

CONSULTATION PAPER

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Review of the Regulatory Regime Governing the Sale and Marketing of Unlisted Investment Products

MAS

Monetary Authority of Singapore

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PREFACE

The current global financial crisis has led regulators to re-examine aspects of their regulatory and supervisory approach. MAS announced in October 2008 that we would undertake a review of the sale and marketing of structured products.

2 MAS is proposing enhancements to the current regulatory framework to enable us to better achieve our supervisory objectives. The proposals focus on the regulatory regime for unlisted investment products that are commonly sold to retail investors. They aim to:

- (a) promote more effective disclosure by improving the quality of information available to investors;
- (b) strengthen fair dealing in the sale and advisory process; and
- (c) enhance MAS' powers under the Financial Advisers Act.

We propose to introduce the concept of complex investment product. Such products will be subject to an enhanced sale and marketing regulatory regime.

3 MAS invites interested parties to forward their views and comments on the issues outlined in the policy consultation paper. Written comments should be submitted to:

Market Conduct Policy Division
Capital Markets Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117

Email: investmentpdts_review@mas.gov.sg
Fax: (65) 6225 4063

4 MAS would like to request for all comments and feedback to be submitted by **23 April 2009**. Please note that all submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submissions.

1 INTRODUCTION

1.1 BACKGROUND

1.1.1 The global financial crisis has led regulators to re-examine aspects of their regulatory and supervisory approach, not just in Singapore but in many other jurisdictions. On 2 October 2008, MAS announced that we would undertake a review of the sale and marketing of structured products. This was in light of investors' experience with structured products that had defaulted or lost value as a result of the crisis, as well as international developments.

1.1.2 In conducting our review, MAS has taken into account public comments, investors' complaints, and our reviews of the systems and processes of the financial institutions along with developments in other jurisdictions. In reaching our proposals, we discussed with market practitioners, industry associations, the Consumers Association of Singapore ("CASE"), and the Securities Investors Association (Singapore) ("SIAS").

1.2 CURRENT REGULATORY REGIME FOR INVESTMENT PRODUCT

1.2.1 The offer and distribution of investment products are governed by the Securities and Futures Act ("SFA") and the Financial Advisers Act ("FAA") respectively. Our regulatory approach comprises two key elements: first, adequate disclosure by the issuer to investors of the features and risks of an investment product; and second, where advice is given, a reasonable basis for the adviser's recommendation.

1.2.2 Under the SFA, any offer of securities must be accompanied by a disclosure document, most often a prospectus. The issuer must include in the prospectus all the information that an investor would reasonably need to make a proper assessment of the securities being offered. The issuer and its advisers are responsible for ensuring the prospectus complies with the law. MAS checks, based on information provided by the issuer and its advisers, that the prospectus discloses the risk and product features, and that there are no false or misleading statements. If MAS is satisfied, we will register the prospectus. MAS does not judge the merits of the investment. This is expressly stated on the cover of the prospectus so that investors understand that the securities are not endorsed by MAS.

1.2.3 The FAA regulates the sale and advisory process for financial products, and sets out the steps to be followed when giving advice on investment products. Financial institutions and their representatives must have a reasonable basis when recommending investments, having considered the investment objectives, financial situation and needs of the investor. Financial institutions bear the primary responsibility for ensuring that they and their representatives comply with these requirements. MAS supervises the industry using a range of supervisory tools. These include conducting offsite reviews and thematic inspections. In 2006, MAS conducted a mystery shopping survey of the practices in the financial advisory industry.

1.2.4 Since the implementation of the SFA and the FAA in 2002, MAS has regularly reviewed and amended these key pieces of legislation to take into account market developments and innovation. In 2004, MAS prescribed structured deposits as an investment product under the FAA to address concerns that structured deposits were being marketed as conventional fixed deposits. We issued the *Guidelines on Structured Deposits [FAA-G09]* to require banks to separate the sale of structured deposits from other deposit products at their premises, and to have clear and adequate product disclosures.

1.2.5 MAS found that banks were also selling products where the issuer may not be under an obligation to return to investors the full principal at maturity, as structured deposits. MAS considered that these products should not be marketed as structured deposits as they do not bear the characteristics of a deposit. To enhance disclosures of the features and risks of such products, MAS defined them as structured notes and imposed prospectus disclosure requirements on their offers¹. MAS further clarified that the FAA would apply in its entirety to the sale of structured notes.

1.2.6 To complement the regulatory requirements set out in the SFA and the FAA, MAS published a set of good practices on 17 November 2004 that financial institutions are encouraged to follow when dealing with retail investors². For example, financial institutions are encouraged to have supervisors review the recommendations made by representatives. Where customers are illiterate or not fluent in English, representatives should suggest that the customer be accompanied by someone who is able to explain what is being presented by the representative. Alternatively, the

¹ *Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005*

² *Information Paper on Good Practices for Licensed and Exempt Financial Adviser [FAA-IP01]*

representative's supervisor should be present during these sales presentations.

1.2.7 MAS also set out in its proposed *Guidelines on Fair Dealing – Board and Senior Management Responsibility for Delivering Fair Dealing Outcomes to Consumers (“Fair Dealing Guidelines”)* on 21 February 2008 its expectations that the board and senior management of financial institutions bear primary responsibility for embedding a culture of dealing with their customers fairly. The *Fair Dealing Guidelines* explicitly articulate the five fair dealing outcomes which financial institutions are expected to achieve, and provide guidance on issues that the board and senior management of financial institutions should address for each outcome. The five outcomes are:

- (a) Customers have confidence that they deal with financial institutions where fair dealing is central to the corporate culture;
- (b) Financial institutions offer products and services that are suitable for the customer segments they target;
- (c) Financial institutions appoint competent representatives who provide customers with advice that meet their financial objectives and suit their personal circumstances;
- (d) Customers receive clear, relevant and timely information to make informed financial decisions; and
- (e) Financial institutions handle customer complaints promptly and in a consistent manner.

1.2.8 We have received feedback on the *Fair Dealing Guidelines* from the industry and consumer groups. MAS is refining the *Fair Dealing Guidelines* to take into account this feedback. We will issue the *Fair Dealing Guidelines* by the end of March 2009.

2 ENHANCED REGIME FOR INVESTMENT PRODUCTS

2.1 APPROPRIATENESS OF CURRENT REGULATORY APPROACH

2.1.1 Recent events have led to questions whether the current regulatory approach is appropriate in view of the nature and risks of complex investment products. There have been suggestions that regulators should take on the responsibility for approving products before they can be sold to retail investors.

2.1.2 MAS has considered these issues carefully. In some situations, the complexity of an investment product may make it difficult for some categories of retail investors to fully appreciate all of its features and risks in the absence of advice.

2.1.3 However, there are a number of reasons why MAS considers it undesirable for a regulator to certify whether products are suitable for retail investors. First, there is a wide range of investors who have different needs and risk appetites. The suitability of a product for an investor depends on individual circumstances and his investment portfolio. We would normally not seek to supplant investor judgment or curtail the range of investment options for all investors.

2.1.4 Second, financial institutions should be responsible for determining and ensuring the investment products that they sell are suitable for their customers. They are better placed to perform this function because the suitability assessment can be better done on an individual, customer-by-customer basis.

2.1.5 Third, investors may place false comfort in investment products that have been certified by the regulator. This is undesirable as they may invest without further consideration as to whether the product is suitable for their individual profiles and needs. Furthermore, an investment product that has undergone suitability assessment by a regulatory authority may not necessarily be a “safe” investment product. While some investment products may be of lower risk than others, investors could still suffer losses on them.

2.1.6 For these reasons, we are of the view that MAS should not take on the role of approving investment products that are to be offered to retail

investors. This approach is in line with that in other jurisdictions such as the US, UK, Australia and Hong Kong³.

2.1.7 Nevertheless, it is clear that some changes are required. By enhancing our current regulatory framework and requiring a change in culture by financial institutions that sell investment products, we will be able to better achieve our supervisory objectives.

2.2 SCOPE OF REVIEW

2.2.1 Investors in Singapore have access to a wide range of listed and unlisted investment products. The former includes shares, warrants, bonds and exchange-traded funds, while the latter includes unit trusts, life policies, debentures and structured deposits.

