

MAS' CONSULTATION PAPERS ON PROPOSED CRYPTO REGULATIONS

Posted on March 24, 2023

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Date Published: 10 March 2023

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On 26 October 2022, the Monetary Authority of Singapore (“**MAS**”) issued two consultation papers containing proposed regulatory measures relating to:

- a) digital payment token service providers (“**DPTSPs**”); and
- b) certain types of stablecoin issuers.

Amidst a particularly disastrous period for crypto markets, with 2022 marking the collapse of terraUSD and Luna (causing the liquidation in June 2022 of Singapore-based cryptocurrency hedge fund Three Arrows Capital), and more recently, the FTX fallout (including Genesis Global Holdco LLC and two of its lending subsidiaries, Genesis Asia Pacific Pte. Ltd. and Genesis Global Capital LLC filing for bankruptcy late last month), the MAS launched these public consultations on proposed regulatory measures as part of its efforts to develop an innovative yet responsible digital asset ecosystem in Singapore, and address the consumer risks associated with such cryptocurrency activities.

Consultation on Regulatory Measures for Digital Payment Token Services

Generally speaking, cryptocurrencies in Singapore are regarded and therefore regulated as digital payment tokens (“**DPTs**”) under the Payment Services Act 2019 (“**PSA**”). The MAS’ Consultation Paper on Regulatory Measures for Digital Payment Token Services sets out proposed additional regulatory measures for DPTSPs, which are MAS licensees that carry on a business of providing DPT services such as buying and selling DPTs, and operating a crypto exchange.

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These measures may be broken down into the following areas:

1. Consumer Access Measures

- **Scope of consumer access measures:** The MAS proposes that DPTSPs will need to apply new consumer access measures to 'retail customers', namely, Singapore residents who are not accredited investors or institutional investors. The proposed consumer access measures are as set out below.
- **Risk awareness assessment:** DPTSPs should assess that a retail customer has sufficient knowledge of the risks of DPT services before providing DPT services to that customer.
- **Restrictions on incentives:** DPTSPs should not offer incentives to retail customers or any person (e.g. existing customers or celebrities) to refer a DPT service to retail customers.
- **Restrictions on debt-financed and leveraged DPT transactions:** DPTSPs will be prohibited from providing any credit facilities, entering into leveraged DPT transactions, and accepting credit card payments in connection with the provision of DPT services to retail customers.

2. Business Conduct Measures

- **Segregation of customers' assets:** The MAS proposes that customers' assets should be segregated from the DPTSPs' own assets, and held for the benefit of the customers, for example, in a trust account or arrangement.
- **Identification and mitigation of conflicts of interest:** Where DPTSPs engage in multiple activities, and conflicts of interest arise (e.g. where a DPTSP has a financial interest in a DPT which is listed on an exchange it operates), DPTSPs should adopt appropriate measures to address these conflicts of interest, and disclose to their customers the general nature of such conflicts and the steps that have been taken to mitigate such conflicts of interest. DPTSPs should disclose the manner in which they handle and execute customer orders (e.g. whether they trade as counterparty against the customer or facilitate trade matching between customers), and the capacity in which they are doing so (e.g. as agent or principal).
- **Disclosure of DPT listing and governance policies:** DPT trading platform operators should disclose the decision-making process, evaluation criteria and fees applied to list a DPT; trading, suspension and removal conditions for listed DPTs; processes by which DPTs are removed from trading and customers' rights; requirements to tackle unfair or disorderly trading practices on the DPT trading platform; and settlement procedures of DPT transactions.
- **Complaints handling:** DPTSPs should have in place adequate policies and procedures to handle customer complaints.

3. Managing Technology and Cyber Risks

- It has also been proposed that the requirements under the MAS' Notice of Technology Risk Management be extended to DPTSPs, which include implementing specific recovery time objectives for critical systems, incident reporting procedures for system malfunctions or IT security incidents,

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and IT controls to protect customer information from unauthorised access.

4. Market Integrity

- The MAS recognises that DPT markets have been susceptible to unfair trading practices including market manipulation, misleading conduct and insider trading, and encourages DPT trading platform operators to adopt good industry practices such as putting in place systems and procedures that promote more transparent trading of DPTs, as well as monitoring trading activities on DPT trading platforms.

Consultation on Regulatory Approach for Stablecoin-Related Activities

The MAS' second consultation paper sets out a proposed approach to regulating stablecoins, which, for the purposes of the consultation paper, refer primarily to single-currency-pegged stablecoins ("**SCS**"). Generally speaking, the four main types of stablecoins are fiat-backed stablecoins, commodity-backed stablecoins, crypto-backed stablecoins; and algorithmic stablecoins. Examples of stablecoins include Tether (or "USDT"), US Coin (or "USDC"), Binance USD (or "BUSD") and Paxos Standard Token (or "PAX"). The MAS consultation paper focuses the regulation of fiat-backed single-currency stablecoins.

Particularly, the MAS sees the potential for stablecoins to perform the role of a credible digital medium of exchange in the digital asset ecosystem, provided they are well-regulated and value stability is assured. In this regard, the MAS proposes the following:

1. New Regulated Activity – 'Stablecoin Issuance Service'

- The MAS intends to introduce a new regulated activity of 'Stablecoin Issuance Service' under the PSA, that will apply to Singapore entities that perform the function of controlling the total supply of, and minting and burning of, SCS. As a start, only SCS pegged to the Singapore dollar (S\$) or one of the Group of Ten (G10) currencies will be considered SCS.

