DREW & NAPIER

LEGAL UPDATE

LEGISLATION UPDATE

1 September 2014

PROPOSALS TO ENHANCE REGULATORY SAFEGUARDS FOR INVESTORS IN THE CAPITAL MARKETS

INTRODUCTION

The Monetary Authority of Singapore ("**MAS**") published a consultation paper on proposals to enhance its regulatory framework for safeguarding investors' interests. The proposed enhancements are in the following three key areas: (a) extending to investors in non-conventional investment products the current regulatory safeguards available to investors in capital markets; (b) requiring investment products to be rated for complexity and risks, and for these ratings to be disclosed to investors; and (c) refining the non-retail investor classes including providing accredited investors the option to benefit from the full range of capital markets regulatory safeguards that are applicable for retail investors.

PROPOSED ENHANCEMENTS

Extending capital markets safeguards to non-conventional investment products

MAS indicates that it has noticed a rise in non-conventional investment products in recent years.

MAS is of the view that some of these products exhibit essentially the same characteristics as regulated capital markets products, but have been deliberately structured in such a way as to take them outside the ambit of regulation under the Securities and Futures Act ("**SFA**"). MAS also notes that such products usually involve investors taking a direct interest in physical assets as opposed to a securitised interest.

To better safeguard investors, MAS proposes that such non-conventional products displaying similar characteristics as capital markets products be similarly regulated under the SFA. Accordingly, MAS proposes to regulate the following two types of products:

(a) buy-back arrangements involving precious metals such as gold, silver and platinum; and

(b) collectively-managed investment schemes, being arrangements in respect of property that display all characteristics of a regulated collective investment scheme, other than the pooling of investors' contributions.

Buy-back arrangements involving precious metals

For certain buy-back arrangements involving precious metals, MAS is of the view that, if in essence, the agreement between the parties is that funds made available are to be repaid with interest at the conclusion of the arrangement and the transfer of ownership of the physical asset is for security and not consumption purposes, then such buy-back arrangements are in effect debt obligations.

MAS also notes that such precious metals buy-back arrangements are being marketed to consumers as financial instruments and have gained traction with a segment of consumers. Such arrangements are comparable to financial assets in their inter-changeability with real currency, transferability and market liquidity.

Given the above, MAS proposes to prescribe and regulate as debentures buy-back arrangements which involve:

(a) Party A purchasing precious metals of gold, silver or platinum from Party B for an agreed sum of money or money's worth,

(b) Party B being under an obligation to purchase the asset back from Party A at a future time; and
(c) The purpose or effect of the arrangement is to enable Party A to receive a "financial benefit" from Party B.

Financial benefit

MAS also proposes that it will consider there to be a "financial benefit" where the effective re-purchase price agreed to at the time the arrangement is entered into is higher than the initial purchase price. The effective re-purchase price will consist of the total payments made by Party B to Party A under the arrangement, whether in one or a series of payments. The initial purchase price will comprise the amount paid by Party A to Party B to purchase the asset under such arrangement, whether in one or a series of payments.

Debenture regulatory regime

MAS proposes to apply the debenture regulatory regime under the SFA and Financial Advisers Act ("**FAA**") to such precious metals buy-back arrangements. Such regulatory requirements include disclosure requirements, an MAS - approved trustee for unlisted debentures and the licensing of intermediaries which deal in or advise others about such debentures.

Although the economic substance of such a buy-back arrangement is similar to that of a debenture, such regulatory treatment may cause complications as the legal structure in the existing regulations is premised on that of a loan. The existing legal requirements relating to borrowings and interest would not fit a re-purchase with a re-purchase premium. The market would be confused and perplexed at the treatment of a sale and repurchase as a loan debenture. Also, there appears to be no comparable regulatory legislation in the United Kingdom, the United States, Australia or other leading financial centres for such regulatory treatment of a buy-back arrangement as a debenture. The proposed change would need complex amendments to the prospectus requirements and debenture trustee requirements. On the other hand, it may be more appropriate to regulate such arrangements as a special type of investment scheme under the collective investment scheme regulatory regime as there is greater flexibility under the investment scheme regulations and as the market is already conditioned to expect regulatory treatment of such agreements as a form of investment scheme.

