MAS’ Regulatory Approach Regarding Payment Tokens and Payment Token Derivatives

DENTONS RODYK

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Introduction

The Monetary Authority of Singapore (MAS) released a consultation paper on 20 November 2019 (Consultation Paper) in relation to the proposed regulatory approach for derivatives contracts that reference “payment tokens” as underlying assets (Payment Token Derivatives). On 15 May 2020, the MAS issued its response to feedback received on the proposed regulatory approach for Payment Token Derivatives (Response to Feedback), and the Security and Futures (Prescribed Underlying Thing) Regulations 2020 (PUT Regulations 2020) came into operation shortly after, on 18 May 2020.

This article will explore the MAS’ regulatory approach regarding “payment tokens” and Payment Token Derivatives.

MAS’ regulatory approach regarding “payment tokens” and Payment Token Derivatives

Payment Tokens

The Consultation Paper references three (3) main types of digital tokens - securities tokens, payment tokens and utility tokens – and highlights Bitcoin and Ether as common examples of payment tokens. With derivatives that reference securities tokens already regulated under the Securities and Futures Act (Chapter 289 of Singapore Statutes) (SFA), the focus of the Consultation Paper is on the proposed regulatory approach for “*derivatives that reference payment tokens as underlying assets*”.

As part of the Consultation Paper, the MAS included a definition for “payment token” in the proposed amendments to the Securities and Futures (Prescribed Underlying Thing) Regulations 2018, and such definition was later reflected in the PUT Regulations 2020.

Under the new payment services regime, any person carrying on a business of providing any service of dealing in “digital payment tokens” will need to be licensed by, and regulated under, the Payment Services Act 2019 (PSA). The PSA, which came into effect on 28 January 2020, provides a definition for “digital payment token”. From guidance provided by the MAS, it is understood that “digital payment tokens” will include, amongst other things, Bitcoin, which is also an example of a payment token.

The definitions for “digital payment token” under the PSA and “payment token” under the PUT Regulations 2020, are set out in the table below:

Definition of “digital payment token” under the PSA	Definition of “payment token” under the PUT Regulations 2020
The term “digital payment token” means any digital representation of value (other than an excluded digital representation of value) that — (a) is expressed as a unit; (b) is not denominated in any currency, and is not pegged by its issuer to any currency; (c) is, or is intended to be, a medium of exchange accepted by the public, or a section of the public, as payment for goods or services or for the discharge of a debt; (d) can be transferred, stored or traded electronically; and (e) satisfies such other characteristics as the Authority may prescribe.	The term “payment token” means any digital representation of value — (a) that is expressed as a unit; (b) the value of which is determined in any way, other than being permanently fixed by the issuer of the digital representation of value at the time when the digital representation of value is issued to either a single currency or 2 or more currencies; (c) that is, or is intended to be, a medium of exchange accepted by the public, or a section of the public, as payment for goods or services or for the discharge of a debt; and (d) that can be transferred, stored or traded electronically.

As highlighted in the above table, the definitions for digital payment token and payment token share a number of similarities. Some of the respondents to the Consultation Paper sought clarification on the difference between the definitions. The MAS clarified in the Response to Feedback that the definition of payment token is for the purposes of the SFA, and does not affect the definitions of payment tokens or similar terms found in any other Acts.

It was suggested by a respondent that the MAS include derivatives on utility tokens. With respect to utility tokens, the MAS has stated that it will “*look through to the underlying that these tokens represent*”, and will regulate the derivatives of such utility tokens under the SFA if the tokens are “*within the scope of an underlying thing that currently attracts regulation under the SFA*”.

In response to questions of whether “*derivatives on fiat-backed stablecoins*” or “ *stablecoin derivatives*” would be considered to be Payment Token Derivatives, the MAS clarified that a derivatives contract referencing a token which value is permanently fixed to one or more currencies is not considered a Payment Token Derivative (see definition for “payment token”), and thus not subject to the additional measures for retail investors. However, it is still a derivatives contract regulated under the SFA, as it is a derivatives contract based on currency.

Payment Tokens Derivatives

The MAS’ approach is to regulate Payment Token Derivatives offered by an Approved Exchange (AE). This position was proposed by the MAS in the Consultation Paper, as AEs are regulated as systemically important facilities, bringing together participants for multilateral trading across a broad suite of capital markets products. As such, AEs are subject to stricter regulatory requirements and supervisory oversight. The stricter requirements and oversight over AEs mean that there is greater certainty that their systems and processes will be able to cope with the new risks posed by Payment Token Derivatives.

At this point, the MAS will not regulate non-AE Payment Token Derivatives, as the MAS is of the view that regulating Payment Token Derivatives offered by non-AE entities (including digital payment token service providers under the

PSA) will confer misplaced confidence in such highly volatile products that could lead to a wider offering to retail investors. However, the MAS also noted in the Response to Feedback that retail participation in such products remains relatively low, and it will continue to monitor developments in this area.

Additional Measures for Retail Investors

The MAS states its view in the Response to Feedback that Payment Token Derivatives are not suitable for most retail investors, and reiterates that investors should act with caution and be aware of the risks of trading payment tokens and Payment Token Derivatives. As such, the MAS has introduced additional measures for retail investors who trade Payment Token Derivatives with Financial Institutions (FIs) regulated under the SFA (including AEs, capital markets services licence holders, banks, merchant banks, and finance companies conducting regulated activities under the SFA).

The MAS updated its "*Frequently Asked Questions on Licensing and Business Conduct (Other than for Fund Management Companies)*" on 27 February 2020, to clarify various operational aspects of the additional measures. For marginable Payment Token Derivatives, FIs have to collect minimum margin from retail investors that is at least 1.5 times the standard amount of margin required by AEs for a comparable contract, subject to a floor of 50% and a cap of 100% of the notional value of the Payment Token Derivative contract. In the event of an absence of a comparable contract on AEs, the FIs should collect a minimum margin of 50% from retail investors, and minimum margin of 20% from accredited, institutional or expert investors.

In line with the MAS' view that Payment Token Derivatives are not suitable for most retail investors, the MAS will continue to step up consumer education efforts (e.g. via MoneySENSE) to caution investors not only against the high risks of trading Payment Token Derivatives, but also against dealings with unregulated entities.

Concluding Remarks

With the advent of digital tokens, the MAS has noted growing industry interest in the payment tokens market. Trading in popular digital tokens has been largely on unregulated markets, which has given rise to allegations of fictitious trades and market manipulation. The introduction of regulated alternatives (such as Bitcoin futures listed and traded on US futures exchanges) could help instil market discipline. The MAS' current approach is to regulate Payment Token Derivatives offered by AEs, which reflects its intention to adopt a balanced view that seeks to allow innovation to co-exist in a regulatory environment with high standards.

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Your Key Contacts

Marian Ho
Senior Partner, Singapore
D +65 6885 3610
marian.ho@dentons.com