

CONSULTATION PAPER

P003 - 2004  
April 2004

# Amendments to the Code on Collective Investment Schemes

MAS

Monetary Authority of Singapore

## **Consultation on Amendments to the Code on Collective Investment Schemes**

The Code on Collective Investment Schemes ("the Code") was first issued on 23 May 2002 to set out the best practices on the management, operation and marketing of funds that managers and trustees are expected to observe.

2 To improve the operating environment, taking into account market developments and investor protection concerns, MAS proposes to amend the Code (see paragraphs 4 to 8 below) and would like to seek feedback from the public.

3 Separately, MAS has recently requested information from fund managers about their policy on market timing. MAS will consider whether any revision to the Code is necessary after reviewing local practices and the efforts undertaken in foreign markets in this respect.

### **Chapter I: Collateral taken during Securities Lending Transactions**

4 We propose removing the requirement that debt collateral received by a fund for its securities lending transactions have a remaining term to maturity of not more than 366 days if certain conditions are met. We also recommend allowing letters of credit and banker's guarantee to be used as collateral.

### **Chapter II: Single Party Limit for investment in Sovereign Debt Securities.**

5 We propose increasing the single party limit for investment in sovereign debt securities.

### **Chapter III: Accounts and Reports**

6 We propose new clarifying clauses and examples relating to deadlines for preparation of accounts and reports by the manager, situations in which accounts or reports need not be prepared or sent and methods by which accounts or reports may be sent.

### **Chapter IV: Reporting for Hedge Funds**

7 We propose to introduce enhanced reporting requirements for hedge funds.

### **Chapter V: Investment Guidelines for Currency Funds**

8 We propose to introduce new investment guidelines for currency funds. These guidelines would constitute a new Appendix in the Code.

### **Request for Comments**

9 MAS invites interested parties to give their views and comments on the proposals set out in this consultation paper. Comments may be submitted to:

Corporate Finance Division  
Securities and Futures Supervision Department  
Monetary Authority of Singapore  
10 Shenton Way  
MAS Building  
Singapore 079117

Email: [ciscode@mas.gov.sg](mailto:ciscode@mas.gov.sg)

Fax: (65) 6225-1350

MAS would request that all comments and feedback be submitted by 8 May 2004.

10 Please note that all submissions received may be made public unless confidentiality is specifically requested for whole or part of the submission.

## **Chapter I: Investment Guidelines: Collateral for Securities Lending**

### Introduction

Appendix 1 of the Code on Collective Investment Schemes sets out the investment and borrowing guidelines, including guidelines pertaining to securities lending, for non-specialised funds.

2 Currently, the manager of a scheme may lend out up to 50% of the deposited property of the scheme provided that it takes adequate collateral. Such collateral must be in the form of instruments consistent with the investment objective and character of the scheme and have a remaining term to maturity of not more than 366 days. These requirements also apply to investments made with cash collateral.

### Practices in Other Jurisdictions

3 MAS notes that jurisdictions such as Luxembourg and Ireland do not specify any maturity requirement for the collateral taken for securities lending. Instead, these jurisdictions require schemes that engage in securities lending transactions to do so within a standardised lending system organised by a recognised securities clearing institution or by a highly-rated financial institution that specialises in such transactions. In addition, the Irish guidelines require the counterparty to the securities lending agreement to have a short-term credit rating of A2 by Moody's; or failing which, the scheme has to be indemnified by a third-party with the same credit rating.

### Proposals

4 We are of the view that the risk arising from removing the maturity requirement for debt securities taken as collateral could be mitigated if the securities lending transaction

is conducted through an institution that accords the fund protection in the event of losses. Such an institution should also be highly rated as an indication of its ability to meet this obligation should it arise.

5 We propose abolishing the maturity requirement for debt securities taken as collateral if:

(a) such debt securities are rated at least A2 by Moody's, A by S&P or A by Fitch Inc;

**AND**

(b) the securities lending transaction is conducted through an institution with a credit rating of at least A2 by Moody's, A by S&P or A by Fitch Inc and it indemnifies the scheme in the event of losses due to failure by the securities borrower to return the borrowed securities.

6 The safeguard in paragraph 5(b) would allow the scheme to be restituted in the event that the securities borrower fails to return the borrowed securities.

7 We propose to retain the maturity requirement for debt securities bought using cash collateral received from securities lending transactions. The scheme would be obliged to return the cash collateral when the securities lending transaction is unwound. Where the cash is invested in debt securities, the scheme would have to liquidate these investments in order to return cash to the borrower. As the market for long-dated debt securities may be less liquid and subject to greater price fluctuations, the 366-day maturity requirement would serve to minimise losses arising from the scheme liquidating debt securities in order to return cash to the borrower.

**Q1:** MAS seeks your view on the proposal to remove the 366-day maturity requirement for debt securities taken as collateral if:

- a) such debt securities are rated at least A2 by Moody's, A by S&P or A by Fitch Inc;  
AND
- b) the securities lending transaction is conducted through an institution with a credit rating of at least A2 by Moody's, A by S&P or A by Fitch Inc and the institution indemnifies the scheme in the event of losses due to failure by the securities borrower to return the borrowed securities.

#### Letters of Credit and Banker's Guarantee

8 MAS notes that Letters of Credit ("LCs") and Banker's Guarantee ("BGs") are acceptable collateral under international standardized contracts for securities lending such as the Overseas Securities Lender's Agreement.

