

29th August 2014

Capital Markets Policy Division

Markets Policy and Infrastructure Department

Monetary Authority of Singapore

10 Shenton Way

MAS Building

Singapore 079117

Submitted via email to: SFA_FAA_LegisConsult@mas.gov.sg

Re: Consultation Paper No. P012-2014 – Proposals to Enhance Regulatory Safeguards for Investors in Capital Markets

Dear Sir,

CFA Society Singapore welcomes the opportunity to participate in this consultation paper to enhance regulatory safeguards for investors in capital markets in Singapore. We commend the Monetary Authority of Singapore (“MAS”) for the comprehensive work done in drawing up the consultation paper.

We are pleased to share our comments in the table below. All comments made are primarily from the perspective of representing investors’ interests and enhancing financial market integrity.

PART I: CAPITAL MARKETS REGULATORY SAFEGUARDS FOR INVESTORS IN NON-CONVENTIONAL INVESTMENT PRODUCTS

Q1. MAS seeks feedback on the proposal to regulate buy-back arrangements involving precious metals where the purpose or effect of the arrangement is to enable Party A to receive a financial benefit from Party B, as set out in paragraph 2.7 (i) – (iii), as debentures.

We agree that such buy-back arrangements should be deemed as debentures. We also presume that this proposal to regulate buy-back arrangements involving precious metals as debentures would be applicable to all investors regardless of whether it is offered to the retail public or institutional and accredited investors.

Q2. MAS seeks comments on the interpretation of “financial benefit”.

Q3. MAS seeks views on the proposal to extend the debenture regulatory regime to buy-back arrangements involving investment precious metals which have been characterised as debentures.

In principle, we have no objections to the interpretation of financial benefit and agree that the debenture regulatory regime should be applicable to buy-back arrangements. However, the regulations have to take into consideration comments from the perspective of Islamic financing structures as these structures typically involve buy-back arrangements.

Q4. MAS seeks comments on the proposed amendments to the SFA and the draft Securities and Futures (Prescribed Debentures) Regulations at Annex 1 and 2.

No comment.

Q5. MAS seeks feedback on the proposal to regulate collectively-managed investment schemes as CIS.

We agree in principle that collectively-managed investment schemes should be regulated as CIS. It would bring other exotic investments under the SFA e.g. wine investments (<http://www.profiters.com/about.aspx>). In particular, the CIS regulation in respect of marketing activities and compliance by issuer or offering company should be applicable.

Q6. MAS seeks comments on the proposed amendments to the CIS definition in the SFA at Annex 1, particularly whether the proposed amendments sufficiently caters to arrangements that display characteristics of collectively-managed investment schemes.

We fully support the proposal to apply CIS regulation on land sales and other sales where interests are pooled.

However, we note that para 3.18 on land investment schemes sets out that “if the arrangements are such that participants can choose not to engage the scheme operator’s services in generating the expected profits, then it is unlikely that the arrangement will be regarded as CIS”. We would like to clarify whether this means that as long as participants are given the **option** to elect not to appoint the scheme operator’s services to generate the expected profits, the arrangement would not be regarded as CIS? Would this result in a loophole in the regulation that allows collectively-managed investment schemes to fall outside the oversight of MAS as long as participants are given the option to elect not to appoint the scheme operators’ services to generate profits?

Q7. MAS seeks comments on the proposals to extend the CIS regulatory regime to collectively managed investment schemes, including the proposal to promulgate specific rules in our CIS Code for schemes that invest solely in gold, silver and platinum.

Under the current framework for licensing of retail fund management companies (FMC), a retail FMC should demonstrate that it or its shareholders have at least a 5-year track record of managing

funds for retail investors in a jurisdiction which has a regulatory framework that is comparable to Singapore. The FMC and its related corporations should also manage total assets of at least S\$1b. Under current requirements, it is unclear if there is currently any company that meets the criteria for the retail FMC licence.