Characterising collectively-managed investment schemes as collective investment schemes

Under the current regulatory framework, collective investment schemes ("**CIS**") are arrangements in respect of any form of property which exhibit all of the characteristics below:

(a) Participants have no day-to-day control over management of the property ("**no day-to-day control**"),
(b) Property is managed as a whole by or on behalf of the scheme operator ("**collectively managed property**"),
(c) Participants' contributions are pooled ("**pooled contributions**"),
(d) Profits or income of the scheme from which payments are to be made to the participants are pooled ("**pooled profits**"), and
(e) Purpose or effect of the arrangement is to enable participants to participate in profits arising from the scheme property ("**rights to participate in pooled profits**").

MAS indicates that it has noticed a number of arrangements which are not considered CIS simply by offering investors direct interests in underlying assets. Technically, such schemes would not fulfil the pooled contributions requirement.

However, in MAS' view, such arrangements expose investors to the same risks as that of a traditional CIS.

Whilst investors technically have a direct interest in underlying assets, day-to-day management of the asset is ceded to the scheme operator, to be managed collectively with the assets of other scheme participants. The purpose is to enable participants to share in scheme profits on a proportionate basis, and as such, assets are effectively pooled. MAS also notes that the investment risks of such schemes may be exacerbated by long gestation periods and a heavy reliance on the scheme operator's expertise.

Given the above, MAS proposes to remove the pooled contributions requirement from the characteristics of a CIS which MAS notes would be in line with other jurisdictions.

In the United Kingdom, section 235 (1) of the Financial Services and Markets Act defined a collective investment scheme as "any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income". There is no requirement for pooling of assets. A similar approach was adopted in Hong Kong.

Whilst MAS is proposing to remove this requirement, MAS is of the view that the remaining requirements would be essential for a scheme to be considered a CIS. MAS provides some guidance on each of these requirements.

No day-to-day control

In MAS' view, the lack of day-to-day control over the investment is an important indication of the need for regulatory intervention, as investors who retain day-to-day control would be in a better position to protect their own interests. MAS notes that investors may retain day-to-day control even if they delegate certain aspects of managing the asset/property such as rent collection or cleaning and maintenance. MAS also notes that a strong indication that investors do not have day-to-day control is where not appointing a manager to manage the property would undermine the whole purpose of the scheme.

Collectively managed property and pooled profits

MAS notes that these two elements, namely, collectively managed property and pooled profits, together establish the collective nature of the scheme. For such collective schemes, participants' property must be effectively pooled to generate profits which would otherwise not be available to participants if each property were to be individually managed.

MAS provides contrasting examples of a block of apartments which is managed on the basis that the only profit which each unit owner receives is that which arises from his unit versus a block of apartments which is managed on the basis that each unit owner receives a portion of income from total lettings, irrespective of whether the owner's individual unit is let or not. In MAS' view, the second example is likely a CIS whilst the first is not.

Rights to participate in pooled profits

MAS considers this element to be important in establishing whether a scheme has been set up for investment purposes. In determining whether an arrangement is "for profit", MAS will have regard to whether an arrangement purports or has the effect of giving participants rights to participate in pooled profits of the scheme. MAS also notes that it does not intend to regulate uses of property which are consumption based.

Examples of CIS

MAS also provides a few examples of collectively-managed investment schemes in the context of real estate which are likely to be regarded as CIS. These are:

(a) Land investment schemes where investors take up fractional interests in undeveloped land, but need to use the scheme operator's services in obtaining planning permission for or disposing of the land as a whole;

(b) Investments in land for forestry or harvesting purposes where investors acquire fractional interests or interests in individual trees in a plantation plot, but the scheme operator handles day-to-day management of the forestry or harvesting operations for the entire plot; and

(c) Buy-to-let schemes where investors are offered units through fractional interests or a room in a block of apartments, and where investors will be entitled to participate in profits generated from the scheme operators management of the properties as a whole.

CIS regulatory regime

MAS proposes to extend the current CIS regulatory regime in its entirety to collectively-managed investment schemes. MAS notes that the CIS regulatory regime is similar to that for debentures with an additional requirement that the scheme be authorised (or recognised for overseas constituted schemes) by MAS.

