

CONSULTATION PAPER

P012 - 2014

Jul 2014

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

MAS

Monetary Authority of Singapore

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PREFACE

1 MAS' capital markets regulatory framework is underpinned by the Securities and Futures Act (Cap. 289) ("SFA") and the Financial Advisers Act (Cap. 110) ("FAA"). The two pieces of legislation set out the regulatory perimeters to facilitate a disclosure-based regime, which seeks to empower investors to make informed investment decisions.

2 The pace of development of the capital markets necessitates continual review of the regulatory framework to ensure that it remains relevant and effective in achieving its regulatory objectives. MAS has reviewed its regulatory framework in light of recent market developments and is consulting on proposals in three key areas to better safeguard the interests of the investing public through: (I) extending to investors in non-conventional investment products the current regulatory safeguards available to investors in the capital markets; (II) requiring investment products to be rated for complexity and risks, and for these ratings to be disclosed to investors; and (III) refining the investor classes under the SFA and FAA.

3 MAS invites interested parties to forward their views and comments on the proposals outlined in the consultation paper. All comments should contain a reference to the part to which the comment pertains. Written comments should be submitted to:

Capital Markets Policy Division
Markets Policy & Infrastructure Department
Monetary Authority of Singapore
10 Shenton Way, MAS Building
Singapore 079117

Email: SFA_FAA_LegisConsult@mas.gov.sg
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4 MAS would like to request all comments and feedback by **1 September 2014**. Please note that all submissions received may be made public unless confidentiality is specifically requested for.

INTRODUCTION

1 MAS' capital markets regulatory framework is underpinned by the Securities and Futures Act (Cap. 289) ("SFA") and the Financial Advisers Act (Cap. 110) ("FAA"). The SFA provides for, amongst others, the regulation of capital markets products through rules on the products which are offered to investors and information that must be provided with such offers. FAA governs the provision of financial advisory services for these products. Together, the two pieces of legislation set out the regulatory framework to facilitate a disclosure-based regime, which seeks to empower investors to make informed investment decisions.

2 The pace of development of the capital markets necessitates continual review of the regulatory framework to ensure that it remains relevant and effective in achieving its regulatory objectives. Product innovation challenges the boundaries of the product definitions. The myriad pieces of product information being pushed out to investors as a result of more complex product features underscore the need for better means of illustrating the risk-return trade-offs associated with each product. An increasingly sophisticated investing public raises questions on whether the corresponding regulatory protections are delivered to the various classes of investors as intended. MAS has reviewed its framework in light of these market developments and is consulting on a package of proposals that aim to enhance regulatory safeguards for the investing public.

3 Part I of this paper sets out proposals to modify the scope of capital markets products regulated under the SFA and FAA taking into account changes in the investment landscape. MAS has noted a number of non-conventional products and schemes being offered to consumers as alternative investments. Some of these products exhibit essentially the same characteristics as regulated capital markets products, but are deliberately structured in a way that takes them outside the regulatory perimeter of the SFA and FAA. Accordingly, MAS is proposing to subject the offer and distribution of products and schemes that exhibit similar features as regulated capital markets products to the same treatment under the SFA and FAA.

4 With respect to regulated investment products offered to retail investors, Part II of this paper sets out MAS' proposals to (i) introduce a framework by which all investment products can be rated for their complexity and the risk that investors may lose some or all, or more than their principal investment amount; and (ii) require product issuers to rate their products and disclose these ratings in regulated offering documents and through other stipulated channels. With this disclosure framework, MAS seeks to empower investors to make informed investment decisions taking into account their own level of understanding and risk appetite.

5 The full suite of regulatory protections under the SFA and FAA is mainly focused on safeguarding the interests of retail investors¹. Offerors and intermediaries are exempt from certain regulatory requirements when making offers or dealing with non-retail investors, who are accorded less regulatory protection as they are able to access professional advice or possess a certain level of financial knowledge or experience. While MAS considers this tiered level of regulatory protection appropriate, MAS' proposals to refine and streamline these classes of non-retail investors are set out in Part III of this paper.

¹ Retail investors are investors who do not fall within one or more of the non-retail investor classes, namely, accredited investors, institutional investors and expert investors.

PART I: CAPITAL MARKETS REGULATORY SAFEGUARDS FOR INVESTORS IN NON-CONVENTIONAL INVESTMENT PRODUCTS

1 Non-conventional Investment Products

1.1 The SFA and FAA² set out MAS' regulatory framework for the offer and distribution of capital markets products, such as shares, debentures and units in collective investment schemes. MAS' regulatory framework seeks to protect investors by requiring offerors to disclose material information to investors to enable them to make well-informed decisions. It also seeks to ensure that intermediaries are competent and deal with their clients fairly.

1.2 In recent years, MAS has observed a number of non-conventional products being offered to consumers as alternative investments. Some of these products exhibit essentially the same characteristics as regulated capital markets products, but are deliberately structured in a way that takes them outside the regulatory perimeter of the SFA. These typically involve consumers taking a direct interest in physical assets (as opposed to a securitised interest with the physical asset as underlying).

1.3 There are many schemes and products that claim to offer consumers potential profits. MAS does not seek to judge the merit of each scheme or product being offered. All investments have risks, and regulation does not and cannot guarantee the viability of products offered, or that the products will deliver on expected returns. However, MAS is of the view that where products are being offered to consumers as investments, sufficient information should be provided to consumers on how the projected returns are made, the expected investment horizon and exit options available to guide consumers in making informed decisions. Products that display similar characteristics as capital markets products should accordingly be subject to the requirements built into the SFA, such that consumers enjoy the regulatory safeguards when being offered such products.

1.4 It is however not desirable or practical for MAS to regulate every product. Expanding regulatory boundaries too widely would risk subjecting all types of transactions with some element of returns, even well-established day-to-day transactions such as purchasing gold from a jeweller or buying a unit in a condominium project, to regulation. On the other hand, too narrow an approach could fail to capture capital markets-like products that are deliberately structured to escape regulation.

² For the purposes of this Part of the Consultation Paper, references to regulation under the SFA include regulation under the FAA.

1.5 In judging where to draw its regulatory boundaries, MAS seeks to ensure that it does not exceed its mandate as a financial sector regulator – products and schemes that are not in substance capital markets products should not be regulated as such. MAS also takes reference from the capital markets regulatory practices in other major jurisdictions in the calibration of its regulatory perimeters to suit the local market.

1.6 With the above in mind, MAS is proposing to extend its regulatory perimeters to include the following two types of arrangements:

- (i) Buy-back arrangements involving gold, silver and platinum (“precious metals”);
and
- (ii) 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.

2 Characterisation of Buy-back Arrangements involving Precious Metals as Debentures

Debentures vs Buy-back arrangements

2.1 Debentures are debt securities regulated under the SFA. Broadly, debentures are instruments representing indebtedness. These are capital-raising instruments, under which the debenture issuer offers to pay interest in lieu of money borrowed for a certain period. These may be:

- (i) *Unsecured* - backed by general creditworthiness of the debenture issuer; or
- (ii) *Secured* - backed by assets, which the debenture holder would have legal claim to if the issuer defaults on its payment obligations under the debenture. Examples include asset-backed securities and collateralised debt obligations.

2.2 This is distinguished from a buy-back arrangement, under which Party A purchases assets from Party B (“sale”), on terms that Party A has a right or option to sell the asset back to Party B in the future (“buy-back guarantee”). Under the “sale” leg, there is a transfer of rights and obligations relating to the asset from the seller to the purchaser, and as such there is no “debt” created at law.

2.3 Where buy-back arrangements involve the sale and re-purchase of regulated financial assets (e.g. securities repurchase transactions), the respective sale and re-purchase legs of the arrangement would already be subject to MAS’ regulatory requirements³. In contrast, direct sale and repurchase of non-financial assets are considered normal economic transactions, entered into in the ordinary course of business. Common examples include arrangements which allow consumers to trade-in products after use for a portion of the initial purchase price, or where the purchaser has the right to sell the product back to the seller at the prevailing market price in the future.

2.4 As is consistent with the practice in other jurisdictions, the rights, obligations and recourse available to the contracting parties under such arrangements are governed by well-established general law, and not subject to financial regulation.

Buy-back arrangements involving gold, silver or platinum

2.5 However, some forms of buy-back arrangements are being marketed to consumers as financial instruments. Arrangements involving precious metals have in particular gained traction with a segment of consumers, as precious metals, even though they are technically non-financial assets, are widely considered as comparable to financial assets due to their inter-changeability with real currency, transferability and market liquidity. This in turn makes

³ For example, the offer of securities is regulated under the SFA. There are available exemptions where a sell or buy-back agreement is entered into on a bilateral basis and not offered generally.

them attractive underlying assets to be used as “collateral” in capital-raising transactions structured as commercial buy-back arrangements.

2.6 Given the unique nature of precious metals, it is necessary to consider the overall purpose or effect of the buy-back arrangement involving such physical assets in determining its true nature. If in essence the agreement between the parties is that funds made available will be repaid with interest at the end of the entire arrangement, and the transfer of ownership of the investment precious metal under the arrangement is for security and not consumption purposes, the arrangement is in effect a debt obligation and the interests of the parties regarded as that of an “investor” and securities “issuer”.

2.7 Such transactions essentially pose to “investors” risks that are similar to those in a collateralised debt obligation, where the “investor” takes on the credit risk of the “issuer”. Consequently, such “issuers” should similarly be subject to regulation. MAS therefore proposes to prescribe and regulate as debentures arrangements which involve:

- (i) Party A purchasing precious metals of gold, silver or platinum⁴ (“asset”) from Party B for an agreed sum of money or money’s worth;
- (ii) Party B⁵ being under an obligation to purchase the asset back from Party A at a future time; and
- (iii) The purpose or effect of the arrangement is to enable Party A to receive a financial benefit from Party B.

Q1. MAS seeks feedback on the proposal to regulate buy-back arrangements involving precious metals where the purpose or effect of the arrangement is to enable Party A to receive a financial benefit from Party B, as set out in paragraph 2.7 (i) – (iii), as debentures.

