

ClientAlert

Investment Funds

October 2011

Updates to Singapore's Proposed Fund Management Regulatory Regime

Introduction

On 27 September 2011, the Monetary Authority of Singapore ("MAS") issued a consultation paper titled, "Proposed Enhancements and Draft Legislative Amendments to Give Effect to the Regulatory Regime for Fund Management Companies" (the "**2011 Consultation Paper**") seeking public comments on draft legislative changes and further proposed enhancements to the regulatory regime. The consultation period ends on 26 October 2011.

Key enhancements recently proposed in the 2011 Consultation Paper:

- All fund management companies ("**FMCs**") to put in place a risk management framework to identify, monitor and manage risks associated with customer assets managed;
- All FMCs to provide independent annual audited reports on financial statements and compliance with key licensing and business conduct requirements;
- New online registration and reporting system to be put in place by the MAS – all FMCs to be charged an annual administrative fee with effect from 1 January 2013.

The 2011 Consultation Paper is a follow-on to the consultation paper that was issued by the MAS in April 2010 (the "**2010 Consultation Paper**") wherein the MAS had set out proposed policy changes to the regulatory regime for FMCs in Singapore. A copy of our earlier Client Alert on the 2010 consultation may be obtained from [here](#).

The 2010 and 2011 Consultation Papers together outline comprehensive proposed changes to the current regulatory regime, imposing new competency, business conduct, risk management and capital requirements on FMCs. The revised regime is expected to take effect in early 2012. This Client Alert seeks to set out the consolidated proposed changes that will affect FMCs that are currently operating or looking to establish an office in Singapore and serving only institutional and accredited investors. Although the proposed changes will also affect FMCs that serve retail investors, those changes are not within the scope of this Client Alert.

Proposed Regulatory Regime

Under the revised regulatory regime, fund managers of private funds offered only to qualified¹ or accredited² investors, including fund managers operating under the current exempt fund manager ("**EFM**") regime, will be categorized as either "**Registered FMCs**" or "**Licensed A/I FMCs**".



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Registered FMCs

FMCs whose assets under management (“**AUM**”) are not more than S\$250 million and who serve not more than 30 qualified investors, of which not more than 15 are funds (including feeder funds) with accredited investors as underlying investors, could opt to fall under this category. The proposed Registered FMC regime is broadly similar to the existing framework for EFM in that no formal application for approval of the MAS will be required for the FMC to commence business in Singapore. However, unlike the existing EFM framework where EFMs may commence business at any time so long as they lodge the requisite notification with the MAS within 14 days from the date of commencement of business, a Registered FMC will not be allowed to represent itself as being registered with the MAS, will not be allowed to enter into any investment management agreement and may not accept client monies until its name has been entered by the MAS into the online directory on the MAS website.

Licensed A/I FMCs

FMCs who serve only accredited and/or institutional investors and whose AUM is more than S\$250 million or who manage more than 15 funds (where the underlying investors are accredited or institutional investors) will no longer be able to operate without a Capital Markets Services (“**CMS**”) licence and will only be able to commence business following the grant of their CMS licence. Unlike under the old EFM regime or the new Registered FMC regime, there will be no restrictions on the number of accredited or institutional investors a Licensed A/I FMC can serve.

Competency Requirements

Under the new regulatory regime, Registered FMCs and Licensed A/I FMCs will need to appoint or employ:

- (i) a minimum of 2 directors with experience in the financial services industry, including managerial experience or experience in a supervisory capacity; and
- (ii) a minimum of 2 full-time representatives who each have at least 5 years of relevant experience³ and reside in Singapore, one of whom must be appointed as the Chief Executive Officer (“**CEO**”) and executive director of the FMC.

Nominee directors will not count towards meeting the 2 director requirement in (i). As with the current regime, the CEO, directors and representatives of the FMC will need to meet the “fit and proper” requirements as specified in the MAS Guidelines on Fit and Proper Criteria.⁴

Business Conduct and Compliance Requirements

Business Conduct

Under the new regulatory regime, all FMCs will be required to meet the following business conduct requirements (all of which are not present in the current EFM regime):

- **Custody Arrangements:** FMCs need to place their customers’ assets with a custodian which is licensed, registered or authorised in the country where the assets are being held. In the case where the custodian is a related entity, there should be proper disclosure of any conflicts of interest. FMCs placing their client’s assets and monies in proper segregated accounts with third party financial institutions such as prime brokers, futures brokers and banks would generally be able to meet the proposed custody requirements.

