

Financial Institutions Group

## MAS Consults on Proposed New Requirements for Digital Payment Token Service Providers to Enhance Investor Protection and Market Integrity

### Introduction

The Monetary Authority of Singapore ("**MAS**") is seeking feedback on the following two consultation papers which will introduce legal requirements that aim to enhance investor protection and address market integrity risks in Digital Payment Token ("**DPT**") services:

1. [Consultation Paper on Proposed Amendments to the Payment Services Regulations](#) ("**Investor Protection Consultation**")
2. [Consultation Paper on Proposed Measures on Market Integrity in Digital Payment Token Services](#) ("**Market Integrity Consultation**")

The consultation period ends on **3 August 2023**.

This development follows from the earlier "Consultation Paper on Proposed Regulatory Measures for Digital Payment Token Services" issued by MAS in October 2022 ("**October 2022 Consultation**") to seek comments on regulatory measures which aim to reduce the risk of consumer harm in trading in DPTs. The October 2022 Consultation contains proposals to introduce consumer access measures for retail customers, business conduct measures and enhanced measures to manage technology and cyber risks for DPT service providers ("**DPTSPs**"). On 3 July 2023, MAS issued [its response](#) ("**MAS Response**") to feedback received on some of the proposed measures in the October 2022 Consultation and they relate to:

- segregation and custody of assets of customers of DPTSPs;
- prohibition against the lending and staking of retail customers' assets by DPTSPs; and
- prevention and detection of market abuse and unfair trading practices in the dealing of DPTs.

MAS will publish its response to feedback received regarding the remaining proposed regulatory measures in the October 2022 Consultation in due course.

The Investor Protection Consultation seeks comments on the legislative amendments to implement the requirements on segregation, custody and safeguard of assets and money of customers of

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DPTSPs. The Market Integrity Consultation focuses on the proposed regulatory measures a DPTSP should establish to ensure market integrity and measures to prevent market abuse in the DPT market.

This Update highlights the key proposals discussed in the two MAS consultation papers.

## Consultation Paper on Proposed Amendments to the Payment Services Regulations (Investor Protection Consultation)

The Investor Protection Consultation seeks feedback on new draft provisions in the Payment Services Regulations 2019 ("**PS Regs**") which aim to implement requirements that safeguard: (1) money received from customers; and (2) customers' assets (including DPTs).

These requirements will apply to DPTSPs who are licensed under the Payment Services Act 2019 ("**PS Act**") ("**Licensed DPTSPs**") and DPTSPs who are exempt under section 13(1)(a), (b), (c) or (d) of the PS Act, with the necessary modifications for the latter ("**Exempt DPTSPs**"). MAS also intends to require DPTSPs relying on the transitional exemptions pursuant to the Payment Services (Exemption for Specified Period) Regulations 2019 to comply with these requirements, and will engage them on a supervisory basis to do so.

MAS targets to implement these requirements by October 2023. MAS stated that although the PS Regs are still undergoing the amendment process, as MAS has already finalised and published its policy positions on the segregation and custody requirements, DPTSPs should prepare to comply with these policy positions by October 2023. MAS will also publish Guidelines setting out its further expectations on the segregation and custody requirements, on or around the date of publication of the finalised amendments to the PS Regs.

### (1) Safeguarding Money Received from Customers

The safeguarding obligations will require Licensed DPTSPs (including both major payment institution licensees and standard payment institution licensees for DPT services) as well as Exempt DPTSPs to safeguard money received from their customers in one of the following manners:

- By an undertaking from a "safeguarding institution" to be fully liable to the customer for the money;
- By a guarantee given by a "safeguarding institution" for the amount of the money; or
- By depositing the money in a trust account maintained with a "safeguarding institution".

The "safeguarding institution" must be a bank, merchant bank, finance company or financial guarantee insurer regulated in Singapore. As proposed in the Investor Protection Consultation, a DPTSP must observe, among other things, the following requirements relating to these safeguarding methods:

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- Assess and satisfy itself of the suitability of the "safeguarding institution"; or
- Disclose in writing to the customer the manner in which his/her money is safeguarded in accordance with the requirements in the PS Regs, etc.

### (2) Safeguarding Customers' Assets

#### Segregation and custody requirements

The key aspects of the requirements on segregation, custody and safeguarding DPTSPs' customers' assets are set out below.