Interpretation of financial benefit

2.8 As MAS’ intention is to regulate buy-back arrangements which are in effect debt financing arrangements, a key element that will need to be established is the right for the “investor” (Party A) to receive a financial benefit from the “issuer” (Party B) as part of the arrangements. The right to receipt of a financial benefit must be agreed upon at the point in

⁴ Gold, silver and platinum are considered as comparable to financial assets, and have also been granted goods and services tax (GST) exempt status by IRAS. Only gold, silver and platinum that (i) meet purity standards, (ii) are tradable on the international bullion market, (iii) bear the mark or characteristic that is internationally accepted as guaranteeing quality, and (iv) trade at a price based on the spot price of the metal it contains will qualify for the GST exemption. See IRAS e-tax guide titled “[GST: Guide on Exemption of Investment Precious Metals \(IPM\)](#)”.

⁵ Including a third party acting on behalf of Party B.

time that the parties enter into the arrangement, although the actual amount received may vary according to pre-determined factors⁶.

2.9 This is contrasted with commercial transactions, where either no financial benefit is guaranteed under the transaction, or any benefit that Party A derives relates to the use or consumption of the asset under the arrangements. Below are generic examples⁷ of commercial transactions, for which MAS considers there to be no financial benefit:

- (i) *Trading contracts* – Where A purchases property from B, on terms that A can sell it back to B at the prevailing market price if A so chooses and no interim payments are made to A. Any returns that A receives will depend on market forces and there is no obligation on the part of B to repay or “refund” the initial purchase price with interest.
- (ii) *Storage contracts* – Where A purchases property from B, on terms that the property will be stored with B until such time as A wishes to take physical possession of the property or dispose of it on A’s own terms.
- (iii) *Consignment arrangements* – Where A purchases goods from B, but places the goods on consignment with B. B will act as agent for the purpose of sale of the goods, and if unable to find a buyer, will return the goods to A.
- (iv) *Sale and lease-back arrangements* – Where A purchases property from B, with a concurrent agreement to lease the property back to B. Under the lease agreement, A will receive compensation for allowing B to use the property. At the end of the contractual lease term, A has the right to deal with the property as A chooses such as leasing to another tenant and B has no further obligations to A.

2.10 MAS considers there to be a financial benefit where the effective re-purchase price that Party B agreed to pay for the buy-back at the time the arrangement is entered into is **higher than** the initial purchase price that Party A paid for the asset.

- (i) *Effective re-purchase price* – This will be the total payments made by Party B to Party A under the entire buy-back arrangement, whether in one or a series of payments.
- (ii) *Initial purchase price* – This will be the amount that Party A pays Party B to purchase the asset under the arrangements, whether in one or a series of payments.

⁶ Including where the pre-determined factors move against Party A such that at the end of the transaction, Party A is in a net financial loss position.

⁷ The examples provided are for illustrative purposes only. The exact features of an arrangement must be considered in determining whether the purpose or effect of the arrangement is to enable Party A to receive a financial benefit from Party B.

Q2. MAS seeks comments on the interpretation of “financial benefit”.

Debenture Regulatory Regime

2.11 MAS proposes to apply the current suite of regulations under the SFA and FAA applicable to debentures to the arrangements prescribed as debentures. The main regulatory requirements are:

- (i) *Disclosure requirements* - Offerors of debentures will need to lodge and register prospectuses with MAS⁸. The prospectus must contain all material information relating to the debenture offer, to enable investors to make well-informed investment decisions.⁹
- (ii) *MAS-approved trustee for unlisted debentures* – An MAS-approved trustee must be appointed for offers of unlisted debentures which require a prospectus to be issued. The role of the trustee is to safeguard the rights and interests of investors during the debenture’s tenure and in the event of issuer default.
- (iii) *Licensing of intermediaries* – Persons who deal in or advise others concerning debentures will need to be licensed by MAS. MAS’ licensing regime for intermediaries seeks to ensure that they are fit and proper, competent and deal with consumers fairly.

Q3. MAS seeks views on the proposal to extend the debenture regulatory regime to buy-back arrangements involving investment precious metals which have been characterised as debentures.

Proposed legislative amendments

2.12 Proposed amendments to the SFA are set out in **Annex 1**. MAS intends to prescribe buy-back arrangements involving investment precious metals using these proposed powers, as set out in **Annex 2**.

Q4. MAS seeks comments on the proposed amendments to the SFA and the draft Securities and Futures (Prescribed Debentures) Regulations at Annex 1 and 2.

⁸ There are available exemptions for small offers (less than S\$5 million raised in any 12 month period), private placements (less than 50 investors in any 12 month period), minimum investment amount of S\$200,000 and offers to accredited and institutional investors (see Part III of this consultation paper on proposed changes to the definition of these investor classes).

Such offers must be accompanied by a statement to alert consumers of reliance on a prospectus exemption, and persons are not allowed to advertise the offer or incur any selling or promotional fee through licensed entities.

⁹ MAS does not guarantee the accuracy of information contained in prospectuses.

3 Characterisation of Collectively-Managed Investment Schemes as Collective Investment Schemes (“CIS”)

3.1 MAS’ capital markets regulatory framework also seeks to safeguard the interests of investors in CIS. As defined in the SFA, CIS are arrangements in respect of any property, whether securities or futures, commodities or real estate¹⁰, that exhibit all of the following characteristics:

- (i) Participants have no day-to-day control over management of the property (“*lack of day-to-day control*”);
- (ii) Property is managed as a whole by or on behalf of the scheme operator (“*collectively managed*”);
- (iii) Participants’ contributions are pooled (“*pooled contributions*”);
- (iv) Profits or income of the scheme from which payments are to be made to the participants are pooled (“*pooled profits*”); and
- (v) Purpose or effect of the arrangement is to enable participants to participate in profits¹¹ arising from the scheme property¹² (“*rights to participate in pooled profits*”).

3.2 The *pooled contributions* element has been a feature of traditional CIS, where contributions of investors are pooled for the purpose of generating profits through the acquisition, holding, management or disposal of scheme property. Investors entrust day-to-day control over management of the scheme property to the scheme operator, and receive rights to participate in profits of the scheme on a proportional basis to their contributions in the scheme.

3.3 As management of the scheme property is entrusted to the scheme operator who has broad discretion to deal with scheme property, this raises concerns of transparency and accountability. To safeguard the interests of investors, CIS that are widely offered to retail investors are subject to prospectus disclosure requirements, authorisation or recognition requirements, investment restrictions and business conduct rules on an ongoing basis.¹³

¹⁰ Property is not defined in the SFA and could include, for example, securities, futures, money, goods and real estate, whether located in Singapore or elsewhere.

¹¹ In this consultation paper, references to rights to participate in profits of a scheme include rights to receive sums paid out of such profits.

¹² Profits are to arise from the acquisition, holding, management or disposal of, the exercise of, the redemption of, or the expiry of, any right, interest, title or benefit in the property or any part of the property.

¹³ Exemptions from prospectus and authorisation or recognition requirements mirror that for offers of debentures, as mentioned in footnote 8 above.

Collectively-managed investment schemes

3.4 MAS has observed a number of arrangements offered to retail investors that fall out of the statutory definition of a CIS, simply by offering investors direct interests in underlying physical assets. This is in spite of an arrangement providing that while investors obtain legal title of the asset, they will cede day-to-day control over management of their property to the scheme operator to be managed collectively with assets of other scheme participants, for the purpose of enabling them to participate in profits of the scheme (“collectively-managed investment schemes”).

3.5 The key distinguishing characteristic of such schemes is that investors’ contributions are not initially pooled. Apart from this, such collectively-managed investment schemes do not differ from regulated CIS. While participants’ contributions are not pooled to invest in scheme property, their assets are effectively “pooled” through the management of their property as a whole with that of other scheme participants, with the purpose of enabling all scheme participants to share in profits of the scheme on a proportionate basis. As participants lack day-to-day control over management of their property, they are essentially exposed to the same risks as in a traditional CIS. These risks are exacerbated by the long gestation periods typically present in such schemes, and the heavy reliance placed on the scheme operators’ expertise in managing the scheme property to generate expected profits.

3.6 In light of the above considerations, MAS proposes to remove the requirement for the pooling of investors’ contributions to be present for an arrangement to be regarded as a CIS. While pooling of contributions for investment used to be a distinguishing characteristic of a CIS, this is no longer the case in the evolving investment landscape. Such an amendment will achieve greater consistency in the regulatory treatment of arrangements which are in substance “collective” investments and which pose essentially the same risks to investors as a regulated CIS. MAS notes that this proposal would also bring our regulatory coverage of CIS in line with that in Hong Kong and the United Kingdom.

Q5. MAS seeks feedback on the proposal to regulate collectively-managed investment schemes as CIS.

Interpretation of what constitutes a CIS

3.7 MAS notes that there are arrangements in respect of property that may present some, but not all of the elements of a CIS as set out in paragraph 3.1. For the avoidance of doubt, MAS’ intent is to only regulate as a CIS arrangements which present all the elements apart from the pooling of contributions. MAS considers these characteristics to be fundamental in determining the nature of the rights that persons participating in the scheme are getting – an interest in a CIS, or direct interest in physical assets.

3.8 While these are existing elements in the statutory definition of a CIS, MAS has set out general principles of how each element should be applied in the context of collectively-managed investment schemes below to provide clarity on the types of arrangements that it intends to regulate as CIS.

“Lack of day-to-day control” element

3.9 This element draws an important distinction about the nature of the investment that each investor is undertaking – investment in property the management of which will be under the investor’s control, or investing to get rights under a scheme that provides for someone else to manage the property. Where investors retain control over how their property is managed, they would be in a better position to protect their own interests without the need for regulatory intervention.

3.10 Participants may have day-to-day control even if they delegate certain aspects of management of the property (e.g. rent collection and cleaning and maintenance of their property), provided they retain control over who they delegate the management to. Where not appointing a particular person to manage their property would undermine the whole purpose of the arrangement, then it is likely that they do not have day-to-day control over management of the property.

Managed as a whole and pooled profits

3.11 These two elements establish the collective nature of the arrangement – property of participants must be effectively “pooled” to generate profits which would otherwise not be available to participants if property was managed on an individual basis. Where consumers take a fractional interest in property, it is more likely that these two elements are satisfied since it would not be meaningful for consumers to deal with their interest on an individual basis.

3.12 The interaction between these two elements is more prominent in the case of arrangements whereby consumers take full ownership interest in a property that could theoretically be dealt with on an individual basis (e.g. individual unit in a block of apartments). In such instances, where the block of apartments are managed on the basis that the only profit or income each individual unit owner obtains is what arises from the management of his property, there is no management as a whole. However, if the units are managed in such a way that each individual unit owner receives an income from total lettings, regardless of whether that person’s unit was let or not, the properties are managed as a whole and the arrangements are likely to be a CIS.

