CONSULTATION ON REGULATION OF BUSINESS TRUSTS - MAS' RESPONSE TO FEEDBACK RECEIVED

On 10 December 2003, MAS issued a Consultation Paper setting out certain key proposals for the governance and offers of business trusts ("BTs"). The consultation paper included a draft of the Business Trusts Bill. Additionally, MAS sought comments on the draft provisions relating to the offers of units in BTs under Part XIII of the Securities and Futures Act ("SFA") on 26 December 2003.

We thank respondents for their comments. We have carefully considered all comments received in our policy deliberations.

The Business Trusts Bill and related amendments to the SFA will be introduced for first reading in Parliament in the third quarter of 2004.

We now set out comments of wider interest, and our responses thereto.

1. Scope of Governance Framework

In our Consultation Paper, we proposed to require that only BTs offered to the retail public in Singapore be registered under the Business Trusts Act ("BTA"), while other BTs (including those being offered to accredited and institutional investors) may do so on a voluntary basis.

Several respondents agreed with the approach. There were however suggestions that BTs offered to accredited and institutional investors be required to register under the BTA, as such investors are likely to be significant investors in BTs.

MAS' Response

BTs which offer units only to accredited and institutional investors may voluntarily register under the BTA if the offeror considers that regulation under the BTA would make the offer more attractive to investors. We prefer giving the offeror of such BTs the choice to register since accredited and institutional investors, compared to retail investors, are generally in a better position to take care of their own interests. The Trustees Act will continue to apply to BTs which are not registered under the BTA.

2. Structure of Responsible Entity for BTs

We proposed that the responsible entity of a registered BT be structured as a single entity, known as a "trustee-manager" ("TM"). It will be responsible for safeguarding the interests of unitholders and managing the business of the BT.

Most respondents agreed with the proposal. A respondent suggested that the legislation should allow for flexibility for the trustee and manager roles to be undertaken by separate entities.

MAS' Response

Requiring registered BTs to have a single TM ensures that fiduciary responsibility towards unitholders of the BT is clearly placed on a single entity. A BT would actively undertake business operations. As such, it would be difficult for an independent trustee to clearly set out an operating mandate under the trust deed or to supervise the manager's business decisions. This poses practical difficulties in apportioning responsibility and liability for any breach of trust on either the trustee or manager.

The TM will have flexibility under the BTA to appoint a separate manager as an agent to perform the management functions for the BT.

3. Trustee-manager to be Incorporated in Singapore

We proposed that the TM be required to be a public company incorporated in Singapore under the Companies Act, for the reason that public companies are required to prepare and report audited financial accounts.

Several respondents felt that it was not necessary to require the TM to be a public company as the financial reporting requirements on the TM may be set out in the BTA as an alternative.

MAS' Response

We agree with the respondents. Public and private companies are subject to the same financial reporting requirements under the Companies Act, except that exempt private companies that are dormant or have turnover below S$2.5m are not required to prepare audited financial statements. We will instead require that the TM must not be an exempt private company and that financial accounts of the TM be made available to unitholders of a registered BT. In addition, TMs will be required to appoint professionally qualified secretaries, consistent with the requirement for public companies under the Companies Act.

4. TM Restricted to Operating a Single BT

We proposed to restrict a TM to operating a single BT.

Responses to the proposal were mixed. Some respondents highlighted that the requirement could be circumvented if multiple TMs, comprising the same personnel, are set up to run the different BTs. Allowing a TM to operate more than one BT may also yield benefits, such as economies of scale.

MAS' Response

We maintain our position to restrict a TM to operating a single BT. This is to ensure that the winding up of a TM due to financial difficulties arising from the operation of any single BT will not pose a contagion effect on other BTs managed by the same TM. As the TM is the legal entity holding the assets and liabilities of the BT, there would be less complications in the event of insolvency of the TM if the TM operates a single BT. Also, the financial reports of the TM would reflect the financial position of the TM in relation to its operation of only a single BT - this would be more transparent and useful to investors. The restriction is aimed at having legal separation at the TM level with respect to each BT, and not at preventing separate TMs from being set up with the same personnel to run different BTs.

5. Duties of Directors of TM

We proposed imposing a statutory duty on the TM and its directors to act in the best interests of unitholders of the registered BT as a whole and, where there is a conflict between the unitholders' interests and interests of the TM, to give priority to the interests of unitholders as a whole.