As such, collectively managed investment schemes offered to retail investors will also have to comply with CIS requirements applicable to retail offers, which include, complying with the Code on Collective Investment Schemes ("**CIS Code**") and management of the scheme by a licensed fund manager or real estate investment trust ("**REIT**") manager who is fit and proper.

Given the proposal that operators of collectively managed investment schemes are to be regulated as licensed fund managers, existing operators of such schemes will require a licence if they take on new investors or offer additional units to existing investors.

MAS further notes that certain collectively-managed investment schemes may not be able to abide by the precise strictures of the CIS Code and indicates that it may promulgate specific rules in the CIS Code for such schemes. These would be akin to the current rules for REITs such as the rule where at least 75 percent of a REIT's portfolio must be made up of income producing real estate assets.

Extending capital markets safeguards to non-conventional investment products

MAS indicates that it has noticed an increasing number of investment products with more complex risk-return profiles being packaged and marketed to investors. Given its concern that investors may face difficulties in understanding the risk-return profiles of such products, MAS proposes to introduce a complexity-risk ratings framework where ratings for each investment product will be given against two dimensions. These are, complexity, being the difficulty in understanding the risk/reward profile of the product, and risk, being the likelihood of losing the principal investment.

The Investment Management Association of Singapore initiated a project which was continued by the Sim Kee Boon Institute for Financial Economics at the Singapore Management University which completed a draft report in September 2013 on a Risk and Complexity Rating Framework for Investment Products. (See "A Risk and Complexity Rating Framework for Investment Products" by Benedict Koh et al, May 2014). This measure followed similar developments in European Union where a uniform regulatory framework on investment suitability viz the Markets in Financial Instruments Directive(Directive 2004/39/EC) ("**MiFID**") came into force in November 2007. In January 2012, the independent Financial Industry Regulatory Authority in the USA released Regulatory Notice 12-03 titled "Complex Products: Heightened Supervision of Complex Products" which identified the types of products that are considered "complex" and provided guidance to member firms regarding supervisory concerns associated with sales of such complex products. Until then, U.S. regulators had not addressed the issues pertaining to "complex" products.

Scope of the risk-ratings framework

MAS proposes that the complexity-risk ratings framework shall be confined to products which are made available to retail investors and are for investment purposes only. Capital market products under the SFA, bank structured deposits, participating whole life and endowment policies and investment-linked policies will fall within the framework, whilst term life policies, non-participating whole life and endowment policies and annuities shall not.

Rating methodology background

MAS indicates that its rating methodology was developed using a framework study report in 2013 titled, "Developing a Risk & Complexity Framework" submitted by the Investment Management Association of Singapore in consultation with Sim Kee Boon Institute for Financial Economics at the Singapore Management University. MAS indicates that it has modified the framework in the above study report with the aim of ensuring that parameters used are as objective as possible and that the rating results are intuitive and comprehensible to retail investors.

This approach is consequent upon the re-assessment of the regulation of financial products in many leading jurisdictions after the global financial crisis of 2008-2009. Different supervisory authorities have adopted different approaches to regulate the sale of retail products. However, the basic approach and building block to investors' protection has been the focus on mis-selling. There has been a growing international understanding that the main source of system stability and the weakest link of investor protection can be traced to mis-selling. A Joint Forum of the Bank of International Settlements (2006) has stated that the way financial firms approach the sale of financial products and services is at the core of consumer confidence in financial markets.

In Europe, the need for MiFID grew out of concerns by institutions and private investors who had incurred losses on their investment portfolios. One key focus of the MiFID investment suitability framework is a risk classification of complex and non-complex products to match the risk tolerance, knowledge, experience, and investment objectives of investors. Besides the EU, the Swiss Financial Market Supervisory Authority, FINMA, also amended its regulation regarding the sale process of financial instruments.

