

CONSULTATION PAPER

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Proposed Regulatory Regime for Managers of Venture Capital Funds

MAS

Monetary Authority of Singapore

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1 Preface

1.1 Managers of venture capital funds (“**VC managers**”) invest into businesses that are in the start-up and early growth phases. VC managers in Singapore are currently required to register with the Monetary Authority of Singapore (“**MAS**”) and be regulated as a Registered Fund Management Company (“**RFMC**”), if they pool and manage monies from third party investors. If their aggregate assets under management exceeds S\$250 million or if they serve more than 30 accredited and/or institutional investors, they are required to hold a Capital Markets Services (“**CMS**”) licence for fund management. Licensed fund managers and RFMCs are required to meet certain admission criteria prior to being licensed or registered, and to comply with financial and business conduct requirements on an ongoing basis.

1.2 VC funds pose high risks to investors, by the nature of their investment in start-ups and early stage business ventures. The fund life typically ranges between five and seven years or longer, with the start-ups and investee companies making little or no profits in the early years. The return on investment to VC investors depends primarily on the eventual success or failure of these business ventures at the end of the fund life. While the VC manager is usually involved in nurturing these companies by providing expertise and business networks, there is no guarantee that all the investee companies will take off and succeed. In the worst case, investors in a VC fund can lose a substantial amount or all of their principal at the end of the fund life.

1.3 Given the significant inherent investment risks, VC investors are typically highly sophisticated, and highly selective of the VC managers that they choose to invest with. Most investors would only fund new rounds of capital raising by VC managers that have demonstrated success and track record in its initial fund. In addition, VC investors often negotiate stringent contractual safeguards to protect their own interests.

1.4 The corollary of the contractual safeguards, stringent due diligence and closer scrutiny that VC investors impose on VC managers is that some of the existing requirements on registered or licensed fund managers are less relevant. The characteristics of VC investments, such as not investing in public markets and being closed-end, also reduce the level of operational and conduct risks that VC managers are exposed to. Furthermore, VC managers play an important role in the VC ecosystem by channelling capital to support the growth of start-up businesses which help to sustain innovation and growth in the economy. Given these considerations, MAS proposes to introduce a simplified regulatory regime for VC managers that meet certain criteria.

1.5 MAS invites interested parties to submit their views and comments on the proposals made in this paper.

Please note that all submissions received will be published and attributed to the respective respondents unless they expressly request MAS not to do so. As such, if respondents would like (i) their whole submission or part of it, or (ii) their identity, or both, to be kept confidential, please expressly state so in the submission to MAS. In addition, MAS reserves the right not to publish any submission received where MAS considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive.

1.6 Please submit written comments by 15 March 2017 to –

Capital Markets Intermediaries Department II
Monetary Authority of Singapore
10 Shenton Way, MAS Building
Singapore 079117
Fax: (65) 62203973
Email: vc_consultation@mas.gov.sg

1.7 Electronic submission is encouraged. Please use this [template](#) for your submission to ease our collation efforts.

2 Introduction

2.1 VC managers make up a small but fast-growing segment of the Singapore fund management industry. Within the VC industry, there is some diversity in the profile of players. There are VC funds which are set up and managed by conglomerates or family offices that are internally funded and do not take in monies from third parties. The managers of these proprietary VC funds do not need to be licensed by or registered with MAS. On the other hand, VC managers that raise monies from and manage funds of third parties are conducting the regulated activity of fund management under the Securities and Futures Act (“SFA”). They are required to be registered with MAS as an RFMC, or hold a CMS licence if their aggregate assets under management exceed S\$250 million or if they serve more than 30 qualified investors.