Rights to participate in pooled profits

3.13 This element establishes the investment nature of the arrangement. It is not MAS’ intent to regulate as CIS arrangements for use of property (consumption-based). An arrangement may in essence be consumption-based, and therefore not regarded as a CIS, even

though consumers may be allowed to earn returns in lieu of their use of the property¹⁴. This is because the consumer ultimately has the choice as to how he wishes to exercise his interest in the property – for personal use or to generate income from allowing another person to use it instead.

3.14 In determining whether an arrangement is “for profit”, MAS will have regard to whether the arrangement purports or has the effect of giving participants rights to participate in pooled profits of the scheme. Rights to receive proceeds from management of a participant’s individual property held on account of that individual participant only will not be considered as rights to participate in pooled profits.

3.15 For illustration purposes, examples of collectively-managed investment schemes which would generally be regarded as a CIS in the context of real-estate have been set out below. It should be noted that where these examples are structured such that investors’ contributions are pooled, they would currently already fall within MAS’ capital markets regulatory framework. As the characterisation of an arrangement as a CIS depends on its individual structure, persons considering operating such schemes and offering units in such schemes to consumers should seek legal advice to determine their legal obligations.

(i) *Land investment schemes*

3.16 Arrangements in which investors are offered fractional interests in undeveloped land, and are required¹⁵ to use the scheme operator’s services in obtaining planning permission for or disposing of the land as a whole (or both) are likely to be a CIS. This is because individual investors do not have day-to-day control over the planning or disposal process and the purpose or effect of arrangement would appear to be to enable investors, as owners of parts of the land, to receive profits arising from the scheme operator’s services in obtaining planning permission or arranging disposal in respect of the land as a whole.

(ii) *Investment in land for forestry or harvesting purposes*

3.17 Arrangements which present the following features are likely to be regarded as a CIS:

- Investors acquire fractional interests in a plantation plot, or individual trees on the plantation plot;
- The scheme operator is entrusted with day-to-day control over management of the forestry or harvesting operations for the entire plot of land; and
- The purpose of the arrangement is for investors to receive rights to participate in profits arising from the forestry or harvesting operations in respect of the scheme property.

¹⁴ For example, an arrangement for rights to use an apartment unit for a certain number of days in a year, where the consumer can choose to have the unit leased out instead of them using up their allocated number of days.

¹⁵ The land purchase agreement is often executed with an agreement granting the scheme operator power of attorney over the land for this purpose.

3.18 As with land investment schemes that involve planning permission arrangements, the management role of the scheme operator in such arrangements is significant and inextricably linked to the generation of expected profits under the scheme. In contrast, where the arrangements are such that participants can effectively choose not to engage the scheme operator's services in generating the expected profits, then it is unlikely that the arrangement will be regarded as a CIS.

(iii) Buy-to-let schemes

3.19 These are arrangements in which investors are offered units (through fractional interests or a room in a block of apartments) in real estate, on the understanding that the investor will be entitled to participate in rental income generated from the scheme operator's management of the properties as a whole¹⁶. The scheme operator will have control over which property is rented out at any time and to whom, and the rental income is pooled and allocated to scheme participants on a proportional basis to their interests in the scheme. Such arrangements are likely to be regarded as a CIS because:

- Participants do not have day-to-day control over management of their units as they do not have effective control over the agency contracts in relation to their unit; and
- Participants receive rights to participate in pooled rental income from the scheme operators' efforts in management of the properties as a whole.

3.20 The above arrangements are distinguished from normal sale and purchase agreements involving real-estate, which may sometimes involve purchase of interests in unbuilt apartments. While the developer is responsible for building of the units, upon completion of the development, purchasers will have rights to the property as opposed to rights to participate in pooled profits arising from the building of the apartments¹⁷. It should also be noted that arrangements to engage the services of a management corporation for a block of apartments are not regarded as a CIS because the owners retain day-to-day control over management of their own respective property (subject to certain restrictions), and such arrangements are not entered into for rights to participate in pooled profits arising from services of the management corporation.

3.21 Buy-to-let schemes are also distinguished from arrangements which contain rental guarantees and rental agency agreements. Sellers of real-estate may offer rental guarantees for the first few years. The purchaser retains control over management of the property, and there is no scheme from which the purchaser will receive profits. Hence, it is unlikely that such arrangements will constitute a CIS. Similarly, rental agency contracts where rental income is derived from management of a participant's unit on an individual basis and

¹⁶ Investors may be entitled to a certain number of free stays in the unit, but such rights are not the predominant purpose for entering into such an arrangement.

¹⁷ This is regardless of whether the consumer actually intends to stay in it, uses it to generate rental income, or for capital appreciation.

participants retain effective control over the agency contract will not normally be regarded as a CIS.

Proposed legislative amendments

3.22 The proposed amendments to the CIS definition are at **Annex 1**.

Q6. MAS seeks comments on the proposed amendments to the CIS definition in the SFA at Annex 1, particularly whether the proposed amendments sufficiently caters to arrangements that display characteristics of collectively-managed investment schemes.

Extension of the CIS Regulatory Regime

3.23 MAS considers the risks of collectively-managed investment schemes to investors to be essentially the same as traditional CIS and therefore proposes to extend the CIS regulatory regime in its entirety to collectively-managed investment schemes. The CIS regulatory regime mirrors that for debentures (see paragraph 2.11), but has an added requirement for the CIS to be authorised (or recognised for overseas constituted schemes) by MAS. Reflecting the need to strike a balance between investor protection and not impeding market development, there are available exemptions for schemes that cater to a small group of niche market participants.¹⁸

3.24 To be authorised for retail offer, a CIS must (i) comply with the Code on Collective Investment Schemes (“CIS Code”)¹⁹; and (ii) be managed by a licensed fund manager or real-estate investment trust (“REIT”) manager who is fit and proper²⁰.

(i) Compliance with CIS Code

3.25 The provisions in the CIS Code are intended to ensure that CIS offered to retail investors are subject to appropriate safeguards, including safeguards against liquidity, valuation and custody risk. Amongst others, retail CIS are required to invest in transferable securities or the likes (e.g. money market instruments or financial derivatives) in a diversified manner.

3.26 However, MAS recognises that some collectively-managed investment schemes may have characteristics that are largely similar to those present in schemes that are already

¹⁸ The exemptions from authorisation or recognition requirements are similar to that for prospectus requirements, as set out in footnote 8.

¹⁹ The Code on CIS, last revised on 30 September 2011, is accessible at: <http://www.mas.gov.sg/Regulations-and-Financial-Stability/Regulations-Guidance-and-Licensing/Securities-Futures-and-Funds-Management/Codes/2011/Code-on-Collective-Investment-Schemes.aspx>.

²⁰ In determining this, any matter relating to any person who is or will be employed by or associated with the manager, any person exercising influence over the manager or a related corporation of the manager may be taken into account.

authorised by MAS for retail offer, and yet due to the particularities of their investments, may not be able to abide by the precise strictures of the CIS Code. MAS will consider promulgating specific rules in the CIS Code for such schemes so that they will be eligible for authorisation by MAS for retail offer. For example, there is a specific appendix in the CIS Code which allows for a CIS that invests in real estate (e.g. REITs) to be authorised by MAS for retail offer, subject to tailored safeguards. These include requirements for such a CIS to derive its income from stable sources (at least 75% of its portfolio must be made up of income-producing real estate assets). MAS will similarly develop specific rules for schemes that invest solely in gold, silver and platinum, given that these assets are widely regarded as comparable to financial assets in terms of their liquidity and tradability.

(ii) Licensing of scheme operator

3.27 The current licensing and registration regime for CIS operators does not extend to persons managing a portfolio of physical assets, with the exception of persons managing a REIT. Under MAS' regulatory regime, scheme managers will need to satisfy MAS' eligibility criteria aimed at providing reasonable assurance of their financial stability, professionalism and competence²¹. For foreign CIS, the CIS must be constituted and regulated in a jurisdiction that provides an equivalent level of protection to Singapore investors and have a manager that is licensed or regulated in the jurisdiction of its principal place of business.

3.28 In line with the proposal to regulate collectively-managed schemes as CIS, MAS proposes to require operators of such schemes that are offered to retail investors to be regulated as licensed fund managers. Existing operators will be required to obtain a licence if they wish to take on new investors or offer additional units of the scheme to existing investors. MAS will separately consult on details of these proposed changes to the fund management regime.

Q7. MAS seeks comments on the proposals to extend the CIS regulatory regime to collectively managed investment schemes, including the proposal to promulgate specific rules in our CIS Code for schemes that invest solely in gold, silver and platinum.

²¹ For instance, a licensed fund manager who manages retail schemes is required to have S\$1 million in base capital and investment professionals with fund management experience and dedicated compliance staff.

PART II: COMPLEXITY-RISK RATINGS FRAMEWORK FOR INVESTMENT PRODUCTS

1 Proposal to Introduce a Complexity-risk Ratings Framework

1.1 As the financial services industry continues to innovate, there is an increasing number of investment products with more complex risk-return profiles being manufactured and marketed to retail investors. MAS recognises that access to a wider range of products is beneficial to the investing public, as it provides them with more options to direct their investments in accordance with their investment objectives.

1.2 However, increasing product complexity carries with it concerns that investors may face difficulties in understanding the risk-return profile of a product and how their expected payoffs will vary under different scenarios. Features of a product may also obscure the risks that investors face when investing in a product, particularly the risk that they may lose some or all, or even more than their initial investment amount.

1.3 With a disclosure-based regulatory regime, it is important to effectively highlight the inherent complexities and risks of products to investors such that they are sufficiently informed to decide on investments that are suited to their level of understanding and risk appetite. MAS is therefore proposing to introduce a complexity-risk ratings framework for investment products, where each investment product can be plotted against two dimensions, namely (i) complexity, being the difficulty in understanding the risk/reward profile of a product; and (ii) risk, being the likelihood of losing the principal investment amount.

