Venturing into the Variable Capital Company: How it works and what to expect

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I. INTRODUCTION

Singapore has long been known as a thriving financial hub, serving as the Asia-Pacific base for many global banks due to its robust infrastructure ecosystem, stable political climate and stable investment friendly regime. In 2019, Singapore's global assets under management amounted to US$89 trillion, increasing by 15% from the year before, showing the prominence of the fund management industry in Singapore.[1] Hence, the launch of the Variable Capital Companies Framework in January 2020 by the Monetary Authority of Singapore and the Accounting Corporate Regulatory Authority had been much anticipated due to the benefits it will bring to the industry.

With that being said, what exactly is a Variable Capital Company ("VCC")? A VCC is a corporate entity tailored for use in investment funds.[2] However, unlike a company which is generally utilised to carry on business, the VCCs can only be used in collective investment schemes.[3] As of March 2021, over 230 VCCs have been established in Singapore. The eager adoption of VCCs despite the current tumultuous COVID-19 economy makes it clear that VCCs are something investors and fund managers in Singapore should be aware of.

II. DISCUSSION

To understand more about VCCs and why their inception is significant, we will first look into what a VCC offers, its benefits and some matters to consider before embarking on a VCC venture.

A. The key features of a VCC and their significance

The VCC has several features that make it a flexible tool. Unlike investment funds that are usually structured as companies, limited partnerships, or trusts, VCCs can be used as an umbrella entity and enjoy flexibility in the redemption of investments and payment of

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[1] BCG Global Asset Management 2020, "Protect, Adapt, and Innovate" (May 2020). https://www.bcg.com/publications/2020/global-asset-management-protect-adapt-innovate

[2] Accounting and Corporate Regulatory Authority Singapore website <https://www.acra.gov.sg/how-to-guides/setting-up-a-vcc/introduction>. (Accessed 14 September 2021)

[3] Section 15 of the Variable Capital Companies Act 2018 (No. 44 of 2018).

dividends. Furthermore, the adoption of the VCC framework could also bring about economies of scale, leading to time and cost-savings.

i. VCCs as an umbrella entity

Firstly, one of the key tenets of the VCC framework is its ability to exist as an umbrella entity. VCCs can be used as either a stand-alone entity or as an umbrella entity. A stand-alone fund is the simplest configuration structurally, as it is a single entity with only one investment strategy.[4] In contrast, an umbrella fund is also a single entity, but allows for multiple sub-funds under it such that each sub-fund is able to provide varying investment strategies or rights to its investors.[5]

With the assets and liabilities under an umbrella VCC legally segregated between each sub-fund,[6] investors would have greater freedom in the investment and allocation of their monies. Different investors have different risk profiles, which determines the type of securities and investments they are willing and able to make. Hence, it is only natural that investors choose to opt out or be excused from specific kinds of investments. This difference in preference could pose difficulties in stand-alone funds which are more rigid in nature and does not allow for the existence of separate pools of assets and liabilities.[7] In comparison, an umbrella VCC allows investors to be excluded from the assets and liabilities they prefer. Fund managers would thus be able to organise investments according to investors' objectives, allowing allocation of investment monies across different classes of assets in a way that accommodates investors' preferences.

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[4] Henri Arslanian,"Fund Structuring." *Entrepreneurship in Finance*, Springer International Publishing, 2016, pp. 85–110, at p 95.

[5] Financial Conduct Authority, "Fund structuring options", <https://www.fca.org.uk/publication/documents/fund-structuring-options.pdf>. (Accessed 18 September 2021)

[6] Accounting and Corporate Regulatory Authority Singapore website <https://www.acra.gov.sg/how-to-guides/setting-up-a-vcc/introduction>. (Accessed 14 September 2021)

[7] Jerry Koh and Jonathan Lee, "Singapore Variable Capital Companies: The Many Uses and Benefits." The Journal of Investment Compliance, vol. 22, no. 3, Emerald Publishing Limited, 1AD, pp. 227–231, at p 230.

