

CONSULTATION PAPER

P003 - 2010
January 2010

Regulatory Regime for Listed and Unlisted Investment Products

MAS

Monetary Authority of Singapore

TABLE OF CONTENTS

PREFACE	3
1 INTRODUCTION TO THE REVISED PACKAGE OF PROPOSALS	5
1.1 Current Regime to continue to apply to List of Excluded Investment Products	5
1.2 New Regime for Non-Excluded Investment Products	6
1.3 Formal Policies and Procedures on Sale of Investment Products – Considering Customers’ Interests	7
2 PROPOSALS FOR UNLISTED INVESTMENT PRODUCTS	9
2.1 Enhanced Safeguards for Retail Customers	9
2.2 The Customer Knowledge Assessment Framework	10
3 PROPOSALS FOR LISTED INVESTMENT PRODUCTS	12
3.1 Enhanced Safeguards for Retail Customers	12
3.2 The Customer Account Review Framework	15
4 ENHANCED COMPETENCY FOR REPRESENTATIVES	16
4.1 Training of Representatives	16
4.2 New CMFAS Module	16
5 PROPOSED REQUIREMENTS FOR PRODUCT HIGHLIGHTS SHEET	18
5.1 Product Scope	18
5.2 Legal Requirements	18

PREFACE

On 12 March 2009, MAS issued a consultation paper on the review of the regulatory regime governing the sale and marketing of unlisted investment products (“March 2009 Consultation Paper”). The March 2009 Consultation Paper set out proposals that aimed to:

- (a) promote more effective disclosure by improving the quality of information given to investors;
- (b) strengthen fair dealing in the sale and advisory process, and
- (c) enhance MAS’ powers for breaches of the Financial Advisers’ Act (“FAA”).

2 The scope of the March 2009 Consultation Paper did not cover listed investment products given their different features. MAS stated that we would consider whether enhancements are required for listed investment products as part of a separate exercise.

3 MAS has carefully reviewed and considered the feedback received on the March 2009 Consultation Paper. We issued our responses to the feedback received in two parts. Part I of MAS’ Response and Part II of MAS’ Response were issued on 8 September 2009 and 28 January 2010, respectively. In Part II of MAS’ Response, we stated we had decided to issue a revised package of proposals.

4 MAS is now consulting on these proposals which are aimed at enhancing the safeguards for retail customers. These proposals will apply to both unlisted and listed investment products sold to retail investors. MAS invites interested parties to forward their views and comments on the issues outlined in the policy consultation paper. Written comments should be submitted to:

Market Conduct Policy Division
Capital Markets Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117

Email: investmentpds_review@mas.gov.sg

Fax: (65) 6225 4063

5 MAS would like to request for all comments and feedback to be submitted by **12 March 2010**. Please note that all submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submissions.

1 INTRODUCTION TO THE REVISED PACKAGE OF PROPOSALS

1.1 CURRENT REGIME TO CONTINUE TO APPLY TO LIST OF EXCLUDED INVESTMENT PRODUCTS

1.1.1 For a broad range of investment products sold to retail investors, the current regime has worked well. These are products that are already established in the market, and have terms and features generally understandable by retail investors. We consider that the existing regulatory regime under the Financial Advisers Act (“FAA”) should continue to apply to these “excluded investment products” set out in Table 1. MAS may from time to time prescribe other products as excluded investment products.

Table 1

Excluded investment products

- Shares
- Depositary receipts
- Subscription rights pursuant to rights issues
- Company warrants
- Units in business trusts
- Units in real estate investment trusts
- Plain vanilla bonds (including convertible bonds)
- Money market instruments
- Life insurance policies (other than investment-linked policies)
- Structured deposits (including dual-currency investments)

Q1: MAS seeks views on the list of excluded investment products set out in Table 1 for which the existing regime under the FAA will continue to apply.

1.2 NEW REGIME FOR NON-EXCLUDED INVESTMENT PRODUCTS

1.2.1 For investment products that are derivatives or contain embedded derivatives, a customer without the requisite knowledge or prior experience may not be able to understand the features and risks of the investment product being sold to him. Some of the products may contain innovative features not previously sold to investors. For some products, intermediaries¹ may require a customer to put up margins that vary depending on the market value of the investment. MAS proposes that the sale of non-excluded investment products be subject to the revised package of proposals contained in this consultation paper.