2. Proposed Regulatory Framework

- **Regulatory treatment of non-bank vs bank-issued SCS:** SCS may be issued by both banks and non-banking entities. Bank issuers will continue to be exempt from being required to obtain a licence under the PSA, and will not require additional reserve backing if SCS are issued as tokenised bank liabilities. On the other hand, non-bank SCS issuers will be required to obtain a major payment institution licence where the SCS in circulation exceeds S\$5 million in value. If this threshold is not met, the non-bank SCS issuers will not be subject to the new proposed regulatory regime and will need to obtain a standard payment institution licence should they only provide regulated DPT services.
- **Labelling:** The MAS proposes to introduce a common label for MAS-regulated SCS to differentiate them from other stablecoins offered. The potential labels for such SCS include "regulated stablecoin", "qualifying stablecoin" or "securely-backed stablecoin".

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- **Requirements imposed on regulated SCS issuers:**

- **AML/CFT:** Regulated SCS issuers will need to comply with existing anti-money laundering and counter-terrorism financing requirements applicable to DPTSPs and banks.
- **Technology and cyber risk management:** Regulated SCS issuers will need to comply with existing technology and cyber risk management standards applicable to DPTSPs and banks.
- **Reserve assets:** Regulated SCS issuers must hold reserve assets to back the SCS issued, and these assets will be subject to requirements on segregation and custody, independent attestation, yearly audit and disclosure.
- **Timely redemption at par:** Regulated SCS issuers must specify and disclose that SCS holders would have a direct legal right to redeem the SCS for the pegged currency at par value, and that redemption requests can be made at any time.
- **Disclosure requirements:** Regulated SCS issuers must publish a white paper on its website to disclose information such as the description of the SCS, rights and obligations of the SCS issuer and SCS holders, and risks of the SCS.
- **Prudential standards:** Regulated SCS issuers must maintain a base capital of above S\$1 million or 50% of annual operating expenses, must hold liquid assets valued at higher of 50% of annual operating expenses, and must not undertake other activities that introduce additional risks (e.g. investing in and extending loans to other companies, lending or staking of SCS and other DPTs, and trading of DPTs).

3. SCS Issued in Multiple Jurisdictions

- The MAS will recognise a SCS issued in multiple jurisdictions as a MAS-regulated SCS only if there is sufficient assurance that the SCS as a whole is subject to sufficient regulatory oversight in the said jurisdictions.

4. Requirements on SCS Intermediaries

- Entities offering SCS-related services will be regulated if the service also falls within the scope of regulated DPT services under the PSA.
- **Disclosure requirements:** DPTSPs that offer SCS that are not MAS-regulated SCS will still be subject to the risk disclosure requirements under MAS Notice PSN08 on Disclosures and Communications.
- **Timely transfer of SCS:** DPTSPs which offer the service of arranging for the transmission of MAS-regulated SCS will be required to complete the transfer of the SCS from one party to another in no more than three business days from the day the transfer request is received.
- **Segregation of SCS:** Entities providing services of transmission or custody of MAS-regulated SCS will be required to hold and segregate customers' MAS-regulated SCS from other customers' assets (e.g. DPTs) as well as its own assets in different custody accounts.

5. Systemic Stablecoin Arrangements

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- Where an arrangement for the transfer of SCS is regarded by the MAS as 'systemic', that is, an arrangement that forms a mechanism for validating transactions, the MAS proposes to regulate these as 'payment systems' under the PSA.

Next steps

Following the consultation stage for both papers (which closed on 21 December 2022), the MAS will publish accompanying guidelines as well as further details on regulatory requirements and subsidiary legislation. It is also expected that there will be a transitional period for various stakeholders to acclimatise to the new requirements. We await the arrival of such guidelines and further details and shall provide an update when these have been issued.

Takeaways and Regional Developments

The MAS' consultation papers also come amidst calls from governments around the world for stronger regulatory supervision in the nascent crypto industry. Yet, it is noteworthy that while regulatory authorities have begun proposing more comprehensive crypto regulatory regimes, they have proceeded on the basis that regulation should serve to instil credibility in crypto markets, and unlock the potential benefits of financial innovation, as opposed to placing outright prohibitions on crypto assets, as some other countries have done.

For instance, to address stability risks of stablecoins, the Hong Kong Monetary Authority ("HKMA") in its Discussion Paper on Crypto-Assets and Stablecoins proposes to introduce the requirement for regulated stablecoins to be fully backed by high quality and high liquidity reserve assets. Similarly, the MAS proposed SCS issuers hold reserve assets equivalent to at least 100% par value of the outstanding SCS.

Yet, at the same time, bifurcation in policy directions among countries is evident. The UK and Singapore are looking to regulate algorithmic stablecoins according to the same requirements as unbacked crypto assets, which, in Singapore, is the regulatory regime applicable to DPTs. Conversely, Hong Kong proposes to leave algorithmic stablecoins outside the regulatory perimeter for the moment. In sum, it would appear that countries have different approaches on regulating crypto markets.

Importantly, these recent developments signal the fact that regulations – both Singapore and international – are slated to come on stream quickly and en masse.

Moving forward, we at CNPLaw LLP stand ready to provide efficient assistance on legal issues relating to blockchain projects, cryptocurrency-based commercial businesses and philanthropic enterprises and digital token offerings in Singapore. Should you have any queries, please do not hesitate to reach out to us and we would be glad to assist.

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