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Circular No. CMI 27/2018

CONTROLS AND DISCLOSURES TO BE IMPLEMENTED BY LICENSED SECURITIES-BASED CROWDFUNDING OPERATORS

In June 2016, the Monetary Authority of Singapore (MAS) streamlined the rules applicable to capital markets services licensees offering securities-based crowdfunding (SCF), to make it easier for start-ups and small and medium enterprises to access SCF. The rule changes were calibrated to strike the right balance between improving access to capital for businesses and protecting investor interests[1].

2 MAS has surveyed and engaged licensed SCF operators over the past year to develop further insights on their business operations. Our review shows that there is scope for SCF operators to enhance their practices and controls in relation to due diligence conducted on issuers, management of defaults, and disclosures to investors. This circular sets out the measures that MAS expects licensed SCF operators to have in place in these areas. These measures also serve to enhance transparency to investors to help them make better informed investment decisions on SCF offers.

Due Diligence Checks on Issuers

3 MAS found varying levels of due diligence conducted on issuers by licensed SCF operators. Most operators performed some due diligence checks, such as on the issuer's board of directors or senior management and financial performance. There were some operators that relied on the due diligence performed by a lead institutional investor.

4 MAS expects licensed SCF operators to disclose to investors the scope of due diligence that they have performed on issuers. This would allow investors to determine if they are satisfied with the due diligence conducted before committing to invest in the SCF securities. In addition, lending-based SCF operators should generally not allow a borrower to take up a new loan to pay off an existing overdue loan. Steps should be taken to ascertain if there are legitimate reasons to extend a new loan to the same borrower before repayment of an existing loan. Lending-based operators should disclose the total outstanding loans of the borrower and the reasons for extending the new loan, so that investors can make an informed decision on whether to invest in the new loan.

Management of Issuer Default

5 Some lending-based operators offered measures to assist investors to recover their debt from the defaulted borrowers, such as appointing a professional debt collector or commencing legal proceedings against the borrower. Investors may however be required to pay the costs of the debt

[1] MAS issued a consultation paper on 16 February 2015 proposing measures to facilitate SCF and responded to the consultation on 8 June 2016. The consultation and response papers can be found in MAS website: www.mas.gov.sg/News-and-Publications/Consultation-Paper/2015/Facilitating-Securities-Based-Crowdfunding.aspx

recovery efforts. In contrast, for equity-based operators, client servicing was not typically provided after the investor had concluded the purchase of his equity stake in the issuer.

6 MAS expects licensed SCF operators, particularly lending-based operators, to institute policies and procedures to handle issuer defaults. These policies and procedures should include the circumstances under which the licensed SCF operator will pursue different options (e.g. closer engagement with issuer, using a debt collection agency, commencing legal proceedings). Licensed SCF operators should disclose to investors the different recovery options, and the costs to be borne by investors under each option. Operators should seek investors' consent before incurring any costs which are to be borne by investors.

7 Licensed SCF operators should submit Annex A1 and A2 within five business days of the last day of the preceding month (the "Reporting Month"). Annex A1 requires information related to debt or other interest-bearing issuances that have become 30 days past due within the Reporting Month. Annex A2 should be submitted to provide updates on any issuances previously reported in Annex A1.

[Amended on 5 March 2021]

Management of SCF Platform Cessation

8 MAS noted that none of the equity-based operators, and only some of the lending-based operators, had put in place a plan to manage any voluntary or involuntary cessation of business. For those that did, some areas were not comprehensively addressed. For instance, the plans did not include any communication to investors, such as informing investors who they should contact following the operator's closure, or whether there will be another party appointed to continue liaising with the borrower on future interest and principal repayments. Where the plans included the appointment of such a party, it was not clear what the role of the party would be.

9 MAS expects licensed SCF operators to put in place a proper business cessation plan. Examples of areas to be included in the plan are arrangements for handling investors' monies and loan agreements kept on behalf of investors, liaison with borrowers and investors on future interest and principal repayments, recovery actions in the case of issuer default, as well as the procedures for communication with investors regarding the business cessation. Licensed SCF operators should disclose the arrangements and the communications which they will make in the event of business cessation before investors make an SCF investment.

Disclosure of Interest and Default Rates

10 MAS observed that while most lending-based operators disclosed a simple or effective interest rate in relation to the loan securities offered on their platforms, operators adopted different methodologies to compute the interest rates. Most operators did not show interest rates net of fees and charges to investors, or provide default rates on the loan securities offered on their platforms. Some operators also publicised on their websites or marketing materials, rates of return based on the highest nominal interest rate (i.e. before fees and charges) of all the loan securities offered on their platforms. This would be potentially misleading to investors.