2.2 A fund manager that seeks to obtain a CMS licence or register with MAS needs to meet MAS’ fit and proper criteria¹ and have a minimum number of key personnel with relevant experience in fund management. It must comply with minimum base capital thresholds², and put in place compliance, risk management and internal audit arrangements. A fund manager is also required to comply with ongoing anti-money laundering, business conduct and notification requirements. Like other regulated financial institutions, MAS has powers to inspect and investigate fund managers, as well as impose business restrictions and conditions on their regulatory status.

2.3 MAS did not differentiate the regulatory treatment of VC managers when the current regime was implemented in 2012, as they were then a small group. MAS intends to simplify the admission requirements and authorisation process for VC managers, in view of recent market developments and MAS’ assessment of the lower risk of business and market conduct issues associated with VC managers.

3 Proposed VC Manager Regime

3.1 VC managers typically acquire non-controlling stakes in early-stage companies, acting as both capital provider and business adviser to the company. VC managers have

¹ The criteria are set out in MAS Guidelines FSG-G01 “Guidelines on Fit and Proper Criteria”.

² Minimum base capital of S\$250,000 applies to fund managers serving only accredited or institutional investors. The requirements are set out in the Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licences) (SF(FMR)) Regulations and Securities and Futures (Licensing and Conduct of Business) (SF(LCB)) Regulations for RFMCs.

the following unique combination of characteristics which lowers their market and business conduct risks:

- (i) VC managers do not trade on public markets. This limits their systemic risks, and the risks of market abuse such as front running and insider trading. VC funds also have negligible liquidity risk as investors are not allowed to continually subscribe to or redeem investments at their discretion.
- (ii) VC managers typically do not use or are contractually restricted from using leverage. This limits contagion risks to the broader financial system.
- (iii) VC managers serve accredited investors (“AI”) and/or institutional (“II”) investors³ and are bound by limited partnership agreements (“LPA”) signed with these investors. They have the ability and the resources to assess the VC manager’s track record, and would typically perform extensive due diligence on the VC manager and to negotiate contractual terms to safeguard their own interests⁴.

3.2 Given the lower market and business conduct risks as a result of these aggregate characteristics, MAS intends to simplify the authorisation process for VC managers by removing the existing admission criteria on minimum base capital, track record and experience of directors and representatives, and the need to submit information on compliance and audit arrangements as part of the application process.

3.3 On an ongoing basis, VC managers will not be subject to business conduct requirements that apply to licensed fund managers and RFMCs. However, the VC manager will still have to meet the fit and proper requirement at the point of admission and on an ongoing basis. MAS will continue to have powers to inspect and investigate VC managers and impose restrictions or revoke the regulatory status of errant VC managers. These authorisation and ongoing requirements will be elaborated at paragraphs 3.8 to 3.11 and are summarised in Annex B.

³ “Accredited investor” and “institutional investor” are defined under section 4A of the SFA.

⁴ Terms typically covered in the LPA include: term of the partnership, management fees, investment and exit guidelines, governance and reporting.

Proposed Criteria

3.4 Having regard to the typical profile of VC funds, MAS proposes the following criteria to differentiate VC managers from other types of fund managers. To be eligible under the proposed simplified regime for VC managers (“**VC Manager Regime**”), MAS proposes that the VC manager must only manage funds that meet the following characteristics:

- (i) Be directly invested⁵ in unlisted business ventures that have been established or incorporated for no more than five years at the time of initial investment.

This reflects the nature of VC investments into start-ups and growth stage business ventures. MAS recognises that VC managers may need to nurture their investees beyond their initial stages of development by participating in further rounds of investment, even after the investee has been established or incorporated for more than five years. Additional rounds of financing by a VC manager into its existing investee will be allowed, provided the VC manager’s initial investment has been made within five years of incorporation of the investee.

VC managers may sometimes hold investments through special purpose vehicles (“**SPVs**”). The five-year criterion will not apply to these SPVs but to the underlying operating businesses or entities.

- (ii) Be closed-end. The VC fund must be non-redeemable at the discretion of the investor, and must not be continuously available for subscription.

