RESPONSE TO FEEDBACK RECEIVED ON PROPOSED AMENDMENTS TO THE CODE ON COLLECTIVE INVESTMENT SCHEMES

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PREFACE

On 17 May 2010, MAS issued a consultation paper inviting comments on proposals to enhance the regulatory regime for Collective Investment Schemes ("CIS"), in particular the investment guidelines, to ensure that it keeps pace with product innovation and industry developments, as well as address specific issues that have been brought to MAS' attention. In conducting the review, MAS took into account the rules and regulatory developments in major fund jurisdictions such as Luxembourg, Ireland, the United Kingdom and Hong Kong, as well as the United States of America.

The consultation period closed on 17 June 2010 and comments were received from 29 respondents (listed in Appendix A). MAS has carefully considered all the comments received and incorporated them in the revised Code, where appropriate. With the proposed amendments, it is envisaged that case-by-case waivers or exemptions for authorised schemes would normally not be required or granted in the future. MAS shall only recognise a foreign scheme under section 287 of the Securities and Futures Act ("SFA") if we are satisfied that, amongst others, the scheme complies with investment guidelines which are substantially similar to those set out in the Code.

MAS thanks all respondents for their views on the proposals in the consultation paper. Comments of wider interest and our responses are set out below.

I. NON-SPECIALISED FUNDS

1.1 Diversification Limits

a) Unlisted Securities

Question 1

MAS seeks your views on the proposal to introduce a list of permissible investments and the accompanying requirements. Specifically:

(i) Do you agree with the introduction of a list of permissible investments?
(ii) If so, do you agree with the accompanying requirements; and
(iii) If not, please explain and provide alternative suggestions.

<u>Public Comments [1a]</u>
Respondents generally agreed with the proposed list of permissible investments. A respondent pointed out that the European Undertakings for Collective Investments in Transferable Securities ("UCITS") framework allows up to 10% of the net asset value of a scheme to be invested in assets other than those defined in the permissible investments list. They suggested that we adopt a similar "deviation" limit to provide flexibility for managers. Another respondent sought clarification on whether participatory notes ("p-notes") which are used to gain access to restricted markets would be considered as transferable securities or financial derivatives.

<u>MAS' Response [1a]</u>
We note that the "deviation" limit under UCITS allows investments of up to 10% of the fund's net asset value in transferable securities or money market instruments that are not admitted to or traded on a regulated market, but these investments must still meet the requirements to be considered a transferable security or money market instrument. This is similar to our 10% limit on shares or securities equivalent to shares that are not listed for quotation and have not been approved for listing for quotation on an organised exchange proposed under the revised Code. We are of the view that a 10% allowance for unlisted securities is sufficient under the revised Code.

Although there is no standard structure for p-notes, they are typically structured under medium term note programmes. We note that p-notes are financial instruments with prices derived from the performance of an underlying reference asset such as a basket of securities. They represent the obligations of the issuer and do not provide any legal, beneficial or equitable interest in the underlying reference assets. As such, p-notes are commonly tailor-made hybrid financial instruments structured to meet the specific needs of a scheme. When a financial instrument is structured as an alternative to an over-the-counter ("OTC") financial derivative, its treatment should be similar to that of the OTC financial derivative. If the p-notes meet the requirements of a transferable security, they will be considered as a transferable security embedding a financial derivative. In such a circumstance, the instrument will be subject to both the transferable security and financial derivative requirements.

Public Comments [1b]
Many respondents sought clarification on whether listed schemes such as Exchange-Traded Funds ("ETFs") and Real Estate Investment Trusts ("REITs") would be treated as units in other schemes or as transferable securities.

A respondent also asked whether closed-end funds fall within the definition of transferable securities since such funds are typically offered as "shares or securities equivalent to shares". The respondent further suggested that investments in closed-end funds should be permitted if they meet the requirements of transferable securities.

MAS' Response [1b]
We acknowledge that listed schemes (e.g. REITs and ETFs) have the characteristics of both a scheme and a transferable security. Investments in underlying schemes are not subject to any limits as long as the underlying schemes meet certain criteria, whereas investments in transferable securities are subject to a single entity limit of 10% of the scheme's NAV. A scheme may invest up to 100% of its NAV in units of another scheme if the underlying scheme is:

(a) an authorised[1] or recognised scheme; or

(b) a scheme which:

(i) is constituted and regulated in a jurisdiction where the laws and practices afford to participants in Singapore protection at least equivalent to that afforded to participants of schemes which are wholly managed in Singapore;

(ii) adheres to investment and borrowing guidelines which are substantially similar to those set out in the relevant Appendices of the revised Code except Appendix 3 on hedge funds; and

(iii) is managed by a manager who is reputable and supervised by an acceptable financial supervisory authority.

Investment in an underlying scheme (e.g. certain ETFs or REITs) which does not satisfy sub-paragraph (a) or (b) but

(A) meets the requirements of a transferable security;

[1] The authorised scheme complies with the relevant Appendices of the revised Code except Appendix 3 on Hedge Funds.

(B) invests in permissible investments or real estate; and

(C) units of the scheme are listed for quotation and traded on an organised exchange

will be subject to a limit of 10% per scheme.

Investments in units of any listed scheme which is invested directly in physical commodities, listed debt securities secured by physical commodities and shares or securities equivalent to shares that are not listed for quotation and have not been approved for listing for quotation on an organized exchange are subject to an aggregate limit of 10% of the scheme's net asset value.

Closed-end funds (such as business trusts) which meet the requirements of a transferable security and are listed on an organised exchange will be permitted and subject to the limits applicable to transferable securities.

Public Comments [1c]

Many respondents suggested having guidelines on the requirement of "regular, accurate and comprehensive" information for transferable securities. In particular, they cited difficulties in complying with this requirement for unlisted fixed income securities which may not have "comprehensive" information available. Two respondents asked if publication of the annual or financial reports of the issuer of the transferable securities satisfies the requirement of "regular, accurate and comprehensive". Another respondent highlighted that the disclosure requirements of most Asian bond markets are less comprehensive than those of the western markets and there may be practical difficulties in complying with the requirement. Other respondents suggested removing the phrase "regular, accurate and comprehensive" and replace it with the term "disclosed". They argued that it is not the manager's role to ensure accuracy of information and that it is subjective whether the information is deemed comprehensive. Accordingly, the manager should only decide whether there is sufficient information available to analyse the investment.

MAS' Response [1c]

In view of the feedback received, we shall require "appropriate" information on the transferable security or, where relevant, on the portfolio of transferable securities to be available. The manager, in determining whether such information is "appropriate", should consider if the information available on the market is regular and accurate, as well as sufficient to analyse the investment. In the context of fixed income securities, the reliance on annual or financial reports is acceptable if the manager is of the view that it is appropriate, taking into account the foregoing guidance.

Public Comments [1d]

On the proposal to require the manager to value OTC financial derivatives by using an appropriate model which is checked at an appropriate frequency by an independent third party if the current market value is not used, a respondent asked whether the independent third party is to be appointed by the manager or the trustee. Some respondents highlighted that there may not be a ready third party with the expertise to check on the valuation model especially if the OTC financial derivatives are complex. A few respondents sought clarification whether checks by internal parties independent of the individual fund manager would be acceptable. A respondent also asked which value should be used if the difference in valuation by the manager and the independent third party is significant. One respondent suggested either removing the requirement for independent third party valuation or applying this requirement only to new schemes. Lastly, a respondent commented that the arrangement to require an independent party to check the model to ascertain the fair value of investment may delay the publication of daily fund valuation.