Several respondents agreed with our proposal. Some respondents were concerned with the drafting of the phrase that directors of a TM have to "act in the best interests of unitholder". This may be interpreted to mean that the sole objective of directors is to preserve unitholders' interests to the exclusion of other stakeholders. As a parallel with companies, directors of companies have a duty to act in the interests of the company and have to take into account the interests of other stakeholders, such as employees and regulators (where the company engages in a regulated activity). There were also suggestions that reliance on common law may be sufficient, whereby directors of a trustee company have been held liable for losses suffered by trust beneficiaries in cases where the director's negligence caused the TM to commit a breach of trust.

Some respondents commented that the proposal for directors of the TM to prefer the interests of unitholders over the interests of the TM may cause conceptual and practical difficulties. There were also concerns that the additional duties to be imposed on directors of a TM, vis-□is those of a company, would disadvantage TMs when recruiting directors.

MAS' Response

We are of the view that a statutory duty should be placed on directors of a TM. We see this as a fundamental measure to safeguard the interests of investors in a BT. It is necessary to pierce the corporate veil of the TM and to pin fiduciary responsibility towards unitholders on its directors.

We agree with the respondents' concerns that the proposed codification that directors "act in the best interests of unitholders" could be read to exclude other stakeholders. We will reformulate the statutory duties of directors of a TM, to require directors to act honestly and exercise reasonable diligence in the discharge of the duties of their office, and in particular, to take all reasonable steps to ensure that the TM discharges its duties towards unitholders. The directors of a TM will also have a statutory duty to give priority to the interests of unitholders where these conflict with those of the TM. This is important to address the inherent conflict between the duty of the TM's directors to operate the BT in the best interests of unitholders and to manage the TM in the best interests of the TM.

6. Independence of the Board of the TM

We proposed that a majority of the board must comprise "truly independent" directors, i.e. directors who are independent of the management of, and business dealings with, the TM and substantial shareholders of the TM.

Respondents generally acknowledged the need for an independent element on the TM's board. However, they proposed that only one-third of the board be truly independent, citing the difficulty of finding independent directors and the advantage of having directors who are connected with the TM and its substantial shareholders.

<u>MAS' Response</u>

We agree with the respondents. The mandatory requirement on the composition of the TM's board will be as follows:

a. one-third of the board of the TM to be truly independent;
b. majority of the board to be independent of management of and business relations with the TM; and
c. a majority of directors must be independent of any single substantial shareholder, unless that substantial shareholder holds 50% or more of the share capital or votes.

We are of the view that at least one-third of the TM's board should be truly independent to mitigate the conflict of duties owed by the board. We recognise that where a parent company of a TM retains majority ownership of the shares of the TM, it should be able to retain control of its board. This is permitted under limb c. A majority of the TM's board should be independent of management of and business relations with the TM, given the board's responsibility for overseeing management's performance and actions.

7. Annual Certification by the Board and Chief Executive Officer ("CEO")

We proposed requiring the TM's board and CEO to certify, on an annual basis, that they have reviewed the relevant policies and measures to ensure that the TM has managed the BT in the interest of unitholders as required by the BTA and are satisfied that these are adequate.

Most respondents were concerned that the certification requirement extends directors' obligations beyond that imposed on listed companies and may pose a problem for TMs when recruiting directors. There were concerns that the certification required was too wide and impractical for the board and CEO to provide.

<u>MAS' Response</u>

We agree with the respondents that the scope of the annual certification may be too wide and onerous for the board and CEO of the TM to provide. We, however, are of the view that some form of certification from the board and the CEO of the TM is important to make them more acutely aware, on a periodic basis, of their responsibility to safeguard the interests of unitholders of the BT. We see this as an important measure to mitigate the inherent conflict of interest that directors of a TM have in relation to its duties towards shareholders and unitholders.

We will narrow the scope of the certification and require that:

a. the board of the TM certify that fees paid or payable to the TM and expenses paid or payable from trust property of the BT are in accordance with the trust deed;

b. the board of the TM certify that transactions with interested parties are not detrimental to the interests of unitholders as a whole based on the circumstances at the time of the transaction; and

c. the CEO and the board of the TM certify that they are not aware of any violation of duties of the TM which would have a materially adverse effect on the business or affairs of the BT and on the interests of unitholders as a whole.

