Changes to investment management law: what's new, what's not, and what might cause you to end up in a knot

On 9 January 2017[1], the Securities and Futures (Amendment) Bill 2016 was passed by the Singapore Parliament ("**Amendment Act**"). An ambitious tome spanning 440 pages, when gazetted as coming into force, the Amendment Act will be the most significant piece of legislative reform affecting the securities, derivatives and fund management industry in recent years.

Media attention on the Amendment Act has seemingly focused only one aspect of the wide-ranging reform; see for example, Business Times headline on 10 January: "*Revised SFA: Tighter definition for accredited investors*" and the Straits Times article of 11 January which reported industry watchers to have said "*[w]ide-ranging changes made… are a positive move that will ramp up investor protection and improve market confidence*". The more stringent definition of "accredited investors" and a corollary change to mandate an "opt-in" process for such investors, are undoubtedly significant changes for investment managers. That said, the Amendment Act also makes quite a number of highly technical but subtle changes to the law which should be carefully considered by alternative asset investment managers and financial services companies with a non-traditional business model.

What's New

A more expansive definition of "collective investment scheme"

Three conditions previously to be satisfied to be a "collective investment scheme"

Prior to the Amendment Act, to be considered as a "collective investment scheme", **three** conditions must be satisfied: (1) the participants in the scheme should not have day-to-day management control of the scheme property which is managed by a manager as "as a whole"; (2) there is a **pooling** of the contributions of the participants made to the scheme and the distributable benefits to the participants; and (3) the purpose of the scheme is to enable the participants to receive economic benefits from the scheme property.

Conditions now reduced to two

The Amendment Act reduces the above number of conditions to **two** and mixes the current criteria to be regarded as a collective investment scheme. The simplest way to understand it is to know that a scheme would be regulated as a collective investment scheme if three factors are found:

[1] Interestingly, the passing of the Amendment Act was only reflected on Singapore Parliament's website on 10 January 2017 after office hours.

(a) the participants in the scheme do not have day-to-day management control of the scheme property (part of the old criterion (1));
(b) the scheme property is either managed by a manager "as a whole" **OR** there is a **pooling** of the participants' contributions and distributable benefits; and
(c) the purpose of the scheme is to enable the participants to receive economic benefits from the scheme property (same as old criterion (3)).

Certain requirements removed

The new definition of a collective investment scheme removes the requirement to have a commingling of the monies entrusted by, and economic returns to, investors as long as there is a collective management of the scheme property by a manager. It also removes the requirement to have collective management by a manager if a commingling of contributions or distributable returns are found. Obviously, it will be easier for an investment scheme to be caught and regulated as a collective investment scheme than before.

What's Not New

Regulation of fund investing in precious metals, agricultural assets etc

No "real assets" funds yet registered as a restricted collective investment scheme

Before we delve into the impact of the new definition of a collective investment scheme, it should be noted that even under the current law, a fund that commingles investors' monies to invest in non-traditional assets like precious metals, collectibles like vintage wines, vintage cars and art, or agricultural assets like emu farms, would be regarded as a collective investment scheme. Even if such a scheme is marketed to accredited investors only, it must be registered first as a restricted collective investment scheme by the Monetary Authority of Singapore ("**MAS**"). To our knowledge, no such 'real assets' funds have been registered as a restricted collective investment scheme and this is likely due to the fact that before a scheme can be so registered, MAS requires the manager of a restricted scheme to be licensed or regulated to carry out fund management activities in the jurisdiction of its principal place of business.

It does not mean that no offer of a collective investment scheme which is not registered with the MAS can ever be made in Singapore. The promoter of such a scheme could market the scheme pursuant to the 'small offers' or 'private placement' provision in the Securities and Futures Act and the offerees need

not even be accredited investors. However, these options have self-limiting factors; for example, an offer under the private placement provision cannot be made to more than 50 persons in any period of 12 months and it is difficult for an investment manager to build a sizeable business if it relies on these provisions.

What's Knotty

No commingling of participants' contributions and distributable benefits

Removal of pooling requirement to close regulatory loop-hole

As mentioned in the ministerial speech when the Amendment Act was debated in Parliament, the motivation to remove the pooling requirement is to close a regulatory loop-hole. Certain investment schemes in undeveloped land, plantation plots and apartment blocks run as a hotel (also known as "condo-tels") were specifically flagged as being structured to escape regulation by avoiding a commingling of interests because individual participants were allocated specific land or property plots/units. These schemes "*in substance pose the same risks to investors as traditional collective investment schemes and should be regulated as such*".

P2P lending; securities or lending based crowdfunding

Possible impact on non-traditional investment products

While the expressed public policy could not be faulted, how does it affect other non-traditional investment products? For instance, a peer-to-peer lending platform that matches a specific borrower to specific lenders, or a crowdfunding platform that offers securities-based or lending-based crowdfunding for identified projects is seldom regarded as a pooled investment scheme, but they are investment schemes nonetheless. Would they be regarded as falling outside the definition of a collective investment scheme because the property entrusted by the investors is not "managed as a whole"? Certainly for an online platform where the operator claims to have sieved out unsuitable borrowers or curated the available projects for crowdfunding, it is difficult to see why the operator has not performed a management function on behalf of all investors.