MAS' Response [1d]
The valuation model may be checked by a party independent of the manager or by a functional unit within the manager that is independent of the fund management function. For the avoidance of doubt, the party should also be independent of the counterparty of the OTC financial derivative. The party may be appointed by the manager. In the event that the values are significantly different, the manager and the independent party should first work together to reconcile the difference. If they are unable to reconcile the difference, the independent party's valuation should be used. Existing schemes using an internal valuation model should obtain an independent party's verification of the model within the allowed transition period, and thereafter at an appropriate frequency. Verification of the model at an appropriate frequency should not lead to a delay in the publication of the daily fund valuations.

Public Comments [1e]
A few respondents sought clarity on whether certain financial instruments such as asset-backed securities ("ABS") including mortgage-backed securities ("MBS") and Islamic financial instruments (e.g. commodity *murabaha*) are permissible investments.

MAS' Response [1e]
ABS including MBS are deemed to be transferable securities under the category of "bonds and other debt instruments". However, ABS will be deemed as transferable securities with an embedded financial derivative if they contain a derivative component that fulfils certain criteria, and the relevant requirements in sections 3 and 4 of Appendix 1 of the revised Code shall then apply to the embedded derivative. Counterparty requirements set out in section 5 of Appendix 1 of the revised Code will apply to the issuer of the embedded derivative if the counterparty risk is passed to the scheme.

Islamic financial products will be deemed to be permissible investments if they meet the conditions set out in section 1 of Appendix 1 of the revised Code. Specifically, schemes may invest in a commodity *murabaha* if such financial instruments have a risk-return profile equivalent to a money market instrument.

Public Comments [1f]
A respondent sought clarification whether financial derivatives used for hedging purposes are to fulfill the proposed requirements of a financial derivative (set out in page 13, paragraph 1.4 of the consultation paper).

MAS' Response [1f]
Yes, financial derivatives used for hedging purposes are to comply with the said requirements.

b) Concentration in Exposures to a Single Entity or Group

Question 2

MAS seeks your views on the proposals to:

(i) limit a scheme's exposure to a single entity through investments in transferable securities of that entity to 10% of the net asset value of the scheme;
(ii) allow a limit of 20% for a scheme’s aggregate investments in or exposures to a group of entities through transferable securities, money market instruments, eligible deposits and exposures to counterparty risk arising from OTC financial derivative transactions, repurchase agreements and securities lending;
(iii) allow the exposure to a constituent of a benchmark index that is (or is part of the same group as) a financial institution with which the scheme has placed deposits, to go up to its benchmark weight plus 2%, plus amount of deposits placed; and
(iv) set a cap on aggregate investments in or exposures to a group of entities of 25% of the net asset value of the scheme where the scheme invests in constituents of its benchmark index.

Public Comments
Two respondents sought guidance on interpretation of the term “entities” and whether it includes governments, government-linked entities, government agencies and supranationals.

MAS' Response
The term “entities” encompasses governments, government-linked entities, government agencies and supranationals.

c) Single issue of securities

Question 3

MAS seeks your views on the proposals to:

(i) limit investment in shares to 10% of the total outstanding shares of a single entity and investment in debt securities to 10% of each individual issuance by a single entity where the issuance is not part of an MTN programme; and

(ii) impose a 20% limit per tranche, while maintaining an overall 10% limit on the aggregate exposure to an MTN programme.

<u>Public Comments [3a]</u>
A respondent sought clarification whether the 10% limit on the shares of a single entity applies to investments in units of other schemes constituted as corporations.

<u>MAS' Response [3a]</u>
No, the concentration limit on the shares of a single entity does not apply to investments in units of other CIS constituted as corporations.

<u>Public Comments [3b]</u>
Another respondent also asked whether a scheme needs to observe the 20% group limit in conjunction with the 10% concentration limit.

<u>MAS' Response [3b]</u>
The 20% group limit will also apply to investments subject to the 10% concentration limit. That is, the total exposure to a group of entities, including exposure through such investments, should not in aggregate exceed 20% of the scheme’s net asset value.

<u>Public Comments [3c]</u>
A respondent asked whether a fund holding one or two debt securities in a mixed equity-debt portfolio which are greater than the 10% limit would constitute a breach.

<u>MAS' Response [3c]</u>
Investments in the two debt securities should not individually exceed 10% of each issue. At the same time, both investments must in aggregate be within the 10% single entity limit.

<u>Public Comments [3d]</u>
A few respondents asked whether the guidelines on debt security investments refer to any debt issuance programme or strictly to MTN programmes only. One respondent also asked whether the “MTN programme” includes plain vanilla or structured note programme. Other respondents were of the view that it may be difficult to ascertain whether an issuance is part of an MTN programme because information may not be readily available and a limit per tranche may be too granular. A few respondents asked

whether the 10% limit is based on the actual notes issued under the MTN programme or the base approved issue size.

MAS' Response [3d]
We wish to clarify that the proposed concentration limit for MTN programmes applies to all debt programmes including securitised debt obligations such as asset backed securities and structured notes. In considering investments in individual tranches of a MTN programme, managers are reminded to comply with the requirements on transferable securities, in particular that the transferable securities are liquid (as defined in section 9.2 of this response paper). MAS also expects the manager to conduct proper due diligence by obtaining appropriate information from information providers such as Bloomberg or Reuters. The 10% limit on the MTN programmes refers to base approved issue size.

1.2 Credit Ratings

Question 4

MAS seeks your views on the proposal to:

(i) require the lowest credit rating to be used where multiple credit ratings exist; and
(ii) impose a tighter single entity limit of 5% for non-investment grade corporate bonds.

Public Comments
A few respondents pointed out that most Singapore listed companies are unrated and felt that the 5% limit is too restrictive. One respondent suggested relying on the ratings of the issuer's parent company as an alternative for bonds without issuer ratings. A number of respondents suggested that an internal rating assigned by the manager should be allowed if rating agencies no longer rate the entity. Some respondents suggested exempting bonds issued by an unrated Singapore entity (or trust) and Singapore bonds issued by a foreign issuer from the 5% limit.

MAS' Response
We are mindful that many Asian corporations may be unrated despite their perceived strong credit standings. We therefore agree that the use of an unrated issuer's parent company ratings is acceptable provided that an explicit guarantee by the parent company for the issuer is in place. In the case where a scheme invests in fixed income debt securities issued by unrated Singapore entities or trusts, the manager may rely on its internal credit rating of the issuing Singapore entity or trust provided that the manager has satisfied the trustee that the internal rating is comparable to a credit rating issued by Fitch Inc., Moody's or Standard & Poor's. Notwithstanding the foregoing, the manager should not unduly rely on credit ratings issued by credit rating agencies. The manager should, where possible, make their own credit assessments to verify the credit ratings issued by credit rating agencies. In the event of a difference between the internal credit

assessment and credit ratings issued by the credit rating agencies, the lowest credit rating should be used. For the avoidance of doubt, all ratings used should be based on a rating scale that is globally comparable.