This also ensures greater protection for investors as assets and liabilities are "ring-fenced" such that if a sub-fund of a VCC is sued, the existence of the VCC's other sub-funds would not be affected.[8]

ii. Administrative flexibility

Another unique feature of the VCC is its flexible capital structure. Under the usual corporate vehicle of companies, limited partnerships, and trusts, the issuance and redemption of shares is a troublesome affair as shareholder approval is required, and solvency statements have to be made by its directors.[9] However, VCCs are absent of this requirement.

The structure of an umbrella VCC also brings about economies of scale, leading to time and cost-savings. The launch of new sub-funds within an existing umbrella VCC would require less time compared to setting up a new stand-alone fund, since sub-funds can share a board of directors and service providers such as the fund manager, custodian, auditor and administrative agent.[10] As such, thanks to the simplification of administrative processes and procurement, savings on time and expenditure can be enjoyed under the VCC framework.

B. Matters to take note of before embarking on a VCC venture

The benefits offered by VCCs make them an attractive vehicle for investment funds. However, there are some points to be aware of before establishing a VCC.

Firstly, the VCC must at all times be managed by a licensed fund management company, an individual exempted under section 99(1)(*a*), (*b*), (*c*), or (*d*) of the Securities and Futures Act ("SFA"), or a holder of a capital markets services licence for fund management under the SFA.[11] This would include any bank, finance or insurance company that is licensed under their respective regulatory bodies.[12]

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[8] Section 32(1) of the Variable Capital Companies Act 2018 (No. 44 of 2018).

[9] Section 7A of the Companies Act.

[10] *Variable Capital Companies Bill (2018) - Second Reading Speech* (1 October 2018),Indranee Rajah, Second Minister for Finance.

[11] Section 46 of the Variable Capital Companies Act 2018 (No. 44 of 2018).

[12] Section 99(1)(*a*), (*b*), (*c*), and (*d*) of the Securities and Futures Act (Chapter 289).

Secondly, under section 29 of the Variable Capital Company Act ("VCCA"), directors and officers of a VCC have the duty to ensure that there is no cross-contamination of liabilities between the sub-funds under the VCC.[13] This means that no assets of a particular sub-fund can be used to discharge any liability for another sub-fund under the VCC. However, the VCCA allows a VCC to allocate any assets and liabilities it holds on behalf of its sub-funds which are not attributable to any particular one as long as it is done in a manner that is fair to its shareholders.

Thirdly, while one of the major benefits of the VCC is the ring-fencing of its sub-funds, investors must be aware that there are risks involved where there are assets located in another jurisdiction outside of Singapore. In its response to feedback on the proposed framework for VCCs, the MAS has warned of the risks of cross-cell contagion.[14] This is the risk that courts in a foreign jurisdiction would not uphold or give effect to the segregation of assets and liabilities that is provided for under the VCCA.[15] Contracts entered under foreign law may be subjected to proceedings in the foreign court, and the foreign jurisdictions where such sub-fund structures are not recognised could require one sub-fund's liabilities to be discharged out of the assets of another. While the MAS requires that VCCs must first have reasonable measures to mitigate cross-cell contagion risks where investing in assets in such foreign jurisdictions,[16] there is still a risk for investors.

III. CONCLUSION

In conclusion, the introduction of VCCs into the Singapore financial landscape is exciting and holds a lot of potential for the enhancement of Singapore as an investment hub. With the many benefits that it brings, from greater freedom in choice of investment strategies to the more relaxed administrative restrictions, it is no wonder that investors and fund managers alike have shown keen interest in the adoption of VCCs.

[13] Section 29 of the Variable Capital Companies Act 2018 (No. 44 of 2018).

[14] Monetary Authority of Singapore, Response to Feedback Received on The Proposed Framework for Singapore Variable Capital Companies, (10 September 2018), at p 8.

[15] Liew Kai Zee and Clement Khoo, Financing a Variable Capital Company, Lexology, 31 January 2020.

[16] Monetary Authority of Singapore, Code on Collective Investment Schemes.

However, those interested must properly educate themselves of the features of VCCs before jumping onto the bandwagon. The benefits offered could be a double-edged sword, bringing about difficulties that are unique to the use of VCCs as an investment vehicle.

As such, before deciding on venturing into VCCs, investors must consider their options and investment objectives carefully. For investors looking into foreign assets and liabilities, it would be best for due diligence to first be done on the jurisdiction's recognised fund structures to avoid exposure to cross-cell contagion.