8. Voting Threshold for Removal of the TM by Unitholders

We proposed to give unitholders the power to remove the TM, subject to a special resolution (75% of votes of unitholders voting in presence or by proxy). We sought comments on imposing an additional threshold requiring unitholders voting in favour of removal of the TM to represent at least 50% of the total outstanding units of the BT.

Although some respondents were in favour of imposing the additional threshold, most respondents were concerned that this would entrench incumbent TMs. Some suggested requiring only an ordinary resolution (50% of votes of unitholders voting in person or by proxy) by unitholders to approve the removal of the TM, for consistency with the threshold for removal of individual

directors of a company by shareholders. There were also suggestions that the TM and parties related to the TM should not be allowed to vote on resolutions on the removal of the TM.

MAS' Response

We will require that the removal of the TM be subject to a special resolution of unitholders. We will not impose the additional requirement for unitholders voting in favour to represent at least 50% of the total outstanding units of the BT. We recognise that the removal of the TM would have a significant impact on the continuity of a BT, as a suitable replacement TM has to be found to operate the BT. We are of the view that requiring a special resolution of unitholders for removal of the TM achieves the right balance between the need to guard against frivolous removal of a TM and the need to provide sufficient rights to unitholders to remove the TM.

9. Amendments to the Trust Deed

We proposed a provision that amendments to the trust deed may be approved either:

b. by unitholders by special resolution. We sought comments on an additional threshold requiring unitholders voting in favour of amendment of the trust deed to represent at least 50% of the total outstanding units of the BT; or

c. by the TM where the amendment will not adversely affect the rights of unitholders.

Responses on the threshold for unitholders' approval of amendments to the trust deed were mixed. One respondent suggested that the TM's consent be required if an amendment to the trust deed would prejudice the interests of the TM.

On amendments to the trust deed by the TM without unitholder approval, several respondents were concerned that the condition that the amendment "will not adversely affect rights of unitholders" is ambiguous, and suggested that all amendments to the trust deed be approved by unitholders. One respondent suggested that unitholders be allowed to empower the TM to make limited amendments to the trust deed.

MAS' Response

On balance, we take the view that approval of amendments to the trust deed should be subject to a special resolution by unitholders. This is similar to the threshold for amendments to the memorandum and articles of a company by shareholders under the Companies Act.

We disagree with the proposal that the TM's consent be required for amendments to the trust deed approved by unitholders, as this would effectively give the TM a power to veto amendments to the trust deed. However, as the trust deed is a contract between the TM and unitholders (for example, fees payable to the TM are set out in the trust deed), the TM should have some protection against unfair amendments to the trust deed that prejudice its personal interests. We will provide that the TM has the right to apply to a Court of Law for a cancellation of an amendment to the trust deed that has been approved by unitholders, if that amendment affects the TM in its personal capacity. The Court will determine if the amendment was made in good faith and confirm, cancel or modify the amendment as it thinks just.

We agree with the concerns that the TM's discretion to amend the trust deed without unitholder approval as set out in the draft may be too wide. We will narrow the TM's discretion, to allow the TM to amend the trust deed without unitholder approval only where the amendment to the trust deed is necessary to comply with any laws or changes in law in Singapore.

10. Financial Statements of BTs

We sought comments on whether BTs should be required under the BTA to prepare their financial statements in accordance with Singapore Financial Reporting Standards ("SFRS"). The alternative was to require in statute that the TM prepare financial statements of the BT that present a true and fair view of the state of affairs of the BT.

Respondents generally agreed that SFRS should apply to financial statements of BTs. There were however comments that modifications to SFRS may be necessary to apply them to BTs, given that SFRS have, as its primary focus, financial reporting for companies.

MAS' Response

We agree with the comments that BTs should prepare their accounts in a manner consistent with SFRS. We however recognize

that it may not be possible for BTs to comply fully with the SFRS as some adaptation of SFRS (for example, the concept of equity where applied to trusts) may be necessary. We will not provide for the compliance with SFRS in legislation, but will instead require that accounts presenting a true and fair view of the affairs of the BT are prepared and audited.

11. Conditions for Distributions to Unitholders

We proposed that distributions may be made to unitholders only if the directors of the TM are satisfied on reasonable grounds that, after making the distribution:

b. the value of the trust property of the registered BT would exceed the liabilities (including contingent liabilities) incurred by the TM in its capacity as TM for that trust ("the net assets test"); and

c. the TM will be able to pay such liabilities in the normal course of business as they fall due.