Complexity-rating

1.4 Since 2012, MAS has introduced an enhanced regulatory regime governing the sale and marketing of more complex products to retail investors. However, product complexity is generally based on whether it is a derivative, or embeds derivatives²². While MAS considers this distinction to be appropriate in most cases, MAS has received feedback that usage of derivatives may not necessarily make a product more complex relative to others. This is particularly so in the case of funds, where derivatives may be used solely for hedging and efficient portfolio management purposes. Furthermore, while a simple divide between non-complex and complex products may be adequate for regulatory purposes, it may not provide sufficient distinction between the relative complexities of products to be useful for investors in their investment decisions.

²² MAS has defined in Notices (Notice on the Sale of Investment Products [SFA04-N12] and the Notice on Recommendations on Investment Products [FAA-N16]) investment products that can be classified by product issuers as Excluded Investment Products (“EIPs”), which are simple, well-established products. Investment products that are not EIPs are the more complex Specified Investment Products (“SIPs”).

1.5 MAS therefore proposes to introduce a complexity-rating framework by which products can be rated for their complexity, having regard to a list of factors that drive a product's complexity. Such a framework would allow for greater differentiation between products' complexity to facilitate investment decisions.

Risk-rating

1.6 In 2009, MAS had explored the possibility of requiring products marketed to retail investors to be assigned a risk rating by an independent party. While noting the implementation costs, potential conflicts arising from third party risk rating agencies and moral hazard risks, MAS expressed its view that a risk-rating framework could be beneficial to retail investors if properly implemented and ratings were widely accessible. Based on feedback received, and the recommendation of a consultant commissioned to review whether an independent rating framework for investment products sold to retail investors would be useful in Singapore, MAS eventually decided not to proceed with a mandatory risk-rating framework for investment products.²³

1.7 Instead, MAS focused its regulatory efforts on ensuring that product risks are adequately disclosed to investors. For instance, MAS has introduced requirements for a product highlights sheet to be given to investors with the prospectus, to highlight key product features and risks to investors in a clear, concise and effective manner²⁴. For unlisted margined derivatives offered to retail investors, MAS has consulted on requiring Risk Fact Sheets to highlight the key risks of trading in such products in a way that is easily understood by retail investors²⁵.

1.8 However, MAS notes that it is common for financial institutions to use different definitions and explanations for risk in internal and external communications, which may lead to inconsistent disclosure and confusion amongst investors.

1.9 Given that MAS is considering a framework to rate products for their complexity, it is timely to re-visit the usefulness of introducing a complementary framework to rate products for their relative risks on a separate dimension. In addition to improving consistency in risks disclosures across financial institutions and investment products, this could also serve to address concerns that classifying products based on their complexity alone may give an

²³ See Section 5 of MAS' Response to Feedback Received – Policy Consultation on Review of the Regulatory Regime Governing the Sale and Marketing of Unlisted Investment Product (Part II) for further details.

²⁴ MAS has introduced such requirements for offers of asset-backed securities, structured notes, unlisted CIS, exchange traded funds via Guidelines, and has consulted on draft Regulations to give these requirements legal effect.

MAS has separately consulted on extending this requirement to all offers of investments made with a prospectus. See MAS' Policy Consultation on Proposals to Facilitate Better Understanding of Prospectuses (P015-2013), issued in October 2013.

²⁵ MAS' Consultation on Review of Regulatory Framework for Unlisted Margined Derivatives Offered to Retail Investors (P010-2012), issued in May 2012.

incomplete picture of a product and cause some investors to equate complexity with risk of a product.

1.10 MAS proposes to introduce a framework by which all investment products can be rated for *both* their relative complexity and risk. This can then be used as a tool to increase investors' awareness of the inherent complexities and risks of a product, enabling them to compare between the wide range of investment products available to them.

Q8. MAS seeks views on the proposal to introduce a framework by which products can be rated for *both* their relative complexity and risk.

Scope of proposed complexity-risk ratings framework

1.11 MAS proposes to confine the complexity-risk ratings framework to products which are for investment purposes only. This is because it would not make sense to talk about risk-return profiles for products that are for savings or protection purposes. The proposed framework is therefore intended to only cover investment products being capital markets products (as regulated under the SFA), structured deposits (issued by banks), participating whole life and endowment policies and investment-linked policies (issued by insurers), but excluding term life policies, non-participating whole life and endowment policies and annuities.

1.12 MAS further proposes for the framework to only cover products which are made available to retail investors. As explained in Part III of this consultation paper, non-retail investors are considered to be better placed to safeguard their own interests and should be able to assess the relative complexities and risks of products without this tool.

Q9. MAS seeks feedback on the proposed scope for the complexity-risk ratings framework, in terms of the product and investor coverage.

2 Rating Methodology and Product Mapping

2.1 In developing the rating methodology for the proposed framework, MAS took reference from a framework study report ("Developing a Risk & Complexity Framework") submitted by the Investment Management Association of Singapore ("IMAS") in November 2013. IMAS had engaged and commissioned the Sim Kee Boon Institute ("SKBI") for Financial Economics at Singapore Management University ("SMU") as project consultant to develop a foundation framework to classify investment products according to their complexity and risk.

2.2 The IMAS/SKBI framework drew references from other existing studies and practices in the industry, and included views of practitioners to refine their study. The complexity and

risk methodologies were also calibrated using a wide range of existing products to ensure the proposed framework was reasonable, practical and applicable to different types of investment products.

2.3 The complexity-risk ratings framework detailed in this section leverages on IMAS/SKBI’s framework study, with some modifications made by MAS to ensure that the:

- (i) Parameters used are as objective as possible – A framework that has clearly defined parameters and leaves little room for subjective interpretation allows for effective and consistent implementation across the industry; and
- (ii) Rating results are intuitive and comprehensible to retail investors – For the framework to be practical for retail investors, it must produce results that are simple and easy for them to understand.

Complexity-rating methodology

2.4 The product value of low complexity products should have a fairly direct relationship with the movement in the price of the underlying. On the other hand, high complexity products have a number of additional factors in play that may greatly alter the relationship between the underlying asset prices and the product value. The complexity rating of an investment product can be derived based on four factors: (1) number of structural layers; (2) expansiveness of derivative used; (3) availability and usage of known valuation model; and (4) number of scenarios determining return outcomes. For each factor, an investment product will be assigned a low, medium or high sub-rating. The weighted values associated with the factor sub-ratings will then be added to derive one of four overall complexity ratings – low, medium, high, or very high.

Table 1: Complexity-rating methodology

Factors used in deriving complexity rating				
Factor		Low	Medium	High
Number of structural layers	Threshold	One layer	Two layers	Above 2 layers
	Score	1	3	5
Usage of derivatives	Threshold	None	Up to two	Above two
	Score	1	3	5
Known valuation models	Threshold	Publicly available	Generic	Proprietary Models
	Score	1	2	3
Number of return outcome scenarios	Threshold	One	Two	More than two
	Score	1	3	5

Complexity Rating			
Low	Medium	High	Very High
4-5	6-7	8-14	15-18

(i) Number of structural layers

2.5 This factor is intended to capture the number of structural layers in a product that determines its payoff – the more “structured” a product is, the more difficult it would be for investors to understand the risk-return profile of the product. For example, where a product is structured such that its payoff is determined with reference to two different underlying assets, it would have two layers.

2.6 Another aspect is the number of layers that are interposed between the investor and the underlying asset. Plain vanilla equity and debt securities would be considered as having one layer, given that the investor is directly exposed to the “underlying asset” – being the issuing entity. This is contrasted with a fund structure²⁶, which would have a fund manager having day-to-day control of the underlying scheme assets. This additional structural layer increases the complexity of the fund, which would be considered as having two layers. Extrapolating from this, a fund-of-funds structure would be considered as having three layers.

(ii) Extensiveness of derivatives usage

2.7 This refers to the use of derivatives that are *inherent* in a product – either because the product is a derivative (e.g. options, forwards, swaps) or it embeds derivatives (e.g. leveraged foreign exchange trading, contracts for differences). In the case of funds, they would not be counted as having used derivatives if derivatives are used solely for hedging or efficient portfolio management purposes. When counting the “number” of derivatives used, it is the types of derivatives used that matters, and not the actual number of contracts. For example, an investment product using plain vanilla interest rate swaps would be deemed to have used one type of derivative.

(iii) Known valuation models

2.8 This factor attempts to capture the ease at which retail investors are able to price a product, taking into account their access to valuation models and input data. Product valuation models can be classified into three broad categories as follows:

- *Publicly available* – This is where products have well-known valuation models and inputs for the models are readily available. Common shares fall into this category, as they can be priced using price earnings model, with data inputs readily obtainable from information providers such as Bloomberg or Reuters. Funds are also considered to have publicly available valuation models.

²⁶ An ILP sub-fund would be treated in the same manner as a CIS in this respect.

- *Proprietary* – These are products where the issuer provides prices based on their own proprietary valuation model. Examples include (a) credit default obligations (CDO) cash flow tranches, which are difficult to value due to lack of established valuation models that calibrate bankruptcy risk accurately, and (b) structured products which are generally traded OTC (over-the-counter) by the product provider who is also the market maker. Prices are not publicly available but can only be provided by the market-maker and investors will face great difficulties in valuing the investment product.
- *Generic* – This is the case where the valuation of the product is clearly not reliant on publicly available models, but that is also not reliant entirely on proprietary models. A prime example would be options, which requires use of slightly more sophisticated, yet commonly available, models like the Black-Scholes option pricing model to price.

2.9 For par-endowments, it is less clear which type of valuation model would apply. They may be considered as having proprietary valuation models as premiums are priced using insurers' internal actuarial models. However, they could also be considered as having generic valuation models as even though the amount of non-guaranteed bonus cannot be determined by the market using publicly available valuation models, the factors to be considered in determining the bonus are disclosed to policyholders in the point-of-sale disclosure document.

(iv) Number of return outcomes

2.10 Financial products with similar number of structural layers may have different degrees of complexity if their return outcomes are dependent on different contingent events. For example, a product with a “knock-out” feature is more complex than one without this feature. Therefore, beyond the number of structural layers, another measure of complexity is the number of potential scenarios that can determine the final return outcome of the investment product. One way of gauging this is to map the different possible pathways throughout the life of the product until maturity that will determine its final payoff.

2.11 In the case of plain-vanilla equity securities, while the quantum of return will depend on when the investor exits the investment, there would only be one return outcome – being the market price of the share. The same applies to funds, where the return outcome would be based on the net asset value (“NAV”) of the fund at the time that an investor redeems his interest. On the other hand, options have two outcomes depending on whether the option is exercised or not. Par-endowment policies and investment-linked policies also have two return outcomes, being (i) pay-out upon death of policyholder; or (ii) pay-out upon maturity or redemption of the product.

