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The VCC: A Game-Changer for Singapore's Funds Industry

On 1 October 2018, Parliament passed the Variable Capital Companies Bill. My second reading speech is available at www.mof.gov.sg. The Bill can be accessed at www.parliament.gov.sg.

The Bill:

- creates a new type of corporate entity, the Variable Capital Company (VCC), a vehicle tailor-made for investment funds; and
- provides the legislative framework governing the VCC.

The VCC is set to be a game-changer in Singapore's drive to be an Asian hub for fund management and fund domiciliation.

This Note explains what the VCC is, why we need it and how it makes a difference. Also, what professionals supporting the funds and asset management industry need to do in order to make the most of this new development.

What is the VCC?

The VCC is essentially a corporate entity, but incorporated under the VCC Act instead of the Companies Act (CA).

It will have:

- Shareholders
- a Board responsible for its governance. This VCC board is the equivalent of the board of directors in a company incorporated under the CA. The VCC board of directors will likewise owe fiduciary duties to the VCC and must act in its best interests.
- a Fund Manager, regulated by the Monetary Authority of Singapore (MAS).
- a Custodian of assets. This is required for funds offered to certain types of investors (e.g. retail investors).

The VCC can be set up as a single standalone fund, or as an umbrella fund with two or more sub-funds, each holding different assets.

To understand the basic structure of the VCC, see: Annex 1 and Annex 2.

The more technical features of the VCC can be found at www.mas.gov.sg.

The response to the feedback from the public consultation on the VCC framework and the Bill can be found at the same website.

Why the VCC?

There is currently a disjunct between the place where a fund is set up or incorporated (i.e. its place of domicile) and where it is managed. Today, many funds managed out of Singapore are domiciled overseas.

One reason for this disjunct is that the existing fund structures in Singapore (such as limited companies under the CA, limited partnerships and unit trusts) have limitations when used as vehicles for investment funds. However, we have strong fund management capabilities.

Consequently, some investors choose to invest via the more flexible fund structures found in other jurisdictions, but have the funds managed out of Singapore, as the substantive fund management expertise is located here.

The VCC is a new fund structure without the limitations of the existing fund structures. With the VCC, Singapore now has a structure comparable to that of other international fund domiciles. It will complement the existing fund structures and add to the suite of investment vehicles on offer, thus giving investors more choice.

Advantages of the VCC

The VCC will:

- provide greater flexibility, thereby facilitating investment fund operations and catering to the needs of global investment funds;
- help fund managers in Singapore reap economies of scale and achieve cost efficiencies; and
- facilitate re-domiciliation.

Greater flexibility

VCCs can be used as vehicles for both open-ended and closed-end funds, and for both traditional and alternative strategies.

- Traditional funds are often structured as open-ended funds, where investors can elect to redeem their investment units or shares in the fund.
- Most alternative funds, such as private equity and venture capital, on the other hand are typically structured as closed-end funds i.e. the fund has a fixed number of shares and an investor's ability to redeem their investments is restricted.
- The VCC's variable capital structure allows it to be either open-ended or closed-end, giving investors the best of both worlds for redemption and exit.

VCCs can issue and redeem shares without the need for shareholder approval.

- This allows investors to enter into, and exit from, their investments as and when they choose.

VCCs can pay dividends out of capital, not only out of profits.

- Unlike companies incorporated under the CA, VCCs are not subject to restrictions on capital reduction. This gives fund managers flexibility to meet dividend payment obligations, an important consideration for investors.

Engagements with industry on the VCC framework

Flexibility in choice of accounting standards.

- VCCs can use either Singapore or other recognised international accounting standards i.e. the International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (US GAAP) for their financial statements.
- Fund managers can therefore choose the accounting standard that best meets the needs of their investors (who may not be based in Singapore) or the requirements of the jurisdiction where the fund assets are located.

Economies of scale and cost efficiencies

The umbrella fund structure creates economies of scale, leading to cost savings.