PART II: COMPLEXITY-RISK RATINGS FRAMEWORK FOR INVESTMENT PRODUCTS

Q8. MAS seeks views on the proposal to introduce a framework by which products can be rated for both their relative complexity and risk.

Through CFA Institute's¹ international network, we have looked at the practices adopted in some other jurisdictions and established the following:-

In Australia, there is a major review of their regulatory structure – Financial System Inquiry (FSI) currently undergoing a second round of consultations (<http://fsi.gov.au/publications/interim-report/>). While there is no specific section on complexity and risk rating of products, there is a particularly relevant Section 6 on Consumer Outcomes where there is significant discussion on three main points.

- a) Quality of disclosures – disclosures are currently too long and technical and of no value to consumers who cannot understand these disclosures. Related to this is the lack of financial literacy – retail investors simply do not have enough financial education and information to make informed choices.
- b) Quality and affordable financial advice – Consumers need affordable, quality advice, from financial advisors that are free from “remuneration conflict”.
- c) Underinsurance among most retail investors/consumers – how to address this.

The FSI focuses not on purely relying on rules, definitions or ratings, but on providing actual value to the consumer. Indeed, there are also suggestions that perhaps the onus should shift to product providers to take on greater responsibility in coming out with suitable products that better fit the profiles of the consumers.

Likewise in the US, there is no explicit risk-rating model. Instead, the US adopts a complicated

¹ CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 119,000 members in 147 countries and territories, including 112,000 CFA charterholders, and 140 member societies. For more information, visit www.cfainstitute.org

accredited investor system that keeps riskier asset classes away from the less sophisticated investors.

In Europe, there is a new EU regulation on Packaged Retail Investment (PRI) and Insurance-based investment Products (PRIIPs) that introduces a complexity label to retail products. In addition, there are already regulations in place in Portugal that require the use of a complexity label in their version of the key information document for retail products (some details can be found on page 33 & Appendix B of <http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2013.n10.1>).

Another consideration is that the introduction of any complexity-risk framework would involve high capital expenditure as the implementation would require upgrading the IT infrastructure for financial institutions to remain profitable. In addition, a “relative” risk framework may be too arbitrary with regard to structured products. An alternative suggestion is that MAS could consider a self-regulation approach as adopted in Switzerland and Europe. MAS could work with industry participants to start a Singapore Structured Product Association to recommend and define industry standards and conduct, which could include agreeing on the different risk-payoff diagrams and for such a framework to be adopted by the industry. The public would have access to such an accepted framework. (see <http://www.svsp-verband.ch/home/index.aspx?lang=en>)

CFAS is prepared to meet with MAS to discuss the concept of self-regulation and to share the experiences of Switzerland and Europe.

Notwithstanding, should MAS wish to proceed with the adoption of the complexity-risk framework, it would be appropriate to issue an “interpretation guide” so that issuers have a basis to assess the complexity (e.g. is COCO more complex than CLN, is ELN more complex than DCI etc.). In addition, the complexity-risk framework would have to be continuously updated to include new product innovation. This complexity-risk framework would also help harmonize industry standards.

Q9. MAS seeks feedback on the proposed scope for the complexity-risk ratings framework, in terms of the product and investor coverage.

As highlighted above (Q8) and below (Q10), it is our view that there are inherent difficulties in attempting to rate structure products according to a complexity-risk framework.

Q10. MAS seeks views on the proposed four factor complexity-rating methodology and proposed application of the factors to various investment products.

While one can understand the rationale that the greater the number of structural layers, the higher the complexity of the product, the end result of this scoring is that a plain vanilla ETF would be

considered “medium” in the complexity rating while holding a direct stock or bond would be considered “low” complexity. This could potentially lead to a problem where conservative investors are guided towards investments in the lower left hand quadrant of Table 3, when they would be better off investing in more diversified collective investment schemes.