Airbnb type arrangement

Possible impact on investment in real estate

The same ministerial speech also mentioned that the expanded definition does not seek to regulate where "*property is managed for the benefit of investors on an individual basis. For example,*

arrangements where property owners simply use the same operator to help them let out their individual apartment units, will not be considered as a CIS". Airbnb's business model comes to mind. It could be justified that since Airbnb is merely a facilitator and the property owners could have utilised other means to rent out their apartment units anyway, it is not the intention to characterize Airbnb as an operator of a collective investment scheme. Intuitively, one would agree with this treatment since unlike a condo-tel project, no investor ever acquires a property unit from Airbnb with the intention to rely on Airbnb to rent it out on a collective basis with other property owners. However, if a strata-titled property project is marketed for sale to individual investors who would then have an option to appoint the vendor's affiliate to rent it out on short term basis, is this an investment in real estate (which is not regulated under the Securities and Futures Act) or an investment in a collective investment scheme?

Pearl Wisdom Limited and The Apex Horizon

Real life scenario

The scenario posited in the preceding paragraph is not merely a hypothetical situation but mirrors a real life in a saga concerning a Hong Kong developer known as Pearl Wisdom Limited and a hotel development called The Apex Horizon. This developer sold 360 hotel rooms of The Apex Horizon to individual investors who then appointed a hotel operator (related to Pearl Wisdom Limited) to operate them as part of a hotel. More facts of this case can be accessed on this hyperlink (https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo= 13PR45).

The Securities and Futures Commission ("**SFC**") (Hong Kong's equivalent of MAS) formed the view that Pearl Wisdom Limited's offer to purchase hotel room units at The Apex Horizon was an invitation to acquire an interest in or to participate in a collective investment scheme as defined in the Hong Kong Securities and Futures Ordinance. Key to the SFC's conclusion was the fact that day-to-day management of the hotel rooms was not in the purchasers' hands, but vested with the hotel operator who would control key functions such as allocation of guests to rooms.

Pearl Wisdom Limited did not agree with the SFC's view and contended that the purchasers had effective day-to-day control of their rooms and that they had made an investment in real estate.

In the end, Pearl Wisdom Limited agreed to rescind the purchase agreements signed by the investors and refunded the purchase

price with interest, and litigation between the SFC and Pearl Wisdom Limited was averted.

It is instructive to remember that the definition of a collective investment scheme in Hong Kong and the law in Singapore after the Amendment Act is substantially the same. It will be interesting to observe if the MAS will take the same stance as the SFC if the facts of this case were to arise in Singapore.

No manager appointed to manage scheme property "as a whole"

Definition of collective investment scheme differs from Hong Kong law

Here is where the definition of a collective investment scheme departs from the law in Hong Kong. As long as the participants' contributions or distributable benefits are commingled, there is no necessity to have the element of management "as a whole" by a manager for the scheme to be considered as a collective investment scheme. Hence, an investment company (which might be known as a family office) who invests through the research done by its employees and who has an investment policy to make investment for the benefit of its shareholders (who do not have day-to-day control of the company's operations), would be a collective investment scheme. In practice, this consequence may be rather academic if the interests in such an investment company is seldom offered to the public or beyond a small group of related persons. Nonetheless, for entities or persons that perform services for such investment companies, there could be licensing requirements that depend on whether their clients are classified as collective investment schemes.

What's New

A more expansive definition of "fund management"

Prior to the Amendment Act, to be considered as carrying on the business of "fund management" (for which a Capital Markets Services Licence from the MAS or a licensing exemption is required) one would be "undertaking on behalf of a customer (whether on a discretionary authority granted by the customer or otherwise) – (a) the management of a portfolio of securities or futures contracts; or (b) foreign exchange trading or leveraged foreign exchange trading for the purpose of managing the customer's funds".

Significant amendment to definition of "fund management"

Besides other technical changes in terminology, the Amendment Act added the rubric: "*managing the property of, or operating, a collective investment scheme" to the definition of "fund*

management". This is a very significant amendment as the activity of fund management would no longer mean the portfolio management of capital markets products, and as long as there is an entity classified as a collective investment scheme, the manager or operator of the scheme would need to have a licence or a licensing exemption.

Scheme manager now must be regulated as a fund manager

Before the Amendment Act, even if an investment scheme like a wine fund was classified as a collective investment scheme, the scheme manager would not be regulated as a fund manager as wine stocks are simply not securities, futures and foreign exchange, and as discussed above, a collective investment scheme not registered with the MAS could still be offered under the small offer or private placement option. With the Amendment Act, the scheme manager would have to be regulated as a fund manager as well. It remains to be seen if new subsidiary legislation would be issued to exempt a fund manager investing in non-capital markets products from the need to hold a Capital Markets Services Licence, in the same way that a real estate fund manager managing real estate funds for accredited and institutional investors only is currently exempted from holding a licence.

