Singapore Venture Capital & Private Equity Association

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SVCA'S RESPONSE TO CONSULTATION PAPER FOR THE PROPOSED FRAMEWORK FOR SINGAPORE VARIABLE CAPITAL COMPANIES
24th APRIL 2017

SVCA Singapore Venture Capital & Private Equity Association

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General comments:

This response to the consultation paper on the S-VACC has been prepared by the Advocacy Committee of the Singapore Private Equity and Venture Capital Association ("**SVCA**") with feedback from members of SVCA. The members of our advocacy committee include fund managers, law firms, tax advisers and compliance advisers. Additional details about the advocacy committee are available at: http://svca.org.sg/about-us/leadership-staff/advocacy-committee-2015-17/.

The responses we provide assume the perspective of the private equity fund and venture capital fund industry. Investment funds in these asset classes are typically (though not exclusively) structured as limited partnerships managed either by an RFMC or a licensed FMC, which is also consistent with the form of vehicle used by managers in Hong Kong, Europe and the U.S.. Some Singapore-based managers may infrequently also use a Singapore private limited company or unit trust as the fund vehicle, but the use of such vehicles are typically driven by considerations specific to the relevant fund.

1. Alternative to the Limited Partnership. We note that US investors, European investors, and Asian institutional investors have become very familiar over a long period of time with the use of a limited partnership (usually Cayman Islands

   ("**Cayman**"), but also England, Delaware and Singapore) as a closed-end fund vehicle. We believe, therefore, that more than just "levelling the field" between the S-VACC and a limited partnership, it is important for the S-VACC to have features that make it a compelling vehicle to use over and above the long-standing limited partnership structure. In its current proposed form, we believe that the S-VACC may also be attractive as an intermediate holding company (as part of an overall fund structure). We have provided more details on this in our response to question 3.

2. Fund Tax Schemes. From a private equity fund and venture capital fund formation perspective, we emphasise that the availability of existing or improved fund vehicle tax schemes for the S-VACC are critical to the decision of a PE/VC fund manager as to whether it will establish a fund as an S-VACC. In particular, we seek clarification on the following:

   Can MAS/IRAS consider the flexibility of allowing an application for the tax exemption scheme to be made both at: (i) the umbrella fund level; and (ii) the sub-funds level?

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b. If an application is made at the umbrella fund level, will there be multiplication of economic conditions? How would each sub-fund be impacted if conditions fail to be met? For additional sub-funds added, does MAS need to be informed/prior approval from MAS required for such additional sub-fund to benefit from the tax exemption scheme?

c. Will there be a requirement for the entity to be a corporate entity (e.g. under the section 13R Singapore Resident Fund Tax Exemption Scheme) or will there be no such limitation (e.g. similar to the section 13X Enhanced Tier Fund Tax Exemption Scheme)?

d. If the application for the tax exemption scheme is made at the umbrella fund level and one sub-fund invests in a non-designated investment, is the apportionment of non-qualifying fund management fees allowed?

e. 13R Singapore Resident Fund Tax Exemption Scheme: We suggest disapplying the controlling shareholding test and the fund manager's requirement to report on Non-Qualifying Investors.

f. Section 13X Enhanced Tier Fund Tax Exemption Scheme: We suggest waiving the minimum threshold of $50 million, and that the minimum requirement for three employees should be calculated at the umbrella fund level and not at the sub-fund level.

3. General Tax Considerations.

a. Can sub-funds apply group relief if there are any Singapore taxes on non-qualifying income?

b. Stamp duty should ideally be exempted (without conditions/requirement for relief if possible) on any issue, redemption, repurchase of shares of an S-VACC.

c. GST remission should be extended to S-VACCs which are managed by approved fund managers under the section 13R and section 13X tax incentive schemes.

4. Other proposed amendments and draft legislation.

It would be good if the following were made available for the consultation prior to implementation:

i. relevant subsidiary legislation under the S-VACC Act (e.g. to implement the incorporation requirements, receivership requirements, [conversion]\ re-domiciliation requirements, arrangements, and amalgamation requirements.)

ii. requisite amendments to the Securities and Futures Act, Chapter 289 of Singapore (the "**SFA**")

iii. requisite subsidiary legislation under the SFA (e.g. to implement the approved custodian requirements, exempt offering requirements, fit and proper director requirements, authorised scheme requirements.)

Question 1. MAS seeks comments on the proposed legislative structure for S-VACCs.

We are supportive of the introduction of a new S-VACC Act to govern S-VACCs instead of including the S-VACC under the existing Companies Act (Chapter 50 of Singapore). Nonetheless, we would note (as would be the case when introducing any new legislative regime) that it will take the industry more time and resources to familiarise themselves with and adopt the new S-VACC vehicle.

