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Regulatory Update

24 September 2019

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Developments in Singapore's Variable Capital Company Regime

Updates on draft subsidiary legislation on AML/CFT and insolvency issues

24 September 2019

Introduction

The Monetary Authority of Singapore ("MAS") has recently released two consultation papers ("CPs")[1] relating to the Variable Capital Companies Act ("VCC Act"). The new consultation papers[2] flesh out the VCC Act's regulatory regime for (i) anti-money laundering/countering the financing of terrorism ("AML/CFT") and (ii) insolvency. Separately, the Singapore Ministry of Finance moved for a first reading in Parliament of the Variable Capital Companies (Miscellaneous Amendments) Bill [3], which amends the VCC Act to account for changes in the Singapore insolvency regime and makes amendments to the Income Tax Act (cap. 134) and other tax related acts. All of this continues to point towards an anticipated implantation date of late 2019.

The VCC Act introduces a variable capital company ("VCC") legal structure to Singapore, in a push to facilitate the growth of the domestic asset management industry. With the new regime in place, Singapore aims to cement itself as a full-service global fund management hub. This enhancement of legal entity options opens the possibility for locally managed funds currently distributed and managed from other financial centres such as Luxembourg and the Cayman Islands to re-domicile in Singapore, consolidating fund control, operations, and management to within one Asian local. The VCC structure in particular aims at improving flexibility, cost efficiencies, and governance.

This bulletin will outline some of the questions raised by the two CPs.

[1] The relevant draft legislative instruments are the: (i) "Consultation paper on the Proposed Notice on Prevention of Money Laundering and Countering the Financing of Terrorism for Variable Capital Companies ("AML/CFT Notice") "; and (ii) "Consultation Paper on the Proposed Framework for Variable Capital Companies Part 3" ("VCC Framework Part 3"). The AML/CFT Notice was released on 30 April 2019, and its consultative period has closed but no response has yet been issued. The VCC Framework Part 3 was released on 24 July 2019, and its consultative period has closed but no response has yet been issued.

[2] Note from Indranee Rajah S.C., Minister in the Prime Minister's Office, Second Minister for Finance and Education dated 2 Oct 2018. Retrieved from https://www.mas.gov.sg/-/media/MAS/News-and-Publications/Press-Releases/Note-by-Second-Minister-for-Finance-Indranee-Rajah-on-the-Variable-Capital-Companies-Bill.pdf on 8 August 2019.

[3] As described by MAS, "[t]he Bill provides for other, mainly technical, amendments to the VCC Act. These amendments include (i) clarifying that a VCC should have at least one member (to align with the minimum number of shareholders for companies under the CA); (ii) requiring a directors' resolution for amendments to the constitution that do not require members' resolution to be lodged with the Registrar for proper records; and (iii) correcting certain referencing errors, such as references to a branch office, or a VCC being registered as a member of itself, as these do not apply to VCCs in the same manner as they apply to companies." (MAS, "Explanatory Brief on the Variable Capital Companies (Miscellaneous Amendments") Bill on 5 August 2019 https://www.mas.gov.sg/news/speeches/2019/explanatory-brief-on-the-variable-capital-companies-miscellaneous-amendments-bill-on-5-august-2019).

AML/CFT Obligations for VCCs

While regulated managers of investment vehicles are already subject to AML/CFT regulations[4], the AML/CFT Notice was deemed necessary due to the risks that the VCC, with its unique features, poses. The requirements within the VCC AML/CFT Notice largely mirror those imposed on existing financial institutions, where they are required to implement internal policies and procedures, appropriate compliance, audit and training procedures.

At first glance, the AML/CFT obligations create an additional burden for the VCC investment structure not present in other fund structures, such as limited partnerships or private limited companies. However, in effect, the VCC will simply need to engage an Eligible FI[5] to execute its AML/CFT duties, including conducting due diligence, the engagement of service providers, and the maintenance of customer records. While the legal obligation for these duties remains with the VCC, the actual activities can be fully delegated to the Eligible FI, once the VCC has satisfied itself that said FI is able to perform these AML/CFT functions adequately, and is also willing and able to provide the necessary documents and data upon request[6].

Definitions of "business relations" and "customer"

Where the AML/CFT regime may diverge to some extent is within the definitions, such as where MAS is consulting on the scoping of the specific terminologies of "business relations" and "customer."

i. "*Business relations*", meaning any direct or indirect contact between a VCC and a person (whether a natural person, legal person, or legal arrangement) that results in the entering or maintaining of such person's particulars in the register of members; and

[4] Comparable notices include "*Notice SFA 04-N02 to Capital Markets Intermediaries on Prevention of Money Laundering and Countering the Financing of Terrorism*".