The proposed requirement is to ensure that distributions to unitholders would not jeopardise the BT's ability to continue its business operations, while preserving the advantage of the BT structure of permitting distributions to unitholders to be paid out of cash flow. Companies, in contrast, are required to pay dividends only out of profits.

Respondents commented that the net assets test would be burdensome as this would require regular revaluation of the assets and liabilities each time a distribution is made. The basis for valuation is also unclear. Some respondents opined that businesses in certain industries with strong cash flows are able to support high levels of borrowings even with a low asset base. Others suggested that the TM disclose distribution guidelines to unitholders to ensure transparency, or be required to set aside sufficient reserves for capital expenditure.

MAS' Response

We agree that the net assets test may be inappropriate for the purpose of determining distributions. Valuation of assets based on historical cost or realisable value does not necessarily reflect their value-in-use or future cash flows to be derived for a continuing business. We will remove the net assets test and require that distributions to unitholders be subject to a certification by the board of directors of the TM that the TM will be able to pay, from the trust property of the BT, the liabilities of the BT as they fall due. In addition, the TM will be required to disclose the distribution policy of the BT and how the distributable amount is derived, including a reconciliation to a measure of profitability or cash flow based on the financial statements and discussion of the reconciling items. The disclosure will provide transparency for investors to assess the appropriateness of the level of distributions paid to unitholders.

12. Rights of Creditors

We proposed to provide in the BTA that creditors have the right of subrogation to the TM's right of indemnity on trust assets (i.e. the creditor can claim from the assets of the BT via the rights of indemnity of the TM), provided that the TM has not acted in breach of trust in incurring the liability. This is consistent with the principles of trust law.

Respondents were generally not in favour of the proposal, as this would place creditors of BTs in a weaker position as compared to the position of creditors of companies. Creditors will face difficulties in checking whether a TM is acting in breach of its fiduciary duties and, consequently, whether their claims will be respected. This may restrain the ability of the BT to borrow and adversely affect the viability of BTs as a business enterprise. Two respondents suggested that creditors have a direct claim on trust assets.

MAS' Response

We maintain our position to apply the trust law on creditors' rights to BTs. While we recognise the concerns raised by respondents, it would be difficult legally in principle to justify an exception from trust law on creditors' rights only for BTs and not other types of trusts. Other jurisdictions with active BT markets, where BTs that are not legal entities, have not departed from trust law. Allowing creditors to be repaid out of trust property even where the TM had acted in breach of trust may also encourage creditors to be complacent in performing their due diligence checks. This would result in trust property being diminished by such creditors' claims and may tilt the balance too much in favour of creditors.

13. Liquidation of BTs

We proposed not to set out proceedings on liquidation of a BT, including the priority ranking of claims, in the BTA. These

should instead be set out in the trust deed.

Several respondents agreed with the proposed approach. Some respondents however were of the view that the BTA should address liquidation proceedings for BTs, including the priority ranking of creditors' claims to provide clarity. Relying on the trust deed of a BT may also be more costly and time-consuming if court directions become necessary.

MAS' Response

We do not intend to set out proceedings for liquidation of the BT, including priority ranking of creditors' claims in the BTA. The TM legally incurs all liabilities on behalf of the BT. In the event of liquidation of the BT, it is the TM that creditors will take action against to recover their claims. For creditors whose loans are secured by specific assets of the BT, they can seek recourse by claiming on the collateral. Unsecured creditors claim on the TM, who then claims on trust assets through its right of indemnity on the BT. The priority by which these creditors are repaid should be addressed at the level of the TM, as a company. We will provide the court with broad powers under the BTA to give directions with regard to the liquidation of the BT. Canada and Australia, which have relatively developed BT markets, do not provide for priority ranking of creditors' claims in their regulatory regimes. We will monitor international developments and review this as we gain experience in administering the BTA.

14. Judicial Management of BTs

We proposed that the BTA will not provide for judicial management of BTs. A judicial manager may, however, be appointed to the TM of the BT under existing provisions in the Companies Act.

Three respondents preferred that a judicial management regime be provided for BTs. The concern was raised that appointing a judicial manager to the TM, rather than to the BT directly, may not provide creditors and unitholders of a BT with similar rights and obligations that creditors and shareholders have with respect to a company.