1.3 Use of Financial Derivatives

a) General Principles
b) Commitment Approach

Question 5

MAS seeks your views on the proposed principles to be applied to schemes that invest in financial derivatives and the method for calculating the scheme's exposure to specific financial derivatives based on the prescribed table.

Public Comments [5a]
Two respondents suggested that the netting of financial derivative exposures should be allowed. For example, positions on two opposite foreign exchange contracts like USD/SGD and SGD/USD could be netted.

MAS' Response [5a]
When calculating the global exposure, netting arrangements may be taken into account to reduce global exposure. When applying the commitment approach, a scheme may net positions between financial derivatives on the same underlying assets (even if the maturity dates are different); or financial derivatives and the same corresponding underlying asset if those underlying assets are transferable securities, money market instruments or a scheme.

c) Alternative Methods

Question 6

MAS seeks your views on the proposed guidelines on the VAR approach for calculating the exposure of a scheme to financial derivatives.

Public Comments
On the use of relative VAR method, some respondents suggested using a limit of 2 (instead of the proposed 1.5) times the VAR of the reference portfolio to be in line with UCITS. They highlighted that the VAR could be easily more than 2 times of its benchmark due to concentration in certain sectors or countries. A few respondents also asked whether exposures arising from Efficient Portfolio Management ("EPM") techniques are to be included in the VAR calculations.

MAS' Response

The VAR measures the maximum expected loss at a given confidence level over a specific time period under normal market conditions and does not represent the absolute loss that may potentially result from the use of financial derivatives. While MAS notes that certain VAR could be higher than 2, we consider it prudent to set the threshold at a lower level of 1.5 times VAR. Exposures arising from the reinvestment of cash collateral received pursuant to EPM techniques are to be included in the VAR calculations.

d) Risk Management Process

Question 7

MAS seeks your view on:

(i) the proposal for the manager to submit information on its risk management process to MAS for consideration when applying for the use of an alternative exposure calculation method for financial derivatives; and

(ii) the proposed information required in the risk management process document to be submitted to MAS.

Public Comments

A few respondents sought clarification as to whether the review by the home regulator or external auditors of their global risk management process would satisfy the requirement for third party verification of the VAR model. A respondent also asked whether existing schemes which feed into an offshore underlying fund are required to make a separate submission to MAS if the VAR methodology of the underlying fund has already been approved by the scheme's home regulator. A respondent was also concerned whether the submission of risk management process would be kept confidential.

MAS' Response

We will take into account the approvals granted by a foreign regulator or validations by external auditors in assessing the application by an authorised fund to use an alternative exposure calculation method for financial derivatives. In the case of a scheme which feeds into an offshore underlying scheme, validations of the model of the underlying fund given by the home regulator will similarly be taken into account. We would like to assure managers that information submitted to MAS on the risk management process is kept confidential.

e) Disclosures

Question 8
MAS seeks your views on the proposed prospectus disclosures in respect of financial derivatives.

Public Comments

Respondents mostly agreed with the proposed disclosures to be made in respect of financial derivatives. However, a few respondents suggested that the manager explains the selection of the chosen methodology used to determine the scheme's exposure to financial derivatives instead of the methodology itself.

MAS' Response

MAS considers it important to provide a description of the methodology chosen to participants. We agree that the manager should explain why a certain method is chosen, in addition to the describing the selected methodology. We have implemented the suggestion in the revised Code.

f) Financial Derivatives on Commodities

Question 9
MAS seeks your views on the proposal to allow non-specialised schemes to invest in financial derivatives on commodities provided that the transactions are cash settled and sufficiently diversified.

Public Comments

A respondent asked whether the proposal applies only to funds which are exclusively focused on commodities, or whether funds which only invest a small portion of its assets (e.g. 10%) in financial derivatives on commodities are also subjected to the diversification requirement within that portion. A few respondents were of the view that the "sufficiently diversified" requirement would not be necessary given that the 10% single entity limit was in place. They argued that the expectation to require the scheme to be diversified across at least three sub-groups of commodities would restrict the manager's investment flexibility. One respondent suggested that it would be sufficient for the investments in financial derivatives on commodities to comply with the requirements set out in the proposed paragraphs 2.1 and 2.2 of the revised Code. Another respondent sought to clarify how the rule would apply for schemes which invest into a specific type of commodity.

MAS' Response
Regardless of the extent to which a scheme's investment objective seeks to invest in financial derivatives on commodities, we consider that the exposure to the underlying asset of a financial derivative should in principle be sufficiently diversified on a portfolio basis. In the case where the underlying investments of a financial derivative are commodities, the spread should comply with the limits in the index fund guidelines, that is, exposure to a single commodity should not exceed 20% of a scheme's net asset value, with an allowance of up to 35% of a scheme's net asset value for one commodity in the portfolio. For the avoidance of doubt, all commodity exposures including those obtained through listed schemes which are invested directly in physical commodities or debt securities secured by physical commodities should be included when computing the commodity exposure limits.

g) Removal of Appendix 7 and Appendix 8

Question 10

MAS seeks your views on the proposal to remove the guidelines on futures and options funds (i.e. Appendix 7) and currency funds (i.e. Appendix 8) in light of the proposals on the use of financial derivatives for non-specialised funds.

Public Comments
Respondents agreed with the proposal.

1.4 Counterparty Risks

Question 11

MAS seeks your views on the proposals to:

(i) allow the manager to enter into an OTC financial derivative transaction with a counterparty which is a financial institution subject to prudential supervision in its home jurisdiction;
(ii) calculate the counterparty exposure by taking into account the replacement cost and the potential future credit risk;
(iii) allow reduction of counterparty exposure through the use of collateral which meets the proposed requirements; and
(iv) allow reduction of counterparty exposure through netting under the proposed circumstances.

Public Comments [11a]
Respondents were supportive of the proposals. A respondent pointed out that the forms of eligible collateral should not be more restrictive than those which are allowed as direct investments by the scheme given that the collateral would form part of the scheme's balance sheet in the event of default by the counterparty. Another respondent noted that it may be impractical to ascertain on a continuous basis that the collateral has no material positive correlation with the counterparty and suggested removing this requirement.

MAS' Response [11a]
We agree that in addition to high quality government bonds, high quality money market instruments issued by government entities and cash may also be accepted as collateral. For the avoidance of doubt, securitised debt instruments as well as money market instruments or bonds with embedded financial derivatives are not eligible as collateral. We also agree to remove the proposal to require the collateral to have little or no material correlation with the counterparty, and will instead require that (i) the collateral cannot be issued by the counterparty or its related corporations; and (ii) the collateral should be taken into account, on a portfolio basis, for the purposes of the requirements on spread of investments in section 2 of Appendix 1 of the revised Code.

Public Comments [11b]
One respondent asked whether a separate legal opinion is to be obtained in addition to the legal opinion required by the ISDA.

MAS' Response [11b]
A separate legal opinion need not be sought if the manager is satisfied that the legal opinion provided to the International Swaps and Derivatives Association ("ISDA") is sufficient to meet the requirements under section 5 of Appendix 1 of the revised Code.