Q10. MAS seeks views on the proposed four factor complexity-rating methodology and proposed application of the factors to various investment products.

Risk of loss bucketing

2.12 A risk-rating methodology based on factors such as volatility, liquidity, credit, duration/cash flow, leverage and diversification, could in theory be used to rate a product's riskiness. However, it would be subject to limitations common to all backward-looking measures of risk and volatility – i.e. past performance may not be an accurate guide to future performance. It may also not adequately capture the relative likelihood of investors suffering complete or near complete loss (“low probability, high impact” risk). For example, the risk of the bankruptcy of a company in whose equity one has invested is much higher than the risk of the bankruptcy of all equities held by a diversified CIS.

2.13 There were thus concerns about the moral hazard risks associated with the use of such a methodology. A “low” risk rating may generate false comfort for investors, when the product could turn into a “high” risk one over a short span of time. Product issuers may also be exposed to legal liability should anything go wrong, even if ratings were produced in good faith.

2.14 Having considered the methodology and associated concerns, MAS proposes to use a simple pre-determined “bucket-based” approach to risk rating, based on the likelihood that an investor would lose some or all, or even more than his principal investment amount. Focusing on the worst-case scenario should also help to mitigate the moral hazard risk that is associated with a risk-rating system, while still providing consumers with a clear warning of the potential loss of their principal investment. Recognising that such an approach may only differentiate product risk at a reasonably high level, MAS is proposing for a historical price volatility indicator to be used alongside the complexity-risk ratings framework (see paragraph 2.23 below).

2.15 MAS notes that fees and charges may act to diminish an investors' principal investment amount, thereby causing a drag on investment returns. However, MAS' proposed risk-bucketing framework will not take such costs into account in determining a product's risk of loss. This is because offerors and intermediaries are already required to disclose fees and charges to investors, and costs are often a function of the distribution process as opposed to being inherent in a product.

Q11. MAS seeks views on the proposal to adopt a risk-bucketing approach that focuses solely on the risk of loss that investors face when investing in a product.

2.16 With the sole focus being the risk of loss that investors face in a product, the lowest category (“low” risk of loss) will be reserved for a small sub-set of investment products in which an investor holding the product to maturity is unlikely to suffer losses to his principal, viewed from a SGD functional currency perspective. On the other end of the spectrum, the “very high” risk of loss category is reserved for any arrangement in which the investor can lose more than his initial investment. This would include futures, contracts-for-differences (“CFDs”), written options and leveraged FX trading.

2.17 The “in-between” range – products in which some or all of the original investment may be lost – is broad and hence the need for two categories. Generally, products would fall into a “medium” risk of loss category if they are (i) non-concentrated, non-leveraged, and non-synthetic funds or (ii) investment-grade debt securities. All other investment products would fall into the “high” risk of loss category, including (i) funds with a high concentration, leveraged, or synthetic structure and (ii) other single securities such as equities and non-investment grade bonds.

Table 2: Bucketing of investment products based on risk of loss

Risk of Loss Bucket				
	Low	Medium	High	Very High
	Very low risk of sustaining losses on investment amount	Possibility of losing full investment amount	High possibility of losing full investment amount	Can lose more than investment amount
Examples	<ul style="list-style-type: none"> S\$ structured deposits (excl. DCI) and par-endowments by MAS-licensed banks / insurers S\$ bonds issued by the Singapore Government and statutory board, including Singapore Government Securities (“SGS”) S\$ AAA-rated corporate bonds 	<ul style="list-style-type: none"> Investment-grade²⁷ debt securities, or guaranteed by investment-grade entity Non-concentrated, non-leveraged and non-synthetic REITs/CIS/ILP sub-funds 	<ul style="list-style-type: none"> Single equities (e.g. share in company A) Business trusts Unrated and non-investment grade debt securities Concentrated, leveraged or synthetic REITs/CIS/ILP sub-funds Dual Currency Instruments Bought options 	<ul style="list-style-type: none"> Written options Leveraged FX trading Contracts-for-differences Futures

REITs, CIS and ILP sub-funds

2.18 MAS proposes that funds can be considered as “non-concentrated” (and therefore fall into the “medium” risk of loss bucket) if they satisfy the following criteria:

- (i) For an equity or debt fund, in addition to complying with the spread of investments limits as set out in Appendix 1 of the Code on Collective Investment Schemes, its investments are not concentrated on a single sector in a single country;
- (ii) For property funds (including REITs), its investments are not concentrated in a single country; and

²⁷ Excluding S\$ AAA-rated corporate bonds, which are in the “low” risk of loss bucket.

- (iii) For commodity or foreign currency funds, its investment exposure is not limited to a single class of commodity or currency respectively.

Debt securities

2.19 Other than the limited types of bonds which fall into the “low” risk of loss bucket as set out in Table 2, a debt security would fall into the “medium” or “high” risk of loss bucket depending on its credit rating. A debt security would be considered as investment-grade, and therefore in the “medium” risk of loss bucket, if (i) it has a minimum long-term rating of BBB- by Fitch, Baa3 by Moody’s or BBB- by Standard and Poor’s, or (ii) is fully guaranteed by an entity that has an investment-grade credit rating. Non-investment grade and unrated debt issuances will be in the “high” risk of loss bucket.

2.20 For unrated debt issuances, MAS notes that issuers may choose to rely on their own credit-worthiness instead of incurring additional costs to obtain a credit rating for individual debt issuances. However, as debt issuances may be sub-ordinated or issued through special purpose vehicles, it may be misleading to rely on the investment-grade credit rating of the issuer to determine which risk of loss bucket the specific debt security falls into. As such, MAS has proposed for unrated debt issuances to fall into the “high” risk of loss bucket, unless fully guaranteed by an entity with an investment-grade credit rating.

Stapled Securities

2.21 The risk of loss bucket for stapled securities will be the higher of the risk of loss buckets of the individual securities that it comprises of. For example, a debt security stapled to a share will fall into the “high” risk of loss bucket.

Q12. MAS seeks feedback on the general categorisation of investment products into risk of loss buckets as set out in Table 2.

Q13. MAS seeks comments on the proposed criteria for splitting REITs, CIS and ILP sub-funds between the “medium” and “high” risk of loss buckets as set out in paragraph 2.18. MAS also welcomes suggestions on how the criteria can be modified to produce more intuitive results, particularly with respect to (i) funds investing in developing or emerging markets; and (ii) funds investing in risky products (e.g. high yield bonds) only.

Q14. MAS seeks views on the appropriate risk of loss bucket for an unrated debt security.

Product Mapping

2.22 The table below shows how products map in a 4x4 matrix based on the proposed complexity-risk ratings framework.

Table 3: Mapping of products based on complexity rating and risk of loss bucket

INCREASING COMPLEXITY ----->	<u>Very high</u>				<ul style="list-style-type: none"> • Accumulator note
	<u>High</u>	<ul style="list-style-type: none"> • S\$ Structured deposit (excl. DCI) from MAS licensed bank 	<ul style="list-style-type: none"> • ILP investing in non-concentrated ILP sub-funds 	<ul style="list-style-type: none"> • Structured products (e.g. credit-linked notes) • Structured warrants • Synthetic Equity ETF • Buying an option • Dual Currency Investment 	<ul style="list-style-type: none"> • CFD • Writing an option • Futures • Leveraged FX
	<u>Medium</u>	<ul style="list-style-type: none"> • S\$ Par-endowment policy from MAS licensed insurer²⁸ 	<ul style="list-style-type: none"> • Global Bond Fund • Global Equity fund • Developed Country (eg Japan) Equities Fund 	<ul style="list-style-type: none"> • REIT, if single country • US Tech Sector Index Fund (<i>narrow focus</i>) • Long-short equity fund (<i>non-synthetic</i>) • Company warrants • Perpetuals 	
	<u>Low</u>	<ul style="list-style-type: none"> • S\$ Singapore Government Securities • S\$ Statutory board bonds • S\$ AAA-rated corporate bonds 	<ul style="list-style-type: none"> • Foreign Government bond (where foreign government has investment grade credit rating) • Investment grade corporate bond 	<ul style="list-style-type: none"> • Corporate shares • Foreign Government bond (where foreign government has non-investment grade credit rating) • Non-investment grade or unrated corporate bond 	
	<u>Low</u>	<u>Medium</u>	<u>High</u>	<u>Very High</u>	
	-----INCREASING RISK OF LOSS ----->				

Q15. MAS seeks comments on the product-mapping at Table 3 as a general representation of the relative complexities and risks of investment products that are available to retail investors.

²⁸ The “medium” complexity rating is assuming that par-endowments are considered to have “generic” valuation models (see paragraph 2.9). If they are considered to have “proprietary” valuation models, they will be rated as “high” complexity.

Historical Price Volatility Indicator / Credit Rating

2.23 As mentioned in paragraph 2.14, historical price volatility (or credit rating in the case of debentures) can be disclosed alongside the risk of loss bucket to provide investors with an indication and comparison of product volatility. MAS recognises that volatility is an important determinant of the outcome for the investor, and disclosing this indicator separately would allow for added differentiation between products within a risk of loss bucket.

2.24 Products for which this indicator would be relevant are products in the “medium”, “high” and “very high” risk of loss buckets only. Products in the “low” risk of loss bucket are fairly limited, and hence MAS is of the view that the costs would outweigh the benefits in having a historical price volatility indicator for such products. It is also possible that such an indicator be limited to certain types of products, such as equity securities, debt securities, and funds, where the concept of volatility is more prevalent.

2.25 Historical price volatility can be calculated based on standard deviation of annualised weekly returns over the past 10 years. MAS notes that such information may not always be available (e.g. for initial public offerings), and a proxy may need to be used. However, selection of proxies is inherently subjective, and may not give a fair representation of the true price volatility of a product.

Q16. MAS seeks views on whether a historical volatility (or credit rating for debentures) indicator should be used alongside the complexity-risk ratings framework. If so, should the indicator be used for products in the “medium”, “high” and “very high” risk of loss buckets or a more limited set of products?

Q17. MAS welcomes suggestions on the approach to be taken where information to calculate the historical price volatility indicator is unavailable.

