



Circular No: CMI 02/2023

6 January 2023

To:

Chief Executive Officers of all Capital Markets Services Licence Holders for the Regulated Activity of Fund Management and Registered Fund Management Companies

Dear Sir/ Madam

OBSERVATIONS FROM INSPECTIONS OF LICENSED VENTURE CAPITAL FUND MANAGERS

The Monetary Authority of Singapore (MAS) conducted a series of inspections on licensed Venture Capital Fund Managers (VCFMs) from March 2022 to November 2022. The inspections served to review the practices of VCFMs operating under the VCFM regime which was introduced in October 2017. Under the VCFM regime, the authorisation process and ongoing requirements are simplified to enhance the operating environment for VCFMs to play a greater role in supporting start-ups and growth stage businesses.

2 There were 156 VCFMs licensed in Singapore as of 31 December 2022, and the number of VCFM licence applications continues to increase over time. The review was timely given the growth in the number of VCFMs since the regime was implemented in 2017.

3 The inspections focused on the following areas:

- a) Whether the VCFMs' business activities were focused on venture capital fund management;
- b) Whether the venture capital funds managed by the VCFMs complied with the fund eligibility criteria;
- c) Whether the VCFMs had made written disclosure to investors that they were not subject to the specified business conduct and financial requirements imposed on other types of fund managers; and
- d) Whether the VCFMs had policies and internal controls to ensure proper oversight of their business processes, and in particular, to manage potential conflicts of interest.

4 Key observations from the inspections are set out in Annex A. While the inspections focused on VCFMs, some of the observations and expectations similarly apply to other licensed fund management companies (LFMCs) and registered fund management companies (RFMCs). In this regard, MAS expects all fund management companies (FMCs) to take note of the supervisory expectations and good practices highlighted in the Annex, and implement measures to address any gaps or issues that may also be present in their own operations. MAS will continue to engage FMCs to promote best practices and maintain high standards of regulatory compliance in the industry.

Yours faithfully

(Sent via MASNET)

TAN KENG HENG
EXECUTIVE DIRECTOR
CAPITAL MARKETS INTERMEDIARIES DEPARTMENT II

Area	Observations
<p>a) Business Activities</p>	<p><u>Focusing on Venture Capital Fund Management</u></p> <p>i) The objective of the VCFM regime is to facilitate access to funding for early-stage and growth-stage businesses. To ensure this objective is achieved, VCFMs are not allowed to carry on business in any regulated activity other than the management of “venture capital funds”, as defined under regulation 14(8) of the Securities and Futures (Licensing and Conduct of Business) Regulations (SF(LCB)R), and MAS expects VCFMs to focus on venture capital investing.</p> <p>ii) The VCFMs inspected did not carry out any regulated activities other than the management of “venture capital funds”. Some VCFMs provided administrative or support services to the portfolio companies, such as assisting the portfolio companies with recruitment or the development of business strategies, which were incidental to the VCFM’s role as a venture capital fund manager. VCFMs that carry out such incidental activities should nonetheless ensure that they remain focused on venture capital investing, and that all potential conflicts of interest that may arise are fully mitigated. In this regard, the VCFMs that provided these services did not charge fees to the portfolio companies or the funds for the services rendered, as a way of mitigating potential conflicts of interest.</p> <p>iii) VCFMs are reminded to ensure that their core business remains focused on managing venture capital funds, and where incidental activities are carried out, that all potential conflicts of interest are fully mitigated.</p>
<p>b) Fund Eligibility Criteria</p>	<p><u>Due Diligence on Investments and Investors</u></p> <p>i) “Venture capital funds” are closed-ended funds offered to accredited and/or institutional investors, where no more than 20% of the committed capital of each fund is invested in “non-qualifying investments”¹. To ensure compliance with the requirement to only manage “venture capital funds”, a VCFM is required to:</p> <ul style="list-style-type: none"> • Ensure that the investment restrictions are complied with as part of the investment due diligence process; and • Ensure that all investors in the funds meet the definition of “accredited investor” or “institutional investor” under the Securities and Futures Act 2001 (SFA). As part of carrying out due diligence on investors, VCFMs are also required to ensure compliance with the requirements in Notice SFA 04-N02 on the Prevention of Money

¹ “Qualifying investments” refer to “specified products” that are directly issued by unlisted business ventures that have been incorporated for no more than ten years at the time of the initial investment. “Non-qualifying investments” refer to any investment that is not a “qualifying investment”, such as unlisted business ventures that are more than ten years of age, or secondary acquisitions.