9 MAS proposes to permit LCs and BGs to be acceptable collateral if their issuers have a credit rating of at least Prime-1 by Moody's, A-1 by S&P or F-1 by Fitch Inc. As the fund would be directly exposed to the credit worthiness of the issuer of the LCs and BGs, the proposed minimum credit rating requirement could help to ensure that the issuer would be in a strong financial position to meet its short-term obligations.

**Q2:** MAS seeks your views on the proposal to permit LCs and BGs as acceptable collateral only if their issuers have a credit rating of at least Prime-1 by Moody's, A-1 by S&P or F-1 by Fitch Inc.

## **Chapter II: Investment Guidelines: Single Party Limit for Investment in Sovereign Debt Securities**

### Introduction

Currently, a fund may invest up to 10% of its deposited property in securities issued by the same issuer. For issuers included in a benchmark that is widely accepted and constructed by an independent party, the single party limit will be the higher of 10% or the benchmark weight of the issuer. This single party limit does not apply if the issuer is, or the issue has the benefit of a guarantee from, a government, government agency or supranational that has a minimum long-term issuer rating of Aa by Moody's, AA by S&P and AA by Fitch Inc.

### Practices in Other Jurisdictions

2 MAS notes that jurisdictions such as Luxembourg, Ireland and the UK would allow a fund to invest up to 35% of its deposited property in sovereign debt securities regardless of their credit rating.

### Proposals

3 Due to the current single party limit for investment in sovereign debt securities rated below Aa by Moody's, AA by S&P and AA by Fitch Inc, fund managers seeking to invest in a particular emerging country would invest any amounts above the 10% single party limit or the issuer's benchmark weight into corporate debt; which would, in most, if not all cases, be more risky than the sovereign debt of that particular country. Therefore, increasing the single party limit for investment in sovereign debt securities would give managers more flexibility.



4 We propose raising the single party limit to the higher of 20% (from 10% now) and the benchmark weight of the issuer for sovereign debt securities where the long-term issuer rating of the issuer is at least Baa by Moody's, BBB by S&P or BBB by Fitch Inc. We note from historical data that default rates increase sharply for non-investment grade issues. For avoidance of doubt, the single party limit would not apply if the issuer is, or the issue has the benefit of a guarantee from, a government, government agency, or supranational that has a minimum long-term issuer rating of Aa by Moody's, AA by S&P and AA by Fitch Inc.

**Q3:** MAS seeks your views on the proposal to raise the single party limit to the higher of 20% and the benchmark weight of the issuer if the issuer is, or the issue has the benefit of a guarantee from, a government, government agency or supranational, which has a minimum long-term issuer rating of Baa by Moody's, BBB by S&P or BBB by Fitch Inc.

## Chapter III: Accounts & Reports

### Introduction

Regulation 8 of the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations (“SFR”) requires:

*the manager*

- to prepare<sup>1</sup> the semi-annual and annual accounts; and
- to prepare the semi-annual and annual reports; and

*the trustee*

- to cause the annual accounts to be audited at the end of each financial year;
- to send<sup>2</sup> the annual accounts and accompanying auditor’s report as well as annual reports to registered unitholders;
- to send the semi-annual accounts and reports to registered unitholders.

2 In response to industry feedback on practical issues that have arisen in respect of the preparation and sending of accounts and reports in certain circumstances, MAS proposes to set out in the Code:

- (a) deadlines for the preparation of the accounts and reports by the manager;
- (b) situations in which the manager and trustee need not prepare, audit nor send the accounts and reports; and
- (c) methods by which the trustee may send the accounts and reports.

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<sup>1</sup> In this consultation paper, the term “prepare” includes a reference to “caused to be prepared”.

<sup>2</sup> In this consultation paper, the term “send” includes a reference to “caused to be sent”.

**A summary table of the existing requirements and MAS' proposed amendments**

		(a) Contents of the accounts or report	(b) Deadline for preparing or sending	(c) Situations in which there is no need to prepare, audit nor send	(d) Method by which the accounts or report may be sent
<b>Manager</b>	Prepare semi-annual and annual accounts	The Code requires financial statements to be prepared in accordance with Recommended Accounting Practice 7.	Proposals are set out in Section 1.	Proposals are set out in Section 2.	N.A.
	Prepare semi-annual and annual reports	The Code sets out the contents of the semi-annual and annual report.			N.A.
<b>Trustee</b>	Cause annual accounts to be audited	N.A.	N.A.		N.A.
	Send auditor's report	N.A.	The current deadlines set out in the SFR will be transferred to the Code.		Proposals are set out in Section 3.
	Send semi-annual and annual accounts	N.A.			
	Send semi-annual and annual reports	N.A.			

Proposals

**Section 1: Deadlines for the preparation of the accounts and reports by the manager**

3 The SFR requires the manager to prepare the semi-annual and annual accounts and semi-annual and annual reports, and the trustee to send them to unitholders. MAS is aware that a situation may arise where the manager does not prepare the accounts and reports in time, resulting in the trustee not being able to fulfil its obligation.