MAS' Response

We maintain our position not to provide for judicial management of BTs itself in the BTA. This is in view that a BT is not a legal entity. The TM legally incurs all liabilities on behalf of the BT and creditors will take action against the TM to recover their claims. Other jurisdictions, including Australia and Canada, have not set out provisions for judicial management of BTs.

15. Offers of Units in BTs

We proposed that offers of units in BTs be regulated by way of disclosure requirements on prospectuses in the same way that offers of shares in companies are regulated.

Respondents agreed with the proposed approach. One respondent commented that certain disclosure requirements applicable to Collective Investment Schemes ("CIS") should also apply to BTs.

MAS' Response

We agree with the respondent. A new Division 1A will be introduced in Part XIII of the SFA to regulate offers of units in BTs. This will comprise provisions adapted from Division 1 of Part XIII of the SFA which regulates the offer of shares in companies. Disclosure requirements in relation to CIS that are also applicable to BTs will be incorporated where appropriate.

16. Take-over Offers for units in BTs

We proposed that the definition of "take-over offer" in the SFA and the Singapore Code on Take-overs and Mergers ("Take-over Code") be amended so that take-over offers for units in BTs will be subject to the provisions under Part XIII of the SFA and the Take-over Code.

Respondents agreed to the proposed approach.

MAS' response

We will be making the appropriate amendments to the SFA and Take-over Code to provide for the take-over offers for units in BTs.

17. Regulatory Treatment of Real Estate Investment Trusts ("REITS")

We proposed that existing REITs be given the choice to continue to be regulated as a CIS under the CIS regime, or structure themselves as a BT under the BT regime. New trusts investing in real estate may also choose to be structured and regulated as a CIS under the CIS regime or as a BT under the BT regime.

While a few respondents agreed with the proposal, some respondents commented that it may be better for trusts investing in real estate to be regulated only under one regime, in order to avoid investor confusion. The respondents differed on whether the BT regime or CIS regime would be more appropriate.

MAS' Response

MAS' intention is to allow trusts investing in real estate, including existing REITs, the flexibility to choose to be structured and regulated as a CIS under the CIS regime or as a BT under the BT regime.

As set out in the consultation paper, property trusts that opt for the CIS regime will be subject to the regulatory requirements under the SFA, such as the requirement to have a manager and independent trustee, borrowing limits and operational restrictions. Property trusts that opt for the BT regime will have a single TM and will not be subject to borrowing limits and operational restrictions. However, in order to distinguish BTs investing in properties from property trusts regulated as CIS and to avoid investor confusion, such BTs will not be allowed to use the term "Real Estate Investment Trusts" (or similar terms) in their name or in marketing themselves.

18. Recognition Regime for BTs constituted outside Singapore

We proposed that BTs constituted outside Singapore ("foreign BTs") may apply under a recognition regime for foreign BTs in order to offer units to the retail public in Singapore. MAS would recognise foreign BTs that are subject to a regulatory framework under a foreign regulator affording unitholders comparable protection to that provided for under the BTA. A recognised BT would be exempted from the requirements of the BTA but may be subject to conditions imposed by MAS.

A respondent highlighted the difficulty in assessing whether a foreign jurisdiction provides comparable protection, given that the BT structure is relatively new globally.

MAS' response

We agree that there are difficulties in implementing a recognition regime for foreign BTs, given that the BT is a relatively new business vehicle globally. It would be useful for MAS to gain experience in administering the BTA before setting out a recognition regime for foreign BTs. In the interim, we may consider exempting foreign BTs that intend to offer units to the retail public in Singapore from the requirement to be registered under the BTA, on a case-by-case basis.

MONETARY AUTHORITY OF SINGAPORE
12 July 2004

LIST OF RESPONDENTS TO PUBLIC CONSULTATION ON REGULATION OF BUSINESS TRUSTS

Allen & Gledhill
Arthur D. Little Asia Pte Ltd
Association of Banks in Singapore
CapitaLand Limited
DBS Bank Ltd
Deutsche Bank AG
Institute of Certified Public Accountants of Singapore

JPMorgan Chase Bank
KPMG
Law Society of Singapore
Marcus Yip, Mr.
Morgan Stanley
PricewaterhouseCoopers
Sembcorp Industries Ltd
Singapore Exchange Ltd
Singapore International Chamber of Commerce
Singapore Power Ltd
Wong Partnership

Last modified on 30/3/2007