With regard to private equity or venture capital (“**PE/VC**”) funds whose underlying investors are accredited and/or institutional investors, the MAS has stated that in lieu of requiring the independent custody of PE/VC fund assets, a FMC may alternatively obtain written acknowledgement from fund investors that such investors are aware that the custody arrangements for PE/VC assets do not meet regulatory requirements, and arrange for an independent auditor to audit and report to investors on the PE/VC fund assets on an annual basis. The MAS indicated in its response to the 2010 Consultation Paper that it will provide further guidance on qualifying PE/VC assets in relation to the custody requirement. The MAS has yet to publish such guidance.

- **Fund Administration:** All fund administration responsibilities must either be outsourced to an independent service provider or, if done in-house, the FMC must ensure that all conflicts of interest are mitigated and there should be a proper segregation of duties and responsibilities between the front and back office functions of the FMC (e.g., through having independent management reporting lines or physical segregation).
- **Risk Management:** All FMCs will be required to put in place a formalized risk management framework to identify, monitor and manage the risks associated with customer assets being managed by the FMC. The risk management framework should be suited to the size and scale of the FMC’s operations. In implementing their risk management framework, FMCs should take into account the key principles set out in the MAS Guidelines on Risk Management Practices⁵ and other relevant industry best practices.
- **Annual Audit:** Licensed A/I FMCs will be subject to the current requirements for licensed fund managers to appoint an independent auditor to audit their financial statements on an annual basis and to provide an auditor’s report to the MAS on their compliance with key licensing and business conduct requirements on an annual basis.

Registered FMCs will be subject to a similar requirement to appoint an independent auditor to audit their financial statements and to provide the MAS with an audit report on the FMC’s compliance with the following criteria and requirements applicable to their regulatory status:

- (i) restrictions in clientele and AUM;
- (ii) minimum base capital requirement (see “Capital Requirements” below);
- (iii) key business conduct rules such as independent custody, valuation of clients’ assets and client reporting; and
- (iv) implementation of a risk management framework.

Compliance

FMCs will also be subject to the following compliance arrangements:

- **Registered FMCs:** Registered FMCs will not be required to have a dedicated compliance function. The MAS will regard the CEO or a designated senior staff as being the person responsible for all compliance matters of the FMC. The CEO or senior staff may, however, receive support from the FMC's head office or third party service providers.
- **Licensed A/I FMCs:** Licensed A/I FMCs must have a compliance function which is independent from the front office. A senior staff with no portfolio management responsibilities (such as the Chief Operating Officer) may be designated as the person responsible for compliance matters. However, Licensed A/I FMCs with AUM of S\$1 billion and above are expected to have a dedicated full-time compliance officer independent from the front office, and individuals such as the Chief Operating Officer will not be permitted to 'double-hat' as the compliance officer.

Outsourced third party service providers may be used and will be viewed favourably by the MAS if the service provider is a member of a professional body and has significant and meaningful onsite presence in the FMC. Regardless of the compliance arrangements, the CEO and board of directors of the FMC will be ultimately responsible for compliance and are expected to assess the relevance of the qualification of the compliance staff, having regard to the type and size of fund operations for the FMC.

Capital Requirements

Registered FMCs and Licensed A/I FMCs will be required to maintain a minimum base capital of S\$250,000 at all times. Paid-up ordinary share capital, irredeemable and non-cumulative preference share capital and retained earnings, less any unaudited interim losses and any dividend that has been declared during the year, may be used to meet base capital requirements. There are no restrictions imposed on the use of base capital for investments in assets, which could be cash, investments in the FMC's own funds or fixed assets such as office equipment.

Licensed A/I FMCs will be subject to an additional risk-based capital requirement to meet operational risk requirements ("**ORR**"), where the amount to be maintained will be 10% of the 3-year average of adjusted gross income of the FMC, where there may be deducted from the gross income measure non-guaranteed staff bonuses (but not performance fees), commission expenses and interest expenses. The ORR is subject to a minimum floor of the higher of S\$100,000 or 5% of the 3-year average of gross income (before deductions).

The MAS may also require Licensed A/I FMCs to set aside financial resources to address counterparty and market risks if it deems that exposures to such risks are significant. Such additional requirements will not apply to Licensed A/I FMCs

without significant counterparty and market exposures on their own books, for instance where the Licensed A/I FMC does not conduct proprietary trading activities.

Professional Indemnity Insurance

Registered FMCs and Licensed A/I FMCs will be strongly encouraged, but not required, to procure professional indemnity insurance ("**PII**") and to provide adequate disclosures to their clients on their PII coverage.

Transitional Arrangements and Administrative Measures

Existing EFM's with AUM of more than S\$250 million, or who manage more than 15 funds, will need to submit an application to the MAS to be licensed as a Licensed A/I FMC. EFM's with AUM not exceeding S\$250 million and who manage not more than 15 funds may choose to either submit a notification to the MAS to continue their business operations under the Registered FMC regime, subject to meeting the admission criteria for Registered FMCs, or to submit an application to be licensed as a Licensed A/I FMC.