11 All SCF operators should disclose information on interest rates and non-performing loan rates in a consistent manner to enable investors to effectively compare different SCF offers and better understand the potential returns on their investments. In this regard, MAS expects licensed SCF operators to comply with the following requirements:

(i) For each loan offer, to disclose the interest rate per annum to be paid by the borrower, and the interest rate per annum net of all fees and charges that investors will receive. Such information should be displayed on a restricted section of the website, accessible only to investors who are assessed to be qualified to invest in SCF offers;

(ii) For loans disbursed in each of the past three calendar years[2], to disclose:

(a) the lowest and highest expected rates of returns, net of fees and charges to investors; and

(b) the weighted average expected rate of returns, net of fees and charges to investors.

Information on these rates should be publicly accessible (e.g. displayed on the public section of the website) and accompanied by disclosures on non-performing loan rates under sub-paragraph (v) below. All rates should be shown as a percentage per annum (see Annex B for an illustration on the computation and format of presentation);

(iii) Where expected rates of returns are shown in advertising or marketing materials, these should be reflected as either a range between the lowest and highest expected rates of return as specified in sub-paragraph (ii)(a), or the weighted average expected rate of return as specified in sub-paragraph (ii)(b) based on loans disbursed in the last calendar year;

(iv) Disclosure of the expected rates of returns under sub-paragraphs (ii) and (iii) should be accompanied by an explanation of what the rates mean and how they are computed, a warning that actual returns may be lower than the expected rates of return, and historical rates of returns may not reflect future returns; and

(v) To disclose non-performing loan rates[3], computed as the ratios of the amount of loans that are 30 days past due and 90 days past due over the total amount of outstanding loans and an overall non-performing loan rate, computed as the ratio of the collective amount of loans which are 30 days past due over the total amount of outstanding loans, for each of the past three calendar years (see Annex B for an illustration on the computation and format of presentation). This information should be publicly accessible.

[Amended on 5 March 2021]

[2] A calendar year is the period from 1 January to 31 December.

[3] For the avoidance of doubt, loans that have subsequently been restructured (and even if the restructured loans are successfully repaid) should continue to be reported as non-performing loans.

12 Licensed SCF operators should update the expected rates of return disclosures in sub-paragraphs 11(ii) and 11(iii) and the non-performing loan rate disclosures in sub-paragraph 11(v) by the end of January in each calendar year. These disclosures should be readily accessible[4] in the public section of the licensed SCF operator's website. Licensed SCF operators should also furnish MAS a copy of the disclosures and an annual attestation that the disclosures have been made publicly available to investors.

[Amended on 5 March 2021]

13 Licensed SCF operators are also reminded to ensure compliance with the requirements on advertisement under the Securities and Futures (Licensing and Conduct of Business) Regulations (SF(LCB)R). Advertisements must inter alia not be false or misleading. In addition, specific requirements under the SF(LCB)R apply for product advertisement, such as the manner in which the advertisement appears in any electronic mail or website and approval by senior management before the advertisement is disseminated or circulated.

Governance and Management of Auto-allocation Tools

14 Licensed SCF operators that offer auto-allocation tools[5] should have a proper governance and management framework over the design, monitoring, testing and operation of the tools. They should ensure that each tool is robustly tested, and measures are in place to mitigate the risk of erroneous allocation before rolling it out to investors. It is important that licensed SCF operators highlight to investors the limitations of the tools and educate them on the functionalities before use.

Next Steps

15 MAS expects the Board and senior management of licensed SCF operators to be responsible for delivering fair dealing outcomes to investors and to exercise effective oversight of their operations. Licensed SCF operators should review periodically their policies and processes against the measures in this circular, and take actions to address any gaps arising from the review. Entities that intend to apply for a CMS licence to operate SCF platforms should satisfy MAS that they are able to implement policies and processes consistent with the measures in this circular.

[Amended on 5 March 2021]

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[4] MAS has observed instances where these disclosures are not easily accessible on the website of some SCF operators. For clarity, MAS expects the disclosure to be easily accessible via the website's home page.

[5] Auto-allocation tools allow investors to set their investment parameters and preferences, such as the investment amount per deal, investment frequency (e.g. consecutive campaigns, weekly basis) and specific industries to be included or excluded from investment. The tool will automatically invest an investor's funds into companies that meet the parameters set.

Annex A1 and A2: Notification to MAS to be submitted within five business days of the last day of the preceding month

Please refer to the excel template for Annex A1 and A2 and submit at the following link:
https://form.gov.sg/603c619030d24e00125f562e

Annex A1 and A2.xlsx

[Amended on 5 March 2021]

Annex B: Illustrations on computation and presentation of lowest and highest expected rates of return, weighted average expected rate of return and non-performing loan rates

(i) Computation of Expected Rates of Return

The expected rate of return on a loan should be computed as interest payments less fees and charges divided by the loan amount and expressed as a percentage.

