



 DREW & NAPIER

Upcoming Regulatory
Measures for Digital Payment
Token Service Providers
(Part 1)

12 July 2023

LEGAL
UPDATE

In this Update

On 3 July 2023, the Monetary Authority of Singapore published the first part of its response to feedback received from a previous consultation paper on proposed regulatory measures for digital payment token service providers, which outlines the authority's final position on some of these proposals and how they will be implemented through guidelines and amendments to the Payment Services Regulations 2019.

In this update, Directors Chua Tju Liang and Benjamin Gaw summarise the upcoming regulatory measures that may impact businesses which are either providing or intending to provide a digital payment token service regulated under the Payment Services Act 2019.



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KEYPOINT

The MAS will proceed to impose additional obligations relating to the safeguarding and custody of customer assets for DPT service providers licenced or exempted under the PS Act. These new requirements will be implemented through guidelines published by the MAS and legislative amendments to the PSR.

INTRODUCTION

The Monetary Authority of Singapore (“**MAS**”) previously published a consultation paper on 26 October 2022, which detailed proposals for regulatory measures applicable to licenced and exempt payment service providers that carry on a business of providing a digital payment token (“**DPT**”) service under the Payment Services Act 2019 (“**PS Act**”). Having received and considered the various feedback to this consultation paper, the MAS has published the first part of its response (accessible [here](#)), which outlines the MAS’s final position on these proposals and how they will be implemented through amendments to the Payment Services Regulations 2019 (“**PSR**”).

The new requirements which will be introduced by amendments to the PSR include:

- (a) segregating customers’ assets and safeguarding customers’ moneys;
- (b) providing all customers with monthly statements of account;
- (c) conducting a daily reconciliation of customers’ assets;
- (d) adopting risk management controls; and
- (e) a prohibition on facilitating the staking and lending of retail customers’ assets.

This article summarises these upcoming regulatory measures.

MEASURES RELATED TO SEGREGATION AND CUSTODY OF CUSTOMERS' ASSETS

(1) Segregation of customers' assets

The MAS will require a DPT service provider to ensure that its customers' assets are both (i) properly segregated from the service provider's own assets, and (ii) held on trust for the customers' benefit. This includes keeping customer assets on a separate set of blockchain addresses from those containing the service provider's own assets.

In highlighting the importance of effective asset segregation requirements to protect customer assets, the MAS has emphasised that DPT service providers must not mix their own assets with customer assets even if the customer's consent has been obtained.

The MAS has clarified that DPT service providers do not need to segregate each individual customer's assets. Instead, the assets of multiple customers may be kept together in a single common pool, as long as this pool is kept separate from the DPT service provider's own assets. However, the DPT service provider must clearly disclose to its customers the risks of such arrangements and the measures in place to mitigate such risks.

(2) Safeguarding customers' moneys

The PS Act currently requires certain non-DPT payment service providers to safeguard customer moneys by obtaining an undertaking or guarantee from a safeguarding institution in Singapore (as defined in the PS Act), or depositing the moneys in a trust account maintained with such safeguarding institution in Singapore. The MAS will extend these requirements on safeguarding of customers' moneys to DPT service providers so that the safeguarding institution in Singapore may facilitate the recovery of customers' moneys in the event of the DPT service provider's insolvency.

(3) Daily reconciliation of customers' assets

In line with current reconciliation requirements imposed on capital markets intermediaries, DPT service providers will be required to conduct a daily reconciliation of customers' assets (including moneys). This reconciliation must be performed at the entity-level, and not on a group-level or on a consolidated basis.

DPT service providers will also be required to keep transaction records, with separate books and records kept at all times for each customer containing details of the customer's assets. Examples of such details include the movement of assets to and from the

customer's custody account, and the names of the safeguarding institutions with whom the customer's assets are deposited or held.

(4) Statement of account

DPT service providers will also be required to provide monthly statements of account to all customers, which contain information on the customer's assets and transactions. The MAS has clarified that DPT service providers may alternatively provide customers with account information on a real-time basis instead of such monthly statements of account.

DPT service providers will be exempt from this requirement if (i) there have been no changes to any particulars since the date on which the last statement of account was made, or (ii) the customer has made a written request not to receive monthly statements of account from the DPT service provider.

