

**CONSULTATION PAPER ON THE REVIEW OF
LICENSING REGIME UNDER THE SECURITIES
INDUSTRY ACT AND FUTURES TRADING ACT**

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EXECUTIVE SUMMARY

MAS is reviewing the licensing framework under the Securities Industry (SI) Act and the Futures Trading (FT) Act. The Authority intends to amalgamate these 2 Acts into a proposed Omnibus Securities and Futures Bill (Omnibus Bill). A separate legislation will be enacted to regulate the provision of investment advisory services.

This paper describes the proposed licensing framework for intermediaries providing services in respect of securities, futures and leveraged foreign exchange trading. It covers in detail the features of the licensing framework under the Omnibus Bill. A consultation paper on the licensing of financial advisers who provide investment advice, will be issued at a later date.

The main proposals are as follows:

- a) To adopt a modular approach to the licensing framework, under which institutions that act as intermediaries will be issued a single licence permitting them to provide a range of specified activities, called "regulated activities".

- b) To classify "regulated activities" into the following functional categories:
 - Investment Dealing;
 - Fund Management;
 - Corporate Finance Advisory Services;
 - Securities Margin Financing;
 - Custodial Services; and
 - Investment Advisory Services.

Except for investment advisory activity, all of the above regulated activities will fall within the ambit of the Omnibus Bill.

Licensees under the Omnibus Bill which provide investment advisory services will not be required to hold a separate licence under the new legislation for financial advisers. However, they will have to comply with the requirements imposed on financial advisers.

- c) To license institutions that provide securities financing and custodial services. However, it is proposed that the representatives of such institutions need not be licensed.
- d) To exempt financial institutions supervised by MAS under other legislation from the licensing ambit of the Omnibus Bill. However, the securities, futures and fund management activities conducted by such financial institutions shall as far as possible be subject to the requirements imposed on entities licensed under the Omnibus Bill.
- e) To require all AFMs, both new and existing, to hold a licence under the Omnibus Bill in order to conduct fund management activities.
- f) To continue to exempt from licensing, persons who manage funds for not more than 30 accredited investors only. Such persons will be required to submit annual statutory returns to MAS to demonstrate that they continue to qualify for the exemption.
- g) To extend the duration of licences from 1 year to 3 years. The licence fee will continue to be payable on an annual basis.

INTRODUCTION

1 Market innovation and advances in technology are transforming the way financial services are provided. Intermediaries have to deal in and advise on securities, futures, foreign exchange, derivatives and other investment products in line with the growing sophistication and integration of various markets of the financial sector. Moreover, the traditional demarcation between securities and futures products is increasingly blurred by the emergence of hybrid products and cross-market activities for managing investment risks. In view of this, the current licensing regime needs to be reviewed to keep pace with the changes in the financial market.

2 This paper recommends a new modular approach to the licensing framework which will be flexible, business-friendly and congruous with developments in the financial marketplace.

PRINCIPLES OF LICENSING REGIME REVIEW

3 We seek to ensure that our licensing regime keep pace with market reality without compromising prudential standards. In this way, only competent and responsible intermediaries and their representatives are admitted into our markets. This is vital to the growth and development of Singapore's financial sector. The review of the licensing regime is guided by three core regulatory objectives, namely –

- a) maintaining market confidence;
- b) providing adequate protection to investors; and
- c) promoting fair, efficient and transparent financial markets.

PRESENT LICENSING REGIME

4 The current licensing framework under the SI Act categorises market intermediaries into **dealers and investment advisers** according to their business functions within the securities and asset management industry. A similar licensing framework under the FT Act - which classifies futures market intermediaries into **futures brokers, futures trading advisers and futures pool operators** - was adopted for the financial futures industry.

5 The existing licensing framework has served us well and met many of our regulatory objectives. However, we feel that it will not be sufficiently flexible to meet the changing needs of the rapidly evolving financial industry. Therefore, we are prepared to allow participants in the securities and futures markets to hold a single licence under the Omnibus Bill, instead of multiple licences under the existing legislation.