- Sub-funds can share a board of directors and service providers such as the fund manager, custodian, auditor and administrative agent. This would benefit fund managers who may wish to group different funds under a single VCC umbrella.
- For umbrella funds, the assets and liabilities of each sub-fund must be segregated. The assets of one sub-fund cannot be used to discharge the liabilities of another sub-fund. This safeguards against the risk that the assets and liabilities of one sub-fund may be commingled with those of another. Further, each sub-fund must be wound up separately, to ensure ring-fencing of each sub-fund's assets and liabilities in case of insolvency.

Foreign-domiciled corporate funds can now transfer to Singapore

The VCC regime allows foreign corporate funds to be re-domiciled to Singapore as VCCs.

- Before a fund or corporate vehicle can re-domicile to another jurisdiction, that jurisdiction must first have in place a regulatory regime which caters to that type of fund or vehicle.
- Prior to this, with only the CA regime, only funds structured as CA-type companies could be re-domiciled to Singapore. However, they must be larger than a small company, which would be inherently difficult for an investment vehicle to satisfy as the size and scale of many funds are smaller than a trading company.
- Now, with the inward re-domiciliation provision in the Bill, investment funds domiciled abroad which are structured similarly to VCCs can also be re-domiciled in Singapore without the need to satisfy the small company requirements, thereby greatly expanding the potential number of funds which can be transferred here.
- If they adopt other structures, they will need to restructure before they re-domicile as VCCs in Singapore. Alternatively, they may choose to incorporate a new VCC and transfer their assets and liabilities to a VCC instead.
- Re-domiciliation can be done through a simple registration process, similar to that for companies under the CA.
- Re-domiciliation has the benefit of allowing a foreign investment fund to retain its corporate history and identity.

VCC Framework

The VCC framework will adopt many of the features for companies under the CA, while incorporating features aimed specifically at the needs of investment funds.

- The Accounting and Corporate Regulatory Authority (ACRA) will administer the Act.
- The anti-money laundering and countering the financing of terrorism obligations of VCCs will be overseen by the MAS.
- VCCs must maintain a register of shareholders, which need not be made public. However, this register must be disclosed to public authorities upon request for regulatory, supervisory and law enforcement purposes.
- The broad tax policy framework for VCCs is set out in Annex 3. Further details will be announced later this year.

Implementation

The Variable Capital Companies Act will come into force in 2019, on a date to be notified by a commencement Notification published in the Gazette.

Growth Opportunities for Professionals

The VCC will encourage new funds to set up in Singapore and facilitate the re-domiciliation of foreign funds here. This will grow Singapore's fund servicing ecosystem.

This will in turn create new opportunities and increase work for fund servicing professionals such as fund administrators, directors, custodians, accountants, lawyers and tax professionals.

I would urge fund service providers to familiarise themselves with the new VCC structure and the Bill, and bring the value proposition of the VCC to their clients' attention as an attractive structuring option.

Helping fund managers and investors understand the VCC, how it works and its benefits, will be key to ensuring that the VCC is widely used as a vehicle for investment funds and growing the pie for all.

Accounting professionals too have an important role to play in providing accounting services to VCCs. You will need to be equipped with relevant skills and competencies to support your clients, including being familiar with IFRS and US GAAP, which may be used by VCCs when preparing their financial statements.

