

CONSULTATION PAPER

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Amendments to the Code on Collective Investment Schemes

MAS

Monetary Authority of Singapore

Consultation on Amendments to the Code on Collective Investment Schemes

The Code on Collective Investment Schemes (the “Code”) sets out best practices on the management, operation and marketing of funds that managers and trustees are expected to observe.

2 As part of our continual review of the Code to keep pace with the operating environment and evolving international practices, MAS proposes to amend Appendix 1 (Non-Specialised Funds) of the Code in the following areas:

- (a) To revise the method for calculating the exposure of a scheme to a single party (“single party limit”).
- (b) To allow Singapore-constituted and managed funds to invest in financial derivative instruments (“Derivatives”) as an asset class, subject to safeguards.

3 For ease of reference the full text of the proposed new paragraph 2, “Single Issuer and Group Limits” and paragraph 4, “Financial Derivatives”, is appended at Appendix A. The proposed consequential amendments to Appendix 1a of the Code is appended at Appendix B.

Request for Comments

4 MAS invites interested parties to give their views and comments on the proposals set out in this consultation paper. Comments may be submitted to:

Corporate Finance Division
(CIS Code Consultation)
Securities and Futures Supervision Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117

Email: ciscode@mas.gov.sg
Fax: (65) 6225-1350

MAS requests that all comments and feedback be submitted by 22 June 2006.

5 Please note that all submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

Investment Guidelines: Single Issuer and Group Limits

Introduction

To avoid concentration of a scheme's exposure to a counterparty, the Code currently stipulates a single party limit ("SPL") where not more than 10% of the deposited property of the scheme may consist of securities issued by and deposits placed with the same entity (defined as a company, its subsidiaries, fellow subsidiaries and holding company). For schemes tracking a widely accepted benchmark that is constructed by an independent party, the SPL may be the higher of 10% or the benchmark weight.

Proposals

2 Some conglomerates have a number of related companies in their stable and these related companies would come under the definition of the same entity. The current requirement to aggregate investments in the securities of such related companies to determine a scheme's SPL may restrict the ability of schemes to execute their investment strategies effectively.

3 The European Union's UCITS¹ guidelines stipulate that a UCITS may invest no more than 10% of its assets in transferable securities and money market instruments issued by the same body but may cumulatively invest up to 20% of its assets in transferable securities and money market instruments within the same group (or entity). This limit could be raised to 35% when it is justified by exceptional market conditions.

4 To overcome the limitations posed by the current SPL requirement, MAS proposes raising the SPL for an entity, as defined in paragraph 1 above, to 20%. Notwithstanding the 20% cap for investments in securities of an entity, the SPL for each reference benchmark security would be the higher of 10% of the deposited property of the scheme or the benchmark weight of the security, with an allowance of a two percentage point overweight above the benchmark weight.

¹ "UCITS" refers to an undertaking for collective investment in transferable securities governed by Council Directive 85/611/EEC and its amendments introduced by Directive 2001/108/EC.

5 The proposed formulation of paragraph 2 of Appendix 1 of the Code is as follows:

Appendix 1 of the Code on CIS:

2 Single Issuer and Group Limits

2.1 Investments in securities issued by a single issuer (“single issuer limit”) should not exceed 10% of the deposited property of the scheme. Further, investments in securities issued by a group of companies (a group of companies is defined as a company, its subsidiaries², fellow subsidiaries and its holding company) (“single group limit”) should not exceed 20% of the deposited property of the scheme.

2.2 Notwithstanding the “single issuer limit” and “single group limit” set out in paragraph 2.1, investments in any security that is a component of a scheme’s reference benchmark, may be up to the benchmark weighting of the issuer, with an additional absolute overweight allowance of two percentage points above the benchmark weight. The reference benchmark should be one which is widely accepted and constructed by an independent party.

2.3 Investments in securities issued by and deposits placed with an issuer, as well as securities of that same issuer which have been lent, should be aggregated in computing the single issuer and group limits. If the scheme holds as collateral securities issued by the aforementioned issuer, these should also be included in computing the scheme's exposure to that issuer.

[Note: Paragraphs 2.1-2.3 above are intended to replace the current paragraph 2.1. The current paragraphs 2.2 to 2.5 will remain unchanged except for numbering.]

Question 1: MAS would like to know if you agree with the proposal set out above. In particular, MAS would like to have your comments on whether the single issuer and group limits allow fund managers sufficient investment discretion.

² The following definition of “a subsidiary” will be inserted in the main body of the Code under section 2 “Interpretation”:

A company is a subsidiary of another company if that other company holds more than half of the issued share capital of the first-mentioned company.

Investment Guidelines: Financial Derivatives

Introduction

Since March 2005, the MAS has allowed the offer of European Union-constituted UCITS III funds in Singapore as part of our existing framework for the recognition of foreign funds. UCITS III funds are allowed to invest in financial derivative instruments (“Derivatives”) as an asset class in addition to their use for hedging and efficient portfolio management (“EPM”).

