

23th January 2015

Primary Markets Conduct Division

Market Conduct Department

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

Attention: Ms. Jill Hong / Mr. Lim Qingyang / Mr. Michael Tang

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Submitted via email to: listingrules@sgx.com

Re: MAS Consultation Paper No. P026-2014 – Consultation Paper on Draft Legislation to Effect the Policy Proposals to Facilitate Bond Offerings to Retail Investors

Re: SGX Initiatives to Improve Retail Access to Debt Securities: Trust Deed Requirements

Dear Sir

CFA Society Singapore welcomes the opportunity to participate in the consultation paper on draft legislation to effect the policy proposal to facilitate bond offerings to retail investors in Singapore. We welcome the proactive effort undertaken by Monetary Authority of Singapore (“MAS”) and Singapore Exchange (“SGX”) in seeking public consultation prior to rolling out the proposed regulatory changes.

CFA Society Singapore look forward to the day when retail investors are better able to diversify their portfolio with the addition of good quality bonds at low minimum investment sizes. Bonds are a key building block in a diversified asset allocation strategy and this proposal will hopefully lead to more bond offerings targeting retail investors, thereby filling a gap that currently exists in the Singapore market.

Notwithstanding, we would like to share some reservations and comments expressed by our members, primarily from the perspective of **protecting retail investors’ interest**.

In response to the first consultation paper on the same subject matter on 30th September 2014, CFA Society Singapore had proposed that:-

QUOTE

“Under the seasoning framework, we agree to the eligibility criteria for the issuers to satisfy 3.1(a) Size Test; 3.1(b) Listing Test; and 3.1(c) Credit Test. In respect of 3.1(c) Credit Test, we would propose that 3.1(c)(i) (“has not recorded a net loss over the previous 5 years”) be a AND and not OR test i.e. it would be a criteria for all issuers to satisfy. However, the minimum threshold of listed or guaranteed bonds under 3.1(c)(iii) can be lowered from S\$750m to S\$500m.”

UNQUOTE

We believe that having a good track record of no net losses is a more important criteria than the amount of listed or guaranteed bonds issued in the market. In the current consultation paper, however, we note that the seasoning framework criteria have been further relaxed. Our key concern being:-

- (1) Relaxation of the Credit Test to “has not recorded on **average** a net loss and has on average a positive net operating cash flow for the **3** most recent audited annual financial statements” together with a reduction in minimum threshold of listed or guaranteed bonds from S\$750m to S\$500m; and
- (2) Reduction in the requirement that the debt securities to be seasoned must have an initial minimum principal amount of S\$300m in the initial issuance to Specified Investors (Paragraph 3.3 of the Eligibility Criteria in the SGX Consultation Paper dated 1 September 2014) to S\$150m.

While we agree in-principle with the move to improve retail investors’ accessibility to bonds offerings, we recognize that the relaxed criteria would admit too many high yield credits (including credits from the Oil & Gas sector, red chips, environmental companies etc.) under the seasoning framework. We would strongly urge MAS to reconsider the proposed relaxation in the criteria for bonds to qualify under the seasoning framework for the following reasons:-

- (1) The Credit Test of no average net loss and average positive operating cash flow in the last 3 years is a backward looking test based on historical performance. This means that mid-sized companies with strong financial performance in the last 3 years and issued S\$150m high yield bonds would qualify under the seasoning framework criteria. However, historical performance is not a reflection of the strength of future financial performance. For example, the Oil & Gas/commodities sectors have enjoyed tremendous growth in the last few years but are

currently undergoing global volatility. It is unclear how long the volatility will last, when the industry will recover and its corresponding impact (financial or otherwise) on companies. As evidence of the scale of financial impact of the industry's volatility, Standard Chartered Bank is reported to be making US\$4.4b extra provision to cover losses from commodities loans. Based on the relaxed Credit Test together with the removal of the minimum initial offer size altogether, the high yield bonds issued by mid-tier companies (including oil & gas sector) and even some penny stocks would be admitted under the seasoning framework and availed to retail investors. This would expose retail investors to the more vulnerable credit.