The MAS proposes a transitional period of 6 months after the new legislation becomes effective (expected in early 2012) for existing EFM's to either meet the revised admission criteria and to submit their notification or application, as applicable, or to otherwise cease their conduct of fund management activities before the end of the transitional period.

The MAS will implement a new online submission system for all FMCs, which will enable existing EFM's and fund managers that are new entrants to submit an online application to file as either a Licensed A/I FMC or a Registered FMC, as well as to make ongoing regulatory submissions, such as notifying the MAS of changes in particulars and making annual declarations in the case of Registered FMCs. Registered FMCs will be charged an annual administrative fee of S\$1,000 with effect from 1 January 2013. Licensed A/I FMCs will be subject to existing application and licence fees for licensed FMCs.

Comments

As with all new laws, there will always be scenarios and questions raised on the practical implications of new regulations; the proposed new regulatory regime in Singapore is no different, particularly so given that it is to apply across the board to all FMCs regardless of whether they are managing traditional mutual funds, hedge funds, private equity funds or fund of funds. Although the MAS has on 28 September 2010 provided its response to some of the comments received during the 2010 consultation, there remains a number of open issues on the proposals (such as the need for independent valuation and custody of assets for private equity/venture capital) which hopefully, the MAS will issue further guidance on shortly.

However, one thing is clear: the barriers to entry are getting higher. Fund managers will have to comply with stricter rules and be subject to closer scrutiny by the regulators going forward. Whilst some of the larger, more established fund managers may consider the new requirements a non-issue, many others are likely to find themselves having to spend considerably more time and money in ensuring compliance with the new regime and CEOs and directors having to take on a much higher level of responsibility and accountability for the businesses.

- 1 Under the Securities and Futures Act (Cap. 289) (the “SFA”), a **qualified investor** refers to:
 - (a) an accredited investor (see note 2 below), other than:
 - (i) one who is a participant in a collective investment scheme referred to in sub-paragraph (b) below;
 - (ii) one who is a holder of a unit in a closed-end fund referred to in sub-paragraph (c) below;
 - (iii) one which is a corporation (A) which is related to or controlled by a key officer or substantial shareholder of such person; and (B) the shares or debentures of which are the subject of an offer or invitation for subscription or purchase made to any person who is not an accredited investor; or
 - (iv) a corporation or an entity which is a collective investment scheme or a closed-end fund the units of which are the subject of an offer or invitation made to any person who is not an accredited investor;
 - (b) a collective investment scheme the units of which are the subject of an offer or invitation for subscription or purchase made—(i) in Singapore only to accredited investors; or (ii) elsewhere if such offer or invitation is made only to accredited investors, or investors in an equivalent class under the laws of the country or territory in which the offer or invitation is made; and
 - (c) a closed-end fund the units of which are the subject of an offer or invitation for subscription or purchase made only to accredited investors, or investors in an equivalent class under the laws of the country or territory in which the offer or invitation is made.
- 2 Under the SFA, an **accredited investor** refers to:
 - (a) an individual whose net personal assets exceed in value S\$2 million (or its equivalent in a foreign currency) or whose income in the preceding 12 months is not less than S\$300,000 (or its equivalent in a foreign currency);
 - (b) a corporation with net assets exceeding S\$10 million in value (or its equivalent in a foreign currency), as determined by the most recent audited balance sheet of the corporation; or where the corporation is not required to prepare audited accounts regularly, a balance sheet of the corporation certified by the corporation as giving a true and fair view of the state of affairs of the corporation as of the date of the balance sheet, which date shall be within the preceding 12 months; or
 - (c) the trustee of such trust as the MAS may prescribe, when acting in that capacity.
- 3 The Consultation Paper clarifies that in determining whether an individual’s experience is relevant, the MAS will look at the function that the individual will be performing on behalf of the FMC. Examples such as experience in activities that form an essential part of the fund management value chain like business development and marketing, portfolio construction and allocation, investment research and advisory activities, trade execution, portfolio reconciliation and risk management are given as being relevant to the fund management business.
- 4 A copy of the MAS Guidelines on Fit and Proper Criteria can be obtained from the MAS website at: http://www.mas.gov.sg/resource/legislation_guidelines/securities_futures/sub_legislation/Guidelines_on_FnP_Criteria.pdf
- 5 A copy of the MAS Guidelines on Risk Management Practices can be obtained from the MAS website at: http://www.mas.gov.sg/legislation_guidelines/risk_mgt/Guidelines_on_Risk_Management_Practices.html

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