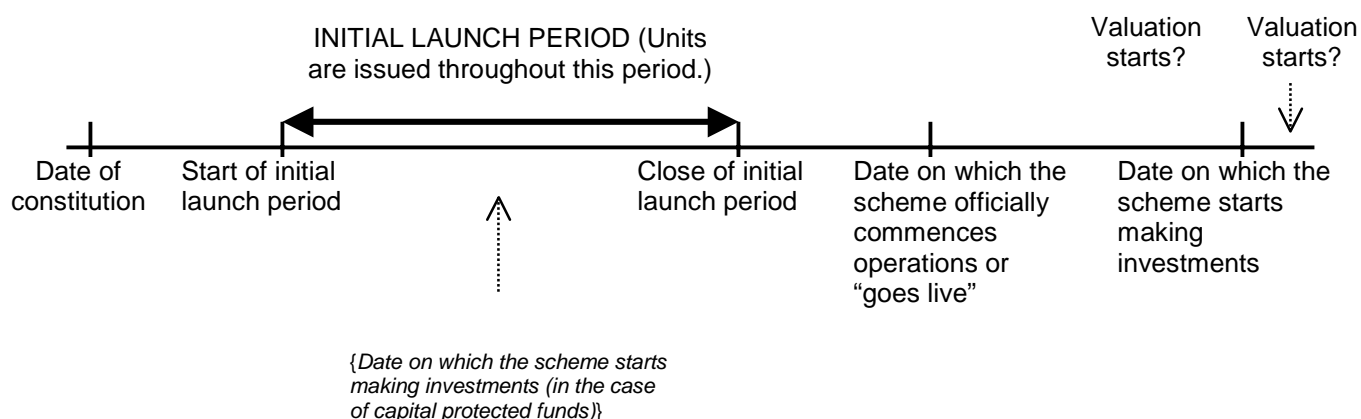
4 MAS proposes setting out in the Code a new requirement for the manager to prepare and furnish to the trustee the semi-annual and annual accounts and semi-annual and annual reports “in sufficient time” for the trustee to cause them to be audited (where an audit is required) and send them to unitholders within the stipulated periods. This is consistent with section 207(1A) of the Companies Act, which requires an auditor to furnish to the directors of a company the auditor’s report in sufficient time to enable the company to present the report at the company’s annual general meeting.

**Q4:** MAS seeks your views on the proposal to require the manager of a fund to prepare and furnish to the trustee the semi-annual and annual accounts and reports in sufficient time for the trustee to cause them to be audited (where an audit is required) and send them to unitholders within the stipulated periods.

## **Section 2: Situations in which the manager and trustee need not prepare, audit nor send the accounts and reports**

### **Situation A – The scheme is new**

5 In order not to impose undue costs on schemes, MAS has exempted managers and trustees from preparing, auditing and sending the relevant accounts and reports if the scheme in question has been in existence for less than 3 months. Such exemptions have been granted on a case-by-case basis. MAS proposes to formalise this policy in the Code. MAS has considered a few possible dates from which to start counting the 3 months. These are illustrated in the following diagram and elaborated on in the paragraphs below.



6 The date of constitution is the date on which the trust deed constituting the fund is executed. A scheme is dormant during the period from the date of constitution to the start of the initial launch period. This period could be extremely long, especially in the case of umbrella funds which constitute many sub-funds at a time but launch them over the course of a few years. Hence, it is impractical to count the 3 months from the date of constitution.

7 The start of the initial launch period is the date on which the scheme starts being offered. Units are issued throughout the initial launch period and accounting transactions commence within this period. However, there is generally no investment activity, no valuation and no deduction of expenses from the scheme. MAS understands that there are exceptions in the case of capital protected funds which sometimes enter into investment transactions *during* the initial launch period. Even though there may be some investment activity during the initial launch period in such cases, the scheme does not officially commence operations and start accruing ongoing expenses such as management fees until after the close of the launch period. The date on which the fund officially commences operations (sometimes referred to as the date on which the scheme "goes live") is usually 1 or 2 days after the close of the initial launch period.

8 The date on which the scheme starts making investments varies among schemes and, depending on market conditions, may take place some time after the scheme "goes live". It is ambiguous as to whether a manager who decides to leave the monies of a

scheme in short-term deposits after the fund “goes live”, to await favourable market conditions before entering into longer-term investments befitting the objective of the scheme, should be considered to have “started making investments”.

9 Lastly, the first valuation date is that date on which the scheme first values its units. This date generally depends on the first dealing day of the scheme i.e. the first day on which the scheme has to redeem units or issue units at a price other than the initial offer price, and would therefore need to price its units. The first valuation date could occur either before or after the date on which the scheme starts making investments.

10 MAS is of the view that the start of the initial launch period would be the most appropriate date from which to count the 3 months. While MAS is cognizant of the fact that no investment activity is carried out during the initial launch period and that the scheme does not officially commence operations until after such period, we are of the view that the transactions of the scheme during this period (comprising mainly the collection of subscription monies) should be accounted for properly and reported expeditiously to unitholders. The proposal is also consistent with the Companies Act, under which a dormant company is exempted from audit requirements if it has been dormant from the time of its formation.<sup>3</sup>

11 Therefore, MAS proposes not to require the relevant accounts and report to be prepared, audited and sent where they would have covered a period ending 3 months or less from the start of the initial launch period.

12 However, the first set of accounts and report that is subsequently prepared and sent to unitholders must cover the period from the start of the initial launch period. Where the first set of accounts is the scheme’s half-yearly financial statements for which no auditor’s report is required, the subsequent set of accounts (i.e. the scheme’s annual