2.2.2 The proposals in this consultation paper focus on enhancing the regulatory regime for unlisted investment products which are commonly sold to retail investors. Specifically these are debentures (including structured notes⁴) and collective investment schemes ("CIS") which are not traded on an approved exchange as defined under the SFA, and life policies (including investment-linked life insurance policies ("ILPs")).

³ We note that several jurisdictions are reviewing their regulatory approaches. In the *Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies (2008)*, the Hong Kong Monetary Authority ("HKMA") stated that it "favours retention of the present disclosure-based system rather than a removal of choice of investment to such a degree as to ban certain products". The Hong Kong Securities and Futures Commission in its *Issues Raised by the Lehman's Minibonds Crisis - Report to the Financial Secretary (2008)*, recommended that Hong Kong maintains the regulatory philosophy of disclosure rather than merit regulation. We will continue monitoring regulatory developments in other jurisdictions.

⁴ "Structured notes", as defined in the *Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005* means any type of debentures or units of debentures –

(a) which are issued –

(i) pursuant to a synthetic securitisation transaction; or
(ii) by a specified financial institution; and

(b) in respect of which

(i) either or both of the principal sum and any interest are payable;
(ii) one or more of the underlying securities, equity interests, commodities and currencies are to be physically delivered; or
(iii) either or both of the principal sum and any interest are payable, and one or more of the underlying securities, equity interests, commodities and currencies are to be physically delivered,

in accordance with a formula based on one or more of the following:

(A) the performance of any type of securities, equity interest, commodity or index, or of a basket of more than one types of securities, equity interests, commodities or indices;
(B) the credit risk or performance of any entity or a basket of entities;
(C) the movement of interest rates or currency exchange rates.

2.2.3 To better safeguard consumers' interests, we will consider a review of the sale and marketing of structured deposits and dual currency investments to harmonise their current requirements with the proposed regime for unlisted investment products. Listed investment products are not covered in this consultation paper given their different features. We will consider whether enhancements are required for listed investment products as part of a separate exercise⁵.

2.3 OBJECTIVES

2.3.1 Our proposals, which are a combination of new legal obligations and enhancements of existing requirements, aim to:

- (a) promote more effective disclosure by improving the quality of information given to investors;
- (b) strengthen fair dealing in the sale and advisory process; and
- (c) enhance MAS' powers for breaches of the FAA.

2.3.2 In addition to the enhanced requirements for unlisted investment products, we are introducing proposals specific to the sale and marketing of complex investment products. The concept of complex investment products is derived from the European Union ("EU") *Markets in Financial Instruments Directive* ("MiFID").

2.3.3 Taken together, our proposals are intended to reinforce the five fair dealing outcomes set out in the *Fair Dealing Guidelines*. In some areas set out below, we will make some aspects of these guidelines mandatory. For example, we discuss in section 4.1 the proposal for financial institutions to conduct formal due diligence for any new investment product or service before they market or distribute it to their customers.

2.3.4 The purpose of the *Fair Dealing Guidelines* goes beyond mere compliance with technical regulatory requirements. At their heart, the *Fair Dealing Guidelines* are about financial institutions moving away from an exclusive focus on commission-driven short-term product sales. The *Fair*

⁵ Listed investment products are traded on an exchange. The continuous disclosure obligations imposed by the exchange mitigate concerns on information asymmetry. There is a price discovery process and investors are able to sell their shares on the exchange if they decide to exit their investment. This is in contrast to unlisted investment products for which information and pricing may not be readily available or accessible to investors. Investors of an unlisted investment product such as a fixed maturity structured note can only exit from his investment if the issuer has a buy-back mechanism in place, and the computation of the buy-back price may not be transparent to investors.

Dealing Guidelines call for financial institutions to review the way in which they deal fairly with and provide real long term value for their customers. Only in this way can financial institutions truly rebuild consumer confidence and trust.

3 PROPOSALS TO PROMOTE MORE EFFECTIVE DISCLOSURE

3.0.1 The proposals in this section⁶ seek to promote more effective disclosure by improving the quality of information available to consumers in the following three areas: (i) the initial disclosures to consumers before a transaction is concluded; (ii) ongoing disclosures to investors during the life of the investment; and (iii) marketing and advertising of the investment product. The aim is to equip investors to make informed investment decisions.

3.1 PRODUCT HIGHLIGHTS SHEET

3.1.1 There is a generally held view that the prospectus has been largely ineffective as a primary disclosure document in helping investors make informed investment decisions. Investors find prospectuses difficult to read and understand as they tend to be drafted in a legalistic manner. The length of some prospectuses may even deter investors from reading them at all.

3.1.2 We considered abolishing the prospectus requirement and moving to a simpler product disclosure regime for investment products. However, while we aim to make the disclosure document as simple and effective as possible for retail investors, we consider it important that issuers have a legal obligation to disclose all material information. In trying to address these twin objectives within a single document, concerns about legal liability inevitably lead to longer and less user-friendly documents. We are of the view that it would be more effective to require a separate simplified document in addition to the prospectus. We also consider that this proposal would be able to be introduced relatively more quickly with less cost to industry⁷.

3.1.3 Several jurisdictions have implemented simplified disclosure initiatives to deal with issues encountered with prospectuses. In November 2007, the US Securities and Exchange Commission ("SEC") announced new regulations that require every prospectus for mutual funds to include a summary section at the front of the prospectus, setting out key information about the fund in clear, concise language. The SEC's stated intention is for

⁶ Proposals apply to unlisted investment products, which are debentures (including structured notes), CIS and ILP sub-funds. ILP sub-fund refers to each separate sub-fund within an ILP to which a policyholder can choose to allocate his premiums.

⁷ Depending on our experience with the separate simplified document and developments in other jurisdictions, we may revisit the need to review the current prospectus requirements at a later stage.

the information to be presented succinctly, in three or four pages, at the front of the prospectus in plain English in a standardised order.

3.1.4 In the EU, the Commission of European Securities Regulators (“CESR”) is currently developing a two-page Key Investor Information document to replace the simplified prospectus required for unit trusts. The simplified prospectus, which is prepared by the unit trust provider, aims to present the principal features of the unit trust to prospective investors. It is meant to be in a readily understandable format so that it can be used prior to any sale for comparisons to be made between unit trusts. In practice, as unit trust providers tend to include too much detail in the document, many simplified prospectuses have become too long and complex for the majority of retail investors to understand⁸.

3.1.5 In Australia, issuers of financial products are required to issue a Product Disclosure Summary. The Product Disclosure Summary is to contain the information on a financial product that a person would reasonably require to make a decision on whether to purchase the product. Product Disclosure Summaries have, as a rule, turned out to be complex and lengthy documents. In December 2005, the Australian Securities and Investments Commission (“ASIC”) amended the regulations to give issuers of financial products the option of providing a ‘short form’ Product Disclosure Summary that contains core information, with the full Product Disclosure Summary available on request or through an easily accessible forum, such as the internet.⁹

3.1.6 Having considered the experiences of overseas jurisdictions and the merits of a separate simplified disclosure document, MAS proposes to develop a Product Highlights Sheet to supplement the prospectus¹⁰. The separation of the two documents serves to distinguish the different focus of these documents - the prospectus is to contain all material information that an investor would reasonably require to make an investment decision, and the Product Highlights Sheet is to highlight key information to investors in a clear, concise and effective manner. The Product Highlights Sheet must be given together with the prospectus to investors before they make investment decisions.

⁸ *CESR Consultation Paper on content and form of Key Investor Information disclosures for UCITS*, October 2007

⁹ *Financial Services Regulation (FSR) Refinements 2005*

¹⁰ “Prospectus”, as used in this context, refers to the Product Summary and sample benefit illustrations in the case of ILPs.

3.1.7 Issuers will be responsible for preparing the Product Highlights Sheet. The Product Highlights Sheet will contain disclosure of key information in plain language in a “Question & Answer” format. Issuers should present answers to the questions set out below in clear and simple language that investors can easily understand. We encourage issuers to use pictorial depictions to make it easier for readers to understand the information presented. To ensure that the Product Highlights Sheet does not become too long, the length of the document will be capped at four pages. Information in the Product Highlights Sheet should be presented in a font size of at least 10-point Times New Roman.

