

# CONSULTATION PAPER

P015 - 2019

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## Proposed Regulatory Approach for Derivatives Contracts on Payment Tokens

MAS

Monetary Authority of Singapore

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## 1 Preface

1.1 The Monetary Authority of Singapore (“MAS”) sets out in this consultation paper its proposed regulatory approach under the Securities and Futures Act (“SFA”) for derivatives contracts that reference payment tokens as underlying assets (“Payment Token Derivatives”).

1.2 MAS invites interested parties to provide their comments and feedback.

**Please note that all submissions received will be published and attributed to the respective respondents unless they expressly request MAS not to do so. As such, if respondents would like (i) their whole submission or part of it, or (ii) their identity, or both, to be kept confidential, please expressly state so in the submission to MAS. In addition, MAS reserves the right not to publish any submission received where MAS considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive.**

1.3 Please submit written comments by 20 December 2019 to –

Capital Markets Policy Division  
Markets Policy & Infrastructure Department  
Monetary Authority of Singapore  
10 Shenton Way, MAS Building  
Singapore 079117

Email: [capital\\_markets@mas.gov.sg](mailto:capital_markets@mas.gov.sg)

1.4 Electronic submission is encouraged. We would appreciate that you use [this format](#) for your submission to ease our collation efforts.

## 2 Introduction

2.1 In recent years, digital tokens have garnered interest and scrutiny from industry participants and regulators alike. While advancements in digital cryptography and distributed ledger technology have the potential to improve access to services, generate cost efficiencies, and spur competition between new and conventional business models, the specific use cases for digital tokens have thus far remained embryonic. Meanwhile, their transformative possibilities may produce new sources of risks, requiring participants and regulators to think of new ways to mitigate these risks, and retain the trust and stability in the financial sector.

2.2 The trading of the most popular digital tokens<sup>1</sup> – which are mostly digital tokens that are intended as payment instruments like Bitcoin and Ether – has largely been on unregulated markets, where there have been allegations of fictitious trades, cornering and market manipulation.

2.3 There has thus been interest from international institutional investors for a regulated alternative that could mitigate some of these concerns. Such regulated alternatives have recently emerged; in particular, Bitcoin futures have been listed and are traded on the US futures exchanges.<sup>2</sup>

2.4 A well-regulated market for derivatives – particularly one anchored by institutional investors with sophisticated risk management and investment strategies – can serve as a more reliable reference of value for the underlying asset. Indeed, the introduction of regulated Bitcoin futures in other jurisdictions has arguably instilled market discipline, and tempered exuberance and price volatility in the unregulated spot markets.

2.5 Nonetheless, regulated derivatives are not without risks. The inherent leverage in derivatives could magnify losses to investors. This is especially so for derivatives that are based on payment tokens which themselves exhibit significant price volatility.

2.6 MAS has received queries from industry participants about whether Payment Token Derivatives, like those referencing Bitcoin and Ether, fall within the regulatory scope of the SFA. MAS has also received indications of interest for Payment Token Derivatives regulated under the SFA to be made available to investors in Singapore. In calibrating our regulatory

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<sup>1</sup> There are three main types of digital tokens – securities tokens, payment tokens and utility tokens. Derivatives that reference securities tokens are already regulated under the Securities and Futures Act. This consultation paper discusses the proposed regulatory approach for derivatives that reference payment tokens as underlying assets. Common payment tokens are Bitcoin and Ether. Payment tokens do not include utility tokens which are used to access a good or service offered by the token issuer only.

<sup>2</sup> Examples include the Chicago Mercantile Exchange and the Intercontinental Exchange Futures US.

response, MAS intends to adopt a balanced view that seeks to allow innovation to co-exist in a regulatory environment with high standards.

2.7 The rest of this consultation paper sets out MAS' views on the appropriate regulatory approach for Payment Token Derivatives under the SFA.

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### 3 Regulatory Approach for Payment Token Derivatives under the SFA

3.1 Currently, a derivative is regulated under the SFA if its “underlying thing” is any of the following —

- (a) a unit in a collective investment scheme;
- (b) a commodity;
- (c) a financial instrument, i.e. any currency, currency index, interest rate, interest rate instrument, interest rate index, securities, securities index, a group or groups of such financial instruments;
- (d) the credit of any person; or
- (e) an underlying thing prescribed by MAS<sup>3</sup>.