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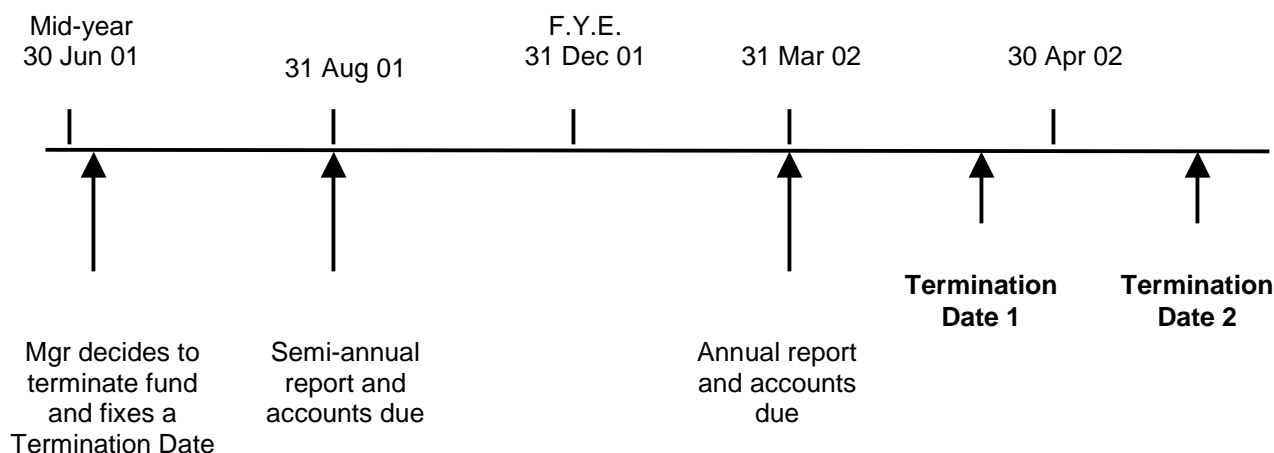
<sup>3</sup> A company is deemed to be dormant during a period in which no accounting transaction occurs. The issue of new shares (like the issue of units in a fund) is regarded as an accounting transaction which would nullify a company’s dormant status.

financial statements) should cover the period from the start of the initial launch period and be audited.

**Q5:** MAS seeks your views on the proposal not to require the relevant accounts and report to be prepared, audited and sent where they would have covered a period ending 3 months or less from the start of the initial launch period.

**Situation B – The scheme is about to be terminated**

13 To avoid undue costs to fund managers and unitholders, MAS’ practice has been to exempt managers and trustees from preparing, auditing and sending the relevant accounts and report if the scheme in question is about to be terminated. Such exemptions have been granted on a case-by-case basis. MAS proposes to formalise this policy in the Code so that the last semi-annual or annual accounts, auditor’s report (where applicable) and semi-annual or annual report for the period ending immediately before the termination date need not be prepared, audited or sent if they are due one month or less before the termination date.



- If termination occurs on or before 30 Apr 02 (Termination Date 1), the annual report and accounts due on 31 Mar 02 need not be prepared or sent.
- If termination occurs after 30 Apr 02 (Termination Date 2), the annual report and accounts due on 31 Mar 02 must be sent.
- In both cases, the semi-annual report and accounts due on 31 Aug 01 must be sent.

### Termination of schemes

14 In addition, MAS proposes that the trustee of all funds which are terminated should be required to submit the following to MAS within 2 weeks after the termination date:

- A statement to the effect that all the assets of the scheme as at the date of termination have been realised, liabilities settled and the resultant proceeds distributed to unitholders in the same proportion as their holdings of units in the scheme:* This is to ensure that proceeds from the liquidation of the scheme are fully and properly distributed to unitholders. The UK has a similar requirement.
- A statement affirming that the manager has managed the scheme in accordance with the investment guidelines and other requirements of the SFA and Code on Collective Investment Schemes since the set of accounts and report last sent to unitholders:* This is to ensure that the manager's management of the scheme between the period of the last report and the date of termination is accounted for to unitholders. In order not to impose undue costs to schemes if the trustee was to be required to send the statement to all unitholders, MAS proposes that such statement be submitted to MAS. The trustee should also keep a copy of such statement at its registered office for a period of 6 years and make it available to any unitholder (who was a unitholder at the time the last set of accounts and report were sent) at the unitholder's request. Currently, a trustee is required to include a similar statement in the annual and semi-annual reports of a scheme.



**Q6:** MAS seeks your views on the proposal not to require the last semi-annual or annual accounts, auditor's report (where applicable) and semi-annual or annual report for the period ending immediately before the termination date if they are due one month or less before the termination date.

MAS also seeks your views on the proposal that trustees be required to submit to MAS within 2 weeks after the termination of any funds:

- (a) a statement to the effect that all the assets of the scheme as at the date of termination have been realised, liabilities settled and the resultant proceeds distributed to unitholders in the same proportion as their holdings of units in the scheme; and
- (b) a statement affirming that the manager has managed the scheme in accordance with the investment guidelines and other requirements of the SFA and Code on Collective Investment Schemes since the set of accounts and report last sent to unitholders, a copy of which should be kept by the trustee at its registered office for a period of 6 years and made available to any unitholder (who was a unitholder at the time the last set of accounts and report were sent) at the unitholder's request.

### **Section 3: Methods by which the trustee may send accounts and reports**

15 Currently, the trustee is required to send the semi-annual and annual accounts, auditor's report on the annual accounts, and semi-annual and annual reports to unitholders by post. MAS proposes that the trustee be allowed to send the relevant accounts and reports to unitholders by electronic means in soft copy form where the unitholder has given his express consent to receive the documents in such manner.

16 The regulations place responsibility on the trustee to send the semi-annual and annual accounts, auditor's report and semi-annual and annual reports. CIS Guideline 2 states that MAS will accept that the trustee has complied with this requirement if it sends

those accounts and reports to unitholders whose names are entered in the register of the fund. Paragraph 4.1(i) of the Code states that in the case of unitholders who purchase units through a distributor and whose names are not entered in the register of the scheme, the manager should require the distributor to put in place arrangements for unitholders to receive those accounts and reports. MAS proposes that such arrangements should ensure that the relevant accounts and reports are sent to unitholders by post unless they have given their express consent to receive the documents by electronic means in soft copy form.