PROPOSED MODULAR APPROACH TO LICENSING

6 We propose to adopt *a modular approach* to licensing, which will allow for –

- a) a range of regulated activities that are more differentiated to accommodate the business needs of the intermediaries; and
- b) a graduated scale of capital and compliance requirements commensurate with the risk exposure of each type of activity. MAS is currently reviewing the capital requirements with a view to introducing a risk-based capital framework.

7 Under the modular framework, market participants that act as intermediaries will be issued a single licence to conduct a specified range of permitted activities. They can apply to MAS to expand their range of

permitted activities. This will be an administrative procedure as compared to the present framework where entities have to apply for separate licences to conduct additional services. This proposed approach does not represent a lowering of standards, as only those meeting our requisite criteria will be allowed to undertake the permitted activities.

8 MAS will be empowered to revise the list of regulated activities and define the financial products that come under the regulatory regime. In this way, our regulations will be able to accommodate market innovation in a timely fashion. The new framework thus provides flexibility and facilitates the commencement of new business activities by market participants.

9 Institutions which provide market-wide facilities, such as exchanges, clearing houses, and central depositories will not require licensing but will have to obtain MAS' approval under the Omnibus Bill. These institutions are required to have comprehensive rules governing membership and business conduct of their members. They are also expected to ensure that their services are provided in a fair, orderly and transparent manner, and to enforce their rules rigorously.

KEY CHARACTERISTICS OF THE MODULAR LICENSING FRAMEWORK

10 The proposed regulatory framework covers only the securities and futures industry in view of the close link and convergence between the two industries. Under this framework, regulated activities will be classified into the following functional categories:

- Investment Dealing;
- Fund Management;
- Corporate Finance Advisory Services;
- Securities Financing;

- Custodial Services; and
- Investment Advisory Services

A list of services, which will be prescribed under each category, is shown in the chart below. (Investment advisory services will be covered under the new legislation for financial advisers. A consultation paper on the licensing of financial advisers will be issued at a later date.)

11 Licensees under the Omnibus Bill, which carry on investment advisory activity will not be required to hold separate licence under the new legislation for financial advisers. However, they will have to comply with the requirements imposed on financial advisers. This will reduce administrative and compliance costs to the intermediaries while ensuring that consistent regulatory and professional standards are maintained across the board.

Chart 1: Types of services under each regulated activity

Investment Dealing

- Trading in securities, futures contracts and leveraged foreign exchange whether as principal or agent¹.
- Underwriting and / or placing out securities, or making an invitation to persons to subscribe for initial offerings of securities.
- Acting as introducing broker.
- Market making.
- Operating a facility for the purpose of routing orders for execution, whether via the conventional medium or on-line².

¹ A person who carries on a business of dealing in securities through a licensed dealer for his own account is exempted from licensing.

² On-line order routers will be subject to additional conditions such as requirements to ensure integrity, security and confidentiality of the on-line trading system, minimise investors' inconvenience in the event of a system breakdown, and make a risk disclosure statement to investors.

<p><u>Fund Management</u></p> <ul style="list-style-type: none"> • Undertaking on behalf of customers the management of a portfolio of securities, futures contracts and foreign exchange. • Managing collective investment schemes.
<p><u>Corporate Finance Advisory Services</u></p> <ul style="list-style-type: none"> • Advising other persons in respect of securities in connection with schemes of take-overs, mergers and re-structuring of companies, including initial public offering, negotiating with or sourcing for buyers / sellers to facilitate such schemes. The scope of permitted activities does not, however, include underwriting and placement of securities, and corporate finance adviser should not handle clients' assets.
<p><u>Securities Financing³</u></p> <ul style="list-style-type: none"> • Provision of credit facilities for the purchase of securities with the securities purchased being held as collateral.
<p><u>Custodial Services⁴</u></p> <ul style="list-style-type: none"> • Providing custodial services in securities. • Providing securities borrowing and lending services.

