

**SVCA's Discussion Paper for Venture Capital
Fund Management Companies
25th October 2016**

1. Introduction

The Singapore Venture Capital and Private Equity Association (SVCA) has prepared this discussion paper for consideration by the MAS.

Our objective is threefold:

- to share insights on certain key regulatory issues faced by venture capital fund management companies (“**VCFMCs**”) operating in Singapore;
- propose an alternative “lighter-touch” notification regime for the oversight of VCFMCs; and
- modify the regulatory framework with the aim of facilitating a conducive environment for the continued growth and development of the venture capital industry in Singapore.

These objectives are in line with the Singapore Government’s Smart Nation initiative, and the goal of developing Singapore into a global FinTech hub and thought leader in the venture capital industry.

2. Background

a. The evolution of venture capital in Singapore

The SVCA was founded in 1992 when there were only a few venture capital funds in Singapore. By 2004, there were more than a hundred venture capital and private equity funds with S\$16 billion (US\$11.7 billion) in assets under management (AUM).¹ The AUM of Singapore-based private equity and venture capital fund managers has since increased dramatically and by 2015 surpassed S\$39 billion (US\$28.4 billion), representing a compounded annual growth rate of 8.4% over the past 11 years. Early stage venture capital AUM alone now accounts for S\$2.5 billion (US\$1.8 billion).²

The rapid increase in valuation and slowing growth in China has fueled the need for diversification and a renewed interest in Southeast Asia. In particular, the success of Alibaba has validated the potential for technology investments in developing Asian economies, thereby contributing to the influx of venture capital into Southeast Asia. From 2011 to 2015, venture capital investment into Southeast Asia has grown 7.8 times from less than US\$200 million to US\$1.28 billion. However, investments by Singapore-based venture capital managers have grown only 3.6 times over the same period. By this measure, the proportion of venture capital investments by Singapore-based fund managers into Southeast Asia has shrunk from 45% to less than 20% in 2015.

Singapore’s infrastructure and business ecosystem has attracted early stage, high growth companies with substantial regional presences, such as Zalora, Garena, Giosis and GrabTaxi, to locate their headquarters in Singapore. These have in turn attracted significant investments from foreign fund managers with little or no presence in Singapore.

¹ “The Venture Capital Industry in Singapore: A Comparative Study with Taiwan and Israel on the Government’s Role”, May 2005 NUS Entrepreneurship Centre

² SVCA-Preqin Asean Fact Sheet 2016, <http://svca.org.sg/wp-content/uploads/2015/12/Preqin-Private-Equity-SVCA-April-2016.pdf>

Hence, with renewed interest in Southeast Asia, Singapore is well placed to play a major role as a venture capital hub for both local venture capital managers and regional/global fund managers if the regulatory and tax environment is correctly calibrated.

b. A typical VCFMC in Singapore

The SVCA counts most registered VCFMCs operating in Singapore in its membership. The following represents the typical profile and features of an SVCA VCFMC member:

- Managing an AUM of S\$20 million to S\$100 million in one or more closed-ended fund vehicles
- Managed by an individual or team of seasoned entrepreneurs who have experience running successful businesses across various sectors, some previously with the support of venture capital
- Executes up to 10 investments a year
- Typical size of investment would range between S\$500,000 to S\$7 million
- Investments made in private (i.e., non-listed) companies which are at the initial/earlier stages of the business life cycle
- Employs 3 to 10 people
- Operating business track record in Singapore of up to 5 years
- Investor profile comprising mainly of high net worth individuals and family offices located both onshore and offshore

Most VCFMCs in Singapore generate their revenue from the receipt of management fees charged for the provision of fund management services to the relevant fund (at a rate of around 2% to 2.5% of committed capital) and a share of the fund's profits in the form of carried interest (at a rate of around 20% of profits).

Assuming a typical VCFMC managing S\$20 million of AUM, an example of the breakdown of the annual costs of operating a VCFMC would be as follows:³

- Management fee revenue (2% of S\$20 million per annum): S\$400,000
- Office overheads (rent, IT, administrative costs and utilities): S\$80,000
- Cost of compliance: S\$75,000 to S\$100,000
- Balance of S\$220,000 to S\$245,000 for employee remuneration

c. Regulation of venture capital fund management companies in Singapore

³ Data compiled based on an informal survey of certain SVCA members.

Fund management is a regulated activity under the Securities and Futures Act, Chapter 289 of Singapore (the “SFA”), and therefore any person that carries on business in fund management (or holds himself out as carrying on such business) is required to be the holder of a capital markets services licence (a “CMS Licence”) for fund management, or otherwise be exempted from the requirement to hold a capital markets services licence to carry on business in fund management.

The regulation of fund management in Singapore does not differentiate between fund management companies investing in different asset classes (with the exception of immovable assets) and therefore VCFMCs that provide fund management services in Singapore typically either (a) register as a registered fund management company (“RFMC”) pursuant to paragraph 5(1)(i) of the Second Schedule to the Securities and Futures (Licensing and Conduct of Business) Regulations (the “Licensing Regulations”); or (b) apply for a CMS Licence for fund management as an Accredited / Institutional Licensed Fund Management Company (“AI LFMC”).