1.2.2. MAS proposes that intermediaries need to obtain from the retail customer² information that is necessary to ascertain the customer's investment knowledge or experience before selling an investment product to him. MAS proposes to require that intermediaries conduct a **Customer Knowledge Assessment** before selling unlisted non-excluded investment products to retail customers. For listed products, taking into account features of the listed platform and how trades are transacted, MAS proposes to require intermediaries to conduct a **Customer Account Review** on retail customers before approving their accounts to trade listed non-excluded investment products. Details on the proposed Customer Knowledge Assessment for unlisted investment products and the proposed Customer Account Review for listed investment products are set out in Section 2 and Section 3 respectively.

1.2.3 It is important that all representatives selling non-excluded investment products have adequate training to enable them to better explain the features and risk-reward characteristics of investment products to customers. Representatives will be required to satisfy the proposed **enhanced competency requirements** set out in Section 4.

1.2.4 MAS had proposed a Product Highlights Sheet to supplement the prospectus. The objective of the Product Highlights Sheet is to highlight to

¹ For the purposes of this consultation paper, "intermediary" refers to a licensed or exempt entity, and representatives of such entity, carrying on business in any regulated activity under the Securities and Futures Act ("SFA"), or providing any financial advisory service under the FAA.

² For the purposes of this consultation paper, references to "retail customers" means persons who are not Institutional Investors, Expert Investors or Accredited Investors under the SFA and the FAA.

investors key features and risks of an investment product. Given the positive feedback on the Product Highlights Sheet, MAS intends to widen the application of the Product Highlights Sheet beyond unlisted investment products. A **Product Highlights Sheet** will be required for all debentures in the form of asset-backed securities and structured notes (including exchange-traded notes), collective investment schemes (including exchange-traded funds), and sub-funds of investment-linked life insurance policies (“ILPs”), for which the offer requires a prospectus to be issued. The details are set out in Section 5.

1.3 FORMAL POLICIES AND PROCEDURES ON SALE OF INVESTMENT PRODUCTS – CONSIDERING CUSTOMERS’ INTERESTS

1.3.1 MAS has set out fit and proper criteria applicable to all relevant persons in relation to the carrying out of any activity regulated by MAS under any written law³. These criteria underpin our requirements that all relevant persons, including intermediaries, perform regulated activities efficiently, honestly and fairly, and act in the best interests of their customers. In addition to having a reasonable basis for recommending an investment product, financial advisers (“FAs”) and their representatives should consider their general obligation to deal fairly with customers and take into account the interests of their customers in the course of providing financial advisory services⁴.

1.3.2 MAS takes the view that this general obligation of FAs and their representatives to take into the account the interests of their customers should not cease upon the provision of advice to their customers, but should extend to the actual sale of investment products to customers. In instances where the FA has assessed an investment product to be unsuitable for a retail customer but the customer nonetheless makes a specific request to purchase the product, the FA should carefully consider whether it would be in the customer’s interests for it to accede to the customer’s request. The FA should not permit the sale of such an investment product to the customer unless it has assessed and is satisfied that the customer fully understands the features and risks of the product and why the product was assessed to be unsuitable for the customer. To provide guidance to their representatives, MAS proposes

³ Guidelines on Fit and Proper Criteria [FSG-G01]

⁴ Guidelines on Fair Dealing – Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes to Customers [FAA-G11]

that FAs have in place formal policies and procedures setting out clearly the circumstances under which FAs would or would not permit the sale to a retail customer of an investment product they have assessed to be unsuitable for the customer. Where the FA does permit such sales at the specific request of the customer, the FA's policies and procedures should set out safeguards to prevent abuse. These policies and procedures are to be approved by the Board and senior management of the FA.

Q2: MAS seeks views on the proposal to require FAs to put in place formal policies and procedures setting out clearly the circumstances under which they would or would not permit the sale to a retail customer of an investment product they have assessed to be unsuitable for the customer.

2 PROPOSALS FOR UNLISTED INVESTMENT PRODUCTS

2.1 ENHANCED SAFEGUARDS FOR RETAIL CUSTOMERS

2.1.1 MAS proposes to require that before intermediaries sell unlisted non-excluded investment products to retail customers, intermediaries are to assess whether the customer has the relevant knowledge or experience to understand the risks and features of the specific investment product being offered to him. Intermediaries are to put in place formal policies and procedures on the form and conduct of the Customer Knowledge Assessment to enable their representatives to conduct proper assessment. The policies and procedures are required to be approved by the Board and senior management of the intermediary.