Public Comments [11c]
A respondent asked whether the intention of the proposal to require the manager to ensure that it has appropriate legal expertise, systems and operational capabilities for proper collateral management is to restrict the manager from delegating such duties to a third party.

MAS' Response [11c]
Although we do not object to the outsourcing of collateral management to third parties, MAS expects the manager to observe the Guidelines on Outsourcing. Notwithstanding that these functions are delegated to a third party, the responsibility continues to rest with the manager to ensure compliance with the Code at all times.

Public Comments [11d]
A respondent suggested allowing financial derivatives which are cleared by an exchange but are not subject to daily margining to be deemed as exchange traded financial derivatives and hence no counterparty risk limits need to be computed.

MAS' Response [11d]
We are of the view that listed financial derivatives which are not subject to daily margining (such as warrants) should be considered as OTC financial derivatives and hence subject to the counterparty limits. For the avoidance of doubt, initial margin and variation margin receivable from a counterparty (e.g. brokers) relating to exchange-traded or OTC financial derivatives which is not protected against the insolvency of the counterparty shall also be subject to the counterparty limits. Conversely, the initial margin and variation margin receivable from a broker relating to a financial derivative need not be computed in the counterparty limit with respect to the broker if they are maintained in an escrow account.

1.5 Securities Lending

a) Scope

Question 12 **MAS seeks your views on the proposed scope of securities lending.**

Public Comments
A number of respondents asked whether securities lending was only for the purpose of EPM. One respondent pointed out that the term EPM is too subjective and could be construed by managers that lending to generate additional income for the benefit of the fund is EPM. Another respondent suggested that the requirement for securities lending to be carried out only for the purpose of EPM be changed to that of generating incremental revenue in a prudent and low-risk manner.

MAS' Response
We wish to confirm that securities lending should be carried out only for the purpose of EPM. EPM is currently defined in the existing Code as a transaction that (i) is economically appropriate; (ii) has exposure that is fully covered; and (iii) has the aim of risk reduction, cost reduction with no increase or a minimal increase in risk, or generation of additional capital or income generation with no increase or minimal increase in risk. We are of the view that the current definition provides sufficient guidance for managers to evaluate whether a particular securities lending transaction satisfies the EPM requirement and should therefore be retained.

b) Securities Lending Programmes

Question 13

MAS seeks your views on the proposal to allow schemes to lend securities directly, through recognised clearing systems or securities lending agents who are specialists in securities lending.

Public Comments
A number of respondents suggested defining the criteria for being a specialist in securities lending.

MAS' Response
We believe that allowing some flexibility in the criteria for being a specialist in securities lending will better cater to the evolving nature of the financial sector, and as such will not prescribe criteria at this point.

c) Counterparty Risk

Question 14

MAS seeks your views on the proposals set out above to address counterparty risks in securities lending.

Public Comments [14a]
A number of respondents pointed out that the proposed rule of requiring the scheme's risk exposure to a single borrower to not exceed 10% of lent assets implies that the scheme has to lend to at least 10 borrowers. This would make it operationally restrictive for the manager to carry out securities lending.

MAS' Response [14a]
We have noted the above feedback. Under our proposals, we already require the borrower to be subject to prudential supervision by a regulator in its home country and have a minimum long-term credit rating of A. An unrated borrower is allowed only if an entity meeting the borrower requirements indemnifies the scheme against losses arising from the unrated borrower's failure. In addition, the collateral obtained are restricted to cash, money market instruments and bonds with a credit rating of at least A. In view of the foregoing, we will not impose the 10% single borrower limit on lent assets.

Public Comments [14b]
One respondent asked whether the proposed requirements to address counterparty risk apply to the lending agent or the borrower, or both.

MAS' Response [14b]
We wish to clarify that the proposed requirements apply to the borrower. The requirements will also apply to the lending agent, if the lending agent acts as a guarantor for the borrower by indemnifying the borrower.

Public Comments [14c]
One respondent asked about the methodology to calculate counterparty risks for repurchase and reverse repurchase agreements, as well as the factors used to adjust for potential future movement. The respondent also asked whether there is a minimum level of collateral required to be received in a repurchase transaction and if the collateral received can be used to reduce the counterparty exposure by netting.

MAS' Response [14c]
We note that repurchase and reverse repurchase agreements (collectively, “repurchase transactions”) on transferable securities and money market instruments are widely used techniques relating to efficient portfolio management. Counterparty risks arising from repurchase transactions will be addressed through the same guidelines that apply to counterparties in securities lending. Collateral held pursuant to repurchase transactions should similarly comply with the requirements on collateral held for securities lending, including exceeding the value of transferable securities or money market instruments transferred and being taken into account, on a portfolio basis, for the purposes of the requirements on spread of investments in section 2 of Appendix 1 of the revised Code.

d) Collateral Deficiency Risk

Question 15

MAS seeks your views on the safeguards proposed to address collateral deficiency risk in securities lending.

Public Comments [15a]
A number of respondents suggested that a buffer should be imposed such that the collateral received has a value of at least 105% of the securities lent in order to accommodate the price volatility of the collateral held.

MAS' Response [15a]
While MAS will require the value of the collateral to exceed the value of the securities lent at all times, we believe it is too prescriptive to set a specific threshold beyond 100%. Nevertheless, managers are reminded that securities lending and repurchase transactions should be effected in accordance with good market practice.

Public Comments [15b]
Some respondents asked whether a breach of the requirement for collateral value to be not less than 100% of the securities is subject to the requirement to rectify the breach within three months.

MAS' Response [15b]
We wish to clarify that collateral value should be marked-to-market on a daily basis and that the value of the collateral should exceed the value of the securities lent at all times. Therefore, rectification should be made no later than the close of the next business day.

e) Settlement Risk

Question 16

MAS seeks your views on the safeguards proposed to address settlement risk in securities lending.

Public Comments
Some respondents commented that the requirement for eligible collateral to be received before or simultaneously with the transfer of ownership of the securities lent is applicable only for the case of a securities lending programme with clearing houses. The respondents asked whether an operational arrangement with custodian banks to receive the eligible collateral before or simultaneously with the transfer of ownership of the securities lent would satisfy the proposed requirement.

MAS' Response
We wish to clarify that the proposed requirement is applicable for all securities lending arrangements regardless of whether they are made with a clearing house or custodian bank.

f) Custody Risk

Question 17

MAS seeks your views on the safeguards proposed to address custody risk in securities lending.

Public Comments [17a]
Some respondents asked whether the requirement for the custodian to be independent of the borrower would be applicable to a custodian and a borrower that are two separate legal entities which belong to the same group of companies.

MAS' Response [17a]
We wish to clarify that independence means that the custodian is not related to the borrower or the agent. In addition, the collateral held by the custodian should be legally secured from the consequences of the failure of the borrower or agent, the custodian and their related corporations.

Public Comments [17b]
Some respondents asked whether the minimum long term rating of the custodian refers only to the rating of the custodian as a single entity or could include the rating of the group of financial institutions it belongs to.

MAS' Response [17b]
As the collateral should be legally secured from the consequences of the failure of the custodian through, for instance, the use of trust accounts, we shall no longer require a minimum rating for the custodian.

g) Risks associated with cash collateral investments

Question 18

MAS seeks your views on the proposed safeguards to address risks associated with cash collateral reinvestments in securities lending.