Conclusion

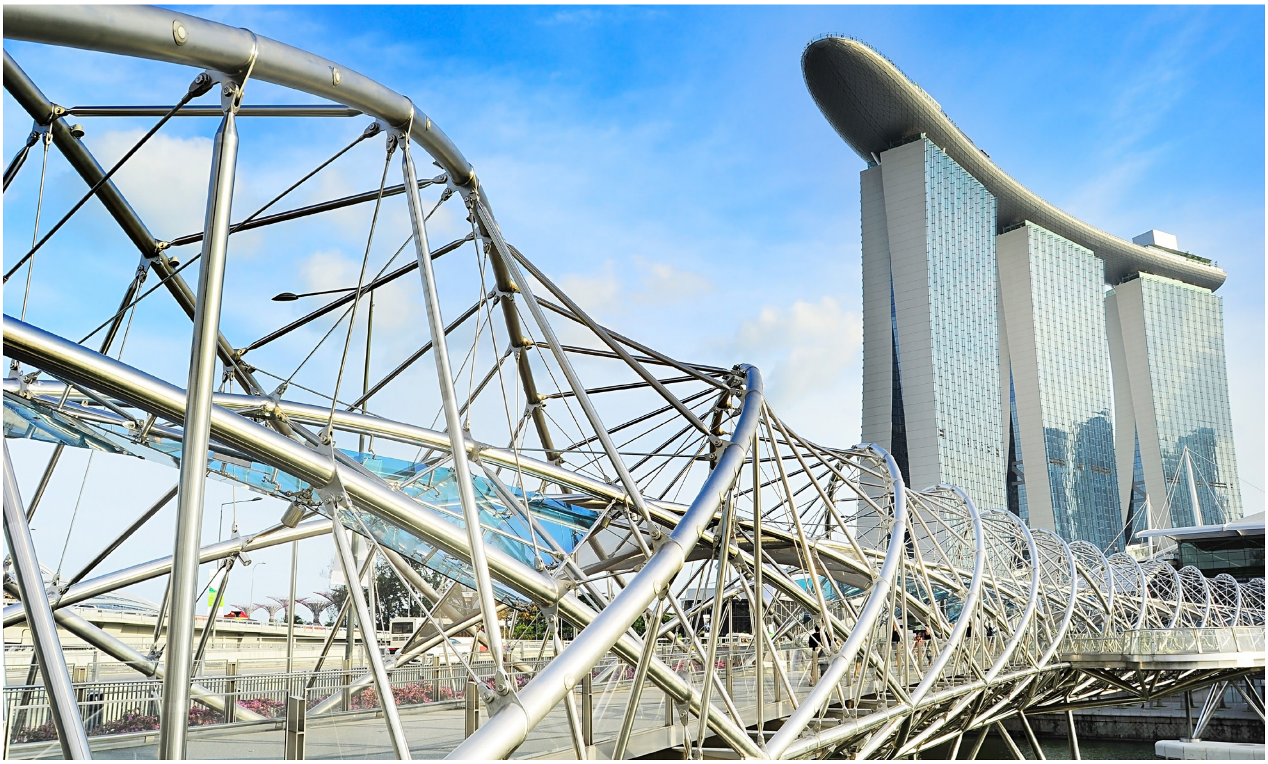
The VCC is a game-changer for Singapore's fund management industry.

It will allow us to capture value from the full fund management value chain, including product development, fund management, administration and distribution.

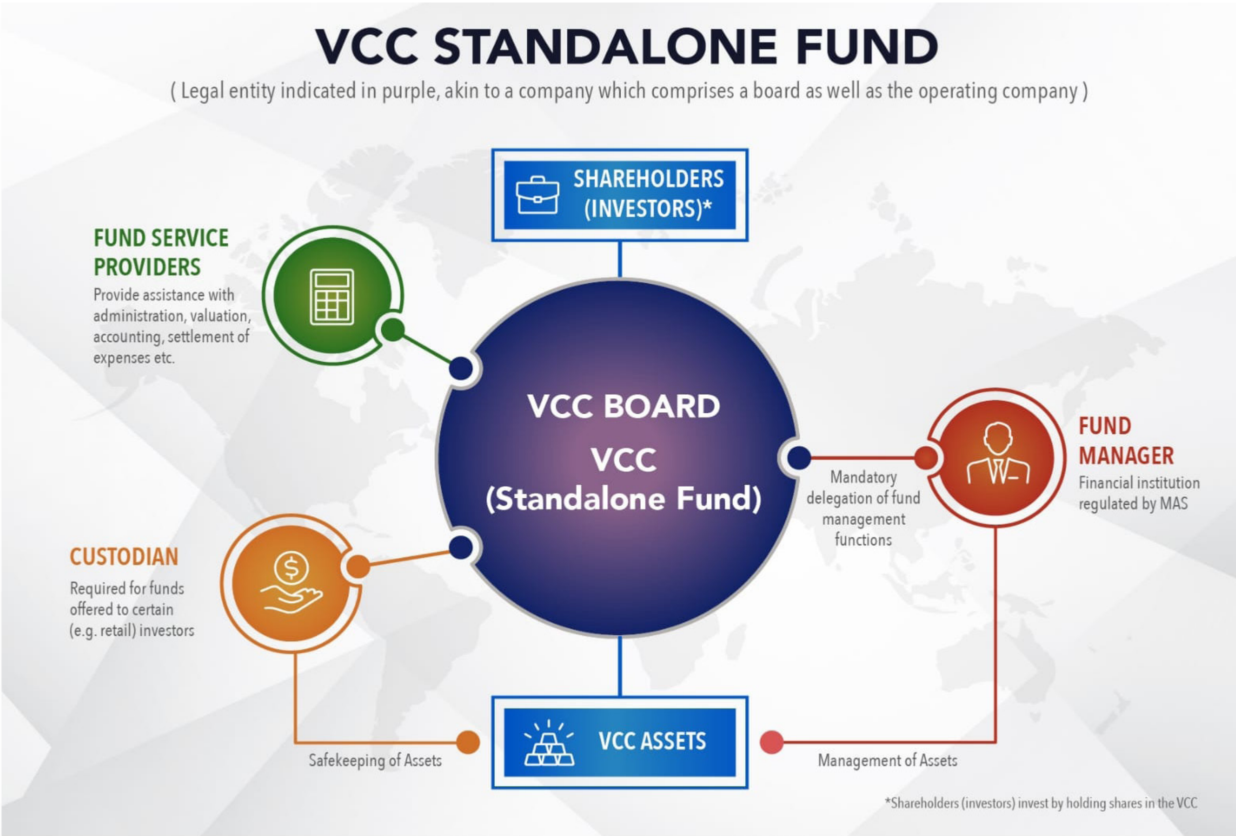
By encouraging investment funds to domicile in Singapore as VCCs, it will facilitate the use of Singapore fund service providers and deepen the capabilities in the funds eco-system. It will also ease administrative burden and bring about cost economies for fund managers in Singapore.