3. Issues Faced by VCFMCs in Singapore

a. Meeting regulatory requirements

As mentioned above, the licensing requirements in Singapore under the SFA do not differentiate between fund management companies investing in different asset classes (with the exception of immovable assets) and therefore VCFMCs are subject to the same suite of requirements as managers operating in other asset classes.

In particular, the following requirements have proven to be particularly onerous for the typical VCFMC operating in Singapore:

- Past work and relevant experience requirements for directors, relevant professionals and representatives⁴
- Requirement for investment team members who wish to invest in funds managed by their employer to be accredited investors⁵
- Conflicts of interest⁶
- Base capital requirements
- Outsourcing guidelines (ongoing and pending requirements)

⁴ We acknowledge that the MAS already specifies in the Guidelines on Licensing, Registration and Conduct of Business for Fund Management Companies (the “FMC Guidelines”) that “relevant experience” may also include sector experience (e.g., corporate strategy and management of businesses). However, for VCFMCs, particularly those that invest in FinTech start-ups, the directors and the CEO of the VCFMC may be relatively young and not have the specified managerial experience, supervisory experience, nor the five years required experience as part of their relevant experience.

⁵ Set out in paragraph 2.2.2 of the FMC Guidelines. It is a common practice in other jurisdictions for early stage venture capital fund managers to allow investment team members to invest in the fund and thereby align their interests with those of investors (i.e., have “skin in the game”). However, the requirement set out in the FMC Guidelines significantly limits such arrangements for venture capital fund managers in Singapore.

⁶ In paragraph 4.1.3 of the FMC Guidelines, the MAS specifies that investing proprietary monies or monies belonging to its employees into the fund is a conflict of interest. In the case of venture capital funds, such investment is invariably the case and we would request that it is acknowledged that it is an acceptable conflict of interest.

b. Cost of licensing and ongoing compliance

As set out in paragraph 2b above, operating a fund management business in Singapore can be an expensive process, and the cost of ongoing compliance with applicable regulations, some of which have been listed above, comprises a significant portion of such costs.

Other than the *ongoing* costs of operating a fund management business in Singapore, prospective managers also have to bear the *one-off initial* costs of setting up the fund management company, applying for the A/I LFMC or RFMC status and implementing a Singapore compliance framework (which may range from a minimum of S\$55,000 and up). Based on the example of a typical VCFMC set out in paragraph 2b above, the cost of complying with MAS regulatory requirements in the first year alone would account for 30% to 40% of the management fee income. This alone poses a significant barrier to entry for any prospective venture capital firms wishing to establish their businesses in Singapore.

c. A comparison with other venture capital jurisdictions

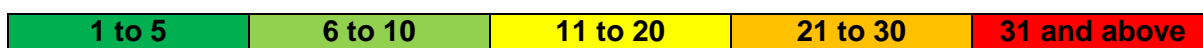
Apart from the challenges faced in relation to the establishment and running of a venture capital fund management business (described above), the availability of investment opportunities and the attractiveness of the venture capital environment plays a significant part in the decision whether to set up and continue a fund management business in a particular jurisdiction.

We have set out on the following page, a table summarising the results from a comprehensive research project carried out by IESE Business School and EMLYON Business School⁷ which tracks the attractiveness of countries around the world for investors in venture capital and private equity limited partnerships. The detailed results of this research have been presented in the Venture Capital & Private Equity Country Attractiveness Index (the "**Index**").⁸

⁷ This is the 6th edition of the index and utilizes 300 different data series, including 200,000 individual data records, from all kinds of providers ranging back to 2000.

⁸ The "Venture Capital and Private Equity Country Attractiveness Index 2016" is available at <http://blog.iese.edu/vcpeindex/profiles/>. Previous editions have been cited by Preqin (<https://www.preqin.com/search.aspx?k=IESE&st=All>), Forbes (<http://bit.ly/2e95JBy>), and the Journal of Private Equity (<http://bit.ly/2e92nyp>).

Country (Ranking 2016)	U.S. (1)	U.K. (2)	Canada (3)	Singapore (4)	Hong Kong (5)	Australia (6)	Japan (7)	Germany (9)	China (24)
Economic Activity	Green	Yellow	Orange	Orange	Yellow	Yellow	Yellow	Light Green	Green
Depth of Capital Market	Green	Green	Green	Light Green	Green	Green	Light Green	Light Green	Light Green
Taxation	Red	Light Green	Red	Orange	Red	Yellow	Red	Yellow	Yellow
Investor Protection and Corporate Governance	Light Green	Light Green	Green	Green	Green	Yellow	Yellow	Yellow	Red
Human and Social Environment	Green	Green	Light Green	Green	Light Green	Light Green	Yellow	Yellow	Red
Entrepreneurial Opportunities	Green	Green	Light Green	Light Green	Yellow	Yellow	Green	Green	Orange



As shown above, Singapore continues its strong showing by maintaining its top five position globally for the sixth consecutive year, and remains the most attractive jurisdiction for venture capital and private equity investments in Asia. These results reflect the success of the efforts to date to make Singapore an attractive jurisdiction for venture capital and private equity investments, but there continues to be room for improvement.