- **Depositing customers' assets in custody account:** A customer's assets (including DPTs) must be deposited in a custody account held on trust for the customer. The customer's assets must be applied solely for the purposes agreed to by the customer and cannot be used to pay the DPTSP's debts and must not be subject to any enforcement order or enforcement process by a court. The custody account may be maintained by the DPTSP or by a "safeguarding institution".
- **Segregating customers' assets from other assets:** Assets (including DPTs) of DPTSPs' customers must be segregated from any other assets (including DPTSPs' own assets). However, the assets belonging to one customer may be commingled with the assets of other customers.
- **No transferring of customers' assets without written consent:** Any right, interest, benefit or title in a customer's assets must not be transferred by the DPTSP, except where the transfer is in accordance with the customer's written instructions obtained prior to each transfer or is authorised by law.
- **Disclosing to customers the arrangements for and risks involved in having their assets held by DPTSPs:** A DPTSP must disclose in writing to a customer:
  - that his/her assets will be held on behalf of the customer in a custody account and the assets are segregated from the DPTSP's own assets;
  - whether or not his/her assets are commingled with the assets of other customers and, if so, the risks of such commingling;
  - what will happen to his/her assets if the DPTSP or "safeguarding institution" that is holding the customer's assets is insolvent, and the arrangements by the DPTSP to protect the customer's assets; and
  - the terms and conditions that would apply to the safeguarding of his/her assets.
- **Conducting daily reconciliation and maintaining proper record of customers' assets:** DPTSPs must conduct daily reconciliation of their customers' assets as well as record and maintain a separate book entry for each customer in relation to the customer's assets with the

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details as prescribed in the PS Regs. The MAS Response elaborates that the reconciliation is to be performed at the entity-level, instead of on a group-level or on a consolidated basis.

- **Mitigating potential conflicts of interest:** Where the customers' assets of a DPTSP are maintained by the DPTSP, it must ensure effective controls and segregation of duties to mitigate potential conflicts of interest that may arise from the safeguarding of assets belonging to its customers. This is to address conflicts of interest which may arise from the situation where DPTSPs conduct multiple activities, including operating a trading platform, providing broker-dealer services and trading for their own or related accounts. In this regard, MAS states in the MAS Response that DPTSPs are required to maintain a separate custody function that is operationally independent from other business units and adopt good risk management practices including the best practices stipulated under the [MAS Guidelines on Risk Management Practices – Internal Controls](#).
- **Maintaining adequate systems, processes, controls, human resources and governance arrangements:** A DPTSP must, in a manner that is commensurate with the nature, scale and complexity of its business, maintain adequate systems, processes, controls, human resources and governance arrangements to:
  - ensure the integrity and security of the transmission and storage of its customers' assets; and
  - reduce the risk of any loss of customers' assets due to fraud or negligence.

In this regard, the MAS Response highlights that the risk management controls that a DPTSP is expected to put in place to comply with this new requirement include, among other things:

- putting in place robust and effective measures to ensure that the movement of customers' assets is controlled by senior managers and personnel who reside in Singapore;
  - implementing operational controls to prevent the loss of cryptographic keys of DPTs that are held or managed by the DPTSP;
  - keeping at least 90% of a customer's DPTs in cold wallets, and up to 10% which may be kept in other wallets (e.g. hot wallets where the customers' assets are stored in storage media that are connected to the Internet), to mitigate the risk of loss of customers' assets due to security breaches or external theft;
  - disclosing to customers their policies on storage arrangements for the customers' assets, measures put in place to mitigate the risk of loss of the assets, and processes for handling any losses of the assets (e.g. compensation arrangements or insurance); and
  - adopting good risk management practices, including best practices stipulated under the [MAS Guidelines on Risk Management Practices – Technology Risk](#).
- **Conducting audit of compliance with segregation and custody requirements:** DPTSPs must be audited annually in respect of their observance of these new segregation and custody requirements, in addition to the other requirements under the PS Act.

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#### Measures relating to lending and staking of customers' assets by DPTSPs

DPTSPs will be restricted from facilitating staking arrangements for retail customers, in addition to lending of retail customers' assets. There will not be any restrictions against DPTSPs enabling or facilitating the entry to staking or lending arrangements for non-retail customers, subject to the DPTSPs providing a clear risk disclosure document and obtaining the explicit consent from a customer before lending or staking the customers' assets.

### Consultation Paper on Proposed Measures on Market Integrity in Digital Payment Token Services (Market Integrity Consultation)

This consultation paper sets out: (1) the proposed regulatory measures to address market integrity risks in DPT services; and (2) proposed statutory prohibitions against market abuse and unfair trading practices in the dealing of DPTs.