In addition, Table 1 on complexity-rating methodology is too arbitrary for structured products. More options or more layers in the product may not necessarily mean that the product is more complex. For example, an ELN can be structured by: (1) buying a deposit and selling a put option or (2) buying the equity, selling a call option and to protect downside risk, buying a put option. However, the complexity for the less risky product (2) is “higher”.

Another example is in a daily accrual note, the daily accrual means that the product is structured with more than 250 options but it does not mean that the product is very complex.

In Annex 3, the general explanations to the complexity-risk ratings are subjective. For example., how would one quantify and differentiate “easily understood”; “less easy to understand”; “difficult to understand”; and “very difficult to understand”?

Q11. MAS seeks views on the proposal to adopt a risk bucketing approach that focuses solely on the risk of loss that investors face when investing in a product.

One positive of focusing on the risk of loss is that it potentially could shift the investors’ attention to the fact that there is a possibility of loss of principal, as opposed to only considering the upside potential, which is normally the case.

However, in any investment, there is always a risk of losing 100% of the investment. This was the case even for investment grade bonds such as Lehman Brothers before the crisis. As such, an approach that focuses solely on the risk of loss for investors may not be very useful. An alternative option could be to look at expected volatility of the underlying asset class (i.e. is it an equity, bond, multi-asset classes etc.). If the Swiss/Europe approach is adopted, this would be clearly defined by the self-regulating body and all issuers who are part of the association will be required to adhere to the code.

Q12. MAS seeks feedback on the general categorisation of investment products into risk of loss buckets as set out in Table 2.

We note that the definitions of Risk of Loss bucket in Table 2 are different from those in Annex 3. Further, looking at Annex 3, it is unclear how one would differentiate between moderate chance and

high chance of losing some or all of one's investment principal amounts. More intuitive definitions perhaps can be used.

In Table 2, S\$ structured deposits are classified as low risk of loss. Would non-S\$ structured deposits still be classified as low risk of loss or medium risk of loss due to potential currency fluctuations?

Medium risk non-concentrated, non-leveraged and non-synthetic REITs/CIS/ILP sub funds vis High risk concentrated, leveraged or synthetic REITs/CIS/ILP sub-funds

Does this mean that an Ascott REIT with a diversified portfolio of service apartments located in emerging countries is deemed medium risk and therefore less risky than CMT REIT where all of its retail malls are concentrated and located in Singapore?

We also think that "non-leverage" and "leverage" needs to be properly defined. REITs typically take on debt in their normal business operations and it would be good to clarify if this counts as leverage.

High risk unrated AND non-investment grade debt securities: if it is unrated, one would not know if it is non-investment grade debt securities. Does this mean unrated OR non-investment grade debt securities? Unrated debt securities need not be high risk with high possibility of losing full investment amount e.g. debt issued by Keppel, SIA, SPH, SCI.

By classifying unrated debt securities in the same "high risk" bucket as single equities, does this imply that the risk reward of debt and equities is the same?

In a split rating of investment grade and non-investment grade debt, would the higher or lower rating be adopted?

Is there a distinction between the listed and unlisted risk bucket for single equities? If listed, is it limited to any stock exchange?

Q13. MAS seeks comments on the proposed criteria for splitting REITs, CIS and ILP sub-funds between the "medium" and "high" risk of loss buckets as set out in paragraph 2.18. MAS also welcomes suggestions on how the criteria can be modified to produce more intuitive results, particularly with respect to (i) funds investing in developing or emerging markets; and (ii) funds investing in risky products (e.g. high yield bonds) only.

No comments.

Q14. MAS seeks views on the appropriate risk of loss bucket for an unrated debt security.

No comments.

Q15. MAS seeks comments on the product-mapping at Table 3 as a general representation of the relative complexities and risks of investment products that are available to retail investors.

We agree that S\$ investment should be the base for the product mapping.

We have already made the point in our answer to Q10 that conservative investors could be guided towards investments in the lower left hand quadrant of Table 3, when they would be better off investing in more diversified collective investment schemes.