**Q7:** MAS seeks your views on the proposal to allow the trustee to send the relevant accounts and reports to unitholders by electronic means in soft copy form where the unitholder has given his express consent to receive the documents in such manner.

## Chapter IV: Reporting for Hedge Funds

### Introduction

On 15 Jun 2001, MAS introduced guidelines for hedge funds that are offered to the retail public. Unlike “traditional” funds, hedge funds are not subject to investment guidelines.<sup>4</sup> Therefore, disclosure is key in helping investors to assess whether they should invest in a hedge fund and to monitor their investments.

### Current Framework

2 Currently, the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2002 require a manager to prepare an annual report and a semi-annual report on a scheme. The required contents of these reports are set out in the Code and Recommended Accounting Practice 7: Reporting Framework for Unit Trusts issued by the Institute of Certified Public Accountants of Singapore.

### Proposals

#### **Section 1: Frequency of Reporting**

3 MAS proposes to require managers to provide investors with updated information on hedge funds at least once every quarter. Unlike traditional products where information on the outlook and performance of a fund may be derived through other sources such as economic reports and the performance of the stock market, the potential complexity and diversity of hedge fund investment strategies may make it difficult for an investor to monitor the performance of a hedge fund based on publicly available information. Balancing the need to provide frequent and timely information updates and the cost of doing so, MAS proposes the following reports be sent to unitholders every year – the

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<sup>4</sup> The only exception is for funds of hedge funds which are required to diversify across managers.

existing annual and semi-annual reports as well as quarterly reports for each of the first, third and fourth quarters<sup>5</sup>. We note that some managers send investors monthly fact-sheets with information such as a fund's performance and current exposures. If the information for the proposed quarterly reports is incorporated in the monthly fact-sheets, managers need not issue quarterly reports separately.

**Q8:** MAS seeks your views on the proposal to require quarterly reports to be prepared and sent to investors for each of the first, third and fourth quarters.

4 We do not propose to require a quarterly report for the second quarter as a semi-annual report must already be sent within 2 months of the end of the reporting period. However, information that would otherwise be contained in a quarterly report should be incorporated in the semi-annual report. Although an annual report will be sent to unitholders after the financial year end, we believe that investors would find a timely fourth quarter report useful since the annual report is due only 3 months after the end of the period.

**Q9:** MAS seeks your views on the proposal to incorporate the report for the second quarter in the semi-annual report.

<sup>5</sup> For a hedge fund with financial year ending 31 Dec, the manager would have to prepare 1 annual report for the year ending 31 Dec, 1 semi-annual report for the half year ending 30 Jun and 3 quarterly reports for the quarters ending 31 Mar, 30 Sep and 31 Dec.

## Section 2: Timeliness of reporting

5 To meet the objective of providing investors with timely information, MAS proposes that for single hedge funds, quarterly reports are to be sent to investors within 1 month of the end of the quarter. For fund of hedge funds (“FOHFs”), we propose that quarterly reports are to be sent to investors within 45 days. MAS proposes that the current time frames for sending the annual and semi-annual reports of a scheme should apply to hedge funds.

**Q10:** MAS seeks your views on the proposed time frame for the sending of quarterly reports. For single hedge funds, quarterly reports are to be sent to investors within 1 month of the end of the quarter. For fund of hedge funds, quarterly reports are to be sent to investors within 45 days.

## Section 3: Content of Annual and Semi-Annual Reports

6 *Adherence to Recommended Accounting Practice 7 (“RAP 7”):* MAS already requires that the semi-annual and annual reports for schemes (see Appendix A) be prepared in accordance with RAP 7, which states that fundamental accounting concepts and policies should generally comply with the measurement principles of the Financial Reporting Standards of Singapore. MAS is of the view that the RAP 7 requirements may be adapted for hedge funds. Where hedge funds feed into underlying funds that might not follow RAP 7 or rely on other accounting standards, it would be sufficient for the manager to comply with RAP 7 to the extent possible.

7 *Classification of Investments:* MAS proposes that investments of single hedge funds and FOHFs should be classified by country, and where applicable, asset class and credit rating of debt securities. For FOHFs, investments by “strategy” should also be disclosed.

8.1 *Portfolio Statement and Top 10 Holdings:* MAS is aware that there are instances where the disclosure of individual holdings of the hedge fund could be unduly burdensome for the manager or detrimental to investors' interests if it creates opportunities for other players in the market to trade against the fund. MAS is prepared to allow hedge fund managers some flexibility in this regard. We propose to waive the requirement to disclose the portfolio statement and top 10 holdings where the manager and trustee / board of directors are of the view that such disclosure could put investors' interests at risk.

8.2 In cases where the portfolio statement and top 10 holdings are not disclosed, MAS proposes that the manager disclose the aggregate exposure for the hedge fund categorised according to criteria such as country, industry and/or asset class. Such exposures could be further broken down into gross long and short positions. For FOHFs, the number of underlying fund managers included in the scheme and where applicable, the number of underlying fund managers under each hedge fund category (for multi-strategy FOHF) should also be disclosed.

9 MAS is also of the view that performance fees, which is not included in RAP 7, is relevant for reporting on hedge funds. The certification by the hedge fund manager as to its monitoring and management of risk could also be included in the fund's annual report.