This will help Singapore stay on top of the game, and strengthen our position as an Asian hub for fund management and fund domiciliation.

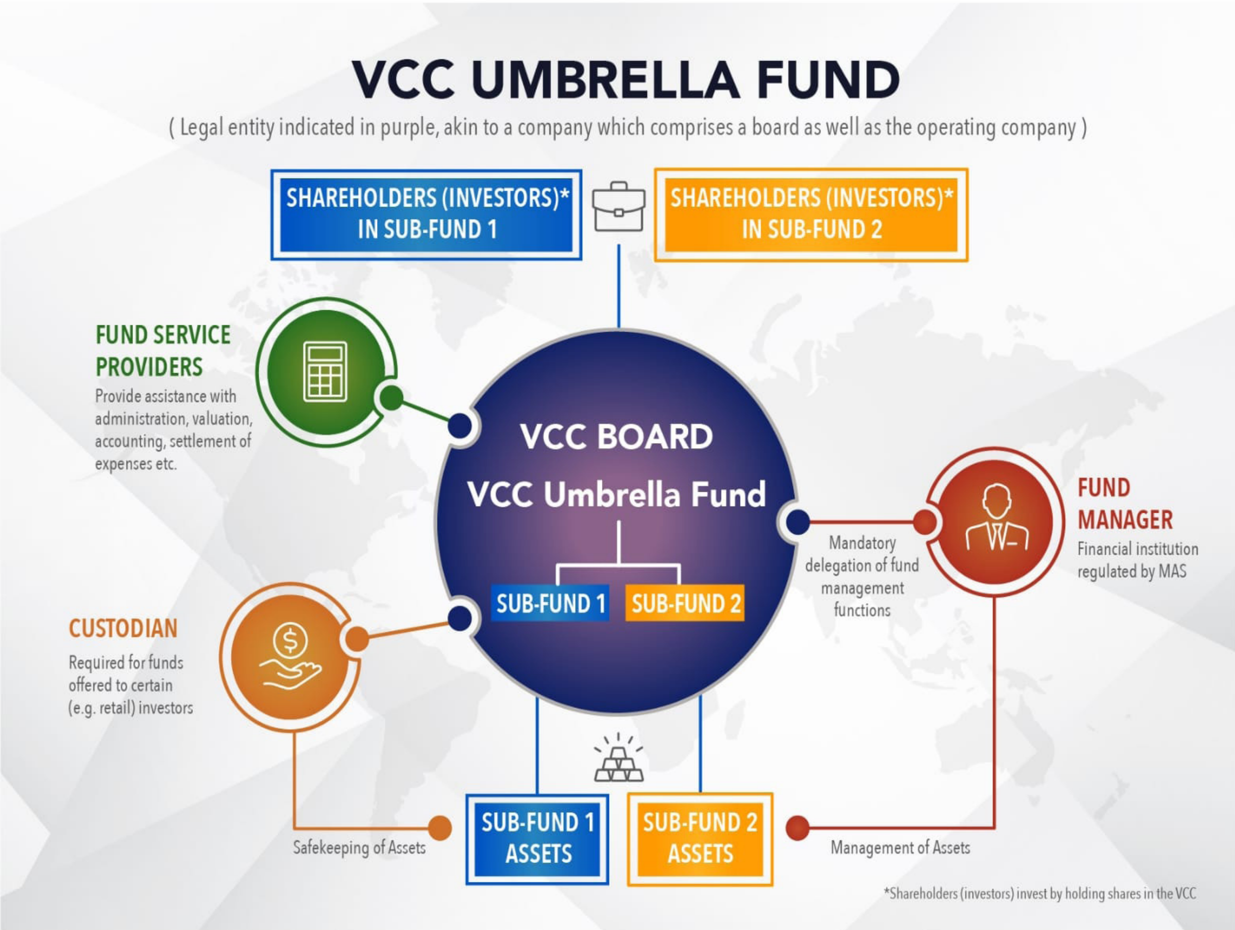
However, to translate this into reality and make it a success, we need the concerted effort not only of government but also the private sector and in particular the fund servicing professionals. I therefore urge all to play your part – get familiar with the provisions of the Bill, get equipped and help get the word about the new VCC framework out!