Some other countries also introduced product risk classification. For example, Germany enacted the "Investor Protection and Capital Markets Improvement Act" (Anlegerschutz- und Funktionsverbesserungsgesetz) to provide investors and savers better protection against mis-selling. A key objective was to improve product transparency and comparability using standardized information. A Synthetic Risk and Reward Indicator ("**SRRI**") was devised and used to calibrate risk. The methodology used to compute the SRRI follows the Commission of European Securities Regulators technical advice 09/1026 dated December 2009. The SRRI is a proxy for the annual volatility of each fund. Funds are assigned to one of seven risk categories using the SRRI. The SRRI has to be shown to investors before funds are sold.

Rating for complexity

MAS notes that low complexity products should exhibit a fairly direct relationship between the value of the product and the price of the underlying asset whilst high complexity products may have additional product features which affect the correlation between the price of the underlying asset and the value of the product.

MAS proposes that the complexity rating of an investment product be based on four factors, namely, number of structural layers, extensiveness of derivative use, availability and usage of known valuation models and number of scenarios determining return outcome. For each factor, an investment product shall be assigned a low, medium or high sub-rating. The weighted values of the four sub-ratings shall then be used to derive the overall complexity rating of the product.

Number of structural layers

MAS indicates that one aspect of "structure" would be the number of underlying assets which affect the payoff on the product. Another aspect would be the number of layers interposed between the investor and the underlying asset. For example, plain vanilla equity and debt securities would be considered as having a single layer as the investor is directly exposed to the underlying asset. On the other hand, a fund would be considered as having two layers as there is a fund manager interposed between investors and the underlying asset.

Extensiveness of derivatives usage

MAS indicates that this would only refer to derivatives that are inherent to the product where the product is a derivative or embeds derivatives. This would not include derivatives used for hedging purposes. MAS also clarifies that in looking at the number of derivatives in the product, such number would be the number of types of derivatives and not the number of contracts of each derivative.

Known valuation models

MAS notes that this factor tries to capture the ease with which a retail investor would be able to price an investment product, taking into account, access to valuation models and input data. For this factor, MAS proposes three broad categories: publicly available, proprietary and generic.

Products such as shares would be classified as publicly available as their prices are readily available and they can be valued using valuation models with publicly available methodology such as the price earnings model. On the other hand, products such as credit default obligations cash flow tranches and over-the-counter structured products would usually be priced using the issuer's proprietary valuation model. In such instances, prices would generally not be publicly available and investors would face difficulty in valuing the product. The third category, generic, refers to products which are priced using more complex but yet commonly available valuation models such as the Black-Scholes option pricing model.

Number of scenarios determining return outcome

MAS notes that this factor refers to the number of potential scenarios that determine the final return outcome of the product and that a possible way of determining this would be to map the different possible pathways from issuance of the product till maturity. MAS gives the example of plain vanilla equity securities which only have one scenario determining return outcome – that being the market price of the equity. On the other hand, products such options would have two scenarios determining return outcome, depending on whether the option is exercised or not.

Rating for risk

MAS proposes a simple four-category approach to risk classification, based on the likelihood of an investor losing some or all of his investment or an amount greater than his initial investment. MAS terms this a "bucket-based" approach to risk rating.

The "low" classification would be for products where there is a very low risk of sustaining losses on the investment amount. The intermediate categories are for products where some or all of the investment amount can be lost. Within the intermediate categories, the "medium" classification is for products such as non-concentrated, non-leveraged and non-synthetic funds or investment grade debt securities whilst the "high" classification is for funds with a highly concentrated, leveraged or synthetic structure and other single securities such as equities and non-investment grade bonds. The "very high" classification is for products where the investor can lose more than his initial investment. These would be products such as futures, contracts-for-differences, written options and leveraged foreign exchange trading.

MAS also provides some further guidance as to how various products will be classified. MAS proposes that funds can considered as non-concentrated and hence fall into the "medium" classification, if:

(a) for equity and debt funds, in addition to complying with the spread of investment limits as set out in Appendix 1 of the CIS Code, its investments are not concentrated in a single sector or country,
(b) for property funds including REITs, its investments are not concentrated in a single country, and
(c) for commodity or foreign currency funds, its investment exposure is not limited to a single class of commodity or currency respectively.