3.1.8 The proposed key questions to be covered in the Product Highlights Sheet are set out in the table below.

PRODUCT HIGHLIGHTS SHEET
KEY PRODUCT FEATURES AND RISKS
1. What are you investing in and who are you investing with? <ul style="list-style-type: none">The objective of this question is for the issuer to describe the nature of the product and state the parties involved.
2. What are the key risks of this investment? <ul style="list-style-type: none">The objective of this question is to allow investors to be aware of the key risks of the investment which they are exposed to.
3. What will you gain or lose in different situations, including the worst case? <ul style="list-style-type: none">The objective of this question is to allow investors to be informed of what they could potentially gain or lose in different situations, including the worst case.
PRODUCT SUITABILITY
4. Is the product suitable for investors who: <ul style="list-style-type: none">do not want to risk any part of their capital?might need to sell their investments for short-term funding requirements?do not have sufficient knowledge or experience investing in derivatives? <ul style="list-style-type: none">The objective of this question is to highlight to investors whether the product is suitable for investors whose investment objective is to preserve capital, investors who have liquidity needs, and investors who lack knowledge or experience in dealing with derivatives.
MINIMUM INVESTMENT AMOUNT, FEES AND CHARGES
5. How much are you paying for this investment? <ul style="list-style-type: none">The objective of this question is to inform investors of the minimum investment sum and the fees and charges of the distributors, fund managers and product providers¹¹, where applicable.
LIQUIDITY
6. How often are valuations available?

¹¹In the case of ILPs, *MAS Notice 307* requires fees and charges to be differentiated into payments through deduction from premium or cancellation of units, or payments through deduction in value of ILP sub-fund.

- The objective of this question is to inform investors whether regular valuations are available and how to obtain them. If valuations are not readily available, the investor should be informed of the associated risks.

7. How can you exit from this investment and what are the risks and costs in doing so?

- The objective of this question is to inform investors of the mechanism by which investors can exit from their investment in the product and if the mechanism poses any risks or costs to investors, to highlight the risks and costs involved.

STRUCTURAL SAFEGUARDS

8. Are the issuer, arranger and counterparties in Singapore and governed by Singapore law? If not, how does it affect you?

- The objective of this question is to highlight to investors whether the transaction parties involved in the product are entities in Singapore and subject to Singapore law. If not, the associated risks are to be highlighted to investors.

9. Is the investment secured by assets in Singapore? If not, how does it affect you?

- The objective of this question is to highlight to investors whether the assets securing the investment are located in Singapore. If not, the associated risks are to be highlighted to investors.

10. Is any aspect of the investment that has a material impact on you governed by foreign law? If so, how does it affect you?

- The objective of this question is to highlight to investors whether any aspect of the investment that has a material impact on investors is governed by foreign law. If so, the associated risks are to be highlighted to investors.

OTHER RELEVANT INFORMATION

11. How do you contact us?

- The objective of this question is to establish the means by which investors may obtain information or raise complaints.

12. What other important information should you know before you invest?

- The objective of this question is to allow issuers to highlight any other material information which investors should know before investing in the product.

3.1.9 The Product Highlights Sheet must: (i) not contain false or misleading statements; (ii) sufficiently disclose the information in the prescribed format; and (iii) be written and presented in a clear, concise and effective manner. Failure to comply with these requirements will be a breach of the law. For purposes of statutory liability, the Product Highlights Sheet will be treated as part of the prospectus, even though it is to be a physically separate document. Persons liable for complying with the prospectus requirements will be liable for the Product Highlights Sheet.

3.1.10 Issuers and their advisers will have the primary responsibility to ensure that the Product Highlights Sheet complies with regulatory requirements. The key role of MAS, as in the case of the prospectus, will be to check based on information provided by issuers whether the Product Highlights Sheet meets the regulatory requirements stated above prior to the registration of the prospectus. MAS will also be empowered to issue a stop order and prevent further issues of securities when a Product Highlights Sheet is found not in compliance with any of the requirements post-registration.

3.1.11 Apart from public consultation, MAS will work with industry and consumer groups to refine the Product Highlights Sheet's content. We will conduct consumer testing to enhance the Product Highlights Sheet's readability and effectiveness. We will also propose specific financial education activities to help investors understand how to use the Product Highlights Sheet.

3.1.12 For particular unlisted investment products, there may be specific features or additional information that should be disclosed to investors in the Product Highlights Sheet. For example, the turnover and expense ratios of CIS should be disclosed as these directly impact the expected returns. MAS will work with the industry to identify the specific features for particular products that should be disclosed.

Q1: MAS seeks views on the proposal to require issuers to prepare a Product Highlights Sheet to accompany an offer of an unlisted investment product where the offer requires a prospectus to be issued.

Q2: MAS seeks views on the proposed form and content of the Product Highlights Sheet.

Q3: MAS invites suggestions on how the Product Highlights Sheet can be made more readable and useful for investors.

Q4: MAS invites suggestions on additional information and specific features that should be disclosed in the Product Highlights Sheet for particular products.

3.2 TIMELY AND MEANINGFUL ONGOING DISCLOSURE

3.2.1 Some investors of the defaulted structured notes have complained that they were not sufficiently updated about developments concerning their structured notes investments. Some investors also argued that if they had received regular updates on their investments, they would have been better able to make informed decisions to protect their interests. These may include liquidating their investments and realising their losses. Investors of the affected structured notes have also complained that they were unaware of the diminution of the value of their investments during the period prior to the failure of Lehman Brothers. While information on the indicative value of their investments is available to investors on request, investors tend to ask for this information only when they intend to liquidate their investments.

3.2.2 We consider that investors in unlisted investment products should receive timely and meaningful ongoing disclosures regarding their investments. Where prospectus requirements apply, we propose to impose specific ongoing disclosure requirements on issuers of unlisted investment products, so that investors are informed about material developments concerning their investments.

3.2.3 MAS proposes to require issuers of unlisted investment products to:

- (a) make available semi-annual and annual reports to update investors on their investments and explain to investors the

- calculation of actual returns received and any significant deviation from advertised returns; and
- (b) report material changes which may affect the risks and returns of the unlisted investment product to investors as and when these changes occur.

3.2.4 MAS also proposes to require issuers to make available, publicly and regularly, bid or redemption prices of each product. This will give investors an indication of the price at which they can exit the investment. Where and when these bid or redemption prices can be readily found should be disclosed to investors through the disclosure documents, including the Product Highlights Sheet. This is to ensure that investors have access to regular and transparent valuation of their investments.

Q5: MAS seeks views on the proposal to impose the specific ongoing disclosure requirements described above to issuers of unlisted investment products, where prospectus requirements apply. MAS invites suggestions for additional ongoing disclosure requirements.

Q6: MAS seeks views on the proposal to require issuers to make available, publicly and regularly, bid or redemption prices.

3.2.5 The proposed requirements set out above are to be applicable to all unlisted investment products where the offer requires a prospectus to be issued. For products such as CIS and ILPs which have existing requirements for ongoing disclosures, MAS will incorporate the proposed requirements into the existing regulations.

3.3 FAIR AND BALANCED MARKETING AND ADVERTISING MATERIALS

3.3.1 Under the SFA, marketing and advertising materials for securities must not provide information which is not included in the prospectus¹², and must not be false or misleading¹³. In addition, financial institutions are guided by the *Code of Advertising Practices* for banks and the *Code of Best Practices in Advertising CIS and ILPs* issued by the Association of Banks in Singapore

¹² Sections 282L and 300 of the SFA

¹³ Regulations 16 and 17 of the *Securities and Futures (Offers of Investments)(Shares and Debentures) Regulations 2005*, and Regulation 21 of the *Securities and Futures (Offers of Investments)(Collective Investment Schemes) Regulations 2005*

("ABS"), and the Investment Management Association of Singapore ("IMAS") and the Life Insurance Association ("LIA"), respectively.

3.3.2 The *Code of Advertising Practices* states that advertisements should present a balanced picture of the product. The main risks and drawbacks should be highlighted and the "headline" benefits should be realistic and not based on an optimistic view of events. The *Code of Best Practices in Advertising CIS and ILPs* states that advertisements should not have exaggerated claims or unsupportable assertions in the headlines, which could create unrealistic expectations. It also advises against the misuse of fine print and specifies the minimum font size of the main text and footnotes. While the industry has been encouraged to closely adhere to the industry codes in preparation of their advertising materials, investors would have limited legal recourse by citing breaches of industry codes.

