS also announced that no legislative mechanism for converting existing domestic CISs to VCCs will be provided, as this may be accomplished through corporate restructuring mechanisms.

## **Taxation**

MAS reiterated the announcements of the Ministry of Finance in its 2018 Budget Statement that:

- (a) a VCC will be treated as a company and a single entity for tax purposes, and only one set of income tax returns will be required to be filed with the Inland Revenue Authority of Singapore;

- (b) existing tax exemptions under sections 13R and 13X of the Income Tax Act (Cap. 134) of Singapore will be extended to VCCs;
- (c) the 10% concessionary tax rate under the Financial Sector Incentive – Fund Management scheme will be extended to Permissible Fund Managers managing incentivised VCCs; and
- (d) the existing GST remission for funds will be extended to incentivised VCCs.

The VCC is also expected to have access to Singapore's network of DTAs, potentially making the VCC attractive to investors accessing investments across Asia and beyond. Furthermore, as a Singapore-domiciled structure, the VCC is also expected to assist Singapore managers with demonstrating substance for the purposes of the Base Erosion and Profit Shifting (BEPS) initiative.

It is also anticipated that the VCC may make an election under the US "check the box" rules to be treated as a "pass-through" entity for US federal income tax purposes. The ability to make such an election is likely to enhance the attractiveness of investing in VCCs for US taxable investors.

### **Final thoughts on the VCC Bill**

The VCC Bill and most of the announcements in the Response Paper will be welcomed by the investment funds industry in Singapore. MAS has also amended its proposals in a number of respects in response to public feedback; for instance, as mentioned above, the requirements for VCCs to have at least two members and for VCCs offered on a restricted basis to appoint a custodian that is an Approved Trustee have been removed.

The restriction on exempt fund managers (as well as foreign licensed fund managers) from managing VCCs, including managers that only manage immovable assets or proprietary assets of related corporations, will unfortunately limit the number of managers that may utilise this new vehicle. Exempt fund managers that wish to launch a VCC would either need to apply to become regulated by the MAS, or contract with a regulated manager to form a VCC.

Although the VCC offers a viable alternative to using a private limited company as a fund vehicle, restricting the use of VCCs to CIS only means that special purpose companies below the fund itself will need to remain as private limited companies. Thus, many of the issues with using a private limited company identified as part of the need for introducing the VCC (such as the requirement for solvency statements, the inability to make distributions from capital and the public nature of shareholder registers) will remain in fund structures. This issue will only be solved if either the CA is amended to address these issues or VCCs are made available for wider use beyond only CIS (e.g., as co-investment and special purpose vehicles).

When compared with the Hong Kong Open-ended Fund Company (OFC), which was launched earlier in 2018, the VCC is expected to require fewer ongoing compliance obligations and offer more flexibility in structuring different share classes. Further, unlike the OFC, the new Bill will not be administered by the financial industry regulator. This comparative flexibility, together with a more certain tax status, will make the VCC a more functional alternative for funds.

The Response Paper contained only one paragraph on taxation; no new announcements on taxation were made. The question as to whether transfers of shares in VCCs will be subject to stamp duty (identified by some of the respondents to the original consultation paper) remains open. It is hoped that there will be clarity on this important question before the VCC Bill is passed.

Finally, the industry would welcome any additional incentives to encourage the use of VCCs, such as tax incentives, as without an additional pull factor, it may prove difficult to convince managers to begin using this new vehicle.

## CONTACTS



**Kai Schneider**  
Partner

**T** +65 6410 2255  
**E** kai.schneider  
@cliffordchance.com



**Lena Ng**  
Partner

**T** +65 6410 2215  
**E** lena.ng  
@cliffordchance.com



**Daryl Liu**  
Counsel

**T** +65 6410 2047  
**E** daryl.liu  
@cliffordchance.com



**Luke Chen**  
Senior Associate

**T** +65 6410 2280  
**E** luke.chen  
@cliffordchance.com

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Clifford Chance Pte Ltd  
12 Marina Boulevard  
25th Floor Tower 3  
Marina Bay Financial Centre  
Singapore 018982

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