Public Comments
A number of respondents suggested providing guidance as to the appropriate limits and guidelines for the diversification requirements necessary for the investment of cash collateral. The respondents asked whether the 10% single entity and 20% group limits are applicable to the transferable securities held through reinvestment of cash collateral.

MAS' Response
The investments of cash collateral held pursuant to securities lending (or repurchase transactions) should be taken into account, on a portfolio basis, for the purposes of the requirements on spread of investments in section 2 of Appendix 1 of the revised Code. For example, if the collateral is invested in debt securities where the entity is a government which has a minimum long term rating of A by Fitch Inc, A by Moody’s or A by Standard and Poor’s, the single entity limit may be raised to 35%.

h) Fund Liquidity Risk

Question 19

MAS seeks your views on the proposed safeguards to address fund liquidity risk in securities lending.

Public Comments
Respondents agreed with the proposal.

i) Disclosure

Question 20

MAS seeks your views on the proposed disclosure in respect of securities lending programmes.

Public Comments
A respondent sought clarification on how the securities lending programme ("SLP") should be disclosed to existing participants of a scheme. Some respondents asked whether the disclosure is required by the feeder fund when the master fund undertakes a securities lending programme.

MAS' Response
As the implementation of a SLP is considered a significant change to be made to a scheme, existing participants should be informed via a notice no later than one month before the change is to take effect. For the avoidance of doubt, a feeder fund is required to make the necessary disclosure as soon as practicable, but no later than one month after the manager becomes aware that the master fund is undertaking a securities lending programme.

We wish to highlight that as proposed in the consultation paper, the scheme's annual report should contain certain requisite disclosures on the SLP. On further consideration, we shall also require the manager to provide a description of the collateral holdings in the scheme's semi-annual and annual reports, including the nature of the collateral, the identity of the counterparty providing the collateral and the marked-to-market value of the non-cash collateral with a breakdown by asset class and credit rating, where applicable.

1.6 Naming of Funds

Question 21

MAS seeks your views on the proposed fund naming guidelines.

Public Comments

While some respondents agreed with the proposal, others felt it was too prescriptive and would limit creativity in marketing funds. A large number of respondents also raised concerns about changing the names of existing schemes and recognised schemes, which are established in foreign jurisdictions. Others sought clarifications on whether the use of acronyms was restricted.

MAS' Response

We note the respondents' concerns with regards to the proposed fund naming guidelines. However, we maintain the view that fund naming guidelines will enhance the quality of product labeling for retail schemes. Therefore, we shall require that the name of a scheme be 'appropriate'. In determining whether a name is 'appropriate', the manager should consider if it reflects the geographical focus, asset type, and sector focus that is in line with the scheme's investment objective, approach and investment universe. We shall also work with the industry to improve product labeling.

In light of the above, the names of recognised schemes will be accepted so long as they are appropriate. The use of acronyms in the name of schemes is acceptable provided that they are appropriate and reflect the investment nature of the fund. For example, schemes using the acronyms "MSCI", "S&P" or "BRIC" is acceptable. The names of all existing schemes will be grandfathered.

II. STRUCTURED PRODUCT FUNDS

Question 22

MAS seeks your views on the proposals to:

(i) remove Annex 1a of the Code which provides for certain exceptions for structured products fund from the usual rules applicable to non-specialised funds; and
(ii) impose a transitional period of three months for authorised structured product funds, except those with fixed maturity dates, to comply with the revised investment guidelines for non-specialised funds
(iii) grandfather existing authorised structured product funds with fixed maturity dates.

Public Comments
A number of respondents were in favour of grandfathering all existing authorised structured products funds. They argued that structured products are specialised products which involve complex documentations and negotiations with specific counterparties. As such, there may not be enough of such counterparties who meet the required criteria and are able and willing to enter into such transactions. A respondent also highlighted that the setup costs of adding counterparties to the structured product funds will increase the expense ratios of these funds which would be detrimental to participants. A respondent highlighted that funds which formerly obtained waivers from certain investment guidelines in the current Code may require extensive restructuring to request issuers to provide collateral or source for more issuers. Overall, respondents were of the view that a one-year transitional period should be given to allow investors to either restructure or terminate the fund.

MAS' Response
We note respondents' concerns on difficulties in unwinding specific structures and the costs involved in doing so. Unlisted structured product funds with no fixed maturity are given the following two choices:

(a) comply with the revised Code by 1 April 2012; or

(b) be grandfathered subject to the conditions that:
  (i) the schemes cannot accept new subscription monies unless the offer is made to institutional or accredited investors pursuant to sections 304 and 305 of the Securities & Futures Act respectively; and
  (ii) disclosure is made to the persons to whom the offer is made that the schemes are grandfathered schemes and are not required to comply with the requirements in the 2011 version of the CIS Code.

Listed structured product funds with no fixed maturity are given the following two choices:

(a) comply with the revised Code by 1 April 2012; or

(b) be grandfathered subject to the conditions that:

   (i) the schemes cannot accept new subscription monies unless the offer is made to institutional or accredited investors pursuant to sections 304 and 305 of the Securities & Futures Act respectively;
   (ii) disclosure is made to the persons to whom the offer is made that the schemes are grandfathered schemes and are not required to comply with the requirements in the 2011 version of the CIS Code; and
   (iii) the trading board lot size be increased to an appropriate level (e.g. $200,000) to limit their exposure to retail investors by 1 April 2012.

The prospectus and trust deed, where applicable, are to be amended within the allowed transition period. The manager is reminded to observe the requirements under the Code for obtaining an extraordinary resolution of participants where necessary. The manager should also inform existing participants not later than one month before the change is to take effect.

III. INDEX FUNDS

3.1 General Indices

Question 23

MAS seeks your views on the proposed guidelines for index funds.

Public Comments [23a]
A respondent sought clarification on whether managers can use their judgment to determine if a change in characteristic of an index is material enough to warrant notification to participants. Another respondent asked whether the prospectus needs to be revised each time the index is re-balanced. One respondent asked whether there are any restrictions to blending various benchmarks to form the reference benchmarks. A respondent suggested that the requirement for information on the index to be published in an appropriate manner should refer only to those that are published by the index providers as some information are confidential and cannot be disclosed.

MAS' Response [23a]
We wish to clarify that managers should use their judgment to determine whether a change is material or significant enough to warrant notification to participants. In addition, there is no need to revise the prospectus each time the index is re-balanced although the prospectus should disclose the frequency of the re-balancing. Blended (or customised) benchmarks are allowed provided that they meet the requirements on index characteristics. We agree that the requirement for information on the index to be published in an appropriate manner refers to the information published by index providers.

Public Comments [23b]
A respondent asked whether indices on underlying investments which are not permissible would be permitted and whether listing is a requirement for eligibility as an index constituent. Another respondent asked whether the 10% single entity, 20% group and 25% aggregate limits, as well as the securities lending requirements will apply to index funds.