- (iii) Be offered only to end-investors who are either AI or II. AI and II have the resources and expertise to protect their own interests. The introduction of the AI opt-in regime⁶ where investors are additionally required to opt to be an AI before managers are allowed to offer AI products to the investor, will further mitigate risks posed to less sophisticated investors, or investors who wish to enjoy the regulatory safeguards and protection accorded under the SFA.

⁵ The underlying investment must be directly acquired from the corporation, as opposed to being acquired from the secondary market.

⁶ More details on the policy proposals in Part III of MAS’ consultation paper and response paper on enhancing regulatory safeguards for investors in the capital markets (issued on 21 July 2014 and 22 September 2015 respectively).

3.5 MAS has also considered whether restrictions should be placed on the use of leverage in VC funds under the proposed regime. MAS recognises that VC funds may have a need for short term bridging facilities, for example pending receipt of capital calls made to investors. In addition, many other jurisdictions with sizeable, regulated VC markets do not single out VC funds and impose a distinct regulatory cap on their leverage. Similarly, MAS has not had regulatory or supervisory concerns on the VC industry in relation to leverage, even in the absence of any explicit regulatory cap to date.

3.6 Nevertheless, MAS notes that in some other established markets where VC managers are defined as a distinct class, some short term leverage is permitted, but is subject to a regulatory cap. MAS is also mindful that the absence of any regulatory guidance or restriction on leverage could widen the scope of fund managers that may qualify for the VC Manager Regime, and potentially dilute the defining characteristics that lower the market and business conduct risks of VC managers and justify a more streamlined regime.

3.7 On balance, MAS does not propose to prescribe any restriction on leverage as a qualifying criterion for the VC Manager Regime. MAS would nevertheless like to seek feedback on this position, and suggestions on calibration if respondents hold the view that such a regulatory criterion is necessary.

Question 1. MAS seeks comments on the introduction of a simplified authorisation and regulatory regime for VC managers.

Question 2. MAS seeks views and suggestions on the proposed criteria to differentiate VC managers from other types of fund managers.

Question 3. MAS seeks views on whether restrictions should be placed on the use of leverage in VC funds and if so, the extent to which leverage should be allowed.

Simplified Authorisation

3.8 MAS will require all VC managers to meet MAS' fit and proper criteria on financial soundness, honesty and integrity and reputation. However, MAS recognises that VC investing could be supported by a diverse range of industry experience and professional expertise. In fact, a deep understanding of the sector(s) that a VC fund focuses on is often

a critical consideration to VC investors. Therefore, MAS will not impose admission criteria⁷ on VC managers to have directors and representatives with at least five years of relevant experience in fund management, to unnecessarily restrict the talent pool that VC managers can draw upon.

3.9 Managers of VC funds that meet the proposed criteria for the simplified regime will need to apply and be licensed by MAS prior to business commencement. The application will require the particulars of the VC manager, its substantial shareholders⁸, chief executive officer, directors, representatives, and a clear description of its proposed VC fund(s) and activities to be carried out in Singapore. MAS will focus primarily on whether the applicant meets MAS' fit and proper requirements. In this regard, applicants can expect an expeditious authorisation process under the VC Manager Regime. MAS will maintain a list of VC managers on the Financial Institution Directory on the MAS website.

Ongoing Requirements

3.10 Under the proposed VC Manager Regime, MAS will not impose the following requirements which currently apply to fund managers:

- (i) Capital requirements. Fund managers are required to maintain a minimum base capital⁹ at all times to support their business operations. Given that VC managers typically invest their own monies in the fund alongside third party investors and the lower market conduct risks associated with VC managers, MAS will remove the base capital requirement for managers under the VC Manager Regime. Risk-based capital requirements¹⁰ which apply to licensed managers would not apply under the VC Manager Regime.