2.1.2 Where the customer is assessed under the Customer Knowledge Assessment not to possess the relevant knowledge or experience, the intermediary is required to advise whether the specific investment product is suitable for the customer if the product is to be made available to the customer. The assessment should take into consideration the customer's personal circumstances, including the lack of knowledge or experience as assessed under the Customer Knowledge Assessment. To mitigate potential conflicts of interests, MAS proposes to require intermediaries to have the Customer Knowledge Assessment performed or approved by a person independent of the financial advisory function.

2.1.3 Customers who are assessed under the Customer Knowledge Assessment to have the relevant knowledge or experience can still request for advice from their intermediary. Intermediaries, when selling investment products, cannot refuse to give advice solely because the customer has passed the Customer Knowledge Assessment.

2.1.4 For execution-only transactions, intermediaries, including online distributors, would only be able to sell non-excluded investment products to customers who have been assessed under the Customer Knowledge Assessment to have the relevant knowledge or experience to invest in the product.

2.1.5 Intermediaries must keep records of all information that they obtain from customers for the purposes of the Customer Knowledge Assessment, and the reasons for assessing whether customers have the relevant knowledge or experience to invest in the product.

Q3: MAS seeks views on the proposals to require intermediaries:

- (a) to conduct a Customer Knowledge Assessment for a retail customer who wants to purchase unlisted non-excluded investment products; and**
- (b) to have the Customer Knowledge Assessment performed or approved by a person independent of the financial advisory function.**

2.2 THE CUSTOMER KNOWLEDGE ASSESSMENT FRAMEWORK

2.2.1 For the purposes of the Customer Knowledge Assessment, intermediaries shall make reasonable enquiries to collect and take into account information on whether the customer has:

- (a) finance-related background relevant to the product or similar products. This may include relevant educational qualifications, professional certifications or attendance at courses organised or accredited by industry associations;
- (b) investment experience in the product or similar products; or
- (c) work experience directly related to the product or similar products.

2.2.2 We are of the view that intermediaries would be better placed to develop their own Customer Knowledge Assessment framework, given their targeted customer base and their familiarity with the products they are distributing. MAS welcomes initiatives by industry associations to develop guidance on the Customer Knowledge Assessment.

2.2.3 In developing guidance on the Customer Knowledge Assessment, MAS expects industry associations to take into account the following:

- (a) Attendance at general financial education courses would not count towards having relevant finance-related background.
- (b) Customers with only one to two transactions per annum in similar products and customers who have not purchased similar products in the past two years should not be presumed to have relevant investment experience.
- (c) Work experience in operations, human resources or corporate services departments of financial institutions and support functions in trading or fund management departments should not be considered as relevant experience.

Q4: MAS seeks views and suggestions on the information proposed in paragraph 2.2.1 to be obtained from retail customers for the purposes of the Customer Knowledge Assessment.

3 PROPOSALS FOR LISTED INVESTMENT PRODUCTS

3.1 ENHANCED SAFEGUARDS FOR RETAIL CUSTOMERS

3.1.1 In this section, we set out proposals for listed investment products. There are differences in features between listed and unlisted products. Listed investment products are traded on an exchange. The continuous disclosure obligations imposed by the exchange help mitigate some of the concerns on information asymmetry. There is a price discovery process and investors are normally able to sell their investment on the exchange if they decide to exit the investment. This is in contrast to unlisted investment products for which pricing may not be readily available or accessible to investors at all times.

3.1.2 Notwithstanding the mitigating features of listed products, some listed products may also have terms and features that retail investors may not easily understand. Accordingly, we propose to enhance the safeguards for retail customers similar to those proposed for unlisted investment products in Section 2. The proposals have been modified to take into account the differences between listed and unlisted investment products. For instance, we acknowledge that it may not always be appropriate or practical to require intermediaries to give advice to retail customers purchasing listed investment products prior to each trade in view of the time-sensitive nature of transactions on an exchange.

3.1.3 In the U.S., broker-dealers are required to approve the customer's account for options trading before the customer can trade options, index warrants, currency index warrants and currency warrants. In approving a customer's account for the trading of such products, broker-dealers are required to exercise due diligence to ascertain the essential facts relative to the customer, his financial situation and investment objectives. These include the customer's investment knowledge and experience for options, stocks and bonds, commodities, and other financial instruments if the customer is a natural person. Broker-dealers are required to perform similar due diligence in approving a customer's account for security futures trading. The Financial Industry Regulatory Association ("FINRA") has issued guidance⁵ suggesting that its members consider whether purchases of structured products should be limited to investors who have accounts approved for options trading, as

⁵ NASD Notice to Members 05-59 (September 2005)

many structured products and options have similar risk profiles.