Whilst the Index does not have a category that specifically addresses the attractiveness of Singapore as a domicile for *setting up a fund management business*, we believe that enhancing the existing regulatory regime for venture capital firms will be a key factor in keeping Singapore competitive and making it even more attractive for venture capital firms. This is particularly so as competition between jurisdictions for talent and expertise continues to increase, and venture capital fund management businesses come under rising cost pressures.

Our proposals are discussed in more detail in the next section.

4. Proposals to Amend and Enhance Existing Regime for VCFMCs

a. A new “lighter-touch” notification regime for venture capital fund management companies alongside the RFMC and AI LPMC regimes

In light of the issues described above, the SVCA proposes that the MAS consider regulating VCFMCs separately from fund management companies focusing on other asset classes.

The broad features of the proposed regime (the “**VCFMC Regime**”) would be as follows:

- Notification regime – qualifying managers would notify the MAS (instead of seeking approval/registration) of their intention to commence business under the VCFMC Regime. This could, in practice, operate in a similar way to the historical exempt fund manager regime (under the now-deleted paragraph 5(1)(d) of the Licensing Regulations) that was phased out in 2012/2013.
- Only “qualifying” managers would be able to operate under the VCFMC Regime. We propose that the following criteria be relevant to MAS’ determination of who would be a “qualifying” manager under the VCFMC Regime:
 - Include a cap on the AUM being managed (on a commitment basis), a suggested amount would be S\$100 million
 - Funds managed by the “qualifying” manager must be closed-ended funds (i.e., funds with a defined term where investors do not have the right to make any redemptions from the fund)
 - Funds must ensure that at the point of first investment, a specified percentage of drawn commitments are invested in portfolio companies that meet specific criteria such as:⁹
 - Non-listed companies
 - Annual turnover not exceeding S\$10 million and balance sheet not exceeding S\$15 million
 - Employs less than 100 persons
- The “qualifying” managers would provide an annual self-certification confirming their compliance with the applicable criteria for the VCFMC Regime

⁹ Instead of these criteria, another way of identifying “qualifying” managers would be to set out criteria relating to the stage of development of the underlying portfolio companies. Some helpful guidance can be derived from the following: (i) EU consultation paper preceding the implementation of the EU Regulation on European Venture Capital Funds (see page 14): http://ec.europa.eu/finance/consultations/2011/venture-capital/docs/consultation_paper_en.pdf; and (ii) the 2016 U.S. National Venture Capital Association Yearbook (see Appendix F): <http://nvca.org/?download=2963>

- “Qualifying” managers would generally be exempt from the regulatory requirements applicable to A/I LFCMs and RFMCs with the exception of the following:
 - Only institutional investors and accredited investors would be permitted to participate in such funds
 - Singapore incorporated company and director requirements under the Companies Act, Chapter 50 of Singapore
 - Fit and proper criteria
 - Carry out an independent audit at least once a year
 - Valuation and reporting requirements (no more than one valuation per year, and “lighter-touch” reporting regime)
 - Mitigation and disclosure of conflicts of interest (if any)
 - Anti-money laundering requirements
 - Notification of any changes to material information previously provided to the MAS

- b. A new tax incentive scheme for venture capital funds modelled on the section 13.X tax incentive scheme**
 - Tax exemption on specified income derived from designated investments by an approved fund
 - Available only for funds receiving fund management services from “qualifying” managers under the VCFMC Regime, A/I LFCMs and RFMCs
 - Minimum AUM of \$20 million
 - No minimum local business spending requirement
 - No requirement to appoint a local fund administrator so long as fund administration is carried out in-house in Singapore by the “qualifying” managers under the VCFMC Regime

- c. A new fund management tax incentive scheme modelled on the FSI-FM award**
 - Administered by the MAS
 - Must be a “qualifying” manager carrying out fund management under the VCFMC Regime

- Award granted for a minimum of 5 years with an automatic renewal unless otherwise notified by the MAS

5. Conclusion

The SVCA and its members strongly believe that Singapore is at an exciting stage in the development of the venture capital industry. Coupled with the Singapore government's Smart Nation and FinTech initiatives, as well as the broader thrust of developing Singapore into a global fund management hub, we are at an opportune time to further enhance the regulatory regime to encourage the growth and development of the venture capital industry as a specific asset class in Singapore.

The proposals set out in this paper are initial thoughts on how we can enhance the venture capital regulatory and tax regimes. We would gladly welcome the opportunity to work together with the MAS to progress this further.

Thank you.