Bonds would be considered investment-grade and therefore fall into the "medium" classification, if:

(a) they have a minimum long-term rating of BBB- by Fitch, Baa3 by Moody's or BBB- by Standard and Poor's, or
(b) they are fully guaranteed by an entity that has an investment-grade rating.

Non-investment grade and unrated debt issuances would fall into the "high" classification.

For stapled securities, the overall classification will be the highest classification that the underlying securities fall into. For example, a debt security stapled to a share will have a "high" classification.

Historical price volatility indicator

MAS proposes that the historical price volatility (or credit rating in the case of debentures) be disclosed together with the risk classification. This will allow for additional differentiation between products within a particular risk classification. This requirement will apply to products in the "medium", "high" and "very high" risk classes only as products in the "low" risk class are fairly limited. MAS is also considering that this indicator be limited to certain products such as equity securities, debt securities and funds, where the concept of volatility is more prevalent.

Production and disclosure of ratings

Given issuers' familiarity with their own products, MAS proposes that issuers be required to rate their products based on the complexity-risk ratings framework, with such ratings to be disclosed in product offering documents for new and on-going offers of investments to retail investors. Issuers seeking to list their products on an Approved Exchange will also be required to inform the relevant exchange and the exchange is to indicate such rating information on its trading platform.

MAS also proposes that the disclosure as to the complexity-risk ratings for various products can be made as follows:

(a) for Part XIII Offers of Investments, in the Product Highlight Sheet;
(b) for futures, in the futures exchange trading platform and Risk Disclosure Statement;
(c) for leveraged foreign exchange and contracts for difference, in the Risk Fact Sheet;
(d) for structured deposits and dual currency investments, in the term sheet;
(e) for par-whole life or par-endowment policies, in the Product Summary; and
(f) for investment-linked policies, in the Product Summary.

Besides the disclosure as to the complexity-rating, MAS also proposes supplementary disclosures for each product, which include, a disclosure as to product mapping, showing how an individual product maps against other products and explanations as to how to interpret the product ratings.

Updating of disclosure

MAS proposes that disclosures as to complexity, risk and historical price volatility be incorporated into documents used to offer products to investors. As such, issuers would not be required to update the offering documents after an offer has closed. Changes as to a product's ratings are to be disclosed to investors in the same manner as investors are currently kept informed of material changes in their investment.

Interaction with existing risk rating frameworks

MAS notes that financial institutions may have their own risk rating frameworks. To avoid investor confusion there should be a general alignment between MAS' complexity-risk framework and financial institutions' risk frameworks. MAS indicates that their intention is not to replace financial institutions' frameworks, but rather to provide a baseline rating within which financial institutions may further differentiate their products for distribution.

MAS also indicates that it has worked with the Central Provident Fund Board to rationalise the ratings produced under the CPFIS Risk Classification Framework and MAS' complexity-risk framework. Generally, CPF approved investments will fall into the "low" and "medium" classifications.

MAS also notes that it had previously defined a list of Excluded Investment Products ("**EIPs**") which are simple, well established products not containing derivatives. Products not in the EIPs list would be considered more complex products and termed Special Investment Products ("**SIPs**"). MAS proposes to align the new complexity-risk framework with the classification of products as EIPs or SIPs. EIPs would be products with a "low" or "medium" rating under the new framework as well as products excluded from the scope of the new framework. All other products would be SIPs. MAS anticipates that a number of funds currently classified as SIPs would be re-classified as EIPs under the new framework as they only use derivatives for hedging or efficient portfolio management purposes.

Refining the investor classes under the SFA and FAA

At present, there are three main classes of non-retail investors under the SFA and FAA regulatory framework. These are, accredited investors ("**Accredited Investors**"), institutional investors ("**Institutional Investors**"), and expert investors ("**Expert Investors**"). Investors who do not fall within any of the non-retail investor classes above are considered retail investors.

MAS is of the view that certain classes of non-retail investors may not necessarily be better informed or require less regulatory protection than retail investors and is proposing refinements to non-retail investor classes with the aim of enhancing investor protection and rationalising the investor classes.

Accredited Investors

Under the current regime, Accredited Investors are investors which meet certain income or wealth thresholds. These criteria are defined under section 4A(1)(a) of the SFA read with regulation 2 of the Securities and Futures (Prescribed Specific Classes of Investors) Regulations 2005.