What's Not New

Investor advisors are regulated

Investment adviser requires licence if providing advice on a portfolio basis for capital markets products

A common misconception of investment managers is to believe that an investment adviser who is not empowered to make investment decisions (either because that power vests in a separate investment committee or a fund manager) is not required to hold a licence or a licensing exemption. Both now and after the Amendment Act, such an investment advisor would need to have a "fund management" licence if it provides such advice on a portfolio basis in relation to capital markets products.

What's Knotty

Managing vs operating a collective investment scheme

Possibility of further guidance on difference between managing and operating a collective investment scheme

We are not sure at this moment if more guidance will be given to the industry to elucidate the difference between managing and operating a collective investment scheme. Since the act of "*operating a collective investment scheme*" *per se* would need the operator to hold a licence or a licensing exemption, it is important to understand the scope of operating a scheme. For instance, if a

fund management group has a Singapore subsidiary that does not perform investment related work but carries out fund operations such as book-keeping, trade reconciliation, compliance and investor liaison work, would the Singapore subsidiary be caught by the licensing requirement?

Perhaps the necessity to introduce the rubric "*operating a collective investment scheme*" is a technical one and should not be understood to impose more regulation on traditional fund management operations. As an entity could be classified as a collective investment scheme without the requirement to have a manager that manages the scheme property as a whole, perhaps it is the regulatory intention that the operator of such a scheme should not escape regulation. If indeed that is the case, going back to the example discussed earlier where we argued that a peer-to-peer lending platform might be classified as a collective investment scheme, it is equally important to consider if the platform operator would need to have a Capital Markets Services licence as well. Securities/lending based crowdfunding platform operators are already subject to the requirements to hold a Capital Markets Services licence for dealing in securities (albeit the Amendment Act would change the terminology to "dealing in capital markets products") and it should not pose great difficulty for them to add fund management as another regulated activity under their licence.

If you would like information on this or any other area of law, you may wish to contact the partner at WongPartnership LLP that you normally deal with or any of the following partners:

Low Kah Keong
Head – Asset Management & Funds Practice
DID: +65 6416 8209
Email: kahkeong.low@wongpartnership.com
Click here to see Kah Keong's CV

Felicia Marie Ng
Partner
DID: +65 6416 8203
Email: felicia.ng@wongpartnership.com
Click here to see Felicia's CV

WONGPARTNERSHIP OFFICES

SINGAPORE

WongPartnership LLP
12 Marina Boulevard Level 28
Marina Bay Financial Centre Tower 3
Singapore 018982
Tel: +65 6416 8000
Fax: +65 6532 5711/5722

CHINA

WongPartnership LLP
Beijing Representative Office
Unit 3111 China World Office 2
1 Jianguomenwai Avenue, Chaoyang District
Beijing 100004, PRC
Tel: +86 10 6505 6900
Fax: +86 10 6505 2562

WongPartnership LLP
Shanghai Representative Office
Unit 1015 Corporate Avenue 1
222 Hubin Road
Shanghai 200021, PRC
Tel: +86 21 6340 3131
Fax: +86 21 6340 3315

INDONESIA

Makes & Partners Law Firm
(an associate firm)
Menara Batavia, 7th Floor
Jl. KH. Mas Mansyur Kav. 126
Jakarta 10220, Indonesia
Tel: +62 21 574 7181
Fax: +62 21 574 7180
Website: makeslaw.com

MALAYSIA

Foong & Partners
Advocates & Solicitors
(an associate firm)
13-1, Menara 1MK, Kompleks 1 Mont' Kiara
No 1 Jalan Kiara, Mont' Kiara
50480 Kuala Lumpur, Malaysia
Tel: +60 3 6419 0822
Fax: +60 3 6419 0823
Website: foongpartners.com

MIDDLE EAST

Al Aidarous International Legal Practice
(an associate firm)
Abdullah Al Mulla Building, Mezzanine Suite 02
39 Hameem Street
Al Nahyan Camp Area
P.O. Box No. 71284
Abu Dhabi, UAE
Tel: +971 2 6439 222
Fax: +971 2 6349 229
Website: aidarous.com

Al Aidarous International Legal Practice
(an associate firm)
Zalfa Building, Suite 101 - 102
Sh. Rashid Road
Garhoud
P.O. Box No. 33299
Dubai, UAE
Tel: +971 4 2828 000
Fax: +971 4 2828 011

MYANMAR

WongPartnership Myanmar Ltd.
No. 1, Kaba Aye Pagoda Road
Business Suite #03-02, Yankin Township
Yangon, Myanmar
Tel: +95 1 544 061
Fax: +95 1 544 069

contactus@wongpartnership.com **wongpartnership.com**