The expected weighted average rate of return on a portfolio of loans should be computed as the percentage of the sum of interest payments less fees and charges for all loans divided by the total amount of loans disbursed.

Example:

A licensed SCF operator has disbursed 6 loans over the past 3 calendar years, with the corresponding loan amounts and expected rates of return as follows:

Year of disbursement	Type of loan	Loan amount	Expected rate of return (net of fees and charges per annum)
2015	Loan A	S$5,000	5%
2015	Loan B	S$10,000	10%
2016	Loan C	S$3,000	3%
2016	Loan D	S$15,000	15%
2017	Loan E	S$5,000	5%
2017	Loan F	S$8,000	8%

The SCF operator should disclose the lowest and highest expected rates of return and the weighted average expected rate of return classified by the year of loan disbursement for each of the past 3 calendar years as shown in Table 1 below. In addition, the SCF operator should –

(i) highlight that actual returns may be lower than the expected rates of return, and historical returns may not reflect future returns; and

(ii) provide an explanation of what the different rates mean and how they are computed.

For loans disbursed in 2015, the lowest and highest expected rates of return are 5% and 10%, respectively. The weighted average expected rate of return is calculated as (S$5,000 x 5%) + (S$10,000 x 10%) / (S$5000 + S$10,000), resulting in 8.33%.

Table 1 below illustrates how the expected rates of return should be presented. Disclosure of expected rates of return should be accompanied by the non-performing loan rates.

(ii) Computation of Non-Performing Loan Rates

The non-performing loan rate should be computed as the ratio of loans that are at least 30 days past due over the total loans outstanding.

Example: Loan G

- Total loan amount: $100
- Loan tenure: 10 months
- Repayment amount and frequency: $10 (principal) on a monthly basis. Payment to be made at end of every month.

Repayment schedule for Loan G and classification of non-performing loans

	Principal Repayment Made	Outstanding Principal	Past 30 days but less than 90 days	Past 90 days
End July	$10	$90	-	-
End August	$10	$80	-	-
End September	Missed	$80	-	-
End October	Missed	$80	$80	-
End November	Missed	$80	$80	-
End December	Missed	$80	-	$80

Assuming that as at 31 December 2015, the total portfolio of outstanding loans facilitated by the SCF operator amounted to $1,000 (including outstanding amounts on defaulted loans). All loans have been repaid by borrowers on a timely basis except Loan G. The computation of the non-performing loan rate is as follows:

As at 31 December 2015	Past 30 days but less than 90 days	Past 90 days	Overall
Non-performing loan (in S$)	-	80	80
Non-performing loan rate (i.e. ratio of loans that are past due over the total loans outstanding)	-	8% (which is 80 over 1,000)	8%

Using the same example, if there is another non-performing loan that is past 30 days but less than 90 days in the SCF operator's portfolio as at 31 December 2015 (i.e. Loan H), the computation of the non-performing loan rates is as follows:

As at 31 December 2015	Past 30 days but less than 90 days	Past 90 days	Overall
Non-performing loan (in S$)	50 (Loan H)	80 (Loan G)	130 (Loan H+G)
Non-performing loan rate (i.e. ratio of loans that are past due over the total loans outstanding)	5% (which is 50 over 1,000)	8% (which is 80 over 1,000)	13% (which is 130 over 1,000)

Once a loan is 30 days past due, it should be classified as a non-performing loan, even if the loan is subsequently restructured and paid off. If such a loan is only restructured 90 days after past due, it should be classified in the 'Past 90 days' column.

(iii) <u>Presentation of expected rates of return and non-performing loan rates</u>

Table 1 illustrates how SCF operators should disclose the lowest and highest expected rates of return, weighted average expected rates of return and non-performing loan rates for each of the past 3 calendar years. If there are subsequent recoveries on non-performing loans (e.g. from repayment by the borrower), SCF operators should not revise the non-performing loan rates. Instead, SCF operators may provide separate information on the recoveries on non-performing loans, e.g. via a footnote to the relevant non-performing loan rate.

Table 1: Expected rates of return and non-performing loan rates

Year of disbursement	Expected rates of return		Non-performing loan rates		
	Lowest and highest rates (per annum)	Weighted average (per annum)	Loans which are past 30 days but less than 90 days	Loans which are past 90 days	Overall
2015	5% to 10%	8.33%	5%	8%*	13%
2016	3% to 15%	13%	6%	10%	16%
2017	5% to 8%	6.85%	4%	12%	16%

*Of which *x*% were subsequently recovered from borrowers.

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