10 *Performance Fees:* A common feature of hedge funds is the charging of performance fees which are usually set at a substantial quantum (e.g. 20%) of profits earned above an identified watermark or benchmark. MAS proposes that the actual amount retained by managers over the period reported on should be disclosed.

11 *Certification as to Monitoring and Management of Risk:* Appendix 4 of the Code states that the senior management of a hedge fund manager must certify annually that the procedures and controls for monitoring the management and risk of the fund ("annual certification") are as set out in the prospectus. For a Singapore constituted FOHF that feeds into a foreign FOHF, the annual certification should be by the manager of the

Singapore constituted FOHF. The manager, should be satisfied that the manager of the foreign FOHF has put in place adequate monitoring and risk management procedures. This certification could be included in the annual report. Any changes to these procedures and controls should also be disclosed.

**Q11:** MAS seeks your feedback on whether the existing requirements on the content of semi-annual and annual reports are relevant to hedge funds. MAS also seeks your views on the proposals relating to adherence to RAP 7, classification of investments, individual holdings and performance fees and inclusion of the annual certification in the annual report

#### **Section 4: Content of Quarterly Reports**

12 The proposed quarterly report is intended to provide investors with a concise update on the activities and operations of the hedge fund on a timely basis.

13 A qualitative report by the manager will be useful to hedge fund investors. MAS proposes that managers provide appropriate information to give investors an overview of the management and investments of the hedge fund for the past quarter and going forward. The report should include key factors that have impacted the fund's financial performance, style drifts, market outlook and any changes in key investment personnel<sup>6</sup>.

14 In terms of quantitative disclosure, MAS proposes that the following items on performance, risk and current exposure be included as they would be relevant to the investment decisions of the investor.

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<sup>6</sup> As part of the review of its Code of Ethics and Standards of Professional Conduct, the Investment Management Association of Singapore is currently examining whether disclosure of changes to key personnel of a fund manager should be required for all funds.

(a) Performance

- Total return<sup>7</sup>(net of fees and charges) for the past month, 3 months and for each year for the past 3 years or since inception

(b) Risk

- Annualised standard deviation<sup>8</sup> and Sharpe ratio<sup>9</sup> each year for the past 3 years or since inception
- Highest and lowest NAV per unit each year for the past 3 years or since inception
- Amount of borrowings and other sources of leverage e.g. margin trades as at the end of the reporting period

(c) Current Exposure

- Fund size and NAV per unit as at the end of the reporting period
- Aggregate exposure for the scheme classified, such as, by country, industry and/or asset class as at the end of the reporting period. For FOHF, the number of underlying fund managers included in the scheme and where applicable, the number of underlying fund managers under each hedge fund category (for multi-strategy FOHF) should also be disclosed.
- Illiquid holdings<sup>10</sup> as at the end of the reporting period
- Amount of seed money contributed by the manager or its related entities as at the end of the reporting period

Note: The calculation basis, definition and any assumptions used should be provided, wherever appropriate.

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<sup>7</sup> Defined as net investment gains or losses and income after taxes.

<sup>8</sup> Defined as the square root of the squared deviations of the actual returns from the simple average return based on the dealing days of the scheme, divided by the number of observations, shown on an annualised basis.

<sup>9</sup> Defined as annual return divided by annualised standard deviation.

<sup>10</sup> Defined as assets for which there are no readily available market values to be transacted between knowledgeable and willing parties in an arm's length transaction, or with no registered turnover in the last 30 days prior to and including the reporting date. For FOHFs, investments in an underlying fund need not be classified as illiquid as long as redemptions for the underlying fund are not suspended, notwithstanding that the frequency of redemption may be less than once every 30 days. For FOHF, the manager must disclose the name, acquisition cost and latest status of underlying funds suspended during the reporting period.



**Q12:** MAS seeks your views on the proposed content for quarterly reports and your input as to other items that should be disclosed.

### **Section 5: Capital Protected or Capital Guaranteed Hedge Funds**

15 MAS is also seeking industry comment on whether the quarterly reporting requirement should be applied to capital protected or capital guaranteed hedge funds. A significant portion of the assets of such funds would be invested in instruments such as fixed income securities to provide capital protection. As these funds are very similar to other capital protected and capital guaranteed funds, which are not subject to quarterly reporting, MAS proposes not to require quarterly reporting for such funds.

**Q13:** MAS seeks your views on the proposal **not** to require managers of capital protected or capital guaranteed hedge funds to prepare quarterly reports.

Appendix A:

**Content required in a semi-annual report**

A) Investment report by the manager

B) Disclosure required under paragraph 7 of the Code

- a) Investments classified by country, strategy of the hedge fund and where applicable, asset class and credit rating of debt securities.
- b) Top 10 holdings;
- c) Exposure to derivatives and the net gains/losses on derivative contracts;
- d) Investments in other schemes;
- e) Borrowings;
- f) Redemptions and subscriptions;
- g) Related-party transactions;
- h) Performance of the scheme and where applicable, performance of the benchmark;
- i) Expense ratio;
- j) Turnover ratio;
- k) Any material information that might adversely impact the valuation of the scheme;

- l) Where the scheme invests more than 30% of its deposited property in another scheme, the top 10 holdings, expense ratio and turnover ratio of the underlying scheme<sup>11</sup> should be disclosed; and
- m) A statement describing the soft dollars received and confirming that the goods and services received were for the benefit of the scheme, the trades were executed on the best available terms and there was no churning of trades.

