

MAS CONSULTS ON REGULATIONS FOR THE PROVISION OF DIGITAL ADVISORY SERVICES

03 August 2017 | Singapore
Legal Briefings

In line with its recognition of the rapid expansion of and new products within the fintech sphere, the Monetary Authority of Singapore (MAS) issued a consultation paper on 7 June 2017 on the provision of digital advisory services (ie advice on investment products using automated, algorithm-based tools, also known as “robo-advisory services”). The consultation closed on 7 July 2017.

The MAS in examining the current regulatory regime has noted that while the existing licensing and business conduct rules under the Securities and Futures Act (SFA) and the Financial Advisers Act (FAA) are able to accommodate the provision of digital advisory services, the legislation needs to be reviewed to ensure that the safeguards remain relevant. In particular, the MAS highlighted that providers of digital advisory services would need to put in place adequate safeguards in order to manage the new technology risks associated with the algorithms and the online tools that such providers rely upon. The MAS also considered that the exemptions regime under both the SFA and the FAA could be reviewed in order to facilitate the development of the provision of digital advisory services.

SAFEGUARDS

To that end, the MAS sets out in the consultation its expectations on the governance and management oversight required from digital advisers, including:

- putting in place a robust framework governing the design, monitoring and testing of

algorithms. This includes the performing of sufficient back-testing of the client facing tool prior to launch to ensure that the tool is reliable and satisfies the MAS' technology risk management requirements;

- staffing of persons with competencies and expertise (even if such functions are outsourced to third parties) to develop and review the methodology of the algorithm;
- putting in place processes, policies and controls which ensure that the algorithms continue to perform as intended, including regular compliance checks, a mechanism for the suspension of advice if an error or bias is detected and the ability of the digital adviser to manage changes to the algorithms; and
- highlighting conflict to clients in situations of actual or potential conflict of interest which may compromise the objectivity or independence of the digital adviser, such as any selectivity or limitations on the recommendations provided. In particular, the MAS seeks feedback on the extent to which the digital adviser should disclose its algorithm to clients, including circumstances under which its algorithm may be overridden or its service suspended, and any adjustments to the algorithm.

The observance and maintenance of these safeguards would rest with the board and senior management of the digital adviser who will be responsible for ensuring that there is a sound risk-management culture and environment.

EXEMPTIONS

In order to facilitate the development of digital advisory services, the MAS also proposes in the consultation certain exemptions and dispensations, including:

EXEMPTION FROM FULL INFORMATION COLLECTION

Allowing exemptions on a case-by-case basis for digital advisers who provide fully-automated client facing tools (i.e. those with no human adviser intervention in the advisory process) from the FAA requirement to collect the full suite of information on the financial circumstances of a client, provided that the risks of providing inadequate advice based on limited client information can be satisfactorily mitigated.

The MAS notes that digital advisers typically provide advice on traditional exchange traded funds (ETFs), which are low cost and diversified investment products. Given that clients have full discretion on the investment amount and are not subjected to any form of influence or active solicitation on their investment amount during the investment process, it may be less relevant to consider the individual financial circumstances of a client. However, in order to ensure that clients make informed choices, the MAS also expects digital advisers to have controls in place to identify inconsistent responses provided by the client, such as incorporating prompts (e.g. pop-up boxes) in the questionnaire to alert the client when his responses are inconsistent, or a backend data analysis process to automatically flag inconsistent information provided by the client for follow up by the digital adviser.

EXEMPTION FROM TRACK RECORD AND AUM REQUIREMENTS

Allowing digital advisers that operate as fund managers under the SFA to offer their services to retail investors even if they do not meet the five-year corporate track record requirement of managing funds for retail investors in a jurisdiction which has a regulatory framework comparable to Singapore and the S\$1 billion assets under management (AUM) requirement to qualify for such a licence. The conditions are that: (a) key individuals will need to have relevant collective experience in fund management and technology; (b) the recommended portfolios should comprise primarily (at least 80%) traditional ETFs, with a cap of 20% invested in listed shares, listed investment grade bonds and foreign exchange contracts for hedging purposes; and (c) the digital adviser must undergo a post-authorisation audit conducted by an independent third party at the end of its first year of operations on key risk areas, including prevention of money laundering and countering the financing of terrorism, handling of client moneys and assets, technology risk and suitability of advice.

EXEMPTION FROM CAPITAL MARKET SERVICES (CMS) LICENCE UNDER THE SFA

Allowing digital advisers that operate as financial advisers under the FAA to assist their clients to execute their investment transactions beyond unlisted collective investment schemes (CIS) to include listed CIS, provided that such dealing is incidental to their advisory services. This licensing exemption will also be made available to non-digital advisers.

The MAS is proposing to exempt licensed and exempt financial advisers (FAs) from holding the CMS licence on a case-by-case basis. With this change, FAs which assist clients by passing on trade orders of recommended portfolios in respect of listed and unlisted CIS to brokerage firms, will not be required to hold a CMS licence for trading in securities. Also, the MAS is proposing that where advice is provided on overseas-listed investment products, licensed and exempt FAs be required to furnish a risk warning statement to their clients.

DISPENSATION FROM OBTAINING CLIENT APPROVAL FOR EVERY REBALANCING TRANSACTION

Allowing digital advisers that are engaged solely in portfolio rebalancing activities for portfolios that comprise solely of listed and unlisted CIS to be exempted from the CMS licence requirement since the rebalancing activities are conducted solely for aligning the portfolio to its original recommended allocation with no change to the constituents making up the portfolio itself. Currently, digital advisers who conduct portfolio balancing activities are required to hold a CMS licence in fund management unless exempted. The proposed safeguards are (a) for the client to provide a one-time prior acknowledgement in writing of the fees and terms of their discretionary portfolio rebalancing services which would include the methodology, scope and frequency of the rebalancing activities; and (b) prior notice to the client before each rebalancing transaction with the option for the client to object.

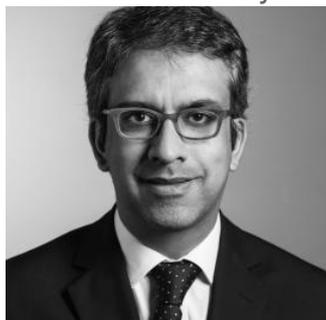
[FOR MORE FINTECH UPDATES, SUBSCRIBE TO OUR FINTECH NOTES BLOG >](#)

ABOUT THE AUTHORS

Co authored by [Sandra Tsao](#), Of Counsel, Prolegis, Singapore. Herbert Smith Freehills contributors below.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



**SIDDHARTHA
SIVARAMAKRISHNA
N**
PARTNER,
SINGAPORE
+65 6868 8078
siddhartha.sivaramakrishnan@hsf.com



HANNAH CASSIDY
PARTNER, HEAD OF
FINANCIAL SERVICES
REGULATORY, ASIA,
HONG KONG
+852 21014133
Hannah.Cassidy@hsf.com



MARK ROBINSON
PARTNER,
SINGAPORE
+65 68689808
Mark.Robinson@hsf.com

LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

© Herbert Smith Freehills 2021

SUBSCRIBE TO STAY UP-TO-DATE WITH LATEST THINKING, BLOGS, EVENTS, AND MORE

Close

© HERBERT SMITH FREEHILLS LLP 2021