Issuers and intermediaries are exempted from certain regulatory requirements when dealing with Accredited Investors. For example, issuers of securities are exempted from having to issue a full prospectus for offers made only to Accredited Investors. MAS notes that an investor may not necessarily be aware of his Accredited Investor status and that issuers and intermediaries are exempt from certain regulatory requirements when dealing with him. On the other hand, even if he is aware of his Accredited Investor status, he is not able to choose to be protected by the same regulatory safeguards that protect retail investors.

Proposed opt-in regime

MAS proposes to introduce an “opt-in” regime for the Accredited Investor class. All investors other than Institutional Investors would by default be treated as retail investors with investors who meet the Accredited Investor criteria having the option of opting for Accredited Investor status.

MAS indicates that the policy objectives of such an “opt-in” regime are to ensure that investors are fully informed of their status as retail investors or Accredited Investors and to provide investors meeting the Accredited Investor criteria with the choice of determining the level of regulatory protection that best suits their risk profile and investment needs. MAS also notes that this would be in line with international best practices recommended by the International Organization of Securities Commissions (“**IOSCO**”) and with the approach of other jurisdictions such as the European Union and Hong Kong.

Opt-in process

Financial institutions are to provide written notification to all clients who are assessed by the financial institution as an investor meeting the Accredited Investor criteria (“**Eligible Investor**”). Such notification should include an explanation of the investor’s right to request for Accredited Investor status and a warning of the regulatory safeguards that would not apply if they were to opt-in for Accredited Investor status. Eligible Investors wishing to opt-in must then confirm this in writing to the financial institution and acknowledge the consequent reduction in regulatory safeguards.

MAS states that the opt-in process should not be treated as a rote process of requiring clients to sign standard forms but rather as a process that promotes fair dealing. In particular, MAS indicates that the explanations to clients regarding the consequences of opting in for Accredited Investor status should be made as clear as possible and easily comprehensible by the investing public.

The proposals are in line with similar developments in the European Union (see Annex II.2 of the MiFID) and in Hong Kong *vide* the Hong Kong Securities and Futures Commission’s Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (at Chapter 15) which have adopted a similar 'opt-in' approach for their main non-retail investor class.

The proposals are also in line with recommendations by the IOSCO (See the IOSCO Final Report on Suitability Requirements with respect to the Distribution of Complex Financial Products, published on 21 January 2013 ("**IOSCO Suitability Report**"). In particular, Principle 1 of the IOSCO Suitability Report*, inter alia,* provides that "the classification of customers should be based on a reasonable assessment of the customer concerned, taking into account the complexity and riskiness of different products."

Under this principle, the IOSCO Suitability Report also recommends that "intermediaries should not automatically rely on a customer’s request for non-retail customer status or, where relevant, on the triggering of a given threshold or size" and "some jurisdictions may allow customers who qualify as non-retail customers to elect to be treated as a retail customer. Moreover, intermediaries may be allowed to qualify and treat all customers as retail customers and afford them the corresponding higher level of protection."

Eligible Investors

MAS proposes that the opt-in process applies to all Eligible Investors, including those that are not natural persons such as corporations, trustees, limited liability partnerships and other types of entities.

Accredited Investor status on a per financial institution basis

To provide maximum flexibility for Eligible Investors in choosing their level of regulatory safeguards, MAS proposes that the Accredited Investor status of any particular Eligible Investor would be on a per financial institution basis. That is, an Eligible Investor may be treated as a retail investor by the bank with which he maintains his savings account but as an Accredited Investor by another bank with which he has a brokerage account, in order to access a wider suite of investment products.

Moving between investor classifications

MAS proposes that an Eligible Investor be able, at any time, to change his classification from Accredited Investor to non-Accredited Investor ("**non-AI**") status, or *vice versa*, by written request to the relevant financial institution. Such a change in classification would not affect transactions that were entered into while the Eligible Investor was classified as an Accredited Investor. Where a client has converted from Accredited Investor to non-AI status, financial institutions would also have the option of choosing whether to continue providing financial services to the client. The exception would be where a financial institution is only licensed to serve restricted clientele, in which case, it would be precluded from serving non-AI clients.