Annex 1


VCC STANDALONE FUND
(Legal entity indicated in purple, akin to a company which comprises a board as well as the operating company)
SHAREHOLDERS (INVESTORS)*
FUND SERVICE PROVIDERS
Provide assistance with administration, valuation, accounting, settlement of expenses etc.
VCC BOARD
VCC
(Standalone Fund)
FUND MANAGER
Financial institution regulated by MAS
Mandatory delegation of fund management functions
CUSTODIAN
Required for funds offered to certain (e.g. retail) investors
VCC ASSETS
Safekeeping of Assets
Management of Assets
*Shareholders (investors) invest by holding shares in the VCC

Annex 2


VCC UMBRELLA FUND
(Legal entity indicated in purple, akin to a company which comprises a board as well as the operating company)
SHAREHOLDERS (INVESTORS)* IN SUB-FUND 1
SHAREHOLDERS (INVESTORS)* IN SUB-FUND 2
FUND SERVICE PROVIDERS
Provide assistance with administration, valuation, accounting, settlement of expenses etc.
VCC BOARD
VCC Umbrella Fund
SUB-FUND 1
SUB-FUND 2
Mandatory delegation of fund management functions
FUND MANAGER
Financial institution regulated by MAS
CUSTODIAN
Required for funds offered to certain (e.g. retail) investors
Safekeeping of Assets
SUB-FUND 1 ASSETS
SUB-FUND 2 ASSETS
Management of Assets
*Shareholders (investors) invest by holding shares in the VCC

Annex 3

Tax treatment for Variable Capital Companies

Tax treatment is an important factor in determining the venue for fund domiciliation and management. The Ministry of Finance (MOF) has announced in its 2018 Budget Statement that:

- a VCC will be treated as a company and a single entity for tax purposes. This means that for ease of compliance, only one set of income tax returns is required to be filed with the Inland Revenue Authority of Singapore (IRAS);
- the tax exemption under sections 13R and 13X of the Income Tax Act (Cap. 134) of Singapore will be extended to VCCs;
- the 10% concessionary tax rate under the Financial Sector Incentive – Fund Management scheme will be extended to approved fund managers managing incentivised VCCs; and
- the existing GST remission for funds will be extended to incentivised VCCs.

MAS, together with MOF and IRAS, will release further information on the tax treatment of VCCs later this year.