3.1.4 In Hong Kong, the Securities and Futures Commission's Code of Conduct⁶ requires a licensed or registered person providing services to a client in derivative products, including derivative warrants, futures contracts or options, to assure itself that the client understands the nature and risks of the products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products.

3.1.5 Having considered the merits of the above approaches, we propose to require intermediaries to conduct a Customer Account Review to ascertain whether a retail customer who wants to trade listed non-excluded investment products has the relevant knowledge or experience to understand the risks and features of derivatives, before approving the customer's account for the trading of such products. Intermediaries are to put in place formal policies and procedures on the form and conduct of the Customer Account Review to enable their representatives to conduct proper assessment. The policies and procedures are required to be approved by the Board and senior management of the intermediary.

3.1.6 Where the customer is assessed under the Customer Account Review not to possess the relevant knowledge or experience in derivatives but still wishes to trade listed non-excluded investment products, intermediaries would need to consider the customer's personal circumstances in deciding whether to approve the account. Should the intermediary approve the account, it must put in place the following safeguards:

- (a) impose an appropriate ceiling on the customer's trading of listed non-excluded investment products, taking into account the customer's personal circumstances; and
- (b) explain to the customer the features and risks associated with investing in derivative products, and provide to the customer a statement of the explanation given.

3.1.7 Intermediaries should have formal policies and procedures setting out the circumstances under which they would or would not approve a customer's account for the trading of listed non-excluded investment products

⁶ Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (May 2006)

when the customer is assessed not to possess the relevant knowledge or experience in derivatives, and the safeguards to be applied if the account is approved.

3.1.8 In all cases, the approval of an account to trade listed non-excluded investment products should be granted by at least one senior management staff of the intermediary who is independent of sales or dealing, or one senior management staff of a related corporation of the intermediary designated with the account approval function. We note that the Singapore Exchange Securities Trading Ltd already requires this of its trading members for the approval of new customer accounts.

3.1.9 Intermediaries must keep records of all information obtained from customers for the purposes of the Customer Account Review and the reasons for approving or disapproving customers' accounts to trade listed non-excluded investment products.

3.1.10 Intermediaries are required to conduct the Customer Account Review for existing customers who had previously traded in listed non-excluded investment products and who wish to continue trading such products.

3.1.11 The proposed requirement for the Customer Account Review is in addition to the current obligations on intermediaries regarding account opening procedures, and will facilitate the continued development of Singapore's capital markets by providing safeguards for retail customers while catering for the listing of more sophisticated products.

Q5: MAS seeks views on:

- (a) the proposal to require intermediaries to conduct a Customer Account Review for a retail customer who wants to trade listed non-excluded investment products; and**
- (b) the safeguards proposed at paragraph 3.1.6.**

3.2 THE CUSTOMER ACCOUNT REVIEW FRAMEWORK

3.2.1 For the purposes of the Customer Account Review, intermediaries shall make reasonable enquiries to collect and take into account information on whether the customer has:

- (a) finance-related background relevant to derivative products. This may include relevant educational qualifications, professional certifications or attendance at courses organised or accredited by approved exchanges or industry associations;
- (b) investment experience in derivative products; or
- (c) work experience directly related to derivative products.

3.2.2 We encourage approved exchanges⁷ to work closely with industry associations to develop guidance on the conduct of the Customer Account Review that intermediaries can adopt. In developing guidance on the Customer Account Review, approved exchanges and industry associations should take into account the considerations set out in paragraph 2.2.3.

Q6: MAS seeks views and suggestions on the information proposed in paragraph 3.2.1 to be obtained from retail customers for the purposes of the Customer Account Review.

⁷ We note that the Singapore Exchange Securities Trading Ltd requires its trading members to undertake additional safeguards during the opening of trading accounts by young investors between the ages of 18 and 21.

4 ENHANCED COMPETENCY FOR REPRESENTATIVES

4.1 TRAINING OF REPRESENTATIVES

4.1.1 It is important that representatives receive adequate training to enable them to better explain the features and risks of investment products to customers. In the March 2009 Consultation Paper, MAS proposed to require intermediaries to ensure that representatives undergo training on the features and risk-reward characteristics of a new complex investment product before being allowed to sell the product.

4.1.2 The proposal is now extended to require intermediaries to ensure that representatives are sufficiently trained on the features and risk-reward characteristics of a new non-excluded investment product before being allowed to sell the product. If intermediaries engage third-party trainers to conduct training for their representatives, they should ascertain that the training provided is adequate.