Record keeping and monitoring obligations

MAS indicates that financial institutions are expected to implement appropriate internal policies and procedures to classify clients, including proper records of the opt-in process and client instructions relating to changes of classification. MAS also proposes to require financial institutions to review their existing Accredited Investor clients as to their eligibility for Accredited Investor treatment at least once every two years, and to take appropriate action to re-classify clients if required.

Transitional arrangements

MAS notes that requiring financial institutions to obtain written opt-in confirmations from clients may present administrative difficulties and proposes a two year transitional period to migrate existing Accredited Investor clients to the opt-in regime. With respect to existing investments predicated on an investor maintaining his Accredited Investor status, MAS proposes to allow an existing Accredited Investor who may no longer be eligible for Accredited Investor status to continue to be treated as an Accredited Investor only in respect of, and for the duration of, the existing investments.

Proposed amendments to the eligibility criteria for Accredited Investors

MAS proposes to leave the existing Accredited Investor criteria unchanged, save for certain proposed amendments to the criteria for individuals, corporations and trustees as discussed below:

Individuals

MAS notes that Accredited Investors are considered to require fewer regulatory safeguards as they are presumed to have the relevant means to seek professional advice to protect their interests. However, this presumption would be weakened if the majority of an Accredited Investor's assets were in illiquid assets such as property. As such, MAS proposes to retain the current monetary thresholds of S$2 million net personal assets or S$300,000 annual income but with a modification to the net assets eligibility criteria 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.

MAS also proposes that any individual who holds a joint account at a financial institution with an individual who is an Accredited Investor, will himself be Accredited Investor eligible, but only in respect of transactions entered into through that particular financial institution using that particular joint account. MAS notes that this proposal may be of benefit to the private banking industry for family wealth planning purposes. Connected persons of Accredited Investors would potentially have the flexibility and choice to determine the level of regulatory protection and access to a range of products that best suit their needs.

Corporations

Under the current regime, a corporation would automatically be classified as an Accredited Investor if it is a corporation that has net assets exceeding S$10 million or a corporation whose sole business is to hold investments and its entire share capital is owned by Accredited Investors.

MAS is of the view that the second criteria above is too restrictive and proposes that any corporation that is wholly owned by Accredited Investors be classified as an Accredited Investor irrespective of the business that it is in.

Trustees

The current Accredited Investor definition includes as an Accredited Investor the trustee of any trust which has assets exceeding S$10 million. On the other hand, the wealth threshold for an individual is S$2 million, which means that an individual who holds assets worth between S$2 million and S$10 million would qualify for Accredited Investor status as an individual but not if his assets were held in trust for him.

MAS proposes to address this inconsistency by extending the Accredited Investor eligibility to the trustee of any trust in which all the beneficiaries are Accredited Investors. MAS notes that this would be consistent with the above proposed amendment for corporations.

Institutional Investors

Institutional Investors are regulated financial institutions or entities that deal in financial products in the ordinary course of business. MAS notes that offers of investments made to Institutional Investors are exempt from prospectus requirements in recognition that Institutional Investors have the expertise to engage in capital market activities.

Widening the institutional investor definition

MAS proposes to extend the Institutional Investor definition to entities organised in foreign jurisdictions carrying out financial services activities similar to those for which MAS licences are granted and that are authorised, licensed and/or regulated in one or more foreign jurisdictions. MAS notes that currently, most foreign financial services entities using the services of Singapore-based financial institutions would qualify as Accredited Investors. However, the extension of the Institutional Investor definition to such firms would preclude them from having to go through the Accredited Investor opt-in process.

MAS also proposes to extend the Institutional Investor definition to all central governments and central government agencies of foreign states, supranational organisations such as the World Bank the International Monetary Fund and sovereign wealth funds as it recognises that such entities are very sophisticated investors. The Institutional Investor definition will however not be extended to provincial and municipal authorities as MAS is of the view that there is a wide variance in the degree of financial knowledge amongst such entities.