3 Production of Ratings and Proposed Disclosure

3.1 MAS proposes to impose requirements on product issuers to rate products based on the proposed complexity-risk ratings framework as they are most familiar with their products. MAS further proposes to require ratings to be disclosed in product offering documents for new and ongoing offers of investments to retail investors²⁹. Issuers who seek to have their products listed on an Approved Exchange (AE) will be required to inform the relevant AE of the rating, and the AE should indicate this information on its trading platform accordingly. Intermediaries will similarly be required to ensure this information is made available to investors transacting in listed products through them.

²⁹ This proposal does not extend to offers which are made in reliance of prospectus exemptions, or which are otherwise restricted to only non-retail investors.

Table 4: Product issuer and where proposed disclosure can be incorporated for different product types

Product type	Product Issuer	Product Disclosure
Part XIII Offers of Investments	CIS – Responsible entity of the CIS Others – Entity that issues the product	Product Highlight Sheet
Futures	Futures Exchange	Futures exchange trading platform and Risk Disclosure Statement
LFX/CFD	Holder of a Capital Markets Services Licence ³⁰	Risk Fact Sheet
Structured deposit and Dual Currency Investment	Bank	Term sheet
Par-whole life or Par-endowment policy	Insurer	Product Summary
Investment-linked policy (“ILP”)	Insurer	Product Summary

Q18. MAS seeks comments on the proposal for product issuers to rate their products for complexity and risk and to disclose such ratings in product offering documents for new and ongoing offers to retail investors.

3.2 The general explanations to accompany the (i) complexity rating, (ii) risk of loss bucket and (iii) historical price volatility/credit rating indicator are set out in **Annex 3**. It is also envisaged that there would need to be supplementary disclosures incorporating the following:

- (a) Product-mapping table (at Table 3) to show how an individual product maps against other investment products;
- (b) Explanations on interpreting (i) – (iii) and what investors should be mindful of when using these factors in investment decisions.

Q19. MAS seeks feedback on the general explanations to accompany the (i) complexity rating (ii) risk of loss bucket and (iii) historical price volatility/credit rating indicator as set out in Annex 3.

Q20. MAS also invites comments on the form and content of supplementary disclosures to be made to investors, bearing in mind the need to ensure that overall disclosures remain simple and understandable to retail investors.

³⁰ Including entities who are exempt from holding a Capital Markets Services licence pursuant to SFA section 99(1)(a)-(d).

Updating of disclosure documents

3.3 A product's complexity-rating and risk of loss bucket should be fairly static over its lifespan, but there may be changes in the historical price volatility indicator or credit rating of a product if used alongside the complexity-risk ratings framework. For clarity, the proposed disclosures are to be incorporated in documents that are used to offer a product to an investor. Therefore, where changes occur *after* an offer has closed, product issuers would not need to update offering documents as these are no longer in use. In such cases, investors can be alerted to changes in the same way that they are currently kept informed of material changes to their investment.

Q21. MAS seeks comments on the practical implications of changes in ratings after initial disclosures are made.

Interaction with existing risk-rating frameworks

3.4 MAS notes that financial institutions may have existing internal risk-rating frameworks which they use to match products to a client's risk profile. In some cases, financial institutions may disclose internal product risk ratings to investors. To avoid investor confusion, there would need to be general alignment between the risk-rating results produced under both frameworks. That is, products rated as having a "high" risk of loss in MAS' proposed framework, should not be rated as "low" risk under internal rating systems and vice versa. For clarity, it is not MAS' intention for the risk of loss bucketing framework to replace financial institutions' internal risk-rating systems, but to provide a baseline rating within which financial institutions can further differentiate products for distribution purposes.

3.5 Separately, the Central Provident Fund Board ("CPF Board") also has a CPFIS Risk Classification Framework ("RCF"). MAS has worked with CPF Board to rationalise the ratings produced under both frameworks. Generally, CPF-included investments will fall into the "low" and "medium" risk of loss bucket, with the exception of equities, REITs investing in a single country and SPDR Gold ETF. CPF Board would further subdivide CPF-approved funds according to asset type and geographical diversification within the "medium" risk of loss bucket.

Q22. MAS seeks feedback on whether the proposed risk of loss bucketing framework would conflict with risk ratings produced under internal risk rating systems. If so, MAS welcomes examples and suggestions on how either framework can be amended to resolve such conflicts.

4 Alignment with EIP/SIP Classification

4.1 As mentioned in paragraph 1.4, more complex products are currently defined based generally on whether it is a derivative, or embeds derivatives. MAS defines a list of Excluded Investment Products (“EIPs”) that are simple, well-established products that do not contain derivatives. Products not in the EIP list are considered more complex Specified Investment Products (“SIPs”), and intermediaries are subject to enhanced regulatory requirements when distributing such SIPs to retail investors.

4.2 With the proposed complexity rating, MAS is also proposing to align the complexity-rating of a product with the classification of products as EIP or SIP. In this regard, MAS proposes to define EIPs as investment products which have been rated as having “low” or “medium” complexity under the proposed complexity-risk ratings framework, as well as investment products which have been excluded from the scope of the complexity-rating ratings framework³¹. All other investment products will be SIPs. This would include products which have been rated as having “high” or “very high” complexity, and products which are unrated³². Based on the current proposed complexity methodology, this should have the effect of enabling a number of funds that are currently classified as SIPs to be classified as EIPs where their use of derivatives is limited to hedging or efficient portfolio management purposes.

Q23. MAS seeks comments on the proposal to align the classification of products as EIP or SIP with their complexity-rating as set out in paragraph 4.2.

³¹ Currently, this would be term life policies, non-participating whole life and endowment policies and annuities as proposed in paragraph 1.11.

³² This would be for overseas-listed investment products, which intermediaries are unable to classify as EIPs.

PART III: REFINING THE INVESTOR CLASSES UNDER THE SFA AND FAA

1 Various Investor Classes under the SFA and FAA

1.1 The SFA and FAA puts in place regulatory safeguards for investors by setting out the rules for issuers of capital market products and for intermediaries dealing in or providing advice on investment products. These aim to promote high standards of disclosure and good conduct practices in intermediaries' interactions with their customers.

1.2 In line with the practice in other major financial centres, MAS differentiates between retail and non-retail investors in terms of regulatory protection. The full range of regulatory safeguards applies when issuers and intermediaries deal with retail investors. Non-retail investors are considered to be better informed or better able to access resources to protect their own interests, and hence require less regulatory protection. This is reflected through exemptions from a number of provisions in the SFA and FAA for intermediaries dealing with non-retail investors, or in the case of offers of investments, to offers that are made to non-retail investors.

1.3 There are three main classes of non-retail investors³³ under the SFA and FAA regulatory framework, as set out below. Investors who do not fall within any of the non-retail investor classes below are considered retail investors.

- (i) ***Accredited investors*** are generally identified by income or wealth thresholds and considered to be sufficiently knowledgeable or experienced in managing their financial affairs (whether directly or through professional advice) and protecting their own investment interests.
- (ii) ***Institutional investors*** and ***expert investors*** generally refer to persons who are professionally active in the financial markets. These professional investors are considered to possess a high level of financial expertise and sophistication that enables them to make their own investment decisions and risk assessments.

1.4 The global financial crisis has led regulators to re-examine aspects of their regulatory approach to retail and non-retail investors, including the appropriateness of existing investor classifications in identifying those with greater need of regulatory protection. In particular, certain classes of non-retail investors may not necessarily be better informed or require less regulatory protection than retail investors.

³³ See section 4A(1)(a) and (c) of the SFA read with the Securities and Futures (Prescribed Specific Classes of Investors) Regulations 2005 for the definitions of an "accredited investor" and "institutional investor" and section 4A(1)(b) of the SFA for the definition of an "expert investor".

1.5 MAS has undertaken a review of the SFA and FAA investor classes. MAS proposes refinements to the SFA and FAA investor classes to enhance investor protection and choice as well as to streamline and rationalise the investor classes to ensure they remain relevant.

1.6 The proposals relating to the accredited investor class are set out under Section 2 of this Part III. Key proposals include introducing an ‘opt-in’ regime and amending the accredited investor eligibility criteria for individuals, corporations and trustees.

1.7 The proposals relating to institutional investors and expert investors are set out under Sections 3 and 4 of this Part III respectively. Key proposals include widening and rationalising the institutional investor definition, and removing the expert investor class.

2 Accredited Investors

2.1 An accredited investor (“AI”)³⁴ is currently defined to include:

- (i) an individual whose net personal assets exceed S\$2 million, or whose income in the preceding 12 months is not less than S\$300,000;
- (ii) a corporation with net assets exceeding S\$10 million, or whose sole business is to hold investments and the entire share capital of which is owned by one or more persons, each of whom is an accredited investor;
- (iii) the trustee of a trust of which all property and rights of any kind whatsoever held on trust for the beneficiaries of the trust exceed S\$10 million;
- (iv) an entity (other than a corporation) with net assets exceeding S\$10 million; and
- (v) a partnership (other than a limited liability partnership within the meaning of the Limited Liability Partnerships Act 2005 (Act 5 of 2005)) in which each partner is an accredited investor.

2.2 Currently, an investor who meets any of the criteria described in paragraph 2.1 would automatically be classified as an AI. Issuers and intermediaries are exempted from a number of regulatory requirements when dealing with such investors. For example, issuers of securities are exempted from having to issue a full prospectus in respect of offers that are made only to AIs³⁵, and intermediaries dealing with AIs are exempted from a number of business conduct requirements under the FAA³⁶. The investor may not necessarily be aware of his AI classification, or the implication that issuers and intermediaries are exempt from certain regulatory requirements when dealing with him. Even if the investor was aware of his AI classification and the implications thereof, he is not able to ‘opt out’ of his AI

³⁴ See section 4A(1)(a) of the SFA read with regulation 2 of the Securities and Futures (Prescribed Specific Classes of Investors) Regulations 2005 for the definition of an “accredited investor”.

³⁵ Under section 275 of the SFA.

³⁶ Such as the requirement to provide adequate product information disclosures under section 25 of the FAA and to have a reasonable basis for product recommendations under section 27 of the FAA.

classification should he prefer to receive the benefit of the full range of regulatory safeguards that are available to retail investors.

Proposed Opt-in Regime for Accredited Investors

2.3 MAS proposes to refine the AI class by introducing an ‘opt-in’ regime. Under such a regime, all investors other than institutional investors would by default be treated as retail investors. An investor who meets any of the criteria stipulated in the AI definition (“Eligible Investor”) would have the choice of electing for retail or AI status (and be made aware of the consequent reduction in regulatory safeguards).