3.3.3 While investors should read the product disclosure documents, some investors may place undue reliance on the information contained in marketing and advertising materials. Many investors have given feedback to MAS that advertisements generally tend to emphasise the benefits rather than the risks of investment products. As such, MAS considers we should enhance the current regime governing marketing and advertising for unlisted investment products to ensure that marketing and advertising materials present a realistic and balanced impression of an investment product, and its features and risks. Our proposals aim to improve the presentation and content of marketing and advertising materials.

3.3.4 MAS proposes to require marketing and advertising materials for unlisted investment products to give a fair and balanced view of the product. While similar to the guidance under the current industry codes, making this a statutory requirement will enable MAS to take regulatory action where there is a breach. This will increase its deterrent effect. The requirement will also apply to financial institutions that are not members of these industry associations. Marketing and advertising materials which clearly set out both the potential upside and downside of the investment, and all material benefits and risks, will be considered fair and balanced. Marketing and advertising materials should also not give the impression that an investor can profit without risk.

3.3.5 To ensure that statements on the downsides or risks are legible and not downplayed, information contained in advertisements appearing in any document should be in a font size of at least 10-point Times New Roman.

Where information is contained in a footnote, the footnote should also be in a font size which is at least half the font size of the word or statement which it relates to, subject to a minimum of 10-point Times New Roman.

Q7: MAS seeks views on the proposal to require marketing and advertising materials for all unlisted investment products to give a fair and balanced view of the product.

3.3.6 MAS proposes to introduce the following restrictions on marketing and advertising materials for unlisted investment products. Such materials should not suggest that:

- (a) the product is, or is comparable to, a bank deposit; or
- (b) there is no or little risk of the investor losing his principal or not achieving the stated or targeted rate of returns.

3.3.7 Marketing and advertising materials should also not contain words or graphics that could convey an impression that is inaccurate or inconsistent with the nature or the risks of the product.

Q8: MAS seeks views on the proposal to introduce restrictions on marketing and advertising materials for unlisted investment products.

3.3.8 MAS does not pre-vet marketing and advertising materials. To ensure that investors are aware that marketing and advertising materials are not endorsed by MAS, we will require marketing and advertising materials to include a statement that marketing and advertising materials are not reviewed or endorsed by MAS.

3.3.9 Some investors have raised concerns that they have difficulty understanding the term “capital/principal protected” and how this term is different from “capital/principal guaranteed”. The added concern is that the Chinese translations of these terms may be the same. To prevent investors from mistaking a “capital/principal protected” product for a “capital/principal guaranteed” product, one option would be for MAS to consider prohibiting the use of the term “capital/principal protected”.

3.3.10 We note that “capital/principal protected” is a commonly used term to describe investment products with features aimed at preserving capital. A prohibition may have the unintended consequence of discouraging financial institutions from offering investment products with such features to investors. The alternative would be for the industry to develop and adopt a standard definition for the term “capital/principal protected. The industry should also develop accurate translations of the terms “capital/principal protected” and “capital/principal guaranteed”. Such an initiative should be complemented with investor education on these industry definitions. MAS invites industry initiatives to develop a standard industry definition of these terms.

Q9(a): MAS seeks views on the alternative proposals:

- (i) to prohibit the use of the term “capital/principal protected”;** or
- (ii) for the industry to develop a standard definition for the term “capital/principal protected” for unlisted investment products.**

Q9(b): MAS invites suggestions on how the terms “capital/principal protected” and “capital/principal guaranteed” can be accurately translated into other languages.

4 PROPOSALS TO STRENGTHEN FAIR DEALING IN THE SALE AND ADVISORY PROCESS

4.0.1 The proposals in this section seek to promote fair dealing in the sale and advisory process so that customers have confidence when they purchase investment products and receive advice from financial institutions. The proposals relate to requirements for distributors to (i) enhance product suitability assessment processes at company and customer levels; and (ii) restrict sale of investment products without advice.

4.1 ENHANCED DUE DILIGENCE FOR NEW PRODUCTS

4.1.1 In practice, financial institutions that distribute investment products (“distributors”) conduct due diligence before offering any new investment product or service to their customers to ascertain whether the new product or service is suitable for their customer base. They do this for both commercial reasons and as part of their obligation under the FAA to conduct a reasonable investigation of the product before making a recommendation. The extent of due diligence conducted by distributors may vary. It is possible for distributors selling the same product to have different assessments of the nature and risks. Even within the same company, some representatives may have an inconsistent understanding of the nature and risks of the same product if the due diligence process is not properly communicated to them.

4.1.2 Some jurisdictions¹⁴ have rules for distributors to exercise due care and diligence in selecting product providers or new products. MAS proposes to require distributors to put in place formal written policies and procedures to assess the nature of a new product and assess its suitability for targeted customer segments. The company level due diligence process will facilitate their representatives’ ability to provide a reasonable basis for their recommendations. This will build customer confidence that they are offered suitable products that meet their needs.

4.1.3 We recognise that distributors’ understanding of the features and risk-reward characteristics of the product and assessment of the product’s suitability for their customers may be based on information provided by the product provider. However, distributors should not accept or rely solely on the assessment of the product provider. As part of their due diligence process,

¹⁴ The US *NASD Notice to Members 05-26* and the UK *FSA Policy Statement 07/11*

distributors have the responsibility to properly assess any new product and reach an independent conclusion.

4.1.4 We propose to set out the key due diligence steps that must be followed by distributors. The due diligence on new products they intend to distribute should cover at least the following questions:

- Who is this product intended for? Does it match the company's customer base?
- What is the product's investment objective?
- How will the company determine which customers this product is suitable for given the risk profile and other features of the product?
- What are the risks for investors?
- What are the cost and fees for the investors?
- How will this product be sold?
- What is the remuneration for representatives? What steps will be taken to ensure the remuneration structure does not lead to product sales to unsuitable customers?
- Do the representatives have the necessary qualifications or competency to sell this product?
- Does the company's current system, including all relevant customer fact-find forms and other documents, support the sale of this product?
- Are there any additional legal, regulatory or tax considerations?

4.1.5 MAS will require the due diligence to be formally approved by the senior management of the distributor. For proper audit trail, distributors will be required to keep records of the approval and other supporting documents of the due diligence assessments.

Q10(a): MAS seeks views on the proposal to require distributors to put in place formal written policies and procedures to assess the nature of a new product and assess its suitability for targeted customer segments.

Q10(b): MAS seeks views on the proposed due diligence questions.

Q10(c): MAS invites suggestions on how to enhance the due diligence process for new products.

4.2 ADVISORY PROCESS

4.2.1 Financial advisory companies (“FA companies”) and their representatives (collectively referred to as “FAs”)¹⁵ are under the obligation to have a reasonable basis for their recommendations on investment products, having regard to the customer’s investment objectives, financial situation and particular needs. The *Notice on Recommendations on Investment Products [FAA N-01]* sets out the steps to be followed when giving advice. FAs must first collect information from the customer. They should then analyse the information and assess whether a product is suitable for the particular customer based on the information obtained before making a recommendation.

4.2.2 The sale and advisory process is typically a conversation between the representative and the customer. We have observed that some FAs’ documentation may not sufficiently detail the basis for their recommendations. For instance, it would not be sufficient to record generic reasons such as “the product is suitable for wealth accumulation” without explaining why the product is suitable for a particular customer. MAS considers that the requirements relating to documentation of the advisory process can be enhanced so that it details the steps taken by the representative when making a recommendation.

¹⁵ Unless otherwise specified, FAs refers to both the company and the representative.

Documentation of the Advisory Process

4.2.3 In the UK and Australia, the regulators set out in detail the requirements for documentation of the recommendation, such as the UK Suitability Report and Australian Statement of Advice. In the event of a dispute, the documentation of the advice serves as a useful record of the sales process and facilitates resolution of complaints.

4.2.4 We propose to enhance existing documentation requirements by requiring FAs to set out in more detail the basis for their recommendation. The basis for a recommendation must at least state the customer's objectives and needs, explain the reasons why the product is suitable having regard to the information obtained from the customer, and explain any possible disadvantages of the investment for the customer. FAs must fully document basis for recommendations given to customers. This will also help the customer to better understand why the product is suitable for him and to make an informed decision.