In addition, it is preferable to have standalone legislation than to be part of the Companies Act in view of the risk (as with the Irish Companies Act) of the US deeming such companies under the Companies Act as not being entitled to US tax pass-through status.

We also note that such approach will be preferable as the Companies Act undergoes frequent amendments which are often not applicable to S-VACCs as collective investment schemes with a regulated fund manager.

Question 2. MAS seeks views on the proposed draft S-VACC Act at Annex B.

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Question 3. MAS seeks comments on the proposal that the S-VACC structure be used as a vehicle for CIS only, and on the proposed restriction on the use of the term, "S-VACC".

We support the MAS' proposal to use the S-VACC structure as a vehicle for CIS at this stage.

The expression "Singapore Variable Capital Company" or "S-VACC" should be confined to companies incorporated under the S-VACC Act. As "S-VACC" is somewhat unwieldy, perhaps "SVCC" or "SVC" (viz. Singapore Variable Capital Company) or "SCVC" (viz. Singapore Company with Variable Capital) should also be allowed as alternative acronyms to S-VACCs registered under the S-VACC Act.

At the moment, it is common for pan-Asian funds to be structured with multiple parallel and feeder fund vehicles in the EU and elsewhere, which then invest via a Singapore private limited company into investments in Asia. We would also request that MAS consider whether the S-VACC can be used as a wholly-owned subsidiary of such an offshore fund structure to access the double tax treaties which Singapore has established with other countries. If so, will a modified version of the S-VACC (which disapplies certain requirements) be made available?

We also note that other jurisdictions use similar structures for other purposes (e.g. CLO issuance from a Cayman SPC), but agree that such additional uses of the S-VACC can be considered and should be explored further at a later point in time.

The requirement for at least two members is problematic as many master fund structures have only one feeder fund (which constitutes the sole member of the master fund structure). The requirement to have at least two members would force the master-feeder fund structure to incur additional unnecessary costs and inconvenience in having to interpose a "second" intermediary special purpose vehicle to meet such two member requirement. The offshore fund structure would also then not be able to use the S-VACC as the intermediary fund company for investment into the region as they will then have to incur the costs and burden of interposing a second member for such S-VACC intermediate fund company. This may result in the S-VACC being regarded as unattractive compared with the OEIC structures in other leading funds jurisdictions. Such two member requirement is also anomalous as it is not required in the authorised \ restricted\ exempt unit trust regulatory regime. It is also anomalous compared with the sole member company structure allowed under the Companies Act.

Question 4. MAS seeks comments on the proposal to allow S-VACCs to be structured as open-ended or closed-end funds, and to require the rights of and limits to redemption to be set out in the constitution of a S-VACC.

We support MAS' proposal to allow the S-VACC to be structured either as an open-ended or closed-end fund.

We support the approach of including provisions relating to the redemption of shares in the constitution. However, where the S-VACC adopts an umbrella/sub-fund structure, we suggest that these provisions be limited to permissive provisions which set out the broad redemption framework only. Details of redemption rights and redemption limits can be set out in a shareholder's agreement (or other similar agreement) relating to the specific fund / sub-fund.

The above approach of an overarching constitution and shareholders agreement per sub-fund would help to preserve flexibility and confidentiality of terms vis-à-vis various sub-funds, as well as facilitating the negotiation process between the fund and investors.

Problem of Partly-Paid Shares for Private Equity Funds. As partly paid shares cannot be redeemed as set out in section 66 (2) of the proposed S-VACC Act, the S-VACC structure will be unattractive to private equity fund managers generally as commitments in a private equity fund often take several years to be drawn down and fully paid and yet it is not uncommon in private equity funds for shares to be wholly or partially redeemed before the shares are fully drawn down.

Clarification needed for Payment out of Capital. In view of the considerable weighty judicial authorities relating to maintenance of capital and the prohibition of dividends out of capital, it should be made clear explicitly in the S-VACC Act that the payment of dividends or other distributions out of capital on shares is allowed (and not merely cryptically under "other payments or returns" as in section 32 (4) (e) (i) of the proposed S-VACC Act). The suggestion that the constitution of the S-VACC would provide for payment of dividend out of capital is arguably not sufficient in view of the many judicial case law authorities against payment out of capital.