2.4 MAS considers that the introduction of an opt-in regime for AIs would be able to achieve the following policy objectives, and ultimately enhance investor protection and choice:

- (i) Ensure that an investor would be fully aware or informed of his status as a retail or accredited investor;
- (ii) Provide each investor with the flexibility or choice to determine the investor classification and level of regulatory protection that is best suited to his circumstances, risk profile and investment needs. For example, an Eligible Investor who wishes to access a broader range of investment products that are not offered to retail investors may be willing to forgo or waive the benefit of certain regulatory safeguards. On the other hand, an Eligible Investor who has a conservative risk profile or who is unwilling to pay for professional advice may prefer to receive the benefit of the full range of regulatory safeguards under the SFA and FAA and be satisfied with access to investment products that are suitable for retail investors; and
- (iii) In consciously opting in to AI status, the Eligible Investor would be fully aware or informed of the regulatory safeguards that he would forgo as a result of his decision.

2.5 The proposed opt-in regime would also bring our regime in line with that of other jurisdictions such as the EU and Hong Kong which have adopted a similar ‘opt-in’ approach for their main non-retail investor class³⁷, as well as international best practices recommended by the International Organization of Securities Commissions (IOSCO)³⁸.

³⁷ See Annex II.2 of the EU Markets in Financial Instruments Directive (Directive 2004/39/EC), and 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).

³⁸ 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”) available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD400.pdf>. 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.”

2.6 The key features of the proposed opt-in regime are set out below:

(i) Opt-in Process

An Eligible Investor who wish to be classified as an AI in respect of his dealings with a particular financial institution or intermediary (“FI”) would have to actively opt in to AI status, through the following opt-in process -

- (a) The FI will provide a written notification to all clients, including new and existing clients, who are assessed by the FI to be Eligible Investors, of their initial classification as retail investors (for new clients) or AIs (for existing AI clients), their right to request for AI status and a clear written description and warning of the regulatory safeguards that may be dis-applied if they opt in to AI status. This information will help clients to understand the basis of their initial classification, the regulatory safeguards attached to each investor class, and their right to request for a different investor classification. Alternatively, an Eligible Investor could, of his own accord, approach an FI to indicate that he wishes to be classified as an AI.
- (b) If the Eligible Investor wishes to opt in to AI status, he must confirm this in writing to the FI and acknowledge that he understands and accepts the consequent reduction in regulatory safeguards. This confirmation should be in a separate document from the FI’s notification letter described in the preceding sub-paragraph.

The opt-in process should not be viewed as a rote process of requiring clients to sign standard forms, but as a process that promotes fair dealing by FIs. In particular, the disclosures to clients regarding the implications of opting in to AI status should be made clear and easily comprehensible to the investing public. By assisting clients to choose the right investor classification for their needs, FIs would be better able to offer products and services that are suitable for their target client segments.

(ii) AI Eligibility Criteria

The monetary thresholds and other criteria stipulated in the current AI definition will be the criteria for determining an investor’s eligibility to opt in to AI status under the proposed opt-in regime, subject to some proposed amendments as set out in paragraphs 2.14, 2.17, 2.21 and 2.22 below.

Under this principle, the IOSCO Suitability Report *inter alia* 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.”

(iii) Eligible Investors

MAS proposes to apply the opt-in process to all Eligible Investors, including those that are not natural persons (e.g. corporations, trustees, limited liability partnerships and other types of entities) to ensure fair and consistent treatment.

(iv) AI Status on per FI Basis

To provide maximum flexibility for investors to choose the level of regulatory protection that accords with their financial or investment needs, MAS proposes that AI status would be held on a per FI basis. For instance, an Eligible Investor may choose to be treated as a retail investor with a bank in which he maintains his primary savings account, but opt in to AI status with a brokerage firm in which he maintains his securities trading account in order to have access to a wider range of products.

(v) Moving between Investor Classifications

An AI client would be able to change his classification to non-AI status (or *vice versa*) at any time by request in writing to the relevant FI. This ability to convert to non-AI status would not affect transactions that were entered into while the investor was classified as an AI.

Where an AI client has converted to non-AI status, the FI has the choice whether to continue providing services to that client on that basis. The exception would be where the FI is licensed to serve a restricted clientele including AIs (e.g. restricted fund managers), in which case the FI may be required to discontinue its business relationship with the client in order to comply with its licensing conditions (unless the proposed transitional arrangements for existing and ongoing investments in paragraph 2.9 apply). Where the FI does not agree to continue business relations, or is required by its licence conditions to discontinue business relations, with an AI client who has converted to non-AI status, the client may have to source for services from another FI.

(vi) Recordkeeping and Monitoring Obligations

FIs would be required to implement appropriate internal policies and procedures to classify clients, including maintaining proper records of the documents related to the opt-in process and any client instructions involving a change in investor classification. FIs should review their existing AI clients' eligibility for AI treatment periodically (at least once every two years). If the FI should become aware of any changes that could affect the AI classification of an existing client, whether through its periodic review or otherwise, the FI

must take appropriate action to verify the client's eligibility for AI treatment and re-classify the client as a retail investor if the client is no longer an Eligible Investor.

Transitional Arrangements for Existing AIs

2.7 Should the proposed AI opt-in regime be adopted, MAS proposes to require an active, written opt-in confirmation from all existing AI clients who wish to maintain their AI status with their FIs. We had considered an alternative passive, 'opt-out' transitional approach, under which existing AI clients would continue to be AIs unless they informed the relevant FI otherwise in writing. While an 'opt-out' approach may be less administratively cumbersome for the industry and clients, it would not adequately achieve the objective of ensuring that all AIs are fully aware of their AI status and the corresponding regulatory safeguards that they forgo as AIs.

2.8 MAS recognises that requiring FIs to obtain written opt-in confirmations from all their existing AI clients, especially those based overseas, may present administrative difficulties for FIs, and may also potentially disrupt their ability to continue serving existing AI clients who do not submit the written confirmations requested by their FIs. To mitigate these concerns, MAS proposes a **two-year transitional period** to migrate existing AI clients to the opt-in regime. During this transitional period, FIs would be allowed to continue to treat their existing AI clients as AIs. This does not however preclude existing AI clients from choosing to be re-classified as retail investors during the transitional period.

2.9 With respect to existing and ongoing investments that are predicated on an existing AI maintaining his AI status, MAS proposes to allow an existing AI who may no longer be eligible for AI status (due to proposed modifications to the net assets AI eligibility criterion for individuals outlined in paragraph 2.14 below) to continue to be treated as an AI only in respect of and for the duration of such investments.

Q24. MAS seeks views on the proposal to introduce an opt-in regime for AIs.

Q25. MAS seeks comments on the proposed key features of the opt-in regime, as set out in paragraph 2.6.

Q26. MAS invites views on the proposed transitional arrangements described in paragraphs 2.7 to 2.9 to migrate existing AI clients to the proposed opt-in regime.

Proposed Amendments to Eligibility Criteria for Accredited Investors

2.10 The monetary and other criteria in the current AI definition would become the eligibility criteria for AI classification under the proposed opt-in regime. MAS proposes to leave the existing criteria unchanged, save for some proposed amendments for individuals, corporations and trustees.

Individuals

2.11 As part of our review of the AI class, MAS has considered whether the current monetary thresholds in the AI definition (i.e. S\$2 million net personal assets or S\$300,000 annual income) should be revised since the thresholds were set more than 10 years ago in 2003. Following the global financial crisis, MAS and other regulators around the world recognise that the setting of any monetary thresholds may be an arbitrary way to differentiate between retail and non-retail investors, as wealth – while a useful indicator – is not the only deciding factor in determining the level of regulatory protection that is appropriate for an investor. Other factors such as an investor’s risk appetite, investment needs and individual circumstances (e.g. financial knowledge) would also need to be taken into consideration.

2.12 With the proposed introduction of the opt-in regime, determining the exact monetary thresholds is less crucial as investors would have the flexibility to decide the investor classification and level of regulatory protection that is best suited to their individual needs and circumstances. Hence, MAS’ preferred approach is to retain the current monetary thresholds of S\$2 million net personal assets or S\$300,000 annual income, with one modification as described in paragraph 2.14.

2.13 Currently, the S\$2 million net assets threshold does not differentiate between liquid and illiquid assets. AIs are considered to require fewer regulatory safeguards as they are presumed to have the relevant means to seek professional advice to protect their interests. This assumption would be weakened if the investor’s wealth is concentrated in illiquid assets, such as his primary residence. For some individuals, their primary residence is a major component of their portfolio of assets.

2.14 Although the proposed opt-in regime for AIs makes the exact threshold less crucial, MAS is nonetheless of the view that it would not be appropriate for investors whose wealth is concentrated in their primary residence, with few other liquid assets, to be able to opt in to AI status. As such, MAS proposes to modify the net assets eligibility criterion such that net equity in an individual’s primary residence³⁹ can only contribute up to S\$1 million of the minimum net assets threshold of S\$2 million.

2.15 In our review, we have also considered the alternative approach of excluding the net equity in an individual’s primary residence altogether from the net assets eligibility criterion, similar with the practice in the US. However, this approach could give rise to unintended results, e.g. an individual who owns a primary residence with net equity of S\$15 million and other assets valued at S\$2 million or below would not be AI eligible, but an individual who does not own a home but have other assets exceeding S\$2 million (e.g. \$2,000,001) would be AI eligible.

³⁹ “Net equity in an individual’s primary residence” is proposed to be defined as the estimated fair market value of the individual’s primary residence less any outstanding amounts in respect of any credit facility granted to the individual or any other person that is secured by that residence.

Joint Account Holders

2.16 MAS has considered how the proposed opt-in regime for AIs should be applied to individuals who hold a joint account. It has been MAS' longstanding policy that each joint account holder should be treated as befits his individual investor status. For example, A and B hold a joint account, where A is an AI while B is not. The FI dealing with account holder A is able to offer him a broader range of investment options that are not available to retail investors. However, where the FI is dealing with account holder B, the relevant rules applicable to retail investors should be adhered to.