#### (1) Proposed Regulatory Measures to Address Market Integrity Risks

MAS proposes that, as a first step, the measures set out in the Market Integrity Consultation will be stipulated in MAS Guidelines. Thereafter, MAS will conduct a separate consultation exercise to seek feedback on details of the regulatory requirements and subsidiary legislation in due course with an aim to implementing these measures in a timely and practicable manner.

To address market integrity risks, MAS expects:

- DPTSPs to maintain adequate systems, processes, controls, human resources and governance arrangements, in a manner that is commensurate with the nature, scale and complexity of their business, to:
  - handle and execute customers' orders in a fair, orderly and timely manner; and
  - prevent and detect unfair trading practices.
- DPTSPs who operate a trading platform ("DPT Platform Operators") to ensure that their platforms are operated in a fair, orderly and transparent manner.

#### (2) Measures to ensure customers' orders are handled and executed in fair, orderly and timely manner

A DPTSP should maintain policies, procedures or processes that, among other things:

- Set out the factors which the DPTSP considers (e.g. price, costs, speed, likelihood of execution and settlement, size and nature of the order) when handling and executing a customer's order,

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and the considerations for determining the relative importance of these factors (e.g. type of customer, characteristics of the customer's order, etc.);

- Prohibit the DPTSP from receiving any commission or other form of payment from other persons for routing customers' orders to it;
- Require the DPTSP to handle and execute comparable orders received from different customers in accordance with the time of receipt of the orders; and
- Dictate the principles and process for cancelling or correcting error trades and controls to mitigate the occurrence and severity of operational errors.

These policies and procedures should be disclosed to a customer in a clear and precise manner.

### (3) Measures to prevent and detect unfair practices

It is proposed that DPTSPs should adopt the following key measures to prevent and detect unfair trading practices which may affect the orderliness and integrity of the market:

- Conduct surveillance, by monitoring orders and transactions for signs of unusual or suspicious activity, on a real-time basis;
- Establish fair and objective procedures to investigate and take appropriate action against any potentially unfair trading practices;
- Maintain proper records with adequate details of all on-chain and off-chain orders (including cancellation of orders) and transactions for a period of five years;
- Maintain a controlled list of persons with access to the material non-public information on a need-to-know basis ("**privy persons list**") and set up information barriers to restrict access of such information to the persons in the privy persons list; and
- Maintain policies and procedures in relation to personal trading activities by their officers and employees.

### (4) Measures to ensure DPT platforms are operated in fair, orderly and transparent manner

A DPT Platform Operator should have clear rules to ensure that:

- **Fair:** All customers of the trading platform have non-discriminatory access to the trading facility and related information, and are assured that their counterparties would not have an unfair advantage over them;

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- **Orderly:** Its trading platform functions smoothly on a continuous basis, its trading processes guard against excessive price movements and the trades on the platform are reliably concluded; and
- **Transparent:** Material information (including pre-trade and post-trade information and alerts on unusual trading activity) is disseminated to its customers in a timely, transparent and comprehensible manner.

#### (5) Proposed Statutory Prohibitions Against Market Abuse and Unfair Trading Practices

MAS proposes to amend the PS Act and other Acts administered by MAS to apply the market misconduct provisions in the Securities and Futures Act ("**SFA**") that prohibit the following unfair trading practices in dealings in DPTs, with necessary modifications:

- False trading and market rigging (i.e. creating a false or misleading appearance of active trading in any DPTs or with respect to any DPT market);
- Market manipulation (i.e. carrying out transactions in DPTs that will, or will likely, have the effect of changing or stabilising the price of DPTs);
- Making false or misleading statement or disseminating false or misleading information to induce someone to invest in any DPTs or to change or stabilise the price of any DPTs;
- Fraudulently inducing someone to deal in DPTs;
- Employment of manipulative and deceptive devices, schemes, practices, etc. in connection with any sale or purchase of DPTs;
- Bucketing (i.e. executing or holding out to execute an order to purchase or sell any DPTs without having good faith in effecting the purchase or sale in accordance with the order);
- Cornering;
- Disseminating information about illegal transactions; and
- Insider trading.

A breach of these market misconduct provisions in the SFA amounts to a criminal offence that is punishable with fine and/or imprisonment. In addition, MAS may bring an action in a court against the offender to claim for a civil penalty, or a person who has been aggrieved by the misconduct committed by the offender may bring a civil action in a court against the offender for compensation. The SFA provides for a concept of "attributed liability" where a corporation is made liable for the criminal offence, civil penalty under the SFA and civil liability for compensation by an aggrieved person under the SFA, in respect of an offence committed by its employee or officer, if the offence is committed with its consent or connivance and for the benefit of the corporation.

