

MAS consults on regulatory approach for payment token derivatives

2 December 2019



The Monetary Authority of Singapore (the “**MAS**”) issued a consultation paper (the “**Consultation Paper**”) on 20 November 2019 on the proposed regulatory approach under the Securities and Futures Act, Chapter 289 of Singapore (the “**SFA**”) for derivatives contracts that reference payment tokens as underlying assets (“**Payment Token Derivatives**”). The consultation closes on 20 December 2019.

Notably, the Consultation Paper was followed shortly by ICE Futures Singapore Pte. Ltd. announcing its proposed launch of the Bakkt™ Bitcoin (USD) Cash Settled Monthly Futures contract on 9 December 2019.

In this client alert, we highlight the MAS’ key proposals to regulate Payment Token Derivatives that are traded on approved exchanges under the SFA¹ (“**Approved Exchanges**”) and the additional safeguards the MAS has proposed to implement for retail investors who trade in Payment Token Derivatives, noting the distinction in approach taken by the MAS in Singapore, the Securities and Futures Commission (the “**SFC**”) in Hong Kong and the Financial Conduct Authority (the “**FCA**”) in the UK.



Background

To date, the trading of popular digital tokens (mostly digital tokens that are intended as payment instruments such as Bitcoin and Ether) has largely taken place on unregulated markets, giving rise to allegations of fictitious trades, cornering and manipulation.

With the need for a regulated product for institutional investors (such as hedge funds and asset managers) to gain and hedge their exposure to payment tokens, one regulated alternative that has emerged is the trading of Payment Token Derivatives.

- > **Pros:** A well-regulated market for derivatives with institutional investors that possess sophisticated risk management and investment strategies can serve as a more reliable reference of value for the underlying payment tokens.
- > **Cons:** Regulated derivatives are not without risk – the inherent leverage in derivatives could magnify losses to investors, particularly where the underlying asset (such as payment tokens) has significant price volatility.

Having received queries from industry participants whether Payment Token Derivatives fall within the regulatory ambit of the SFA, coupled with indications of interest for Payment Token Derivatives to be made available to Singapore investors, the MAS issued the Consultation Paper to consult the industry on the proposed regulatory approach for Payment Token Derivatives. The MAS has set out its intention to allow innovation to co-exist in a regulatory environment with high standards.

¹ As at the date of this client alert, this refers to Asia Pacific Exchange Pte. Ltd., ICE Futures Singapore Pte. Ltd., Singapore Exchange Derivatives Trading Limited, and Singapore Exchange Securities Trading Limited.



Regulatory approach for Payment Token Derivatives under the SFA

Derivatives are currently regulated under the SFA, but only where the underlying asset is one of the specified “underlying things” (including a unit in a collective investment scheme, a commodity, a financial instrument or the credit of a person). Payment Token Derivatives are therefore currently not regulated unless the payment token falls within the category of specified “underlying things”.



Proposal 1 MAS proposes to regulate Payment Token Derivatives offered by Approved Exchanges

- > Given that Approved Exchanges play a central market infrastructure role and hold systemic importance, MAS should have oversight over products offered on such Approved Exchanges due to the risk of contagion to the wider financial system.
- > The stricter requirements and oversight over Approved Exchanges mean greater certainty that the systems and processes can cope with the new risks posed by these products.
- > In order to implement this change, MAS proposes to amend the Securities and Futures (Prescribed Underlying Thing) Regulations 2018 to widen the definition of prescribed “underlying thing” (as set out in [Annex B](#) to the Consultation Paper) to include Payment Token Derivatives that are traded on an Approved Exchange.



Proposal 2 MAS does not intend to include, within the regulatory scope of the SFA, Payment Token Derivatives that are not offered by an Approved Exchange

- > At present, MAS takes the view that it is not critical to regulate Payment Token Derivatives unless they are offered by an entity that is systemically important. This approach takes into consideration the Financial Stability Board’s assessment that crypto-assets do not presently pose material risks to global financial stability².
- > MAS intends to work with entities that are subject to the highest regulatory scrutiny (i.e. Approved Exchanges) to set appropriate standards.
- > MAS will revisit Payment Token Derivatives offered by other types of entities at a later stage, based on industry’s general readiness to meet the MAS’ standards and the systemic risk they pose.



Proposal 3 MAS intends to implement additional protection for retail investors

- > MAS does not view Payment Token Derivatives to be suitable for most retail investors due to the volatility of the underlying payment tokens which are intrinsically difficult to value. The leverage element in derivatives means that investors may also lose more than the whole amount they had invested.
- > MAS intends to introduce a number of measures for retail investors who trade in Payment Token Derivatives offered or distributed by financial institutions regulated by MAS³, aimed at discouraging retail investors from trading in such highly risky products.



Additional margin

MAS regulated financial institutions will have to collect from retail investors 1.5 times the standard amount of margin required for contracts offered by Approved Exchanges subject to a floor of 50%. This requirement will apply to both listed and over-the-counter Payment Token Derivatives.



Risk warnings/advertising restrictions

The margin requirement will be supplemented with other measures such as tailored risk warnings and restrictions on advertising.



Engage MAS

Such measures will also be extended to products like debentures that are based on payment tokens. Issuers are strongly encouraged to engage MAS in advance if they intend to offer such products to the public.

² See the Financial Stability Board 31 May 2019 report on “Crypto-assets: Work underway, regulatory approaches and potential gaps” at <https://www.fsb.org/wp-content/uploads/P310519.pdf>.

³ This includes Approved Exchanges, capital markets services licence holders, banks, merchant banks and finance companies.