Enhance Quality of Information Collected by FAs

4.2.5 In addition, we consider it necessary to enhance the quality of information that FAs obtain from the customer. Currently, the *Notice on Recommendations on Investment Products [FAA-N01]* requires representatives to collect and document the following key information:

- (a) the financial objectives of the customer;
- (b) the risk tolerance of the customer;
- (c) the employment status of the customer;
- (d) the financial situation of the customer, including assets, liabilities, cash flow and income;
- (e) the current investment portfolio of the customer, including any life policy; and
- (f) for any recommendation made in respect of life policies, the number of dependants of the customer and the extent and duration of financial support required for each of the dependants.

4.2.6 MAS considers that FAs should also check the customer's ability to bear potential losses arising from the proposed investment. This information is necessary for FAs to advise more comprehensively on the appropriate asset allocation for a customer. In the UK and EU MiFID, there are such obligations on distributors. We propose to require FAs to obtain the following additional

key information:

- (a) information on the source and extent of the customer's regular income;
- (b) whether the amount to be invested is a substantial portion of the customer's assets; and
- (c) the regular financial commitments of the customer.

4.2.7 We propose that FAs make reasonable enquiries to obtain the key information stated above from their customers.

4.2.8 MAS considers representatives' failures to comply with these obligations as affecting whether they can continue to be considered fit and proper to be allowed to conduct regulated activities. We intend to make this more explicit in the *Guidelines on Fit and Proper Criteria [Guidelines No. FSG-G01]*. We also propose to make it an obligation for the FA company to put in place effective systems and internal controls to ensure that their representatives give a formal document recording the basis for a recommendation, and make reasonable enquiries to obtain key information from their customers.

Q11: MAS seeks views on the proposal to enhance existing documentation requirements by requiring FAs to set out in more detail the basis for their recommendation.

Q12: MAS seeks views on the proposal that representatives make reasonable enquiries to obtain key information from the customer.

Q13: MAS seeks views on the proposal to make it an obligation for FA companies to put in place effective systems and internal controls to ensure that their representatives fulfil these obligations.

4.3 RESTRICTIONS ON SALE WITHOUT ADVICE

4.3.1 Customers may choose not to provide information requested by the FA. Customers may also choose not to accept the recommendation of the FA and instead purchase another investment product which had not been recommended by the FA. In such situations, the obligation for the FA to conduct suitability assessments is not owed to the customers. The FA may

proceed with the customer's request for the transaction but not before highlighting to the customer that it is the customer's responsibility to ensure suitability of the product selected.

4.3.2 We note that giving advice involves time and costs on the part of FAs. Some FAs have adopted an "execution only" model where they do not offer advice to the customer for certain products that they distribute. To avoid FAs cherry-picking their regulatory obligations, MAS proposes that FAs may dispense with giving advice only when the customer contacts the FAs on his own initiative to purchase the investment product. For instance, we would consider customer self-directed purchases of investment products through internet portals as customer initiated, where FAs may dispense with advice to such customers.

4.3.3 Customers who purchase investment products without receiving advice from the FA may not be aware of or understand that they have little recourse in holding the FA responsible for not having a reasonable basis for a recommendation. Irrespective of whether it is the customer who chooses not to receive advice, or it is the FA who does not offer advice, MAS proposes to require that FAs warn customers in writing that the customer is waiving his right to receive advice as to whether a product is suitable for him under the FAA.

Q14: MAS seeks views on the proposal that FAs may dispense with giving advice only when the customer contacts the FAs on his own initiative to purchase the investment product.

Q15: MAS seeks views on the proposal to require that FAs warn customers in writing that the customer is waiving his right to receive advice as to whether a product is suitable for him under the FAA.

4.4 RESTRICTIONS ON BANK TELLERS' ACTIVITIES

4.4.1 Walk-in customers of banks cannot buy investment products from bank tellers¹⁶ as bank tellers are not authorised to sell such products. There is usually some form of physical segregation between representatives who sell

¹⁶ Bank tellers include counter staff dealing with customers for traditional bank-related transactions such as rollover of fixed deposits, updating of bank books and cash withdrawals.

investment products and bank tellers who attend to walk-in customers for traditional bank-related transactions. These representatives have distinct designations that reflect their roles.

4.4.2 We consider that customers seeking to conduct traditional banking transactions should not be aggressively targeted for referral to representatives to purchase investment products.

4.4.3 MAS proposes to prohibit bank tellers from referring customers to representatives for the purchase of investment products. This proposal will also apply to finance companies. Taken together with our earlier proposal to prohibit marketing and advertising materials that suggest that an investment product is similar to a deposit, customers will be able to better distinguish between the deposit-taking function performed by bank tellers and the sale of investment products by the representatives.

Q16: MAS seeks views on the proposal to prohibit bank tellers from referring customers to representatives for the purchase of investment products.

4.5 REMUNERATION FOR SALE OF INVESTMENT PRODUCTS

4.5.1 Currently, FAs are required to disclose the remuneration, including any commission, fee and other benefits, that the company receives that is directly related to the making of a recommendation on an investment product or the sale of a CIS or a life policy¹⁷. This covers remuneration such as fees charged to customers, commissions from the product provider, trailer commissions or such other benefits accruing to the company. The purpose of requiring such disclosure of remuneration is to enable customers to be aware of the costs of the financial advisory services rendered, and for them to be able to make informed decisions. There are equivalent requirements in overseas jurisdictions such as Australia, the US and the UK.

¹⁷ *Notice on Information to Clients and Product Information Disclosure [FAA-N03]*

4.5.2 For the life insurance industry, FAs are required to disclose the total distribution cost in the Benefit Illustration. The total distribution cost is defined as the sum of each year's expected distribution-related costs, without interest. Such costs include cash payments in the form of commission, and the costs of benefits and services paid to the distribution channel.

4.5.3 Views have been expressed that in addition to the disclosure of the remuneration received by the company, representatives should disclose the remuneration they receive from the sale of investment products. There are concerns that representatives may be financially motivated to sell particular products that may not be suitable for the customer.

4.5.4 There are practical implementation issues with requiring the disclosure of the representative's remuneration. There is no standard way in which FA companies remunerate representatives for advising and selling investment products. Remuneration for representatives could involve complicated point systems and targets that are not easily explained to customers in a meaningful manner at the point of sale.

4.5.5 Alternatively, distributors could address concerns that representatives may be financially motivated to sell particular products by implementing remuneration structures that seek to align representatives' interests with those of customers. Other jurisdictions are studying ways to address this issue. The UK Financial Services Authority ("FSA"), as part of its *Retail Distribution Review*, has proposed to distinguish independent advice from sales advice, as well as to modernise the way advice is paid for to reduce the conflicts of interest inherent in remuneration practices. For example, it is proposing to mandate that fees for advice from independent financial advisers should be agreed upfront with customers.

4.5.6 We will continue monitoring developments in other jurisdictions relating to the disclosure of and structure for remuneration of representatives. At this stage, MAS will formalise the expectation in the *Fair Dealing Guidelines* for the board and senior management to focus on ensuring that the remuneration structures are not only driven by sales volume but better align the interests of representatives and customers. We have observed some good practices where distributors take a balanced approach for their representatives' remuneration by including factors such as quality of advice and complaints received, to mitigate the potential for conflicts of interest.

Q17: MAS invites suggestions on how remuneration structures can better align the interests of representatives with those of customers.

5 ADDITIONAL PROPOSALS FOR COMPLEX INVESTMENT PRODUCTS

5.0.1 This section sets out the proposals to introduce the concept of a complex investment product and an enhanced regulatory regime for the sale and marketing of complex investment products.

5.1 DEFINITION OF “COMPLEX INVESTMENT PRODUCTS”

5.1.1 Some products will be more complex to understand than others. With ongoing financial innovation, there is no clear-cut boundary between products of different levels of complexity. Accordingly, we are proposing to take a prudent approach by having a single broad definition of “complex investment product” rather than trying to define different levels of complexity within the category of complex investment product.

5.1.2 We propose to define a complex investment product based on whether or not derivatives are embedded in the investment product. This is derived from the EU MiFID definition of “complex products”. The rationale is that the inclusion of derivatives in an investment product can lead to the product having features and risks which may be difficult for an investor to understand. We define “complex investment products” as:

- (a) Unlisted debentures which embed derivatives; and
- (b) Unlisted CIS and ILPs where the funds in which the ILPs invest in have an investment approach directed at delivering returns from investments in derivatives¹⁸.