MAS' Response [23b]
The index should compose only of permissible investments, commodities, interest rates, foreign exchange rates or currencies. For the avoidance of doubt, listing is not a requirement for eligibility as an index constituent. As proposed in the consultation paper, constituents of the index should be sufficiently diversified. We wish to clarify that the index should have a weighting per constituent of no higher than 20%, or in the case of an index based solely on constituents which are non-entities (such as a commodity index), the 20% limit may be raised to 35% for one constituent. An index fund should also comply with the core investment requirements set out in Appendix 1 of the revised Code.

3.2 Hedge Fund Indices

Question 24

MAS seeks your views on whether funds should be allowed to track hedge fund indices.

Public Comments

We received mixed responses on the tracking of hedge fund indices by index funds. Some respondents were not in favour of allowing index funds to track hedge fund indices and cited concerns that the underlying and construction of such indices may not be suitable for retail investors. One respondent however argued that there are already a few retail fund of hedge funds and a scheme which tracks a hedge fund index would not be substantially different from those funds. Another respondent argued that the weaknesses identified by MAS pertain to those associated with hedge fund indices in the past and recent improvements in index construction and regulatory developments have addressed these weaknesses adequately to make hedge funds viable and appropriate underlying constituents for indices.

MAS' Response

While improvements in index construction may address some of the inherent biases in a hedge fund index, the effects of these inherent biases will not be completely mitigated or removed. The underlying hedge funds of a hedge fund index may not be sufficiently investable and hence the index may not be reflective of the characteristics of the hedge funds it aims to represent. For instance, the underlying hedge funds may not be liquid due to the imposition of redemption gates. They also typically face capacity constraints for their particular strategy or are already closed to new investment. Moreover, the proposed characteristics of an acceptable index for index funds require the strategies of the underlying hedge funds to be clearly defined. However, the classification of hedge fund strategies remain diverse and are susceptible to style drifts. We will therefore prohibit funds from tracking hedge fund indices.

IV. MONEY MARKET FUNDS

4.1 Credit Ratings

a) Existence of Multiple Credit Ratings

Question 25

MAS seeks your views on the proposal to amend the money market fund guidelines to clarify that in cases where multiple credit ratings exist and in the event of a difference in ratings by the rating agencies, the lowest credit rating should be used.

Public Comments
Respondents were generally in agreement with the proposal. Some respondents noted that the lowest rating may not be the most recent rating and therefore not reflective of the current credit standing of an entity.

MAS' Response
At the point of investment, the manager should consider whether the ratings issued are valid and actively reviewed by the rating agencies. In the event of a difference in ratings by the rating agencies, the manager should rely on the lowest credit rating. The manager should monitor the ratings on an ongoing basis and ensure that the scheme complies with the applicable limits at all times.

b) Short Term Ratings

Question 26

MAS seeks your views on the proposal to expand the short term ratings to include Moody's Investor Services.

Public Comments
Respondents were in agreement with the proposal.

4.2 Portfolio Maturities

Question 27

MAS seeks your views on the proposal to introduce a dollar-weighted average portfolio maturity of 120 days for money market funds.

Public Comments [27a]
A large number of respondents commented that the 120-days maturity limit is too restrictive and operationally difficult as there is limited choice and availability of short-dated Singapore dollar ("SGD") instruments in the local debt market. Respondents have commented that it is rare to find short-term SGD-denominated corporate debt with maturity between 120 days and six months in the secondary market as most corporate debt issuance (through a medium-term note programme) usually has a maturity of at least one year. Some respondents have suggested that the current guidelines already adequately allow a manager to construct a portfolio with highly liquid bills, deposits and highly rated credits.

MAS' Response [27a]
We shall adopt a two-tier approach which differentiates between the usual money market funds ("Money Market Funds") and short-term money market funds ("Short-Term Money Market Funds"). "Money Market Funds" are those that seek to generate enhanced yields, taking on investment risk to do so. To address the industry's concerns and allow this category of money market funds the flexibility to implement its investment strategy, "Money Market Funds" will be subject to a weighted average portfolio maturity of no longer than 12 months and be permitted to invest in instruments with a remaining term to maturity of not more than 2 years. Money market funds which hold themselves out to be "Short-Term Money Market Funds", that is those which seek to serve as cash management vehicles and where investors do not expect significant investment risk, will be subject to a shorter weighted average portfolio maturity of no longer than 120 calendar days and be permitted to invest in instruments with a remaining term to maturity of not more than 397 calendar days.

Public Comments [27b]
A respondent asked for the rationale for including T-bills in the computation of the dollar-weighted average portfolio maturity given that T-bills are generally considered to be liquid and safe as they have little duration risk and negligible credit risk.

MAS' Response [27b]
We wish to clarify that although government securities may have enhanced credit risk profiles, they are still exposed to interest rate spread risk associated with longer term adjustable-rate securities like other non-government securities. For example, an issuer's 30-day floating rate securities would likely widen to a lesser extent than the spreads on

that issuer's 397-day floating-rate securities in the event of a deteriorating credit risk profile. As the dollar-weighted average portfolio maturity was introduced to limit, among other risks, interest rate spread risk, it may not be appropriate to allow money market funds to have a longer portfolio maturity simply because they hold more government securities. In addition, we note that the recent US amendments to rule 2a-7 regarding portfolio maturity (weighted average life) did not exclude government securities as well.

Public Comments [27c]

A respondent suggested that the weighted average portfolio maturity should be calculated based on securities holdings and exclude deposits. The respondent also sought clarification on whether the average life and reset dates of a security should be taken into account as they are standard market conventions when measuring maturity.

MAS' Response [27c]

We wish to clarify that the weighted average portfolio maturity is calculated based on the fund's securities holdings and excludes deposits. In addition, we note that in the US and EU, the weighted average maturity ("WAM") is measured by treating a variable- or floating-rate security as having a maturity equal to the time remaining to the next interest reset date while the weighted average life ("WAL") is measured without regard to a security's interest rate reset dates. As the intention behind the introduction of the weighted average portfolio maturity is similar to that for WAL, the calculation should likewise be based on each security's remaining term to maturity without taking into account the reset dates of variable- or floating-rate securities.

V. HEDGE FUNDS

5.1 Short Selling

Question 28

MAS seeks your views on the proposal to prohibit hedge funds from short selling of securities, whether or not backed by securities borrowing.

Public Comments
A number of respondents expressed concerns with the proposed prohibition. They cited difficulties in executing hedge fund strategies if the proposal is implemented. They suggested that the prohibition be extended to only uncovered short sales instead. One respondent suggested not prohibiting hedge funds from engaging in short selling.

MAS' Response
We note the respondents' concerns and recognise that the short selling of securities is an integral part of many hedge fund strategies. We shall only prohibit hedge funds from conducting uncovered short sales. We wish to highlight that the minimum subscription requirement for hedge funds will continue to be in place.

VI. CAPITAL GUARANTEED FUNDS

6.1 Credit Ratings

Question 29

MAS seeks your views on the proposal to use the long term credit rating to determine guarantor eligibility.

Public Comments
A respondent asked whether the minimum credit rating requirements will apply to the guarantors of offshore UCITS III compliant schemes. Another respondent asked whether the new guarantor eligibility criteria will apply to existing capital guaranteed funds.