The suggested clarification is set out in italicised wording below:-

"[32] (4) (e) (i) the right to participate in or receive profits, income, *capital distributions* or other payments or returns arising from the acquisition, holding, management or disposal of, the exercise of, the redemption of, or the expiry of, any right, interest, title or benefit in the property or any part of the property of the S-VACC, or to receive sums paid out of such profits, income, *capital distribution* or other payments or returns; [*emphasis added*]

Such payment of dividends out of capital should be allowed even if such shares are not yet fully paid (and hence could not be redeemed as specified in section 66 (2) S-VACC Act).

Question 5. MAS seeks comments on the proposed cellular structure for S-VACCs.

It is noted that each sub-fund's assets and liabilities are merely statutorily segregated and that each sub-fund does not constitute a separate legal entity. For collective investment schemes, it is not the practice nor is it preferred that each sub-fund constitutes a separate legal entity.

In addition, whilst we think that the cellular structure will offer a flexible and cost-effective structure to fund managers managing a small AUM (assets under management) who wish to manage more than one fund strategy, fund managers will still need to get comfortable with the inherent risks and obligations associated with such a structure (e.g. contagion risk, liability of directors, etc).

Question 6. MAS seeks comments on the proposed safeguards against the risk of cross-cell contagion within a S-VACC.

Paragraph 4.4 refers to the S-VACC's duty to ensure proper segregation of assets and liabilities of sub-funds, and that such duty is also implied in each S-VACC's constitution, so as to provide shareholders with an avenue to recover damages where there is a breach. Would directors of the S-VACC be held personally liable for such breach, and what steps must a director take to ensure that he/she has properly discharged such duty?

We would nonetheless query whether such safeguards will be sufficient to ensure ring-fencing and segregation of assets and liabilities for each sub-fund in a court outside of Singapore (or any other jurisdictions which offer a similar legal structure).

Question 7. MAS seeks comments on the proposal to allow a sub-fund to be wound up as if it were a separate legal person in the event of the sub-fund's insolvency, and on the ring-fencing of each sub-fund's assets and liabilities during insolvent liquidation.

We believe this is absolutely critical to the success of the S-VACC structured as an umbrella-fund/sub-fund. We further note that this is similar to the UK approach and has worked without notable problems.

Following the liquidation of a sub-fund, if IRAS realises that the liquidated sub-fund has outstanding tax obligations, can IRAS seek recourse for such tax liabilities from other sub-funds or will it be treated like other creditors such that its recourse is limited to that particular (liquidated) sub-fund only?

Question 8. MAS seeks comments on the proposal for the valuation and redemption of shares in a S-VACC to be carried out at NAV, except where the S-VACC is listed on a securities exchange.

This may impose limitations in a private equity fund or venture capital fund.

In a private equity fund or venture capital fund, there may be circumstances where redemption of shares could be at a value which is less than the NAV of such shares.

This could happen where the investor fails to advance its commitment and the fund seeks to impose default remedies against such investor (e.g. a defaulting investor scenario) or where certain tax or regulatory restrictions may limit the percentage participation of an investor in order to avoid an adverse outcome for the fund.

The S-VACC should accommodate such scenarios, and therefore include flexibility for the redemption of shares to be less than NAV where agreed with an investor, or otherwise for tax, regulatory or legal reasons.

Question 9. MAS seeks comments on the proposal to allow directors of S-VACCs to dispense with AGMs.

AGMs are usually not necessary in collective investment schemes. In the case of the S-VACC, there is an additional safeguard in the mandatory requirement for the S-VACC to appoint a MAS-regulated fund manager.

We note that in the private equity and venture fund context, typically 50% / 66.67% of investors can require a meeting of investors to be called and therefore a 10% threshold would be too low in the context of a private equity or venture fund.

Question 10. MAS seeks comments on the proposals for the appointment of auditors, not requiring audit committees, as well as the preparation and disclosure of financial statements of S-VACCs.

The appointment of fund auditors is market practice in private equity and venture capital funds.

We agree that the S-VACC should not be required to appoint an audit committee.

Please clarify whether investors in one sub-fund will have access to the financial information of another sub-fund under the same umbrella fund structure?

Please clarify whether the annual return of the S-VACC will be made available to members of the public?

In relation to the financial statements, it is noted that the Consultation Paper at paragraph 6.6 indicated that: “as the audited financial statements of funds contain proprietary information relating to investment strategy, *MAS does not intend to require that the statements be made publicly available*.” The provisions relating to accounts in Part 8 and elsewhere in the draft S-VACC Act are silent on restrictions on public access to the financial statements. The S-VACC Act should explicitly state that the financial statements filed with ACRA will not be publicly accessible.