- (2) A benchmark bond is typically S\$300m issue size to ensure that the bond is well subscribed by a good spread of institutional and sophisticated investors. An initial issue size at S\$300m would also ensure that there is sufficient market liquidity to support secondary trading. Bonds with an initial issue size of S\$150m is really too small to meaningfully price, could be tightly held and controlled and lacks market liquidity.
- (3) We recognize that bond instrument can be complex and it would take time to educate retail investors to fully appreciate the various risks (credit, interest rate, time value etc.) associated with a bond.
 - a. In respect of credit risk, retail investors would have to understand that there is a wide spectrum of high grade to high yield credits. Investors need to be credit discerning to distinguish between investing in a high-grade blue-chip corporate bond versus investing in a high yield medium sized enterprise credit. Investment in a high-grade credit offers a small yield pick up over bank deposit but certainty of getting back capital. On the contrary, investing in a high yield credit may offer better yield pick-up but the probability of a credit default is higher and investors could risk losing capital. Retail investors may not be ready to undertake independent credit assessment and misconstrue that as the bonds qualify under the seasoning framework criteria (i.e. **it has met regulators' stringent requirements**) and therefore all credits are safe for investment.
 - b. In a recently released CFA Institute Global Market Sentiment Survey report (GMSS 2015), CFA Singapore Society members placed the rise in domestic interest rates as the biggest risk facing Singapore market in 2015. A copy of the GMSS report is attached for your ease of reference. With interest rates likely to head higher over the next several years, retail investors would be entering the bond market at the bottom of the interest rate cycle. Retail investors need to be educated on the inverse relationship between interest rate and bond price and on the possibility of marked-to-market losses.

- (4) We wish to seek clarification of what will happen if an issuer initially meets the eligibility criteria and offer its seasoned bonds to retail investors but subsequently fails to meet the eligibility criteria. Would the bonds become ineligible for purchase by retail investors or would retail investors be “stuck” with a technically ineligible bond? By relaxing the Credit Test to “has not recorded on average a net loss and has on average a positive net operation cashflow for the 3 most recent audited annual financial statements” could mean that a loss or negative net operating cashflow in the latest financial statement could still qualify the issuer’s bond under the seasoning framework but should the company not turnaround and continues to record losses and/or negative net operating cashflow, the issuer would eventually not qualify for retail purchase.

In view of the above considerations, we would recommend that retail investors be introduced to bond investing on a measured step-by-step basis rather than availing a wide spectrum of bonds (including high yield bonds of even “penny stocks” companies) at the peak of the bond market cycle. Otherwise, an event risk could trigger a credit default and retail investors may shy away from bond investment forever. In the long term interest of ensuring that retail investors allocate bonds into their investment portfolio, CFA Society Singapore would like to recommend that a tighter criteria for the seasoning framework be adopted at the initial launch, subject to being reviewed 18-months after implementation. We would recommend that the following criteria be considered:-

- (1) If the Credit Test of “has not recorded on **average** a net loss and has on average a positive net operating cash flow for the **3** most recent audited annual financial statements” is adopted, then minimum threshold of listed or guaranteed bonds should stay at S\$750m instead of reducing to S\$500m; and
- (2) To reinstate the minimum initial offer size at S\$300m as part of the Eligibility Criteria for debt securities to be seasoned and not to reduce it to S\$150m.

The implementation of a tighter set of criteria for the seasoning framework at the initial launch would give retail investors time to be educated on the mechanics of bond investments. Thereafter, once retail investors become more sophisticated, the criteria can be relaxed to avail access of high yield bonds.

Other Remarks

As retail investors are mostly not familiar with investing in bonds, we suggest that various investor education initiatives be organized in the lead up to the launch.

With the implementation of retail access to bonds, we would like to establish if the same tranche of bonds would be traded on the Mainboard (for retail access) and over-the-counter (“OTC” for institutional access). If so, we would recommend that there be a mechanism to capture the volume traded OTC so that retail investors are kept informed of the activities on OTC.

In addition, we would recommend that there be at least 2 to 3 market-makers to provide market liquidity and make bid-offer price for the retail investors. It would be good if the original lead managers of the initial issue remain committed to the issue and make-market for retail investors.

We wish to seek clarification on whether the SGS auction system can be adopted for re-opening of seasoned bonds and/or exempt bond offering to retail investors.

We wish to share that in the same CFA Institute GMSS report, CFA Singapore Society members ranked mis-selling by financial advisors as the highest ethical issues facing Singapore market in 2015. In addition, to help improve investor trust and confidence, CFA Singapore Society members view better alignment of compensation with investor objectives as most critical action. As a step towards winning over investor trust and confidence, we would like to recommend that it be a requirement in the Product Highlight Sheet for the distribution commission that is payable to any distributors for the retail bonds be reflected.

Concluding Remarks

CFA Society Singapore urges MAS and SGX to reconsider the further relaxation of the criteria under the seasoning framework. We are available to meet with MAS and/or SGX to discuss these comments in greater detail and certainly look forward to the day when retail investors are better able to diversify their portfolios with the addition of good quality bonds at low minimum investment sizes.

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 organization where we work.

Yours sincerely,

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