Structured notes, and CIS and ILP sub-funds investing in structured products will be captured within this definition.

5.1.3 Defining complex investment products as products with embedded derivatives may be overly simplistic. As it is difficult to draw a line between derivatives that are simpler and those that are more exotic, we propose to include all derivatives. We invite suggestions on how the definition of “complex investment products” may better capture the differences between simpler and more exotic derivatives.

5.1.4 MAS proposes that complex investment products be subject to an enhanced regulatory regime to enable investors to be more aware of the

¹⁸ Excluding products which use derivatives solely for the purposes of hedging and efficient portfolio management.

implications of their investment decisions and to be able to make better investment choices. The sale and marketing of complex investment products will be subject to the following requirements in addition to those applicable more generally to all investment products:

- (a) Distributors must ensure that complex investment products are only sold to investors with financial advice;
- (b) Issuers must include a health warning in both the prospectus and the Product Highlights Sheet, and all marketing and advertising materials, that the product being offered is a complex investment product; and
- (c) Representatives must have undergone adequate training and have the competencies to sell complex investment products.

Q18(a): MAS seeks views on the proposal to define a complex investment product based on whether or not derivatives are embedded in the investment product.

Q18(b): MAS invites suggestions on how the definition of “complex investment products” may better capture the differences between simpler and more exotic derivatives.

5.2 RISK RATING

5.2.1 Before arriving at our proposal to introduce the concept of complex investment products, we had explored the possibility of requiring unlisted investment products marketed to retail investors to be assigned a risk rating by an independent party. The risk rating would be disclosed to investors in disclosure documents to facilitate their investment decisions. It could also assist distributors in assessing whether the product is suitable for a particular investor.

5.2.2 Risk is multi-dimensional and there are many types of risk such as liquidity risk, market risk, operational risk, credit risk and legal risk. A single risk rating may not meaningfully capture all the types of risks present in an investment product. It may also generate false comfort for investors who may purchase products solely on the basis of a risk rating without considering other factors such as their liquidity needs and portfolio diversification.

Furthermore, a product's risk is not static and changes according to market conditions. Risk ratings need to be constantly updated and investors need to monitor such changes in risk ratings.

5.2.3 There are also issues of potential conflicts of interests arising from third-party risk rating agencies. Accordingly, there are increasing reservations among regulators about mandating the use of third-party ratings for regulatory purposes¹⁹.

5.2.4 Nevertheless, MAS recognises that there may be benefits to retail investors if a risk rating system is properly implemented and investors are well-informed on how to use the rating. We welcome industry initiatives on this matter.

5.3 MANDATORY ADVICE

5.3.1 Under the EU MiFID and UK regulatory models, "complex products" may be sold without advice to retail investors only upon the distributor having first performed an appropriateness test to determine if the investor has the appropriate knowledge and experience to purchase the product.

5.3.2 We consider it important that the sale of complex investment products be accompanied by an assessment of whether the product is suitable for the investor, notwithstanding the investor's knowledge and experience. MAS proposes to require the sale of complex investment products be allowed only with advice.

5.3.3 This means that complex investment products cannot be sold on a "no advice" or "execution only" basis. When selling complex investment products, representatives will have to explain the nature and risks of such products to their customers. Representatives will also have to assess that the product is suitable for their customers, taking into consideration the respective customer's personal circumstances.

¹⁹ In the *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience* dated 7 April 2008, authorities are urged to check that the roles that they have assigned to ratings in regulations and supervisory rules are consistent with the objectives of having investors make independent judgment of risks and perform their own due diligence, and that they do not induce uncritical reliance on credit ratings as a substitute for that independent evaluation.

5.3.4 MAS proposes to require distributors to put in place additional safeguards to ensure that representatives do not sell complex investment products to customers with limited knowledge of investment products. This includes requiring the representatives' supervisors to monitor the sale activities of their representatives and obtain higher level approval for the transaction before it can be executed.

Q19: MAS seeks views on the proposal to require the sale of complex investment products to be allowed only with advice.

Q20: MAS seeks views on the proposal to require distributors to put in place additional safeguards to ensure that representatives do not sell complex investment products to customers with limited knowledge of investment products.

5.3.5 We note that the proposals for complex investment products may pose a challenge for distributors that sell investment products through internet portals. These online distributors' business models are to sell investment products on an "execution only" basis and their customers are typically self-directed in their transactions. In this regard, we are prepared to consider feedback on how the proposals for complex investment products may be adapted for online distributors.

Q21: MAS invites suggestions on how the proposals for complex investment products may be adapted for online distributors.

5.4 "HEALTH WARNING"

5.4.1 Having mandated advice for sale of complex investment products, we propose to require issuers and distributors of complex investment products to incorporate a "health warning" in all disclosure documents, and marketing and advertising materials of complex investment products. The intention is to alert investors that they may not easily understand the features and the risks of the product and should seek to do so when the FA provides them advice. If

investors are unable to fully understand the product, they should not invest in it²⁰.

5.4.2 The “health warning” should be presented in the following manner:

THIS IS A COMPLEX INVESTMENT PRODUCT.

**THIS PRODUCT CANNOT BE SOLD TO YOU UNLESS YOUR
FINANCIAL ADVISER HAS EXPLAINED WHETHER THIS
PRODUCT IS SUITABLE FOR YOU.**

**IF YOU DO NOT FULLY UNDERSTAND THIS PRODUCT, YOU
SHOULD NOT PURCHASE IT.**

The text will be required to be in bold, and a minimum of font size 12, Times New Roman, and is to be placed in the front cover of the prospectus, the Product Highlights Sheet, the marketing and advertising materials, and any other documents which the issuer or distributors may use to disclose information about the product or to market the product to the public.

Q22: MAS seeks views on the proposal to require issuers and distributors of complex investment products to incorporate a “health warning” on all disclosure documents, and marketing and advertising materials.

5.5 ENHANCED COMPETENCY REQUIREMENTS FOR REPRESENTATIVES

5.5.1 Distributors have the primary obligation to ensure that their representatives are fit and proper, and are competent and suitably qualified. Currently, representatives must pass the Capital Markets and Financial Advisory Services Examination (“CMFAS”) Modules 1A or 1B, and Module 5 on rules and regulations for dealing in securities and financial advisory

²⁰ In the *Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies (2008)*, the HKMA has recommended “health warnings” to be attached to retail structured products with embedded derivatives or retail derivative products generally. These “health warnings” are intended to alert investors not to purchase such products if they do not understand them and their inherent risks.

services, respectively²¹. Representatives selling investment products are required to pass Module 6 on product knowledge on securities or have qualifications in lieu of CMFAS Module 6.

Training of Representatives

5.5.2 MAS considers that representatives selling complex investment products should have more specialised training to enable them to better explain the features and risks of complex investment products to customers. MAS proposes to require distributors to ensure that representatives undergo training on the features and risk-reward characteristics of a new complex investment product before being allowed to sell the product.

5.5.3 In practice, distributors may engage product providers or third-party trainers to conduct training for their representatives. It is insufficient for distributors to accept or rely entirely on the product provider or any other third-party trainer without ascertaining whether the training is adequate. Distributors should ensure that their representatives have attended adequate training before being allowed to sell complex investment products.

New CMFAS Module on Complex Investment Products

5.5.4 MAS proposes to introduce a new CMFAS module for product knowledge on complex investment products. This is aimed at raising the overall competencies of representatives selling complex investment products. The content and coverage of the new CMFAS module will be developed by the Institute of Banking and Finance together with the industry.

Q23: MAS seeks views on the proposal to require distributors to ensure that representatives undergo training on the features and risk-reward characteristics of a new complex investment product before being allowed to sell the product.

²¹ Notice on Minimum Entry and Examination Requirements for Representatives of Licensed Financial Advisers and Exempt Financial Advisers [FAA-N07] and Notice on Minimum Entry and Examination Requirements for Representatives of Holders of Capital Markets Services Licence and Exempt Financial Institutions [SFA 04-N06]

Q24: MAS seeks views on the proposal to introduce a new CMFAS examination module for product knowledge on complex investment products.