4.2 NEW CMFAS MODULE

4.2.1 MAS previously proposed to introduce a new Capital Markets and Financial Advisory Services (“CMFAS”) module for product knowledge on complex investment products. New and existing representatives would be required to pass the new CMFAS module before they are allowed to sell complex investment products.

4.2.2 To raise the minimum competency standards for representatives, MAS will proceed with the proposal to introduce a new CMFAS module. The curriculum of the new CMFAS module will be expanded to include product knowledge in respect of non-excluded investment products. The content and coverage of the product knowledge will be developed by the Institute of Banking and Finance with the Singapore Exchange Ltd (“SGX”) and the industry.

4.2.3 We will provide a transition period for existing representatives who wish to sell non-excluded investment products to pass the additional curriculum on product knowledge. Details on transitional arrangements for existing representatives and enhancements to existing CMFAS modules for product knowledge will be provided in due course. In the interim, MAS will

require intermediaries to ensure that representatives are adequately trained on the investment products they are selling before they are allowed to sell such products to retail investors.

Q7: MAS seeks views on the proposal to require intermediaries to ensure that representatives undergo training on the features and risk-reward characteristics of a new non-excluded investment product before being allowed to sell the product.

Q8: MAS seeks views on the proposal to require existing representatives who wish to sell non-excluded investment products to pass the additional new CMFAS module.

5 PROPOSED REQUIREMENTS FOR PRODUCT HIGHLIGHTS SHEET

5.1 PRODUCT SCOPE

5.1.1 As part of our revised proposals, we are proposing to extend the scope of the Product Highlights Sheet requirement to include a number of listed investment products. MAS will require Product Highlights Sheets for all debentures in the form of asset-backed securities and structured notes⁸ (including exchange-traded notes), collective investment schemes (including exchange-traded funds) and ILP sub-funds, for which the offer requires a prospectus to be issued⁹.

5.2 LEGAL REQUIREMENTS

5.2.1 In the March 2009 Consultation Paper, MAS proposed to require a Product Highlights Sheet for unlisted investment products to supplement the prospectus. The Product Highlights Sheet is to highlight key features and risks of the investment product to investors. We proposed that the Product Highlights Sheet must:

- (a) not contain false or misleading statements;
- (b) sufficiently disclose the information in the prescribed format;
and
- (c) be written and presented in a clear, concise and effective manner.

5.2.2 For purposes of statutory liability, we had proposed to treat the Product Highlights Sheet as part of a prospectus, even though it is to be a physically separate document. Persons liable for complying with the prospectus requirements would also be liable for complying with the Product Highlights Sheet requirements.

5.2.3 Respondents to the March 2009 Consultation Paper raised concerns that issuers would use legalistic language and technical terms to

⁸ The Product Highlights Sheet will apply to unlisted and listed debentures in the form of asset-backed securities and structured notes instead of all debentures, which may include plain vanilla corporate bonds.

⁹ In the case of ILP sub-funds, "prospectus" refers to the Product Summary.

ensure accuracy of the information disclosed if prospectus liability is imposed on the Product Highlights Sheet. Respondents also raised concerns that the proposed requirement that information presented in the Product Highlights Sheet be “clear, concise and effective” is highly subjective, in particular the interpretation by different individuals of what constitutes “effective”.

5.2.4 After careful consideration of the feedback received, MAS is of the view that the objective of the Product Highlights Sheet, as a simplified disclosure document for retail investors, would be better served if the legal liability attached to the Product Highlights Sheet is applied in a way that allows issuers the flexibility to disclose the key features and risks of the product in an easily understood manner. We propose the following requirements for the Product Highlights Sheet:

- (a) information must be clearly disclosed in the prescribed format (e.g. the specific questions, number of pages, layout and font size);
- (b) must not contain any information that is not included in the prospectus; and
- (c) must not contain any information that is false or misleading.

5.2.5 These requirements will apply to the Product Highlights Sheet as a standalone document and not as part of the prospectus. Failure to comply with these requirements will be a breach of the law. Issuers and issue managers will be liable for the Product Highlights Sheet. They will be required to provide MAS with the Product Highlights Sheet at the time of the initial lodgment of the preliminary prospectus with MAS.

5.2.6 We are working with SGX to enhance current listing rules relating to term sheets for listed products such as structured warrants and certificates. Our intention is for the term sheets to have a format and content similar to that of the Product Highlights Sheet. This will facilitate comparison of features and risks for a wider range of investment products. SGX will conduct a separate consultation on any changes to the listing rules.

Q9: MAS seeks views on the proposed requirements for the Product Highlights Sheet set out in paragraph 5.2.4.



Monetary Authority of Singapore