(5) Risk management controls

The MAS will also be requiring DPT service providers to adopt a series of risk management controls to safeguard the private keys and storage of their customers' DPTs, in a manner reflecting the nature, scale and complexity of their business. Examples of such controls include:

- (a) ensuring that the movement of customers' assets is controlled by senior managers and personnel who reside in Singapore (such managers and personnel should be authorised to facilitate the return of customers' assets where required by MAS or the court);
- (b) implementation of operational controls to prevent the loss of cryptographic keys of DPTs that are held or managed by DPT service providers;
- (c) keeping at least 90% of customers' DPTs in cold wallets, with a maximum of 10% being kept in other types of wallets;
- (d) disclose to customers their policies on storage arrangements for customers' assets, including the measures DPT service provider has in place to mitigate the risk of loss and processes for handling any losses of customers' assets (whether by compensation or through insurance); and
- (e) adopting good risk management practices, including the best practices prescribed by the MAS Technology Risk Management Guidelines (link available [here](#)).

To ensure compliance with the segregation and custody requirements when they are introduced, the MAS will also expand the current scope

of the annual audits required to be conducted on DPT service providers licenced under the PS Act. Such annual audits will therefore not only assess the service provider's observance of their relevant obligations under the PS Act, but will also include an assessment on the service provider's compliance with these new requirements as well.

(6) Separate custody function

While the MAS has indicated that DPT service providers will not be required to use independent custodians for customer assets, DPT service providers will be required to maintain a separate custody function which is operationally independent from the service provider's other business units.

DPT service providers will also be required to adopt good risk management practices, which include the best practices prescribed by the MAS Guidelines on Risk Management Practices for Internal Controls (link available [here](#)), that reduce the risk of any loss of customers' assets due to internal fraud or negligence.

Additionally, the MAS has highlighted that regardless of the custody arrangement chosen by the DPT service provider, it still expects the service provider to continually review, identify, assess and adopt appropriate arrangements that may further strengthen the overall governance and controls for safeguarding customers' assets.

(7) Disclosures

DPT service providers will also be required to provide their customers with written disclosures which:

- (a) contain the service provider's terms and conditions (including arrangements for receiving instructions and providing information to the customers, applicable fees and costs);
- (b) specify that the customers' assets are segregated from the service provider's own assets and are held for the customers' benefit;
- (c) indicate if customers' assets will be commingled with other customers' assets, and if so, the risks of such commingling; and
- (d) detail what happens to the customers' assets should the service provider become insolvent, and the arrangements in place to protect these assets.

These disclosures will be required to be made to all customers in a clear, legible and concise manner.

While the MAS will not be prescribing a template or form for these disclosures, it has indicated that the disclosures should be specific to the DPT service provider's individual arrangements. Additionally, the MAS encourages the industry to consider developing standard formats if this would assist customers in better understanding the risks involved.

LENDING AND STAKING OF RETAIL CUSTOMERS' ASSETS

The MAS has indicated that it will take a more prudent approach and restrict DPT service providers from facilitating the lending and staking of the assets of retail customers, as it views risk disclosures as insufficient for mitigating any potential consumer harm that arises from these activities. Aforesaid, the MAS has clarified that retail customers will not be prohibited from handling their own assets, and may continue to lend and stake their crypto-assets themselves and transact with unregulated platforms or protocols directly. However, the MAS emphasises that such retail customers will be doing so at their own risk, and are responsible for doing their own due diligence and understanding the risks involved.

In contrast, DPT service providers may enable or facilitate the entry into staking or lending arrangements by non-retail customers. In this regard, the MAS will require DPT service providers to provide these customers with a clear risk disclosure document and obtain the customer's explicit consent before lending or staking such customer's assets.

It is notable that the reference to "retail customer" here is to the current classification of retail customers under the Securities and Futures Act 2001. MAS has sought feedback on whether and how the value of DPT holdings will be taken into account in assessing whether a customer meets the eligibility as an accredited investor (and thus not fall within the definition of a retail customer), and will be responding to feedback received on their proposals in the second part of the consultation responses (not yet published at the time of writing).

CONCLUSION

The MAS has indicated that it intends to effect the proposed amendments to the PSR by October 2023. Given that the MAS's policy positions in relation to segregation and custody requirements have been finalised, DPT service providers should begin to review these requirements in depth and ensure that they are in a position to

comply with them by October 2023, because no transitional buffer period will apply to temporarily exempt compliance with these amendments.

Of the measures described in this article, a significant change is the restriction of DPT service providers licenced or exempt under the PS Act from facilitating the lending and staking of assets of retail customers. This will not only prevent such DPT service providers from providing such services to their retail customers, but also prohibit them from offering such services on behalf of another service provider.

MAS is currently consulting on the amendments to the PSR and invites comments on the proposed changes by 3 Aug 2023 (link available [here](#)).

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