C) Half-yearly financial statements required under paragraph 7.1.2 of the Code and prescribed in Recommended Accounting Practice 7: Reporting Framework for Unit Trusts

- a) **Statement of Total Return** - comprising net investment gains or losses (capital gains/losses) together with income after tax (dividends or interest) less expenses.
- b) **Statement of Movements in Unit holders' Funds** - shows growth resulting from the creation of units or contraction resulting from the cancellation of units or distributions to unit holders.
- c) **Balance Sheet** – includes all assets and liabilities
- d) **Portfolio Statement** – Value of each investment and the percentage for each classification of investment
- e) **Summary of Financial Highlights**
  - Per unit NAV at the beginning of the period
  - Per unit net investment income or loss

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<sup>11</sup> Where the underlying scheme is managed by a foreign manager which belongs to the same group of companies as, or has a formal arrangement or investment agreement with, the Singapore manager, the above information should be disclosed on the underlying scheme. In other cases, such information on the underlying scheme should be disclosed only if it is readily available to the Singapore manager.

- Per unit realised and unrealised gains and losses
- Per unit distribution to unit holders
- Per unit total return
- Expense ratio
- Net investment income to weighted average net assets
- Portfolio turnover ratio
- 10 largest holdings

f) **Notes to the financial statements** - including material accounting policies used in preparing the financial statements and any information that is required for the financial statements to be presented fairly, in all material respects.

[Note: The half-yearly financial statements need not be audited.]

### **Content required in an Annual Report**

A) Investment report by the manager

B) Disclosure required under paragraph 7 of the Code

[See requirements for semi-annual report above.]

C) Audited financial statements

[See requirements for semi-annual report above.]

D) Report by the auditor

E) Report by the trustee

F) Statement of responsibilities of the trustee

## Chapter V: Investment Guidelines for Currency Funds

### Introduction

To broaden the range of collective investment schemes available to the investing public and deepen the pool of fund management expertise in Singapore, MAS proposes to introduce guidelines for schemes whose primary investment objective is currency positioning. The proposed guidelines (see Appendix B) set certain exposure limits and counter-party requirements.

2 Recognising that investments in non-deliverable forward contracts pose particular risks (e.g., liquidity risk) to the scheme, it is proposed that the total exposure to such instruments should not exceed 10% of the deposited property of the scheme. Similarly, we intend to limit the exposure arising from writing currency options at 10% of the deposited property of the scheme. The proposed 10% limit helps ensure that the deposited property of the scheme is sufficiently diversified across various instruments.

3 As currency instruments are typically traded over the counter rather than on an exchange, we propose to require the scheme's counterparties in such transactions to be regulated financial institutions with a minimum short-term credit rating of Prime-1 by Moody's, A-1 by S&P or F-1 by Fitch Inc. This helps to minimise the risk of counter-party default. To help ensure diversification among different counter-parties, it is proposed that the total exposure of the scheme to a single counter-party should not exceed 10% of the deposited property of the scheme.

4 The proposed guidelines also deal with, among other things, eligibility criteria for managers of currency funds, risk management controls and disclosure requirements in prospectuses.

**Q14:** MAS seeks your views on the proposed guidelines set out in Appendix B.

Appendix B:

**Code on Collective Investment Schemes**

**Appendix 8: Currency Funds**

**1 Scope and Definitions**

1.1 These Guidelines apply to a scheme whose primary objective is to invest in currencies and/or in currency derivatives.

1.2 For the purposes of this Appendix:

- a) **Delta** means the change in the price of a call option for every one basis point move in the price of the underlying currency.
- b) **Eligible counter-party** means a financial institution that:
  - i) is regulated by a securities, futures, insurance and/or banking regulatory authority; and
  - ii) has received a minimum short-term rating of Prime-1 by Moody's, A-1 by Standard & Poor's or F-1 by Fitch Inc.
- c) **Eligible money market instruments or debt securities** means money market instruments or debt securities:
  - i) with remaining maturity of not more than 366 days; and
  - ii) either a minimum short-term credit rating of F-2 by Fitch Inc. or A-2 by Standard and Poor's (including such sub-categories or gradations therein), or where it only has a long-term credit rating, a rating of A by Moody's, A by Fitch Inc. or A by Standard and Poor's (including such sub-categories or gradations therein).

Where a money market instrument or debt security is issued by a supranational agency or other foreign entity and rated other than by the credit

rating organisations specified in c(ii) above, the manager must satisfy the trustee that the quality of the security is comparable to those with the aforementioned ratings.

Where a money market instrument or debt security is issued by a Singapore entity, including the Singapore Government and statutory boards, and is not rated, the manager must satisfy the trustee that the quality of the security is comparable to those with the aforementioned ratings.

## **2 The Manager**

2.1 The manager of a scheme should have expertise in managing such schemes. Where investment decisions are outsourced to a sub-manager or adviser, the sub-manager or adviser should have expertise in managing such schemes.

2.2 The manager, or where investment decisions are outsourced to a sub-manager or adviser, the sub-manager or adviser, should have at least 1 executive who has at least 5 years of experience in currency investment and management.

## **3 Risk Management & Monitoring Procedures & Internal Controls**

3.1 The manager of a scheme should have in place proper risk management and monitoring procedures and internal controls. The risk management process employed must enable the manager to monitor and measure, at any time, the exposure of the positions and their contribution to the overall risk profile of the portfolio.

3.2 The Authority will require senior management of a manager to certify annually in the annual report of the scheme that the procedures and controls for monitoring the management and risk of the scheme are as set out in the prospectus.