⁷ Existing admission requirements and expectations are set out in the SF(LCB) and SF(FMR) Regulations and MAS Guidelines SFA 04-G05 "Guidelines on Licensing, Registration and Conduct of Business for Fund Management Companies".

⁸ A substantial shareholder refers to a person who controls or holds not less than 5% of the voting shares.

⁹ Base capital is defined as the sum of paid-up ordinary share capital, paid-up irredeemable and non-cumulative preference share capital, any unappropriated profit or loss in the latest audited accounts of the corporation, less any interim loss in the latest accounts of the corporation and any dividend that has been declared since the date of the latest audited accounts of the corporation.

¹⁰ Risk-based capital requirements for holders of a CMS licence are set out in the SF(FMR) Regulations, along with associated annual and quarterly reporting requirements.

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- (ii) Business conduct requirements. Having regard to the lower market and business conduct risks associated with VC managers, the proposed criteria on VC funds, and the extent of contractual safeguards negotiated by sophisticated investors, MAS will not make it mandatory for managers under the VC Manager Regime to satisfy MAS that they have:
- (a) an in-house compliance capability;
 - (b) internal audits of their business activities;
 - (c) independent valuation of the funds managed and independent reporting to investors;
 - (d) disclosed and will be able to effectively manage and mitigate conflicts of interests; and
 - (e) accord priority to customers' orders and transactions.

Notwithstanding that MAS will not impose these requirements on VC managers, investors may still require these safeguards as part of their contractual agreements with the manager. VC managers will still have to comply with applicable regulations and reporting to MAS, and ensure that there are adequate controls.

- (iii) Independent annual audit of the fund manager. Since capital and business conduct requirements will not be imposed, VC managers will not be required to submit annual audited financial statements and auditor reports to MAS¹¹.

3.11 While MAS is proposing to simplify the regulatory regime for VC managers, it is imperative that the VC industry and the financial system at large remains clean, safe and sound. MAS also needs to retain supervisory powers to achieve this objective. Following from this, MAS will apply all other ongoing regulatory requirements that are applicable to fund managers to VC managers, including:

- (i) Notifications to MAS. VC managers must notify of changes to its particulars previously submitted to MAS, its substantial shareholders, CEO, directors and

¹¹ Existing requirements are set out in the SF(FMR) and SF(LCB) Regulations for licensed and registered fund management companies.

representatives within 14 days of the change, and when the VC manager intends to cease regulated activity. MAS' prior approval for these changes would not be required.

- (ii) Annual declaration to MAS. For supervisory and sector monitoring purposes, VC managers will have to report annually to MAS their funds under management, number and types of investors, fund types and deals by geography and sector, and confirm in writing to MAS that it meets the proposed criteria under the VC Manager Regime.
- (iii) Anti-money laundering and countering the financing of terrorism (“AML/CFT”) requirements.¹² VC managers remain exposed to risks associated with money laundering and the financing of terrorism, and need to put in place robust and effective controls to detect and deter the flow of illicit funds through Singapore's financial system. VC managers will also be required to keep abreast with AML/CFT announcements, and adhere to amendments to the AML/CFT requirements. To this end, VC managers are required to have in place systems and controls to identify, assess and implement appropriate measures to prevent money laundering and terrorism financing, and to monitor and report any suspicious transaction.
- (iv) MAS' powers to inspect and issue directions. MAS will retain existing powers to inspect and investigate managers under the proposed VC Manager Regime, as well as issue directions to and impose conditions on them. MAS will also retain its powers to revoke the regulatory status of the manager, and issue prohibition orders against the CEOs, directors and representatives of VC managers. This would enable MAS to deal with individuals who are not fit and proper or whose actions adversely impact the reputation of the Singapore financial sector and VC industry.

Question 4. MAS seeks views on the requirements under the proposed VC Manager Regime.

¹² The requirements are set out in MAS Notice SFA04-N02 “Prevention of Money Laundering and Countering the Financing of Terrorism - Capital Markets Intermediaries” and MAS Notice CMG-N01 “Reporting of Suspicious Activities and Incidents of Fraud”.