6 ADDITIONAL PROPOSALS FOR UNLISTED DEBENTURES

6.0.1 This section sets out additional proposals that apply to one type of unlisted investment product - unlisted debentures. The proposals are to better safeguard the interests of investors in unlisted debentures.

6.1 COOLING OFF PERIOD

6.1.1 A cooling off period provides investors an opportunity to reconsider their investment decisions. It allows investors to exit the investment without having to incur sales charges or commissions.

6.1.2 Cooling off periods are currently mandated for unit trusts and life policies. For unit trusts, the investor is given seven days from the purchase date to consider the investment decision ("cancellation period"). If he decides to terminate his investment within the cancellation period, the distributor will refund the amount he has paid, less any expense incurred and fall in market value. For life policies, a policyholder will be given 14 days from the date of receipt of policy document ("free-look period") to decide if the insurance policy is suitable for his needs. If a policyholder decides to cancel the policy within the free-look period, the insurer has to refund the premiums that the policyholder has paid, less any expense incurred by the insurer in underwriting the policy and fall in market value.

6.1.3 For some structured notes, investors have the opportunity to cancel their investments any time during the offer period. The length of the cooling off period available to an investor will, therefore, depend on when he purchases the product. If an investor purchases the product towards the end of the offer period, he will have shorter time to change his mind and cancel his investment.

6.1.4 MAS proposes a cooling off period of seven days for unlisted debentures. The cooling off period is to be disclosed in the Product Highlights Sheet. FAs are to also disclose the cooling off period at the point of sale to investors.

Q25: MAS seeks views on the proposal for a cooling off period of seven days for unlisted debentures.

6.2 APPOINTMENT OF APPROVED TRUSTEE

6.2.1 While the Listing Rules of the Singapore Exchange (“SGX”) require issuers of listed debentures to appoint a trustee, there is no requirement for issuers of unlisted debentures to appoint a trustee²². In the case of CIS, there are presently requirements for a trustee approved by MAS to be appointed for authorised CIS.

6.2.2 MAS proposes to require issuers of unlisted debentures, where the offers require a prospectus to be issued, to appoint a trustee approved by MAS. A properly empowered trustee would be able to take action within its powers to safeguard the interests of investors during the debenture’s tenure and in the event of issuer default.

6.2.3 An approved trustee will have to meet a set of prescribed criteria that relate to the financial soundness of the company and the fit and properness of its officers. The criteria will be largely developed from the current approval criteria for trustees of authorised CIS²³. The trustee should also be independent of the issuer to avoid conflicts of interest.

Duties of Trustee

6.2.4 Currently, the duties of a trustee for debenture holders are provided under the Trustees Act, the relevant trust deed as well as general trust law. Generally, a trustee is required to exercise reasonable care and skill in carrying out its duties. We propose to provide more specifically that the relevant trust deed must contain a covenant binding the trustee to exercise all due diligence and vigilance in carrying out its functions and duties, and in safeguarding the rights and interests of investors in the unlisted debentures at

²² In 2002, the Company Legislation and Regulatory Framework Committee (“CLRFC”) proposed removal of the statutory requirement for the appointment of trustees for all debentures on the basis that such a requirement was already prescribed in the SGX Listing Rules for listed debentures. For unlisted debentures, the CLRFC left this to the dictates of the targeted market.

²³ The criteria would include (i) the company having a minimum level of paid-up capital, shareholders’ fund, a sound financial position and a sufficient number of qualified personnel with experience in performing the duties of an approved trustee or other relevant experience, having regard to the nature and extent of the activities which the company carries on or will carry on; (ii) the company is a fit and proper person; (iii) each officer of the company is a fit and proper person; and (iv) the company has obtained professional indemnity insurance for such amount and on such terms as may be specified by the Authority by notice in writing; or provided the Authority with a performance bond, guarantee or any similar instrument (by whatever name called) from its holding company, if any, for such amount and on such terms as may be specified by the Authority by notice in writing.

all times. In addition, where the unlisted debenture is secured on collateral which has a trustee acting on behalf of the collateral holders (“collateral trustee”), the trustee for the unlisted debenture must ensure that the collateral trustee is subject to equivalent or higher duties and obligations.

6.2.5 A trustee must ensure that it has the necessary expertise and sufficient powers under the trust deed to allow it to meet these obligations.

6.2.6 MAS will be empowered to issue directions to the trustee to act in the public interest.

Q26: MAS seeks views on the proposal to require issuers of unlisted debentures, where the offers require a prospectus to be issued, to appoint a trustee approved by MAS.

Q27: MAS seeks views on the proposed specific duties in relation to a trustee approved by MAS.

7 PROPOSALS TO ENHANCE MAS' POWERS

7.0.1 The proposals in this section seek to strengthen MAS' powers to investigate and take regulatory action through several measures, including the introduction of the civil penalty regime in Part III of the FAA and the power for MAS to apply to court for injunctions.

7.1 INTRODUCTION OF CIVIL PENALTY REGIME IN THE FAA

7.1.1 Currently, breaches of FAA provisions will attract criminal liability and may give the affected investor a right to statutory civil action²⁴. However, there could be circumstances where criminal prosecution may not be appropriate due to the lack of evidence or mitigating factors.

7.1.2 MAS considers it would be useful to have greater flexibility in its regulatory response to breaches of Part III of the FAA which contains the provision that relate to the conduct of business by FAs. A more graduated approach in enforcing such breaches would enable MAS to choose the more appropriate regulatory response depending on the facts and circumstances of any given case. To this end, we considered the merits of adopting in Part III FAA the civil penalty regime, which is currently in force in the SFA.

7.1.3 Civil penalties were first introduced in the Securities Industry Act ("SIA") in 2000 for insider trading offences. It was then noted that the SIA lacked civil remedies, and that many developed financial jurisdictions had complemented their criminal regime for insider trading with autonomous civil actions, where the burden of proof was on a "balance of probabilities" as opposed to the higher criminal burden of proof of "beyond reasonable doubt". The civil penalty regime under the SFA was extended in the 2001 to the other forms of market misconduct in Part XII SFA. In the latest set of amendments to the SFA, civil penalties have also been introduced for breaches of the substantial shareholdings notification requirement in the SFA.

7.1.4 Accompanying the SFA's civil penalty regime are provisions that give investors a better opportunity to obtain civil remedies. These provisions are the (i) civil liability provision; and (ii) coat-tail action provision which is triggered upon a conviction of, or civil penalty order being made against, a contravener.

²⁴ Section 27 of the FAA

7.1.5 MAS proposes to introduce a civil penalty regime in Part III of the FAA. This will allow MAS to take civil penalty actions against persons who contravene these FAA provisions. Aside from giving MAS greater flexibility in choosing an appropriate regulatory response, a civil penalty regime will serve as an added deterrent to breaches.

Civil Penalty Liability

7.1.6 Currently, breaches of some of these provisions under Part III of the FAA already attract criminal liability. MAS proposes that civil penalty liability be imposed for regulatory contraventions of these provisions, including provisions relating to the making of false or misleading statements, and the disclosure of material product information.

7.1.7 Where there is a regulatory contravention of these FAA provisions, MAS may, with the consent of the Public Prosecutor, bring an action in court against the contravener to seek an order of a civil penalty. The burden of proof upon MAS will be the civil standard of proof, namely, on a balance of probabilities.

Civil Penalty Settlement

7.1.8 MAS proposes that the FAA civil penalty provision provide for court ordered civil penalty settlement, and civil penalty settlement between MAS and the contravener. This will be similar to the current SFA provisions.

Investigation Powers

7.1.9 Should a civil penalty regime be introduced in the FAA, MAS will require enhanced investigation powers under the FAA to complement MAS' ability to take civil penalty actions. We are considering including more explicit investigation powers similar to those in the SFA. For example, these would be provisions explicitly requiring a person to give reasonable assistance for an investigation and to appear before MAS for examination on oath and to answer questions, and for MAS to take statements.

Transfer of Evidence

7.1.10 A recent amendment to the SFA enables the transfer of evidence between the Commercial Affairs Department (“CAD”) and MAS²⁵. This mechanism is required as investigations under the SFA are undertaken by either the CAD or MAS at the onset, based on prima facie evidence. The CAD investigates when criminal proceedings are likely, while MAS investigates cases when civil penalties appear appropriate. As the investigation progresses, it may sometimes be necessary for one agency to transfer the matter to the other, based on their preliminary findings. This provision provides for transfer of evidence between CAD and MAS, so that the agency taking over the investigation does not expend resources to re-investigate the case and eliminates duplication of efforts.