#### 4 Permissible Investments

The scheme may:

- a) enter into deliverable or non-deliverable currency forward contracts with an *eligible counter-party* using internationally standardized agreements;
- b) invest in currency options written by an *eligible counter-party* using internationally standardized agreements;
- c) invest in currency futures;
- d) write currency options that are fully covered;
- e) place deposits with a bank licensed under the Banking Act, Cap. 19 or an equivalent law in a foreign jurisdiction;
- f) invest in money market instruments or debt securities such as government or supranational bonds, Treasury bills, bank certificates of deposit, banker's acceptances, floating rate notes, commercial papers, trade bills, asset backed securities and repurchase agreements, and
- g) purchase units of a scheme which invests in the instruments listed in 4(e) and 4(f). Such investments would be subject to provisions in paragraph 4.3 of the Code, where applicable.

Forwards and options contracts entered into must be those which can be sold, liquidated or closed at their fair value by an offsetting transaction at any time.



## **5 Measure of Cover for Options Written and Risk Capital for Forwards**

5.1 For the purpose of determining if options written are “fully covered” [referred to in paragraph 4(d)], outstanding options written by the scheme as at the close of a business day, T, should be fully covered by underlying currencies held by the scheme at the close of business the preceding day, T-1. This means that the amount of underlying currencies held must be sufficient to match the *delta* exposure which exists or may arise as a result of the outstanding options written.

5.2 The manager should also set aside sufficient quantities of the underlying currencies or currencies that are highly liquid to match the potential losses that could arise as a result of the scheme’s forward contracts. The amounts proposed to be set aside (including the type of currency) should be disclosed in the prospectus.

## **6 Minimum Capital Reserve**

6.1 The scheme should maintain at least 20% of its net asset value in a capital reserve which should be in the form of deposits placed with a bank licensed under the Banking Act, Cap. 19 or an equivalent law in a foreign jurisdiction and has received a minimum short-term rating of Prime-2 by Moody’s, A-2 by Standard and Poor’s or F-2 by Fitch Inc. or *eligible money market instruments or debt securities*. This minimum capital reserve may be used to meet margin calls.

6.2 The borrowings of the scheme, the cover for options and the risk capital for forwards may not be counted towards this minimum capital reserve.

## **7 Exposure Limits of Scheme**

7.1 The scheme's exposure arising from a forward, option or futures contract should be calculated taking into account the daily marked-to-market value of the contract and an add-on/haircut to account for factors such as future market movements, the time needed to liquidate positions, the current values of the underlying currencies and the credit risk of the counterparty. If the foregoing approach is not appropriate, the exposure should be calculated based on an estimate of the maximum potential replacement cost of the contract.

7.2 The scheme's exposure should be calculated based on the following parameters:

- a) The exposure should be calculated not less than once every business day, using not less than a 99th percentile and one tailed confidence interval, and
- b) The exposure should be calculated assuming a holding period of not less than one month for each forward, option or futures position.

7.3 The method used for determining scheme's exposure should be disclosed in the prospectus and be subject to an assessment by the manager's in-house risk management experts or an independent expert.

7.4 The total exposure of the scheme to a counterparty, whether that counterparty is the issuer of securities or a party to any contract, should not exceed 10% of the net asset value of the scheme.

7.5 The total exposure arising from the options written by the scheme should not exceed 10% of the net asset value of the scheme.

7.6 The total exposure arising from the scheme's non-deliverable forward contracts should not exceed 10% of the net asset value of the scheme.

7.7 The total exposure arising from the scheme's investments in forward, option and futures contracts should not exceed 20% of the net asset value of the scheme.

## **8 Borrowing**

There should be no borrowing other than for the purposes of meeting redemptions of units and short term bridging requirements. Aggregate borrowings for such purposes should not exceed 10% of the net asset value.

## **9 Limited Liability**

The liability of investors should be limited to their investment in the scheme. For this purpose, the constitutive documents of the scheme should contain a provision limiting the liability of investors to their investment in the scheme.

## **10 Disclosure Requirements**

10.1 Where the scheme intends to use forwards or options as part of its investment strategies, a prominent statement to that effect must be included. The impact of the use of currency derivatives on the risk profile and volatility of the return of the scheme should also be disclosed.

10.2 The manager should disclose in the prospectus information on:

- a) the scheme's quantitative risk management limits;
  
- b) the manager's risk management process;

10.3 The manager should disclose in the semi-annual and annual reports to the participants:

- a) the total amount of realized net gain/loss on positions liquidated during the period;
- b) the change in unrealized net gain/loss on open positions during the period;
- c) the total amount of net gain/loss from all other transactions in which the scheme engaged in during the period, including interest and dividends earned;
- d) the total transaction costs incurred for the period, including management fees, investment advisory fees (if any) and commissions.

## **11 Breach of Limits**

11.1 Where the minimum capital reserve has been drawn down below the 20% specified in paragraph 6, the manager should within a reasonable period of time, but in any event no later than 3 months, take action to restore the minimum capital reserve. The period may be extended if the manager satisfies the trustee that such extension is in the best interest of participants. Such extension should be subject to monthly review by the trustee.

11.2 The minimum capital reserve, exposure limits and borrowing limit in paragraphs 6, 7 and 8 respectively are applicable at the time a transaction is entered into. Where any of these limits are breached as a result of:

- a) the appreciation or depreciation of the value of the scheme's assets; or
- b) any redemption of units or distributions made from the scheme,

the manager should not enter into any transaction that would increase the extent to which the relevant limit is breached. In addition, the manager should, within a reasonable period of time but no later than 3 months from the date of the breach, take action as is necessary to rectify the breach. This period may be extended if the manager satisfies the trustee that it is in the best interest of participants. Such extension should be subject to monthly review by the trustee.