MAS' Response
MAS shall recognise a foreign scheme if, amongst others, it is subject to investment guidelines which are substantially similar to that set out in the Code. The minimum credit rating of the guarantor is one aspect that will be taken into account when we consider the recognition of a capital guaranteed scheme under section 287 of the SFA. Existing authorised capital guaranteed funds are required to comply with the revised Code by 1 October 2011.

VII. FUND OF FUNDS

7.1 Name of Funds

Question 30

MAS seeks your views on the proposal for a fund-of-funds or a multi-manager fund to include the term "fund-of-funds" or "multi-manager" in its name but need not reflect the scheme's investment geographical focus, asset type and sector focus.

<u>Public Comments</u>

Although one respondent agreed with the proposal, some respondents were of the view that it is more important for the name to include an indication of at least one of its geographical focus, asset type, sector focus or strategy as opposed to the generic term "fund-of-funds" or "multi-manager". Other respondents sought clarifications on a number of aspects including whether acronyms (e.g. FoF) are allowed; and whether recognised fund-of-funds are required to comply with the fund naming guidelines.

<u>MAS' Response</u>

We agree with the view that the name of a fund-of-funds should include an indication of its geographical focus, asset type, sector focus or strategy. In line with the fund naming guidelines (see Question 21), schemes whose primary investment approach is to invest all or substantially all of its assets in other schemes via fund-of-funds or multi-managers should use 'appropriate' names to reflect their geographical focus, asset type and sector focus, including highlighting to investors in the fund's name that the investment approach is that of a fund-of-funds or multi-manager. We will deem a fund-of-funds or a multi-manager fund to be one where a scheme invests into five or more underlying funds. Since the name may become long and cumbersome, we accept the use of acronyms like "FoF" or "MM".

In view of the whole suite of proposed revisions to the Code, and in particular the proposed fund naming guidelines, we believe that sufficient safeguards are in place for funds-of-funds such that we may remove the existing fund-of-funds appendix. For the avoidance of doubt, a fund-of-funds may feed substantially into another fund-of-funds, but the latter fund-of-funds should invest in schemes directly, that is, not through another fund-of-funds or feeder fund.

VIII. Operational Requirements

8.1 Sending of Accounts and Reports

Question 31

MAS seeks your views on the proposals:

(i) to allow trustees to send, or cause to be sent, the accounts and reports to unitholders by electronic means; and
(ii) to require hardcopies to be sent to investors who are aged 55 and above at a specified date unless they have given consent to receive the accounts and reports by electronic means.

Public Comments
A large number of respondents suggested that all unitholders regardless of age can be sent electronic copies and that they should be notified when hard copies are available and be sent to them if they wished. One fund manager pointed out that investors' dates of birth are not required for fund subscriptions. Two respondents sought further clarification on the operational aspects of the requirements, such as whether unitholder's agreement to the terms and conditions during the account opening to receive reports electronically or in hardcopy would suffice. One respondent proposed stating in the prospectus how the reports can be accessed electronically.

Separately, a respondent suggested that the time frame given to REIT trustees to send, or cause to be sent, the reports to REIT unitholders should be synchronised with the time frame applicable to companies under the Listing Manual, that is at least 14 days before the date of the annual general meeting.

MAS' Response
We note that a number of respondents agree with the proposal of providing electronic reports by default, whilst allowing participants to choose to receive the hardcopies. We shall proceed with allowing the sending of accounts and reports by electronic means to all participants regardless of their age. We consider that it is more practical for trustees to send, or cause to be sent, a hardcopy letter to inform all unitholders that the reports are available on the website. Unitholders may still request for a hardcopy if they wish.

In the case of REITs, we agree that the deadline to send the reports should be synchronised with that for listed companies. In other words, REIT trustees are to send, or cause to be sent, the reports to REIT unitholders at least 14 days before the date of the annual general meeting.

8.2 Transactions with Related Parties

Question 32

MAS seeks your views on the proposal to allow managers to invest in the securities of related companies up to the benchmark weight with an additional absolute overweight allowance of two percentage points above the benchmark weight.

Public Comments
Respondents did not object to the proposal.

8.3 Valuation Error Reports

Question 33

MAS seeks your views on the proposed information to be submitted in the valuation error report.

Public Comments [33a]
All respondents were supportive of codifying the valuation error template. One respondent asked whether the requirement to disclose the total number of subscribing investors and redeeming investors during the relevant period refer to Singapore investors only. Another respondent asked whether “subscribing investors” and “redeeming investors” will be based on the names of those recorded in the fund register. One respondent sought clarity on whether the name of parties responsible refers only to the legal entity’s name and not an individual’s name.

MAS' Response [33a]
The investors referred to in the template are Singapore investors whose names appear in the fund register. We wish to clarify that the number of investors need only be provided if the error represents 0.5% or more of the scheme’s net asset value per unit after adjustment for the error. As regards the name of parties, stating the name of the legal entity in the valuation error report is sufficient. We have amended the template for clarity.

Public Comments [33b]
One respondent suggested clarifying how and when investors should be duly notified of a valuation error. The respondent also suggested that investors be given a choice to either make free switches or receive compensation.

MAS' Response [33b]

We agree with the suggestion that the manager should notify affected participants if the valuation error is materially adverse from the point of view of the participant. That is, the manager should notify affected participants of the compensation made if the valuation error represents 0.5% or more of the scheme's net asset value per unit after adjustment for the error. We however believe that the option for participants to make free switches over and above compensation should be left as a commercial arrangement between the manager and its distributors.

IX. MISCELLANEOUS

9.1 Performance Fees

Question 34

MAS seeks your views on the proposed guidelines for performance fees in the event where such fees are payable to the manager and charged to the scheme.

Public Comments [34a]
Several respondents asked for further guidance on the expected methodology to administer the performance fee such that the calculation is equitable to all investors. A respondent said that it would be nearly impossible to track individual participants as their names would be contained in the omnibus accounts of distributors. Individuals can also redeem from the fund before the end of the performance measurement period so as not to be charged the performance fee, leaving remaining investors to pay the performance fee at the end of the period. The respondent suggested that the requirement for equitability should be removed. An alternative suggestion by another respondent was that disclosures be made to inform investors that they may potentially be treated inequitably for payment of performance fees.

MAS' Response [34a]
We consider that the proposed High Water Mark ("HWM") and fulcrum fee methods applied on an annual basis to be equitable. We however note that there are other equalisation methodologies which enhance the proposed High Water Mark ("HWM") method such as equalisation credit[2] or depreciation deposit[3], equalisation credit or contingent liquidation[4] and series of shares method[5]. The manager may submit other methods which it views to be equitable to MAS for consideration.

While the tracking of a large number of individual participants entering and leaving the fund may be operationally tedious, we are of the view that equalisation to enhance the HWM method is technically possible with assistance from the distributor. The manager is therefore encouraged have systems in place with the distributor or relevant parties in

[2] **Equalisation Credit –** When a shareholder subscribes at a price that exceeds the current fund HWM, the investment will be subject to a performance fee that exceeds what should be paid so an equalisation credit amount in the form of additional shares or cash is granted.
[3] **Depreciation Deposit –** Where an investor subscribes at a price under the fund's HWM, this methodology effectively represents an incentive fee pre-payment, such that the additional performance fee is deducted upon subscription and segregated from the rest of the fund's assets.
[4] **Contingent Liquidation –** Where an investor subscribes at a price under the fund's HWM, the additional performance fee payable will be charged through forced liquidation of shares at the end of the period.
[5] **Series of Shares –** A new series of shares is issued for each dealing day, usually at a fixed price per share. Investors may only subscribe into this new series on one particular dealing date. When the performance fee is crystallised for each series, all performing series may be rolled into (consolidated with) a roll up (lead) series.

the event that performance fees are payable to the manager. Where performance fees are charged but the equalisation of performance fees is not achieved, the fact and how the absence of equalisation may affect the amount of performance fees borne by the participant should be disclosed in the prospectus.