7.1.11 Should a civil penalty regime be introduced in the FAA, a similar provision for the transfer of evidence will be required, as both CAD and MAS will have jurisdiction to conduct investigations for breaches of FAA provisions.

Q28: MAS seeks views on the proposal to introduce a civil penalty regime in Part III of the FAA.

7.2 REMEDIES FOR INVESTORS

7.2.1 Where investors have suffered losses and wish to obtain compensation or damages, they may do so by either relying on a statutory civil liability provision (if available), or taking up civil recourse against the FA alleged to have caused the loss. A civil cause of action is distinct from the criminal prosecutions and regulatory civil penalty actions.

7.2.2 MAS' approach regarding investors obtaining compensation or recovering damages has been to empower them to obtain remedies themselves. This is achieved through making available avenues of recourse to assist investors in resolving disputes or to take up civil action. Our approach of empowering investors is the more common approach among securities regulators. There are few regulators that have powers to apply to court for compensation or to order compensation to be made to affected

²⁵ *Securities and Futures (Amendment) Bill 2009*

investors²⁶. MAS has considered whether we should adopt similar powers, but this would be a fundamental shift in philosophy for MAS. It may also have impact on broader policy issues.

7.2.3 MAS does not propose, at this point in time, to acquire powers to apply to court for compensation or to order compensation to be made to affected investors. As part of MAS' continual review of its regulatory framework, we will monitor the ability of consumers to take up civil actions themselves to obtain redress. Currently, there are remedial avenues available to investors in the form of affordable dispute resolution fora, and other forms of civil actions provided through legislation in the form of civil liability and coat-tail action provisions.

Dispute Resolution Schemes

7.2.4 One way in which investors may obtain compensation or damages is by commencing a civil action in the courts. This avenue of recourse is available to investors, and can arise from a civil liability provision or common law. Commencing a civil action suit in court may not always be a feasible avenue of recourse as it could involve substantial expenditure of costs and time. This may disadvantage investors whose claim amounts are small or who have limited resources. To address the needs of such investors, MAS established the specialised Dispute Resolution Scheme²⁷ for the resolution of individual complaints and disputes between financial institutions and their customers. The Dispute Resolution Scheme is similar to the UK's Financial Ombudsman Service and Australia's External Dispute Resolution Scheme. Currently, there is one MAS-approved Dispute Resolution Scheme in operation – the Financial Industry Disputes Resolution Centre ("FIDReC").

7.2.5 FIDReC provides an affordable and accessible one-stop avenue for consumers to resolve their individual complaints and disputes with their financial institutions. FIDReC's mediation services are free to consumers and its adjudication services are charged at a nominal fee. Investors involved in individual complaints and disputes with their financial institutions, and who seek compensation or damages can choose to resolve their complaints in an affordable and timely manner at FIDReC.

²⁶ The UK FSA and the Manitoba Securities Commission, Canada

²⁷ Established under section 28A of the MAS Act, and the *MAS (Dispute Resolution Schemes) Regulations 2007*

7.2.6 There are claim limits for complaints lodged at FIDReC²⁸. Financial dispute resolution fora in other jurisdictions similarly set monetary limits on claims, or set a maximum quantum that can be awarded to the consumer. MAS will monitor developments in other jurisdictions and consider if a separate review of this issue is required.

7.2.7 Any decision made at a FIDReC adjudication is binding on the financial institution but not on the consumer, who can choose to reject the decision and pursue other forms of civil remedy. As consumers always have the option to pursue other forms of civil remedy, MAS has considered that it would be beneficial to introduce in Part III of the FAA the provisions relating to civil liability and “coat-tail” actions.

Civil Liability Claims by Investors

7.2.8 Under a civil liability provision, a contravener may be liable to pay compensation to any person who has suffered loss, whether or not the contravener has been convicted or has had a civil penalty imposed. This gives an affected investor a statutory cause of action beyond common law, to file a civil claim against a contravener where he has suffered a loss. This is currently available under the SFA for market misconduct offences and under section 27 of the FAA. MAS proposes to widen the application of this provision to other provisions in Part III of the FAA so that affected investors will be able to avail themselves of a similar statutory right to take action against the contravener for any loss suffered.

7.2.9 In conjunction with the above, MAS proposes to introduce a provision that will enable a court, in making an order in an action filed under a FAA civil liability provision, to have regard to whether the investor had made a reasonable effort to resolve the dispute with the FA before commencing the action in court. Where applicable, the court will also have regard to whether the investor sought to resolve the dispute through an approved Dispute Resolution Scheme, before commencing legal action.²⁹

²⁸ For claims between insureds and insurance companies, the limit is \$100,000. For disputes between banks and consumers, capital market disputes and all other disputes, the limit is \$50,000.

²⁹ This is similar to the provision under section 7(9) of the Consumer Protection (Fair Trading) Act (Cap. 52A).

“Coat-Tail” Actions

7.2.10 Under the SFA, where a contravener has been convicted or ordered to pay a civil penalty by the court, the court may fix a date for all affected investors to file and prove their claims for compensation. This means that affected investors can ride upon the verdict of a criminal conviction or a civil penalty action brought by MAS, to file compensation claims. They will not need to take individual separate court actions to prove that the contravention had occurred before applying to court for compensation. MAS proposes to include a similar “coat-tail” provision in Part III of the FAA.

Q29: MAS seeks views on the proposal to widen the application of the civil liability provision in Part III of the FAA.

Q30: MAS seeks views on the proposal to enable a court to have regard to whether the investor had made a reasonable effort to resolve the dispute before commencing action in court.

Q31: MAS seeks views on the proposal to introduce a “coat-tail” provision in Part III of the FAA.

7.3 POWER TO APPLY TO COURT FOR INJUNCTIONS IN THE FAA

7.3.1 Under the SFA, MAS has the power to apply to court to make certain injunctive orders to, for example, prevent a person from transferring money out of Singapore. This power may be exercised when MAS wishes to corral a sum of money belonging to a person or financial institution subject to civil proceedings, so that there will be sufficient funds to meet any civil penalty imposed or protect the interests of the public. MAS considers including such a provision in the FAA would similarly go towards protecting the interests of the public.

7.3.2 We note that the UK FSA has powers to make an application to the court for injunctions. The US SEC has similar powers to apply to a court for a temporary freeze order on certain payments, or to bring an action in a district court to seek an injunction on any person engaged or about to engage in acts that constitute a contravention.

7.3.3 To enhance MAS' enforcement powers under the FAA, and to further complement a civil penalty regime, we propose introducing the power for MAS to apply to court for injunctions under the FAA.

Q32: MAS seeks views on the proposal to introduce the power for MAS to apply to court for injunctions under the FAA.

7.4 WIDER SCOPE OF PROVISION ON FALSE OR MISLEADING STATEMENTS IN THE FAA

7.4.1 Under the FAA, FAs are prohibited from making false or misleading statements. However, this prohibition only applies to statements in relation to amounts payable in respect of the contract, or the effect of a provision of the contract.

7.4.2 MAS considers that it would be timely and appropriate to widen the scope of this provision and to make it an offence to make false or misleading statements in relation to a wider scope of issues. This would strengthen the FAA's jurisdiction over offences relating to false or misleading statements. Widening the scope of this provision will reinforce to FAs that special care should be taken when communicating and dealing with their customers.

7.4.3 MAS considered the provisions in the SFA that deal with false or misleading statements. Examples of such elements in the SFA provisions are where a person: (i) makes a false or misleading statement which is likely to induce a purchase of securities; (ii) makes a statement which he ought to have reasonably known that the statement is misleading, false or deceptive; (iii) dishonestly conceals material facts; (iv) is reckless in making the statement; (v) omits to state a material fact; or (vi) commits any act or practice that operates as a fraud or deception.

7.4.4 MAS proposes to incorporate these elements from the SFA provisions into a new wider provision in the FAA that makes it an offence to make false or misleading statements.

Q33: MAS seeks views on the proposal to widen the scope of the provision that makes it an offence for FAs to make false or misleading statements.



Monetary Authority of Singapore