International Perspective



Hong Kong

The MAS Consultation Paper follows shortly after the SFC in Hong Kong issued a **warning** to investors on 6 November 2019 about the risks associated with the purchase of virtual asset futures contracts in Hong Kong. Among others, the SFC noted that the prices of the underlying virtual assets are extremely volatile and difficult to value. Investors are also exposed to amplified risks due to the highly leveraged nature of virtual assets futures contracts, while the complexities and inherent risks of such products are likely difficult for the average investor to understand.

In addition, trading platforms or persons which offer and/or provide trading services in virtual asset futures contracts without a proper licence or authorisation may be in contravention of the Securities and Futures Ordinance, Chapter 571 of the Laws of Hong Kong (the “**SFO**”) or the Gambling Ordinance, Chapter 148 of the Laws of Hong Kong. Given the current risks associated with virtual asset futures contracts and in order to protect the investing public, the SFC, taking a markedly different approach from the MAS, has indicated that it would unlikely grant a licence or authorisation to carry on a business in such contracts.

On the same day, the SFC also released a **position paper** setting out the regulatory framework for virtual asset trading platforms. In essence, the regulatory framework for virtual asset trading platforms in Hong Kong will only be available to platforms which choose to include at least one virtual asset or token which is a “security” as defined in the SFO. More details are set out in our **client alert** released on 25 November 2019.



United Kingdom

In July 2019, the FCA issued a **consultation paper** suggesting a blanket ban against the sale, marketing and distribution to retail consumers of crypto-derivatives by firms acting in or from the UK, demonstrating its clear stance on the importance of investor protection. Crypto-derivatives are derivatives and exchange traded notes that reference unregulated transferable cryptoassets.

In the FCA's view (and not unlike the concerns raised by the MAS and the SFC), consumers need protection because cryptoassets have no reliable basis for valuation, their value is extremely volatile, and retail consumers lack adequate understanding of the investment. Other risks highlighted in the FCA paper include financial crime, market abuse, and opaque costs and charges.

The FCA is expected to finalise its proposals in Q1 2020. More details are set out in our blog post available [here](#).

Concluding Thoughts

To date, there has been some uncertainty in Singapore surrounding the issue of whether payment tokens would fall within the ambit of an “underlying thing”, and in turn, whether Payment Token Derivatives would be regulated as “derivatives contracts” under the SFA. The MAS’ consultation process brings greater, welcomed clarity on the regulatory position in Singapore.

Globally, crypto-assets and the distributed ledger technology which underpins them continue to attract significant attention. It remains to be seen how various regulators will continue to perform the delicate balancing act between innovation, investor protection and the promotion of the financial markets, in the space of Payment Token Derivatives. Crucially, providing regulatory certainty is key and in this regard the MAS consultation paper is a step in the right direction.



Key contacts

For further information please contact:



Peiying Chua

Partner, Financial Regulation
Tel: +65 6692 5869
peiying.chua@linklaters.com



Natalie Lye

Associate, Financial Regulation
Tel: +65 6321 5223
natalie.lye@linklaters.com



Peter Fairman

Associate, Financial Regulation
Tel: +65 6692 5818
peter.fairman@linklaters.com



Teddy Tang

Associate, Financial Regulation
Tel: +65 6692 5725
teddy.tang@linklaters.com



Melissa Khaw

Legal Assistant (Singapore qualified)
Financial Regulation
Tel: +65 6692 5778
melissa.khaw@linklaters.com

Linklaters Singapore Pte. Ltd.

One George Street #17-01
Singapore 049145

Tel: (+65) 6692 5700 / Fax: (+65) 6692 5708



Abu Dhabi | Amsterdam | Antwerp | Bangkok | Beijing | Berlin | Brisbane* | Brussels | Cape Town*** | Delhi^Δ | Dubai
Düsseldorf | Frankfurt | Hamburg | Hanoi* | Ho Chi Minh City* | Hong Kong | Jakarta** | Jeddah^{ΔΔ} | Johannesburg*** | Lisbon
London | Luxembourg | Madrid | Melbourne* | Milan | Moscow | Mumbai^Δ | Munich | New York | Paris | Perth* | Port Moresby*
Riyadh^{ΔΔ} | Rome | São Paulo | Seoul | Shanghai^{ΔΔΔ} | Singapore | Stockholm | Sydney* | Tokyo | Warsaw | Washington, D.C.

* Office of integrated alliance partner Allens

** Office of formally associated firm Widyawan & Partners

*** Office of collaborative alliance partner Webber Wentzel

^Δ Office of best friend firm TT&A

^{ΔΔ} Office of Zamakhchary & Co. Linklaters in agreement with Zamakhchary & Co.

^{ΔΔΔ} Linklaters Shanghai and Linklaters Zhao Sheng (Joint operations office with Zhao Sheng Law Firm)

linklaters.com



This alert is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice.

Linklaters Singapore Pte. Ltd. (Company Registration No. 200007472C) is a qualifying foreign law practice, incorporated with limited liability in Singapore. Linklaters Singapore Pte. Ltd. is affiliated with Linklaters LLP, a limited liability partnership registered in England and Wales with registered number OC326345. Linklaters LLP is a law firm authorised and regulated by the Solicitors Regulation Authority. The term partner in relation to Linklaters LLP is used to refer to a member of Linklaters LLP or an employee or consultant of Linklaters LLP or any of its affiliated firms or entities with equivalent standing and qualifications. A list of the names of the members of Linklaters LLP together with a list of those non-members who are designated as partners and their professional qualifications is open to inspection at its registered office, One Silk Street, London EC2Y 8HQ, England or on www.linklaters.com. This document contains confidential and proprietary information. It is provided on condition that its contents are kept confidential and are not disclosed to any third party without the prior written consent of Linklaters.

Please refer to www.linklaters.com/regulation for important information on our regulatory position. LIN.LAT.1851.19