Public Comments [34b]
Some respondents enquired if the new guidelines on performance fees will be applied to existing schemes that charge performance fees.

MAS' Response [34b]
Existing schemes are to adopt the new guidelines and implement them by 1 October 2011.

Public Comments [34c]
Some respondents sought clarification on whether it would be possible for all funds, regardless of whether they utilise absolute or relative strategies, to charge performance fees.

MAS' Response [34c]
All funds are permitted to charge performance fees. Schemes which pursue relative return strategies should calculate the performance fee based on the return of the scheme compared to an appropriate benchmark given the scheme's investment objectives. Schemes which pursue absolute return strategies should calculate the performance fee against a specified hurdle rate.

Public Comments [34d]
Some respondents sought clarification if performance fees should be crystallised upon investors' redemptions. Other respondents asked if performance fees can be charged during redemption in addition to that which is charged on an annual basis.

MAS' Response [34d]
We would like to clarify that performance fees may be crystallised upon investors' redemptions. Performance fees can be charged upon redemption in addition to that charged on an annual basis.

Public Comments [34e]
Some respondents asked if the guidelines on performance fees will be applicable to property funds.

MAS' Response [34e]
For the avoidance of doubt, the guidelines on performance fees will not be applicable to property funds.

9.2 Definition of "Liquid"

Question 35

MAS seeks your views on the proposed definition for 'liquid' in respect of a transferable security or financial derivative. In particular, do you agree with the proposed 7 business day timeframe? If not, would a principle-based definition be more appropriate for managers?

Public Comments

A number of respondents disagreed with the specification of a seven-day limit as it does not correspond to the settlement cycle of markets or securities in general. In particular, the seven-day limit would result in practical difficulties for investments in Asian bonds. Two respondents suggested that flexibility for schemes to hold a certain percentage of the deposited property in illiquid holdings should be introduced as non-publicly traded instruments such as bonds would have difficulty meeting the proposed changes. A respondent pointed out that liquidity has many dimensions which not only include the ease of converting the asset into cash but also the transaction costs incurred when doing so. Another respondent suggested considering whether an investment can be converted into cash at a value close to its fair price as another key aspect of liquidity. There was also a suggestion that reference to 'business days' should be with respect to a 'business day in the relevant market' since the transferable security or financial derivative may be traded in an offshore market. Many respondents also commented that it would not be feasible to use an "arbitrary" definition of seven business days to determine liquidity during market distress.

MAS' Response

MAS notes that most respondents felt the seven-day definition was too short and would prefer a principle-based definition instead. Taking into account the feedback received, we agree that the definition of "liquid" should be principle-based and include the following principles:

(a) be readily converted into cash at a value close to its fair price under normal market conditions (e.g. in the absence of trading restrictions); and

(b) not impair the scheme's ability to comply with the redemption period requirements as stated in chapter 3.2(a) of the revised Code.

We shall accordingly provide the following definition in the revised Code:

> "Liquid means the ability to be readily converted into cash at a value close to its fair price under normal market conditions. In determining if an instrument or collateral is liquid, the manager should also take into account the following factors: (i) transaction costs, (ii) bid-offer spread, (iii) size of the holding relative

to issue size, (iv) settlement time, (v) number of market participants, and (vi) characteristics or nature of the instrument. The manager should have a reasonable belief that the financial instrument does not impair the scheme's ability to comply with its redemption obligations set out in chapter 3.2(a) as well as meet other payment commitments."

9.3 Back-testing and Simulated Performance Data

Question 36

MAS seeks your views on whether to allow the use of back-testing and simulated performance data for disclosure of performance figures; and if so under what conditions and circumstances.

Public Comments

The vast majority of the respondents were not in favour of allowing the use of back-testing and simulated past performance data for the disclosure of performance figures. Some respondents believe that while the Global Investment Performance Standards ("GIPS") advocated by the Chartered Financial Analyst Institute may allow some form of back-testing and simulated past performance data, the retail public may not understand the methodologies used as well as institutional investors.

There were a few respondents who felt that the use of back-testing and simulated past performance data for disclosure of performance figures should be allowed if there is sufficient disclosure on the methods and assumptions used, and if the results can be easily replicated. A respondent asked for clarification if this proposal would apply to property funds.

MAS' Response

Taking into account the view of the majority of respondents who were not in favour of disclosing back-testing data, and the concern that the use of back-tested or simulated past performance data may be subject to manipulation, back-testing and the use of simulated past performance data will be prohibited in all circumstances. For the avoidance of doubt, this prohibition does not extend to the use of pro-forma financial information by property funds.

X. TRANSITIONS

Question 37

MAS seeks your views on the proposal to give fund managers and approved trustees three months to comply with the revised Code.

Public Comments

Almost all respondents were of the view that the proposed period of three months was too short. A number of respondents suggested a transition period of at least six months would be appropriate in view of the amount of changes to the investment guidelines and operational requirements. One respondent asked whether fund managers and approved trustees are required to update prospectuses and trust deeds during the transition period as it may be costly to do so.

MAS' Response

We note that a large number of respondents prefer a transition period of at least six months. With the exception of structured product funds, MAS shall extend the proposed transition period from three to six months and require managers and approved trustees of authorised funds to comply with the revised Code by 1 October 2011. Managers and approved trustees who wish to comply with the revised Code prior to 1 October 2011 are encouraged to do so.

The prospectus and trust deed, where applicable, are to be amended within the allowed transition period. The manager is reminded to observe the requirements under the Code for obtaining an extraordinary resolution of participants where necessary. The manager should also inform existing participants not later than one month before any significant change is to take effect.

APPENDIX A

List of Respondents

1. DBS Bank Ltd
2. UOB Bank Ltd
3. The HSBC Group
4. iFast Financial Pte Ltd
5. Deutsche Asset Management (Asia) Ltd
6. Lion Global Investors Ltd
7. Phillip Capital Management (S) Ltd / Phillip Securities Pte Ltd
8. Fidelity International
9. Prudential Asset Management (Singapore) Ltd
10. Schroders Investment Management (Singapore) Ltd
11. DBS Asset Management Ltd
12. Aberdeen Asset Management Asia Ltd
13. Helvetic Investments Pte Ltd
14. Grace Chua
15. Andrew Kwek
16. Ivan Png
17. Life Insurance Association of Singapore (LIA)
18. Investment Management Association of Singapore (IMAS)
19. Tan Peng Chin LLC
20. Chan & Goh LLP
21. State Street Bank and Trust Company
22. BNP Paribas / BNP Paribas Trust Services Singapore Ltd / BNP Paribas Securities Services
23. Citicorp Trustee (Singapore) Ltd