2 The EU Commission had allowed UCITS schemes greater leeway in the use of Derivatives subject to safeguards. Managers of such schemes must have a risk management process in place and information of this process must be submitted to the regulatory authorities. Further the global exposure relating to Derivatives held by a scheme may not exceed 100% of the scheme property, and exposure is to be calculated using either the commitment approach for UCITS offered to non-sophisticated investors or the Value at Risk (VaR) model for UCITS offered to sophisticated investors.

Proposals

3 The existing investment guidelines under our Code do not allow Singapore-constituted and managed funds to invest in Derivatives beyond hedging and/or EPM. This restricts the extent to which managers of Singapore-constituted funds can utilize Derivatives in their investment strategies.

4 MAS proposes to allow Singapore-constituted and managed funds to invest in Derivatives as an asset class subject to a cap of 100% of the deposited property of the scheme, similar to the treatment extended to EU-constituted funds. However this will be subject to the condition that the fund managers put in place risk management procedures and controls, and disclose these in the prospectus. As such procedures and controls may vary across fund managers, MAS will not specify the method of calculation of derivative exposure.

5 The proposed formulation of paragraph 4 of Appendix 1 of the Code on CIS is as follows:

Appendix 1 of the Code on CIS:

4 Financial Derivatives

4.1 Adequate risk management procedures and controls should be in place if the scheme invests in financial derivatives for purposes other than hedging existing positions in a portfolio.

4.2 The manager should set out in the prospectus the risk management procedures and controls of the scheme as well as state that these procedures and controls will be in place so long as the scheme invests in financial derivatives as part of their general investment policy.

4.3 Exposure arising from investments in financial derivatives should not exceed 100% of the deposited property of the scheme.

4.4 In calculating exposures arising from investments in financial derivatives, the true and accurate risk of the investments should be reflected. An example of calculating such exposure is by converting the derivative positions into the underlying assets embedded in those derivatives. The method used for determining the scheme's exposure should be disclosed in the prospectus and be subject to an assessment by the manager's in-house risk management experts or an independent expert.

[Note: Paragraphs 4.1 -4.4 above are intended to replace the current paragraphs 4.1 -4.2.]

Question 2: MAS would like to know if you agree with the proposal set out above. In particular, MAS seeks your views on whether you agree that MAS should not specify a method for calculating derivative exposure. If not, please explain.

Appendix 1 of the Code on CIS:

2 Single Issuer and Group Limits

2.1 Investments in securities issued by a single issuer (“single issuer limit”) should not exceed 10% of the deposited property of the scheme. Further, investments in securities issued by a group of companies (a group of companies is defined as a company, its subsidiaries³, fellow subsidiaries and its holding company) (“single group limit”) should not exceed 20% of the deposited property of the scheme.

2.2 Notwithstanding the “single issuer limit” and “single group limit” set out in paragraph 2.1, investments in any security that is a component of a scheme’s reference benchmark, may be up to the benchmark weighting of the issuer, with an additional absolute overweight allowance of two percentage points above the benchmark weight. The reference benchmark should be one which is widely accepted and constructed by an independent party.

2.3 Investments in securities issued by and deposits placed with an issuer, as well as securities of that same issuer which have been lent, should be aggregated in computing the single issuer and group limits. If the scheme holds as collateral securities issued by the aforementioned issuer, these should also be included in computing the scheme's exposure to that issuer.

2.4 The single issuer limit of 10% in paragraph 2.1 may be raised to 35% of the deposited property of the scheme where:

- a) the issuer is, or the issue is guaranteed by, either a government, government agency, or supranational that has a minimum long-term issuer rating of BBB by Fitch Inc, Baa by Moody’s or BBB by Standard and Poor’s (including such sub-categories or gradations therein); and
- b) except for schemes with a fixed maturity, not more than 20% of the deposited property of the scheme may be invested in any single issue of securities by the same issuer.

2.5 The single issuer limit in paragraphs 2.1 and 2.2 does not apply where:

- a) the issuer is, or the issue has the benefit of a guarantee from, either a government, government agency, or supranational that has a minimum long-term issuer rating

³ The following definition of “a subsidiary” will be inserted in the main body of the Code under section 2 “Interpretation”:

A company is a subsidiary of another company if that other company holds more than half of the issued share capital of the first-mentioned company.

- of AA by Fitch Inc, Aa by Moody's or AA by Standard and Poor's (including such sub-categories or gradations therein); and
- b) except for schemes with a fixed maturity, not more than 20% of the deposited property of the scheme may be invested in any single issue of securities by the same issuer.
- 2.6 Exceptions to the single issuer and group limits are also allowed for **structured products** subject to the criteria set out in Annex 1A.
- 2.7 For the avoidance of doubt, the single issuer and group limits do not apply to placement of short-term deposits arising from:
- a) subscription monies received at the scheme's inception pending the commencement of investment by the scheme;
 - b) liquidation of investments pending reinvestment; or
 - c) liquidation of investments prior to the termination or maturity of a scheme, where the placing of these monies with various institutions would not be in the interests of participants.
- 2.8 A scheme may not hold more than 10% of any single issue of securities by the same issuer.