Question 11. MAS seeks comments on whether S-VACCs should be allowed to prepare their financial statements using an applicable ASC Standard, the IFRS or RAP 7 (for S-VACCs consisting of Authorised Schemes). What are the considerations that may influence the accounting standards which a S-VACC uses (e.g. fund manager's operations, investors' preference or location of assets)?

We support the use of IFRS for the preparation of financial statements.

We propose allowing sub-funds to adopt the financial accounting standard most appropriate to such sub-fund. For instance, if the sub-fund is investing into American assets, that sub-fund may wish to report in accordance with US Generally Accepted Accounting Principles. As the assets and liabilities of each sub-fund are separate from other sub-funds, and as the investors\ shareholders\ creditors are almost wholly concerned with such sub-fund, and not other sub-funds, this should not cause much confusion. The MAS should have the statutory power, upon application by the fund manager of such sub-fund to allow a different financial accounting standard to be applied for that sub-fund.

Question 12. MAS seeks comments on the proposal regarding the disclosure of a S-VACC's shareholder register.

We agree with MAS' proposal not to disclose the register of shareholders to the public but to make the register available to MAS, ACRA and other public authorities for regulatory, supervisory and law enforcement purposes.

Please also confirm whether the register of shareholders can be maintained by the S-VACC/Permissible Fund Manager or must it be maintained by a third party company secretary.

Please clarify whether the constitution of the S-VACC will be made available to members of the public? Private equity and venture fund managers are unlikely to use a vehicle where the constitution is (or could become) publically available.

Question 13. MAS seeks comments on the proposal to adopt the same requirements on beneficial ownership information and nominee directors as those under the CA amendments.

To the extent this does not go beyond what the RFMC or licensed fund manager is required to do as part of its KYC/AML obligations, we see no issue with this.

Question 14. MAS seeks comments on the proposed requirements on a S-VACC's directors, residency and name of a S-VACC.

We have no comment on this.

Question 15. MAS seeks comments on the proposal to allow only Permissible Fund Managers to manage S-VACCs.

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The MAS should have power, upon application, to allow other categories of fund managers, albeit with additional conditions, to manage S-VACCs. For instance, the MAS could consider an exemption with conditions for a fund manager of S-VACCs where the shareholders are all related corporations of the fund manager; or where all the shareholders are institutional investors. The MAS could also consider an exemption for a joint-venture fund manager managing an S-VACC where each shareholder of the S-VACC owns at least 20% of the fund manager and there is a joint venture agreement amongst such shareholders in place over such fund manager.

Would MAS consider allowing private equity real estate managers operating under the licensing exemption in paragraph 5(1)(h) of the second schedule to the Securities and Futures (Licensing and Conduct of Business) Regulations to manage an S-VACC?

Assuming the new light-touch regulatory regime for venture capital managers is adopted, will such managers qualify as a Permissible Fund Manager for the purposes of managing an S-VACC?

(On a drafting point, the reference to registered fund management company in section 106 (2) as being under "regulation 2 of the Securities and Futures (Licensing and Conduct of Business) Regulations" should refer to "paragraph 5(1)(i) of the *second schedule to the* Securities and Futures (Licensing and Conduct of Business) Regulations" [*emphasis added*]

Question 16. MAS seeks comments on the proposed AML/CFT requirements on S-VACCs.

Paragraph 7.6 [b] states that the S-VACC is required to outsource the performance of AML/CFT duties to its fund manager, and to hold the S-VACC ultimately responsible for compliance with its AML/CFT requirements. Presumably the S-VACC is not required to carry out AML/CFT checks additional to similar checks that are already the responsibility of the fund manager and that such wasteful duplicative work is avoided. On this basis, the proposed AML\CFT requirements are supported.

Question 17. MAS seeks comments on the proposal for S-VACCs consisting of Authorised or Restricted Schemes to have an approved custodian that is an Approved Trustee, and to align the duties of the approved custodian with those of an Approved Trustee under the SFA, except where such duties are already imposed on the S-VACC or its directors as covered under the S-VACC legislation.

In the context of Restricted Schemes, we note that this requirement does not apply to the interests of a Singapore limited partnership or any other offshore fund vehicle being offered in Singapore under section 305 of the SFA, and therefore would disadvantage any private equity or venture capital fund manager which is considering the use of an S-VACC.

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In addition, we would highlight that hedge funds and retail funds typically hold investments which are fungible and can be co-mingled, therefore it is a regulatory requirement in many jurisdictions for such funds to appoint a custodian to safe-guard the title to assets in the event of the insolvency. However, the investments typically made by private equity funds and venture capital funds are different (typically being illiquid investments in the shares of private companies) and therefore the rationale supporting the appointment of custodians in hedge funds and retail funds does not apply to them. MAS appears to acknowledge such differences in the nature of investments in FAQ 5 of the "Frequently Asked Questions on The Licensing and Registration of Fund Management Companies" (last updated on 6 February 2017).