MAS proposes to extend the similar enforcement regime and the attributed liability concept to the market misconduct provisions in relation to DPTs.

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## **Concluding Remarks**

MAS sends a strong signal through the proposals in these recent consultation papers on regulatory measures to reduce the risk of consumer harm in trading in DPTs that cryptocurrency speculation has hazards. Despite acknowledging that cryptocurrencies serve no useful function outside a blockchain network except as a vehicle for speculation, MAS has decided not to prohibit the offering of cryptocurrency services to retail investors entirely due to the cross-border nature of cryptocurrency trading and services. Prohibiting such offers in Singapore would not prevent Singapore retail investors from participating in overseas offers that can be extended to them online. MAS' strategy in this regard is to anchor high quality players with strong risk management and value propositions, mitigate the risks of consumer harm, and educate consumers on the risks of cryptocurrencies and their related services.

Should you have any queries on the above developments and would like to provide feedback on the above two MAS consultation papers, please feel free to contact our team members below who will be happy to assist.



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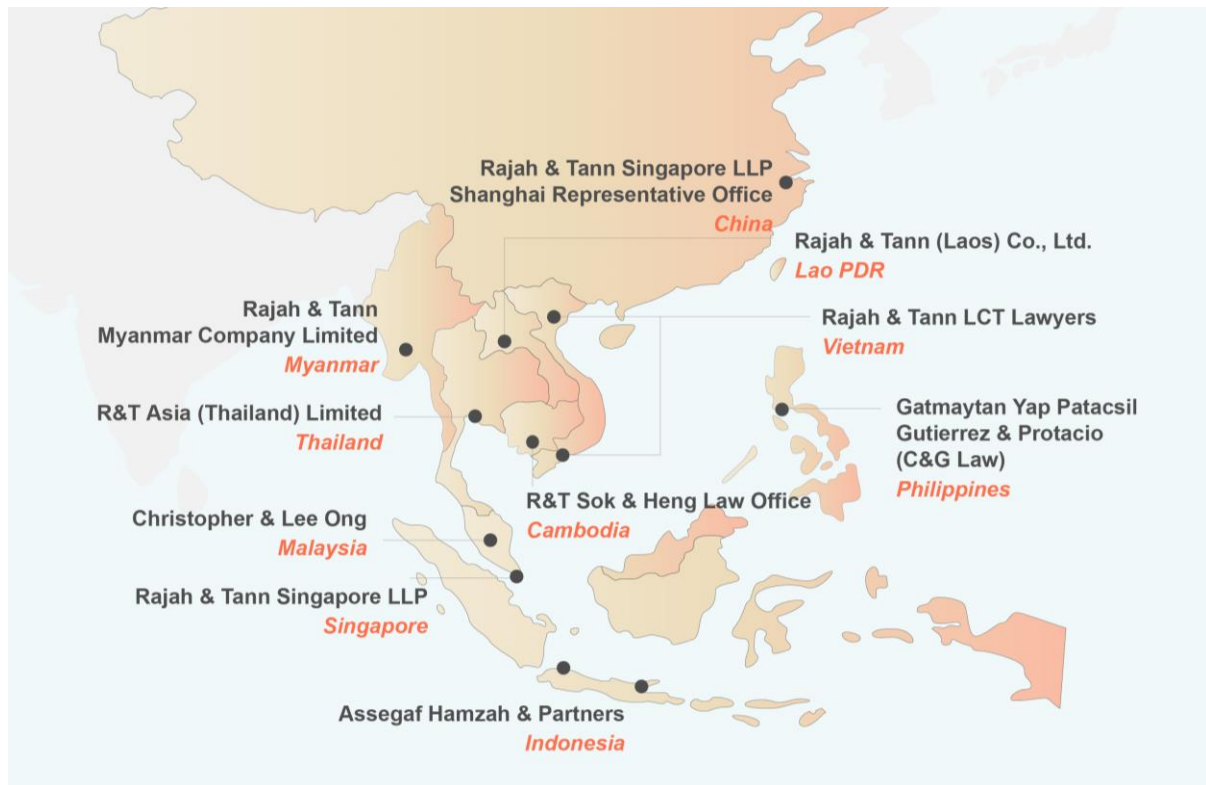
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