2.17 With the proposed introduction of the AI opt-in regime, MAS considers that there is scope to extend the AI eligibility criteria to any individual who holds a joint account at an FI with an AI. MAS proposes to provide that any individual, who holds a joint account at an FI with an individual who is an AI, will himself be AI eligible, but only in respect of transactions entered into with or through the FI, using the joint account. The fact that a person is holding a joint account with an AI is considered to be *prima facie* proof of the existence of a meaningful relationship between them. Investor protection is unlikely to be compromised, as each joint account holder must separately go through the opt-in process and make the conscious choice of opting in to AI status. In addition, the fact that AI status is only in respect of transactions made through the joint account held with the main AI client will limit any potential detriment that could occur.

2.18 This proposal is also relevant to the Singapore private banking industry and their clients, as it is common for joint accounts to be opened for AIs and their non-AI family members for asset protection and family wealth planning purposes. This proposal would provide such connected persons of AIs the flexibility and choice to determine the level of regulatory protection and access to a range of products that best suit their needs. Assuming that a connected person opts in to AI status in a joint account with the main AI client, the private bank ("PB") will be able to offer both clients, as holders of the joint account, the full suite of PB services and product offerings.

2.19 With this proposal, PBs will no longer require the flexibility accorded by way of a case-by-case exemption pursuant to section 100(2) of the FAA⁴⁰ to service the segment of their clients who do not meet the AI definition. The removal of this case-by-case exemption will provide clarity to PB clients as to the regulatory safeguards that are available to them, in deciding whether to opt in to AI status⁴¹.

⁴⁰ MAS may grant exemption under section 100(2) of the FAA to a licensed financial adviser or an exempt financial adviser, upon application, from sections 25, 27, 28 and 36 of the FAA in respect of any financial advisory service provided by a separate and distinct department, division, section or unit of the applicant [Guidelines on Exemption for Specialised Units Serving High Net Worth Individuals Under Section 100(2) of the FAA].

⁴¹ Exemptions from FAA requirements are granted to PB specialised units in respect of any client that they serve. With the proposed introduction of the AI opt-in regime, PB clients who choose not to opt in as AIs may be confused as to the regulatory safeguards that are available to them.

Corporations

2.20 Currently, a corporation would automatically be classified as an AI if it is *either*:

- (i) a corporation that has net assets exceeding S\$10 million⁴²; or
- (ii) a corporation whose sole business is to hold investments and its entire share capital is owned by AIs⁴³.

2.21 The criterion described in paragraph 2.20(ii) provides a statutory ‘look through’ approach for corporations wholly owned by AIs which do not have net assets exceeding S\$10 million, provided that their sole business is investment holding. The application of the ‘look through’ approach to *AI-owned investment holding corporations* only may be too restrictive. For example, a corporation which operates a business and which has less than S\$10 million in net assets would not be AI eligible even if it is wholly owned by AIs. MAS therefore proposes to amend this AI eligibility criterion such that any corporation that is wholly owned by AIs would be AI eligible.

Trustees

2.22 The current AI definition includes the trustee of any trust which has assets exceeding S\$10 million⁴⁴, and an individual whose net personal assets exceed S\$2 million. As a result, investments options that are available to an AI whose net personal assets exceed S\$2 million would not be available if such assets were held under a trust for him, if the value of the total assets under the trust is S\$10 million or less. To address this inconsistency, MAS proposes to extend AI eligibility to the trustee of any trust in which all the beneficiaries are AIs. This proposal would also be consistent with the statutory ‘look through’ approach for corporations which are wholly owned by AIs.

Q27. MAS seeks views on the proposal to modify the net assets AI eligibility criterion for individuals to cap the contribution of the net equity in an individual’s primary residence to S\$1 million of the minimum net assets threshold of S\$2 million (as described in paragraph 2.14).

Q28. MAS seeks views on the proposal to extend AI eligibility to any individual who holds a joint account at an FI with an individual who is an AI, in respect of transactions entered into with or through the FI, using the joint account.

Q29. MAS seeks views on the proposal to extend AI eligibility to any corporation which is wholly owned by AIs.

⁴² See section 4A(1)(a)(ii) of the SFA.

⁴³ See section 4A(1)(a)(iv) of the SFA read with regulation 2(d) of the Securities and Futures (Prescribed Specific Classes of Investors) Regulations 2005.

Q30. MAS seeks views on the proposal to extend AI eligibility to any trustee of a trust in which all the beneficiaries are AIs.

3 Institutional Investors

3.1 Institutional investors (“IIs”) are regulated FIs or other entities that deal in financial products in the ordinary course of their business. In recognition that IIs have the expertise to engage in capital markets activities, MAS exempts offers of investments made to such investors from the prospectus requirements, and from the FAA requirements when they deal with IIs.

3.2 The current II definition includes the Singapore government and MAS-regulated FIs that carry out capital markets services activities⁴⁵.

Proposals to Widen the Institutional Investor Definition

3.3 Internationally, it is common for governments and financial services firms to be designated as a class of *de facto* non-retail investors⁴⁶. MAS is of the view that the underlying assumption that these investors have the expertise to look after their own interests remains valid. However, there is scope to widen this class of investors to cover additional types of investors (see paragraphs 3.4 and 3.5 below).

Foreign Financial Services Firms

3.4 MAS proposes to extend the II 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 jurisdictions⁴⁷. Therefore all entities professionally active in the financial services markets, and using the services of Singapore-based FIs, would automatically be non-retail investors. Currently, most foreign financial services entities can be treated as non-retail as they have been able to qualify as AIs. Given the proposals to introduce an AI opt-in regime, this extension of the II definition would avoid the need for FIs and their foreign financial services firm clients to go through the AI opt-in process.

⁴⁵ For the full definition of institutional investors, please see section 4A(1)(c) of the SFA read with regulation 3 of the Securities and Futures (Prescribed Specific Classes of Investors) Regulations 2005. The list includes banks, merchant banks, finance companies, insurance companies or co-operatives, trust companies, broker-dealers, fund managers, custodians, real estate investment trust managers etc.

⁴⁶ The United Kingdom and Hong Kong are examples of jurisdictions that take this approach.

⁴⁷ An entity that only holds a financial adviser’s licence from MAS is not an II. In practice, this means that all FIs authorised, licensed and/or regulated in foreign jurisdictions would be IIs, *except* for those FIs that are authorised, licensed and/or regulated solely to provide financial advice.

Foreign Governments

3.5 MAS also proposes to extend the II definition to all *central* governments and *central* governmental agencies of foreign states, supranational governmental organisations (e.g. the World Bank and the International Monetary Fund) and sovereign wealth funds, in recognition that these are very sophisticated investors.

3.6 As there is a wide variance in the degree of financial knowledge, experience and sophistication among *municipal* or *provincial authorities of foreign states*, MAS does not consider it appropriate to extend the II definition to these investors.

Proposals to Exclude Certain Statutory Bodies from the Institutional Investor Definition

3.7 The current II definition includes all statutory bodies⁴⁸. Statutory bodies comprise statutory boards (e.g. CPF Board, Economic Development Board and MAS), town councils⁴⁹ and other entities incorporated under specific Acts of Parliament (e.g. The Anglican Bishop of Singapore, Brothers of St. Gabriel and Kwong-Wai-Shiu Free Hospital). As not all statutory bodies deal in financial products on a regular basis and/or have the financial expertise associated with the II investor class, MAS proposes to refine the II definition in relation to statutory bodies to include *only* statutory boards.

3.8 Statutory bodies excluded from the II definition would still be able to become non-retail investors if they are AI-eligible and choose to opt in to AI status.

Rationalising Regulatory Exemptions for Dealings with AIs and IIs

3.9 In calibrating the regulatory safeguards in the SFA and FAA, MAS' policy intent is to accord the full range of regulatory safeguards to retail investors, followed by AIs, then IIs. Correspondingly, exemptions available for dealings with AIs should, in principle, also be available for dealings with IIs. This is presently not the case for a small number of regulatory exemptions⁵⁰ and MAS will undertake amendments to rationalise the SFA and FAA regulatory exemptions that apply in relation to dealings with AIs and IIs, in line with our policy intent.

⁴⁸ See section 4A(1)(c)(vii) of the SFA.

⁴⁹ Town councils are incorporated under the Town Councils Act (Cap 329A).

⁵⁰ Primarily, this occurs with some regulatory exemptions in the Securities and Futures (Licensing and Conduct of Business) Regulations for dealings with AIs (e.g. FIs are exempted from posting collateral when borrowing securities from AIs, and are also exempted from having to explain the risks involved in securities lending to AIs) which are not similarly available for dealings with IIs.

Q31. MAS seeks views on the proposed amendments to the II definition, in particular the proposal to include central governments and central governmental agencies of foreign states, supranational governmental organisations, sovereign wealth funds, as well as financial services firms that are authorised, licensed and/or regulated in foreign jurisdictions within the II definition.

4 Expert Investors

4.1 An expert investor (“EI”)⁵¹ is currently defined as:

- (i) a person whose business involves the acquisition and disposal, or the holding, of capital markets products, whether as principal or agent;
- (ii) the trustee of such trust as MAS may prescribe, when acting in that capacity; or
- (iii) such other person as may be prescribed by MAS.

4.2 The main category of persons who fall within the EI definition only (those that are not also, for example, IIs) consists of individuals who work for FIs as traders, in respect of those individuals’ *own* personal trading.

4.3 FIs are exempted from most FAA requirements in respect of their dealings with EIs. However, offerors are still subject to full prospectus requirements when making offers of investments to EIs.

4.4 MAS proposes to remove the EI class of investors from the SFA and FAA regulatory framework. The intended application of the EI definition is limited to a small group of investors, but the EI class of investors adds complexity to the SFA and FAA regulatory framework as a class of investors with a level of regulatory protection falling between that accorded to retail investors on the one hand, and AIs and IIs on the other. Investors who are affected by this proposal can opt in to be AIs if they are Eligible Investors or assume retail status.

Q32. MAS seeks views on the proposal to remove the expert investor class from the SFA and FAA regulatory framework.

⁵¹ See section 4A(1)(b) of the SFA for the definition of an “expert investor”. As of to date, MAS has not prescribed any trustees or other persons as EIs.

5 Proposed Legislative Amendments

5.1 Proposed legislative amendments to give effect to our proposals on the various non-retail investor classes are set out in **Annex 4**.

Q33. MAS invites comments on the proposed legislative amendments to the SFA and the Securities and Futures (Prescribed Specific Classes of Investors) Regulations set out in Annex 4.



Monetary Authority of Singapore