12 Licensed institutions will be charged a separate fee for each regulated activity that they engage in. They will also be subject to business conduct rules, capital adequacy rules, prudential and reporting requirements under the Omnibus Bill. In addition, individuals who engage in regulated activities on behalf of these institutions will be licensed. This ensures that the individual licensees are fit and proper to perform their duties and to deal with the public.

13 While the intention is to regulate institutions which provide securities financing and custodial services, it is proposed that the staff

³ Securities financing business requires proper credit and market risk assessment. If companies engaging in such activity are not properly managed, it could bring about significant losses to both the companies and their clients. It is therefore proposed that securities financing be regulated under the Omnibus Bill. Under the proposal, companies licensed under the Moneylenders Act which provide credit facilities for the purchase or sale of securities will be subject to the licensing requirement under the Omnibus Bill.

⁴ It is essential to subject institutions providing custodial services in securities to some form of supervision so as to provide appropriate protection to investors.

employed by these institutions to conduct the above activities need not be licensed.

14 The supervisory approach for institutions which provide market-wide operations (eg central depository and stock exchange) is different. These institutions are self-regulatory organisations and are responsible for enforcing their own rules governing membership, fair trading and business conduct on their members. MAS will require that their rules are adequate, meet the regulatory objectives and are enforced rigorously. In this respect, while the establishment of such institutions is subject to MAS' approval, they are not required to be licensed. Upon approval, MAS will exercise surveillance over them to ensure that they perform their self-regulatory functions properly.

INSTITUTIONS SUPERVISED BY MAS UNDER OTHER LEGISLATION

15 We envisage that financial institutions which are supervised by MAS under other legislation will not need to be separately licensed under the Omnibus Bill. However, such institutions and their representatives will be required to comply with the same set of rules and requirements which apply to licensees under the Omnibus Bill.

16 **Banks⁵** are currently exempted from licensing as dealers and investment advisers under the SI Act as their securities business had traditionally consisted of custodial services and corporate finance advice. However, in recent times, banks have increasingly participated in a greater array of securities business, with these businesses no longer making up an insignificant portion of their total business.

⁵ For futures business, banks are only exempt from holding a futures trading adviser's licence but not the futures broker's licence under the FT Act.

17 **Insurance companies** are currently exempted from licensing as investment advisers under the SI Act. They are required to hold the requisite licences if they intend to engage in other activities regulated under the SI Act or FT Act.

18 **Merchant banks** are exempted from licensing under the SI Act and FT Act⁶ only for certain activities. For example, merchant banks are exempt dealers under the SI Act in respect of their corporate finance business where such business does not constitute their main business. In view of the limited scope of exemption given, a number of merchant banks hold dealer's and investment adviser's licences in order to conduct a wider range of securities dealing and investment advisory activities.

19 As intermediaries are moving towards providing customers with a "one-stop" financial service, a review of the exemption and licensing requirements for banks, merchant banks, and insurance companies under the proposed licensing regime is needed. Our review is guided by two principles –

- a) To minimise regulatory overlap for intermediaries conducting securities and futures activities in addition to their core business; and
- b) To ensure consistent regulation for intermediaries participating in the securities and futures markets.

20 Based on the above principles, we propose that all financial institutions which are regulated under any other legislation administered by MAS be exempted from the need to obtain a licence under the proposed licensing regime. This will minimise regulatory overlap and reduce

⁶ Under the FT Act, merchant banks are only exempted from holding a futures trading adviser's licence but not the futures broker's licence.

compliance costs to the institutions. Such institutions, referred to as "exempt financial institutions (EFI)", will include banks, finance companies, merchant banks and insurance companies.