4 Implementation of the VC Manager Regime

4.1 MAS proposes to give effect to the VC Manager Regime through legislative amendments to license VC managers and exempt them from capital and business conduct requirements. Fitness and propriety and the relevant rules set out in paragraph 3.11 will apply to VC managers. The proposed amendments are set out in Annexes C to F.

4.2 An existing fund manager that manages VC funds can operate under the VC Manager Regime after notifying MAS that it meets all the proposed criteria, and obtaining MAS' acknowledgement of the notification. Alternatively, existing fund managers can choose to maintain their current regulatory status and be subject to the full set of ongoing requirements, even if they meet all the proposed criteria to qualify for the VC Manager Regime.

4.3 Where a VC manager anticipates that it would no longer be able to meet the proposed criteria under the VC Manager Regime, the VC manager should engage MAS early on the appropriate regulatory status that is needed. MAS will take a facilitative approach to these cases.

Question 5. MAS seeks comments on the proposed implementation approach for existing licensed fund managers or RFMCs that manage VC funds and meet the proposed criteria.

Question 6. MAS seeks views on the proposed legislative amendments at Annexes C to F.

Annex A

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Question 6. MAS seeks views on the proposed legislative amendments at Annexes C to F. 12

Annex B

**Comparison of Proposed VC Manager Regime and Current Regime for
Fund Management Companies**

Requirements:	Proposed VC Manager Regime	Current Regime for Fund Management Companies (Licensed and Registered)
1. Authorisation by MAS prior to commencement of fund management, including meeting MAS' fit and proper criteria and having presence in Singapore	Applicable	Applicable
2. Base capital thresholds and risk-based capital requirements	Not applicable	<ul style="list-style-type: none"> • Minimum base capital of S\$250,000, if it serves only accredited and/or institutional investors. • Risk-based capital requirements apply, if licensed.
3. Requirements in respect of the conduct of business in fund management	Not applicable	<ul style="list-style-type: none"> • Independent valuation • Compliance capability • Internal audit • Risk management • Custody of assets • Conflict of interest
4. Requirement to have independent annual audit	Not applicable	Submission of an auditor's report and audited financial statements to MAS annually
5. Submission of annual regulatory returns to MAS on funds managed and investors	Applicable	Applicable
6. Prevention of money laundering and countering the financing of terrorism	Applicable	Applicable
7. Annual fees payable	S\$4,000	<ul style="list-style-type: none"> • S\$1,000 if registered • S\$4,000 if licensed

Annex C

Draft Amendments to the Securities and Futures (Licensing and Conduct of Business) Regulations

[DISCLAIMER: THIS VERSION OF THE AMENDMENTS IS IN DRAFT FORM AND SUBJECT TO CHANGE. IT IS ALSO SUBJECT TO REVIEW BY THE ATTORNEY-GENERAL'S CHAMBERS.]

[\[Link to draft SF\(LCB\) Regulations\]](#)

Annex D

Draft Amendments to the Financial Advisers Regulations

[DISCLAIMER: THIS VERSION OF THE AMENDMENTS IS IN DRAFT FORM AND SUBJECT TO CHANGE. IT IS ALSO SUBJECT TO REVIEW BY THE ATTORNEY-GENERAL'S CHAMBERS.]

[\[Link to draft FA Regulations\]](#)

Annex E

Draft MAS Notice SFA04-N09 (Amendment) 2017

[DRAFT AND SUBJECT TO CHANGE]

[\[Link to draft MAS Notice SFA04-N09 \(Amendment\) 2017\]](#)

Annex F

Draft MAS Notice SFA04-N13 (Amendment) 2017

[DRAFT AND SUBJECT TO CHANGE]

[\[Link to draft MAS Notice SFA04-N13 \(Amendment\) 2017\]](#)