Typically, in a liquidation scenario for a corporate, the priority of ranking of creditors are as follows:-

- secured debtors (secured bonds)
- unsecured debtors (unsecured bonds)
- preference shareholders (perpetuals)
- equity shareholders (corporate shares)/ REIT holders

Based on the mapping of products in Table 3, corporate shares which ranks last in a liquidation scenario is classified as similar in risk of loss as non-investment grade or unrated corporate bonds. Does this include secured corporate bonds? There should be a risk distinction between secured and unsecured bonds and a risk distinction between bonds and corporate shares.

Bonds, preference shares and corporate shares are non-structured plain vanilla instruments. Preference shares (perpetuals) rank ahead of corporate shares in a liquidation scenario but are classified as more complex. What is the basis used to determine the complexity of bonds vis-à-vis perpetuals vis-à-vis corporate shares vis-à-vis REITs?

Q16. MAS seeks views on whether a historical volatility (or credit rating for debentures) indicator should be used alongside the complexity-risk ratings framework. If so, should the indicator be used for products in the “medium”, “high” and “very high” risk of loss buckets or a more limited set of products?

A historical volatility indicator could be considered for the high/very high complex and high/very high risk of loss products where there is no readily available valuation model to value the investment. This would be useful for structured investments.

Q17. MAS welcomes suggestions on the approach to be taken where information to calculate the

historical price volatility indicator is unavailable.

Where information to calculate the historical price volatility indicator is unavailable, information on historical events or circumstances that would have triggered the worst case scenario for the investment should be provided.

Q18. MAS seeks comments on the proposal for product issuers to rate their product for complexity and risk and to disclose such ratings in product offering documents for new and ongoing offers to retail investors.

No comments.

Q19. MAS seeks feedback on the general explanations to accompany the (i) complexity rating (ii) risk of loss bucket and (iii) historical price volatility/credit rating indicator as set out in Annex 3.

No comments.

Q20. MAS also invites comments on the form and content of supplementary disclosures to be made to investors, bearing in mind the need to ensure that overall disclosures remain simple and understandable to retail investors.

No comments.

Q21. MAS seeks comments on the practical implications of changes in ratings after initial disclosures are made.

It could be practically challenging but investors should be apprised of any rating changes. MAS may have to provide further guidance on the timeliness of disclosure of any ratings changes.

Q22. MAS seeks feedback on whether the proposed risk of loss bucketing framework would conflict with risk ratings produced under internal risk rating systems. If so, MAS welcomes examples and suggestions on how either framework can be amended to resolve such conflicts.

No comments.

Q23. MAS seeks comments on the proposal to align the classification of products as EIP or SIP with their complexity-rating as set out in paragraph 4.2.

We agree in principle with this proposal. Practice note SFA PN-01 states that an investor who passes the SGX learning module assessment will be deemed to have passed the CAR and presumably would be allowed to transact in High or Very High Complexity products. The CAR has a validity of 3 years. However, it is unclear what happens after the CAR “expires” – would the investor have to retake the SGX learning module assessment again, assuming that he does not meet the other criteria for passing

the CAR?

Separately, Practice note FAA PN-02 states that “Where a client is assessed to not possess knowledge or experience in an unlisted Specific Investment Product (SIP), but subsequently demonstrates sufficient understanding of the features and risks of that SIP through a learning module provided by an independent body as set out in the Practice Note on Recommendations on Investment Products [FAA PN-02], the client may be deemed to possess the knowledge to transact in that unlisted SIP.” We note that FAA PN-02 currently does not indicate what this learning module is.

PART III: REFINING THE INVESTOR CLASSES UNDER THE SFR AND FAA

Q24. MAS seeks views on the proposal to introduce an opt-in regime for AIs.

We agree with this proposal as investors are given the choice whether they wish to receive higher regulatory protection as a non-AI.

Q25. MAS seeks comments on the proposed key features of the opt-in regime, as set out in paragraph 2.6.