21 To ensure level playing field for all market participants and to apply uniform standards for functionally similar activities across the financial industry, the supervision of securities and futures activities undertaken by the EFIs should be similar to the supervision of licensed institutions under the Omnibus Bill. In this respect, we propose that –

- a) EFIs be subject to any market code and practices which are imposed on licensed institutions under the Omnibus Bill;
- b) Employees and agents of EFIs who carry on regulated activities in the securities and futures markets for the EFIs will be required to register with MAS. They will have to comply with the requirements imposed on representatives of licensed institutions under the Omnibus Bill, such as the requirement to pass the relevant professional examinations.
- c) Relevant rules on the securities and futures business will be imposed on the EFIs. These rules include time-stamping of orders, and maintaining trust accounts and register of interest in securities.

APPROVED FUND MANAGERS (AFMs)

22 It is proposed that the exemption from licensing for AFMs be de-linked from the tax incentive, and all AFMs, both new and existing, be licensed to conduct fund management activities. Presently, a fund

manager that is granted preferential tax treatment under the AFM scheme⁷ is exempted from licensing under the SI Act.

23 It is proposed that all AFMs, both existing and new, be required to hold a licence under the Omnibus Bill in order to conduct fund management activities. This proposal is consistent with international regulatory practice. Bringing AFMs within the licensing regime will assure maintenance of Singapore's high regulatory standards and allow for cooperation with overseas securities regulators.

EXEMPTION UNDER SI REGULATION 41(1)(e)

24 The present SI Regulations provide exemption from licensing for persons who act as an investment adviser, directly or indirectly, to not more than 30 accredited investors. This provision was introduced in 1994 to provide an entry point into the fund management industry for local fund managers who do not yet satisfy the admission criteria for an IA licence. Such fund managers will continue to be exempted from licensing under the Omnibus Bill and be required to comply with the terms of their exemption.

25 As mentioned earlier in the paper, new legislation will be enacted to regulate financial advisers that offer investment advice. The new legislation will grant exemption from licensing to persons who provide investment advice to not more than 30 accredited investors. A person who is exempted from licensing under both the Omnibus Bill and the new legislation governing investment advice shall not have in aggregate more than 30 accredited investors.

⁷ Under the AFM scheme, a fund manager pays a concessionary tax rate of 10% on fee income earned from managing offshore funds and his offshore investors need not pay Singapore tax.

26 It is proposed that –

- a) Fund managers which manage funds for not more than 30 accredited investors (referred to as "EFM") will continue to be exempted from licensing, subject to the terms under which they are exempted;
- b) EFMs submit an annual statutory report to MAS, such as external auditor's report, verifying that they have complied with the limit on the number of accredited clients; and
- c) MAS be granted powers to refuse an exemption under prescribed circumstances.

DURATION OF LICENCES

27 At present, all licences (corporate and individual) issued under the SI Act and FT Act are valid for 1 year, renewable upon approval by MAS and payment of annual fees. To lighten the administrative load for our licensees, it is proposed that the frequency of renewal of licences (for both companies and individuals) be changed from an annual basis to once every 3 years. However, the licence fee will continue to be payable on an annual basis.

28 We will adopt a single expiry date, which is 31 Mar, such that all licences will be valid for a period of 3 years beginning 1 Apr. With a longer licence period, licensees will only need to renew their licence once in 3 years, but the licence fee will be payable annually on 1 Apr.

29 New licence applications may be made any time during the year, and if approved, the licence will be issued for a period of up to 3 years, ending 31 Mar. The licence fee for new application will be pro-rated up to 31 Mar. For example, the initial licence fee for an application submitted on 1

Sep 2000 will be pro-rated to cover the period between 1 Sep 2000 and 31 Mar 2001. Thereafter, the standard annual licence fee will apply, payable on 1 Apr 2001.

30 *Transitional issue:* After the Omnibus Bill takes effect, existing licensees will be allowed to hold their existing licence(s) till expiry. Upon renewal, they will be each issued a single licence with validity of up to 3 years (expiring on 31 Mar). The licence fee will be pro-rated accordingly. Thereafter, the standard annual licence fee will apply.