[5] Eligible financial institutions that VCCs may engage to perform its AML/CFT duties include (a) Banks in Singapore licensed under section 7 of the Banking Act (Cap.19); (b) Merchant banks approved under section 28 of the Monetary Authority of Singapore Act (Cap. 186); (c) Finance companies licensed under section 6 of the Finance Companies Act (Cap. 108); (d) Financial advisers licensed under section 6 of the Financial Advisers Act (Cap. 110) except those which only provide advice by issuing or promulgating research analyses or research reports, whether in electronic, print or other form, concerning any investment product; (e) Holders of a capital markets services licence under section 82 of the Securities and Futures Act (Cap. 289); (f) Fund management companies registered under paragraph 5(1)(i) of the Second Schedule to the Securities and Futures (Licensing and Conduct of Business) Regulations (Rg. 10); (g) Persons exempted under section 23(1)(f) of the Financial Advisers Act read with regulation 27(1)(d) of the Financial Advisers Regulations (Rg. 2) except those which only provide advice by issuing or promulgating research analyses or research reports, whether in electronic, print or other form, concerning any investment product; (h) Persons exempted under section 99(1)(h) of the Securities and Futures Act read with paragraph 7(1)(b) of the Second Schedule to the Securities and Futures (Licensing and Conduct of Business) Regulations; (i) Approved trustees approved under section 289 of the Securities and Futures Act; (j) Trust companies licensed under section 5 of the Trust Companies Act (Cap. 336); (k) Direct life insurers licensed under section 8 of the Insurance Act (Cap. 142); or (l) Insurance brokers registered under the Insurance Act which, by virtue of such registration, are exempted under section 23(1)(c) of the Financial Advisers Act except those which only provide advice by issuing or promulgating research analyses or research reports, whether in electronic, print or other form, concerning any investment product.

[6] As clarified by the MAS in Para 2.5 of the Consultation Paper on the Proposed Notice on Prevention of Money Laundering and Countering the Financing of Terrorism for Variable Capital Companies.

ii. "*Customer*" means a person (whether a natural person, legal person, or legal arrangement) with whom the VCC establishes or intends to establish business relations.

As these terms form the nexus for the start of AML/CFT obligations, any differences from other should be carefully considered. As VCCs do not interact with customers in the same manner other regulated entities, the concept of establishment of business relations are meant to replace the alternate concepts of the "opening of accounts." The logic for this replacement is self evident, seeing as the maintenance of said accounts would lie with the fund managers, rather than the VCC.

Transparency Requirements

Similar to private companies, VCCs are also required to maintain internally a register of beneficial owners of its own structure and a register of nominee directors ("Registers"), with all the relevant particulars (including names and start and end dates). These Registers are not required to be made public, but must be made available to ACRA, MAS, and other law enforcement authorities when necessary. These need to be kept up to date and held at the registered office of the S-VACC itself, its appointed fund manager, or the eligible financial institution.

Insolvency and Winding Up

The proposed subsidiary legislation[7] relating to the insolvency and winding up of a S-VACC (and its sub-funds) is adapted from the existing framework set out under the Companies' Act ("CA"), with the relevant modifications for this business model and changes to fit the Restructuring and Dissolution Act 2018 ("IRDA")[8].

The insolvency propositions further augment the VCC Act's purpose of ensuring efficiency and the ability of managers to exploit the benefits of the new investment structure, while ring-fencing the liabilities including the process of winding down a sub-fund. For example, aside from the general events triggering the insolvency of the entire VCC structure as a whole, sub-funds within an umbrella VCC may also be individually wound up voluntarily by the shareholders of the VCC [9]. "Connected persons" of a sub-fund are only considered as such if they are associates of the sub-fund itself, rather than being viewed in relation to the umbrella VCC [10].

[7] Relevant legislation includes the "*Variable Capital Companies (Application of Bankruptcy Act Provisions) Regulations 2019*"; the "*Variable Capital Companies (Filing of Documents) Regulations 2019*"; the "*Variable Capital Companies (Maximum Amount Payable in Priority in Winding Up) Order 2019*"; the "*Variable Capital Companies Regulations 2019*", the "*Variable Capital Companies (Winding Up) Rules*".

[8] The IRDA currently sets out the regime on insolvency and restructuring for other corporate structures in Singapore.

[9] Para 4.1 of the Consultation Paper on the Proposed Framework for Variable Companies Part 3.

[10] Para 4.2 of the Consultation Paper on the Proposed Framework for Variable Companies Part 3.

Conclusion

The propositions set out by the new two new CPs are mostly operational, but demonstrate a commitment to the alignment of the administrative obligations relevant to VCCs to ensure that the administration of the new investment structure remains as efficient as was intended. The practical-minded approach to the new structure is one that has been long anticipated by the industry, enabling funds to maintain substantive economic substance in Singapore and reducing hidden costs and concerns that arise from cross-border structuring, such as access to tax treaties, transparency, and exposure to shifting international standards.

Contacts

Mark Jacobsen
Founder
Integrium

T +65 6216 9474
E mark@integrium-sg.com

Liyana Mahirah
Manager
Integrium

T +65 6932 2785
E liyana.mahirah@integrium-sg.com

Fizah Daud
Manager
Integrium

T +65 6932 2785
E fizah.daud@integrium-sg.com

Integrium Pte. Ltd
20 Collyer Quay
#01-02, Suite 2019
Singapore 049319

www.integrium-sg.com