Area	Observations
	<p>Laundrying and Countering the Financing of Terrorism, and the Securities and Futures (Classes of Investors) Regulations 2018.</p> <p>ii) MAS did not observe any breaches by the VCFMs inspected in respect of exceeding the cap on non-qualifying investments, or the onboarding of non-accredited or non-institutional investors. However, a number of VCFMs failed to:</p> <ul style="list-style-type: none"> • Maintain documentation evidencing that investors satisfied the “accredited investor” definition; • Complete customer due diligence on investors prior to onboarding; and/or • Obtain the accredited investor “opt-in” from their investors. <p>iii) While LFMCs and RFMCs are not subject to the same investment restrictions as VCFMs, LFMCs and RFMCs are subject to conduct of business requirements which include the need to have written policies on all areas of their operations, and an effective risk management framework². All FMCs are subject to the same requirements in respect of customer due diligence, and obtaining the “opt-in” from investors that are accredited investors. In this regard, MAS expects all FMCs to establish appropriate procedures and processes to mitigate the risks arising from its business operations, and to ensure compliance with all applicable laws and regulations.</p>
<p>c) Disclosure to Investors</p>	<p><u>Disclosure that VCFMs are Not Subject to Specified Requirements</u></p> <p>i) VCFMs are required to disclose in writing to all investors that the VCFM is not subject to the conduct of business requirements and financial requirements that apply to LFMCs under the SF(LCB)R and Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licences) Regulations (SF(FMR)R). Investors may negotiate for relevant safeguards to be put in place, as part of the contractual agreements between VCFMs and their investors.</p> <p>ii) Most of the VCFMs inspected had incorporated the requisite disclosures to investors as part of their funds’ private placement memorandums (PPMs), and/ or investor subscription documents. However, MAS observed that a small number of the VCFMs inspected had not made the requisite disclosures. It is important for VCFMs to ensure regulatory compliance at all times, and to ensure the requisite disclosures are made prior to accepting capital commitments from the investor. For VCFMs that had been managing existing funds as an LFMC or RFMC prior to becoming a VCFM, written disclosure is also required to be made to the investors in those existing funds. VCFMs that have not made the requisite disclosure should take prompt action to ensure regulatory</p>

² The conduct of business requirements applicable to LFMCs and RFMCs are set out in regulations 13 and 13B of the SF(LCB)R.

Area	Observations
	<p>compliance, such as by amending the relevant PPM, or by writing to investors separately.</p>
<p>d) Policies and Internal Controls</p>	<p><u>Having Formalised Policies and Procedures</u></p> <p>i) VCFMs are not subject to the conduct of business requirements² applicable to other LFMCs and RFMCs. However, most of the VCFMs inspected had written policies and procedures to govern their operations in areas such as investment and divestment, valuation, conflict management, cash management, and/or compliance. A few VCFMs did not have formalised policies and procedures in certain areas, and relied on established processes and documentation to guide their operations. It is good practice for FMCs to have formalised policies and procedures in key areas as this helps to mitigate operational risk, and VCFMs are encouraged to consider formalising policies and procedures in key areas of their operations. FMCs should also review their policies and procedures periodically, to ensure that the policies and procedures remain up to date, and are effective in mitigating potential risks.</p>
<p>e) Governance</p>	<p><u>Segregation of Duties and Mitigating Conflicts of Interest</u></p> <p>i) All FMCs are required to mitigate conflicts of interest that arise in the course of their business³. Employees of FMCs may have roles and responsibilities straddling front office and middle/back-office functions. This is often the case for smaller FMCs with fewer employees and a smaller scale of operations. These FMCs should be mindful that potential conflicts of interest can arise where there is a lack of segregation of duties between the firm’s business activities and control functions, and accordingly, should implement the necessary processes to ensure conflicts are mitigated. FMCs should also be cognisant of ensuring the clear segregation of duties amongst its employees as the FMC expands its operations/ grows its headcount.</p> <p>ii) In addition to ensuring the proper segregation of duties amongst employees, good practices that help to ensure proper conflict management include:</p> <ul style="list-style-type: none"> • Having formalised policies and procedures on conflict management, in areas such as handling related party transactions, deal allocation across multiple funds, and co-investments; and • Establishing governance committees (such as advisory committees or risk committees) to deliberate on issues involving potential conflicts of interest. In this regard, it is also important for these committees to have a suitable degree of independence from the FMC (e.g. independent members, or representatives of investors).

³ VCFMs and LFMCs are subject to a licence condition requiring them to mitigate any conflicts that arise. LFMCs and RFMCs are also subject to requirements related to conflict management as stated in regulations 13(b)(ix) and 13B(1)(e) of the SF(LCB)R.

Area	Observations
f) Base Capital	<p><u>Having Positive Base Capital</u></p> <p>i) LFMCS serving only accredited or institutional investors are subject to a minimum base capital requirement of S\$250,000, as stated in the SF(FMR)R, and are required to maintain financial resources in excess of a prescribed “total risk requirement”. VCFMs are not subject to these risk-based capital requirements. However, VCFMs are required to maintain a positive level of base capital⁴ (i.e. a minimum base capital of S\$0), to ensure that the VCFM is able to operate as a going concern. From the inspections, a number of VCFMs were observed to have negative base capital, commonly due to the impact of accumulated losses during the early years of the VCFMs’ operations. VCFMs are reminded to monitor their base capital on an ongoing basis, and ensure that a positive level of base capital is maintained at all times in accordance with the SF(FMR)R. VCFMs with negative base capital are expected to take immediate action to rectify the breach, such as through the injection of additional capital.</p>

⁴ As stated in regulation 4 and the First Schedule of the SF(FMR)R. This requirement is also stated in the ‘Compliance Toolkit for VCFMs’.