Assume the following scenario where an individual holds an account with a Financial Institution (“FI”) and opted-in as an AI. The individual invests through the FI and loses all/part of his/her investment and no longer qualifies under the definition of AI. Does the individual continue to be accorded AI status if the individual does not write in to the FI to change his classification to non-AI status?

Q26. MAS invites views on the proposed transitional arrangements described in paragraphs 2.7 to 2.9 to migrate existing AI clients to the proposed opt-in regime.

No comments.

Q27. MAS seeks views on the proposal to modify the net assets AI eligibility criterion for individuals to cap the contribution of the net equity in an individual’s primary residence to S\$1 million of the minimum net assets threshold of S\$2 million (as described in paragraph 2.14).

We agree in principle with this proposal. However, is the FI required to undertake a valuation of the primary residence to determine its value?

Q28. MAS seeks views on the proposal to extend AI eligibility to any individual who holds a joint account at an FI with an individual who is an AI, in respect of transactions entered into with or through the FI, using the joint account.

We agree in principle with this proposal. There could be a scenario where the AI maintains a few accounts with the FI, one of which is a joint account with his/her domestic helper. Does this mean that the domestic helper is eligible to “opt-in” as AI as long as the transaction is undertaken using the joint account? Would MAS consider according the AI the right to advise the bank not to accept any “opt-in” by the domestic helper?

Q29. MAS seeks views on the proposal to extend AI eligibility to any corporation which is wholly owned by AIs.

Q30. MAS seeks views on the proposal to extend AI eligibility to any trustee of a trust in which all the beneficiaries are AIs.

As described in para 2.18, it is common for a high networth individual (HNWI) to have a joint account with members of his family, who are not AI, but MAS proposes that they may become AI by association. We have also seen the following structures used in private banks:

- HNWI sets up a private investment company and names his family members, who are not AI, as shareholders.
- HNWI sets up a trust as settlor and names his family members, who are not AI, as his beneficiaries.

To be consistent with MAS’ approach to treat these family members as AI by association, would MAS consider treating the private investment company/trustee of the trust as AI even though they do not have S\$10m in net assets?

Q31. MAS seeks views on the proposed amendments to the Institutional Investor (“II”) definition, in particular the proposal to include central governments and central governmental agencies of foreign states, supranational governmental organisations, sovereign wealth funds, as well as financial services firms that are authorised, licensed and/or regulated in foreign jurisdictions within the II definition.

No comments.

Q32. MAS seeks views on the proposal to remove the expert investor class from the SFA and FAA regulatory framework.

We agree to remove the expert investor class as it adds complexity to the existing framework and is applicable only to a limited pool of investors.

Q33. MAS invites comments on the proposed legislative amendments to the SFA and the Securities and Futures (Prescribed Specific Classes of Investors) Regulations set out in Annex 4.

No comments.

Other remarks

While it is commendable that MAS is seeking to establish an industry standard framework of rating products on complexity and risk, we believe that this is arguably of lesser importance compared to raising the financial literacy of investors and the removal of potential conflicts of interest of financial intermediaries. On the latter point, remuneration plays a large role in driving the behaviour of financial intermediaries and hence the type of products distributed to the public. We believe that the interests of investors would be better served if the remuneration of financial intermediaries is better aligned with the investment objectives of investors.

Concluding remarks

CFA Society Singapore welcomes the proactive effort undertaken by MAS in seeking public consultation prior to rolling out the proposed regulatory changes. We are available to meet with MAS to discuss these comments in greater detail and certainly look forward to the favorable impact on investor protection after the eventual deployment of these measures.

Please note that all feedback is made in our personal capacities as CFA Society Singapore members and do not necessarily represent the views of the organisations where we work.

Yours sincerely,

CFA Society Singapore Advocacy Committee

(email: advocacy@cfasingapore.org)

Daryl Liew, CFA

Tan Lay Hoon, CFA

Maurice Teo, CFA

Werner Schlossmacher, CFA

Hon Shin-Ming, CFA