Finally, we note that it is unlikely any existing custodian will agree to act as a custodian for a private equity or venture capital fund, since their role would be limited to physically holding share certificates (assuming the relevant portfolio companies even issue share certificates) and this is outside the typical role of a custodian (and we understand not a commercially viable service).

Question 18. MAS seeks comments on the proposal to adopt the same requirements on re-domiciliation as those introduced by ACRA under the CA for S-VACCs. In particular, what aspects of the CA re-domiciliation provisions should be modified for S-VACCs?

As the provisions on re-domiciliation in the Companies Act context are new and untested, it is preferable that the MAS should have broad flexible powers to apply / dis-apply / impose conditions regarding the re-domiciliation provisions in the Companies Act. The

MAS should have wide statutory powers to impose additional requirements or exempt certain particular applicants from certain requirements with the objective of welcoming bona fide foreign corporate collective investment schemes, while keeping out dubious foreign collective investment schemes.

The MAS should allow an informal application process with the possible grant of an in-principle conditional approval as such foreign collective investment schemes, particularly private family fund structures, would not wish to embark on a formal application process if there is a risk of being rejected.

Question 19. MAS seeks comments on the type of foreign structures (including their original jurisdiction of domicile) which would seek to re-domicile as an S-VACC in Singapore and the issues envisaged.

There should be no explicit exclusion of any foreign corporate collective investment schemes from any relevant foreign jurisdiction. So long as such re-domiciliation is permitted by such foreign jurisdiction, and such applicant fulfils the relevant requirements (under the Singapore Variable Capital Company Act and the relevant provisions of the SFA), such application should be considered.

Please clarify whether a company under the Companies Act (Chapter 50 of Singapore) would be allowed to re-domicile as an S-VACC.

We note that there are numerous restricted schemes which are structured as companies with redeemable preference shares under the Companies Act of Singapore. The Minister should be empowered to issue subsidiary legislation to allow such companies to be converted into S-VACCs with appropriate safeguards.

Question 20. MAS seeks comments on the proposal to adopt a winding-up regime similar to that under the CA for S-VACCs and sub-funds, as well as the proposed modifications.

The winding-up regime adapted for S-VACCs and Sub-Funds is supported.

Question 21. MAS seeks comments on the proposal to allow S-VACCs to issue debentures, including to allow S-VACCs to issue debentures relating to specific sub-funds.

We seek clarity on what MAS means by "global industry practice" in paragraph 11.1 of the consultation paper and what types of funds are envisaged by this question.

Please also clarify whether the term "debentures" is being used interchangeably with the term "leverage". Whilst we support the ability for an S-VACC to utilise "leverage", the issuance of debt instruments in the form of "debentures" is not a common practice in private equity and venture capital funds.

Question 22. MAS seeks comments on the proposal to adopt a receivership regime similar to that under the CA for S-VACCs and their sub-funds.

We have no comment on this.

Question 23. MAS seeks comments on the proposal to not adopt the mechanisms for arrangements, reconstructions and amalgamations under the CA.

There are statutory regulations for arrangements and amalgamations for Irish ICAVs and UK OEICs. If there are analogous regulations adapted and simplified for S-VACCs, it is not necessary to rely on the Companies Act provisions for such arrangement and amalgamations.

It should be highlighted that if the policy intention is to allow S-VACCs, in appropriate circumstances, to amalgamate with companies under the Companies Act, it may then be appropriate to consider allowing the Companies Act provisions on arrangements and amalgamations to be applicable to S-VACCs.

Question 24. MAS seeks comments on the proposal to require the constitution of a S-VACC to clearly set out shareholders' rights in respect of a scheme of arrangement, merger, reconstruction or amalgamation involving the S-VACC (including any of its sub-funds)

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It is legally necessary for arrangements and amalgamations to be effected by way of statutory legislation / subsidiary legislation as the rights of creditors, and other third parties are affected; and it may involve the dissolution of one or more S-VACCs. It is not legally possible to effect such arrangements / amalgamations by way of provisions in the S-VACC constitution only.

The UK has detailed regulations to effect simplified arrangements without the necessity for court involvement and also permitting arrangements, and amalgamations with other investment structures under the UK Companies Act or otherwise. It is suggested that the UK position be considered for adoption, as this gives flexibility to the fund managers and enhances the attractiveness of Singapore as a fund management structuring and restructuring jurisdiction.