4 Financial Derivatives

- 4.1 Adequate risk management procedures and controls should be in place if the scheme invests in financial derivatives for purposes other than hedging existing positions in a portfolio.
- 4.2 The manager should set out in the prospectus the risk management procedures and controls of the scheme as well as state that these procedures and controls will be in place so long as the scheme invests in financial derivatives as part of their general investment policy.
- 4.3 Exposure arising from investments in financial derivatives should not exceed 100% of the deposited property of the scheme.
- 4.4 In calculating exposures arising from investments in financial derivatives, the true and accurate risk of the investments should be reflected. An example of calculating such exposure is by converting the derivative positions into the underlying assets embedded in those derivatives. The method used for determining the scheme's exposure should be disclosed in the prospectus and be subject to an assessment by the manager's in-house risk management experts or an independent expert.

Annex 1a: Non-Specialised Funds

Exceptions to Rules in Appendix 1 for Structured Products

This Annex sets out guidelines on when:

- the 10% limit on investments in unlisted securities under paragraph 1 of Appendix 1 may be increased to one-third of the deposited property of the scheme; and
- the single issuer and group limits under paragraph 2 of Appendix 1 may be increased to one-third of the deposited property of the scheme or entirely lifted for structured products.

1 Definition

Structured products are tailor-made for a scheme such that the issuer(s) of the securities and/or instruments, or an entity other than the issuer(s) (referred to in this Annex as the “Third Party”), stands ready to unwind the product(s) at prevailing market prices so as to enable the scheme to meet redemptions on each dealing day.

2 Issuer and Counter-party Requirements

2.1 The unlisted securities limit may be increased to one-third of the deposited property of the scheme only for investing in unlisted derivatives that form part of a structured product and only if the counterparty and, where applicable, the Third Party in the transaction meet the minimum ratings set out in paragraph 2.2.

2.2 For the single issuer and group limits to be increased to one-third of the deposited property of the scheme:

- a) in the case where the issuer of the security is a corporation, government, government agency or supranational, it should have a minimum long-term issuer rating of A by Fitch Inc, A by Moody’s or A by Standard and Poor’s (including such sub-categories or gradations therein).
- b) in the case where a deposit is placed with a financial institution (“FI”), the FI should have a minimum individual rating of B by Fitch Inc or a financial strength rating of B by Moody's (including such sub-categories or gradations therein).

2.3 For the single issuer and group limits to be entirely waived, the issuer should be, or the issue should have the benefit of a guarantee from, either a government, government agency, or supranational that has a minimum long-term issuer rating of AA by Fitch Inc, Aa by Moody’s or AA by Standard and Poor’s (including such sub-categories or gradations therein).

2.4 An entity that stands ready to unwind more than 10% of the deposited property of the scheme should have the ratings specified in paragraph 2.2.

2.5 Where the entity that stands ready to unwind the product is also the issuer of a bond, equity or derivative component that forms part of the structured product, the prospectus of the scheme should state this fact.

3 Revision in Ratings of Issuer or Counter-party

3.1 Where the rating of the issuer referred to in paragraph 2.2(a) or of the Third Party:

- a) falls to BBB by Fitch Inc, Baa by Moody's or BBB by Standard and Poor's (including such sub-categories or gradations therein), no action need be taken; or
- b) falls below those specified in (a) above or if the issuer or Third Party ceases to be rated, the manager should within 3 months from the occurrence of such event take action to comply with the single issuer and group limits. The 3-month period may be extended if the manager satisfies the trustee that it is in the best interests of the participants. Such extension should be subject to monthly review by the trustee.

3.2 Where the rating of the FI referred to in paragraph 2.2(b) or of the Third Party:

- a) falls to an individual rating of C by Fitch Inc or a financial strength rating of C by Moody's (including such sub-categories or gradations therein), no action need be taken; or
- b) falls below those specified in (a) above or if the issuer or Third Party ceases to be rated, the manager should within 3 months from the occurrence of such event take action to comply with the single issuer and group limits. The 3-month period may be extended if the manager satisfies the trustee that it is in the best interest of the participants. Such extension should be subject to monthly review by the trustee.

3.3 Where the rating of the issuer referred to in paragraph 2.3:

- a) falls to A by Fitch Inc, A by Moody's or A by Standard and Poor's (including such sub-categories or gradations therein), no action need be taken; or
- b) falls below those specified in (a) above or if the issuer ceases to be rated, the manager should within 3 months from the occurrence of such event take action to comply with the single issuer and group limits. The period may be extended if the manager satisfies the trustee that it is in the best interest of the participants. Such extension should be subject to monthly review by the trustee.



Monetary Authority of Singapore