Excluding certain statutory bodies from the institutional investor definition

The current Institutional Investor definition includes all statutory bodies such as statutory boards, town councils and other entities incorporated under specific acts of Parliament. MAS is of the view that not all statutory bodies deal in financial products or have the necessary financial expertise associated with the Institutional Investor class and proposes to amend the Institutional Investor definition in relation to the statutory body portion to include only statutory boards. MAS notes that excluded statutory bodies may still be classified as non-retail investors if they meet the Accredited Investor criteria and opt-in for Accredited Investor status.

Rationalising regulatory requirements for dealings with Accredited Investors and Institutional Investors

MAS notes that in calibrating the range of regulatory safeguards under the SFA and FAA, its policy intent is to accord retail investors the full range of safeguards followed by Accredited Investors, then Institutional Investors. As such, all exemptions for dealing with Accredited Investors should in principle apply to Institutional Investors as well. MAS notes that this is not the case, primarily for certain regulatory exemptions in the Securities and Futures (Licensing and Conduct of

Business) Regulations for dealings with Accredited Investors. For example, financial institutions are exempted from posting collateral when borrowing securities from Accredited Investors and from having to explain the risks involved in securities lending to Accredited Investors, but this exemption does not apply to Institutional Investors.

MAS proposes to undertake amendments to rationalise the SFA and FAA regulatory exemptions that apply in relation to dealings with Accredited Investors and Institutional Investors.

Expert Investors

An Expert Investor is currently defined as a person whose business involves the acquisition and disposal, or the holding, of capital markets products, whether as principal or agent, or as the trustee of such trust as MAS may prescribe, when acting in that capacity or such other person as may be prescribed by MAS.

MAS proposes to remove the Expert Investor category from the SFA and FAA regulatory framework. MAS notes that the Expert Investor category comprises mainly individuals who work for financial institutions as traders, in respect of such individuals own trading. MAS is of the view that the Expert Investor category applies only to a small group of investors but adds another layer of complexity in that level of regulatory safeguards available to Expert Investors is less than that for retail investors but more than that for Accredited Investors and Institutional Investors. MAS also notes that affected investors call still opt-in to be Accredited Investors if they qualify as Eligible Investors or otherwise assume retail status.

REFERENCES

Please click on the link below to refer to the relevant document.

Consultation Paper on "Proposals to Enhance Regulatory Safeguards for Investors in the Capital Markets"

If you have any questions or comments on this article, please contact:

Sin Boon Ann
Deputy Managing Director, Corporate & Finance
T: +65 6531 2206
E: boonann.sin@drewnapier.com

Petrus Huang
Director, Corporate & Finance
T: +65 6531 2208
E: petrus.huang@drewnapier.com

Su Jen Jen
Director, Corporate & Finance
T: +65 6531 2215
E: jenjen.su@drewnapier.com

Grace Lai
Director, Corporate & Finance
T: +65 6531 4166
E: grace.lai@drewnapier.com

Yap Siew Ling
Director, Corporate & Finance
T: +65 6531 2566
E: siewling.yap@drewnapier.com

Joanne Lee
Director, Corporate & Finance
T: +65 6531 2276
E: joanne.lee@drewnapier.com

Ron Cheng
Director, Corporate & Finance
T: +65 6531 2230
E: ron.cheng@drewnapier.com

Mark See
Director, Corporate & Finance
T: +65 6531 2234
E: mark.see@drewnapier.com

Wu Geng
Associate Director, Corporate & Finance
T: +65 6531 2310
E: geng.wu@drewnapier.com

Rachel Poon
Associate Director, Corporate & Finance
T: +65 6531 2748
E: rachel.poon@drewnapier.com

Felicia Koh
Associate Director, Corporate & Finance
T: +65 6531 2707
E: felicia.koh@drewnapier.com

LEGAL UPDATE

Editorial Team

Priyanka Ahluwalia
Jacelyn Chan
Odesa Tay
Fiona Tan
Alvin Chan

Drew & Napier LLC
10 Collyer Quay
#10-01 Ocean Financial Centre
Singapore 049315

www.drewnapier.com

T : +65 6535 0733
T : +65 9726 0573 (After Hours)
F : +65 6535 4906