3.2 Payment tokens are not categorically defined as “underlying things” under the SFA. Accordingly, Payment Token Derivatives are currently not regulated unless the payment token is also any of the above-mentioned underlying things.

#### **Payment Token Derivatives offered on an Approved Exchange**

3.3 MAS has received enquiries for Payment Token Derivatives to be listed and traded on Approved Exchanges in Singapore.

3.4 Approved Exchanges are regulated as systemically important facilities. They bring together participants for multilateral trading across a broad suite of capital markets products. Commensurate with the level of potential systemic risks posed by them, Approved Exchanges are subject to stricter regulatory requirements and supervisory oversight. Given the central market infrastructure role that Approved Exchanges serve and their systemic importance, **MAS views it as important to have effective oversight over products offered on Approved Exchanges** due to the risk of contagion through the Approved Exchanges to the wider financial system.

3.5 The stricter requirements and oversight over the Approved Exchanges mean that there is greater certainty that the systems and processes of these Approved Exchanges will be able to cope with the new risks posed by these products. First, Approved Exchanges have business rules backed by legislation that provide for the governance of members and participants, and errant members may be subject to disciplinary action and suspension of trading access where appropriate. They also have surveillance systems and functions to monitor, detect and deter market manipulation. Transactions on Approved Exchanges are also subject to robust margining, clearing and settlement processes through a regulated

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<sup>3</sup> Any intangible property is prescribed to be an underlying thing, in the case of a futures contract traded on an organised market established or operated by any approved exchange or recognised market operator.

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clearing facility, which mitigates the counterparty risks that can be aggravated by large price movements inherent in highly volatile products.

3.6 Given the above two reasons, **MAS proposes to regulate Payment Token<sup>4</sup> Derivatives offered by Approved Exchanges.**

**Payment Token Derivatives not offered by an Approved Exchange**

3.7 **MAS does not intend to include, within the regulatory scope of the SFA, Payment Token Derivatives that are not offered by an Approved Exchange<sup>5</sup>.**

3.8 MAS does not regard it as necessary or appropriate at this point to scope all Payment Token Derivatives within the regulatory scope of the SFA. Payment Token Derivatives as a general asset class do not pose systemic risks to the financial system.<sup>6</sup> Therefore, it is not critical to regulate Payment Token Derivatives unless they are offered by an entity that is systemically important.

3.9 It is presently unclear that most platforms are generally ready to develop and adopt processes and controls that are sufficiently robust to ensure the reliability and efficiency of transactions in Payment Token Derivatives. Thus, MAS considers that Payment Token Derivatives as a general asset class are not suitable to be legitimised and accorded a regulatory status at this point in time. Instead, MAS will work with the entities that are subject to the highest regulatory scrutiny – the Approved Exchanges – to set standards that will be appropriate for such products. We will consider the issue of regulating Payment Token Derivatives offered by other types of entities at an appropriate stage, taking into account the industry’s general readiness to meet our standards and the systemic risks that they pose.

3.10 Investors should thus be aware that they are dealing with unregulated products should they trade in Payment Token Derivatives that are not offered by an Approved Exchange.

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<sup>4</sup> The proposed definition of payment tokens is given in Annex B. For the avoidance of doubt, that proposed definition of payment tokens is for the purposes of SFA, and does not affect the definitions of payment tokens or similar terms (if any) found in any other Acts.

<sup>5</sup> i.e. traded on other types of trading platforms such as on Recognised Market Operators or unregulated trading platforms, or over-the-counter on a bilateral basis.

<sup>6</sup> In March 2018, the Financial Stability Board (“FSB”) made its initial assessment that crypto-assets did not pose risks to global financial stability at that time: <https://www.fsb.org/wp-content/uploads/P180318.pdf>. Since then, the FSB has continued to reiterate its assessment that crypto-assets do not pose material risks to global financial stability: <https://www.fsb.org/wp-content/uploads/P310519.pdf>.

## 4 Additional Measures for Retail Investors

4.1 As highlighted in paragraph 2.5, Payment Token Derivatives – even if regulated – are not without risks. In general, **MAS does not view Payment Token Derivatives to be suitable for most retail investors to trade**. This is because the underlying payment tokens tend to exhibit high volatility and are intrinsically difficult to value. For instance, it is not clear if payment tokens have any inherent economic value, or what their demand is driven by. Losses are also amplified due to the leveraged nature of derivatives, and investors may even lose more than the whole amount they had put in.

4.2 MAS will thus introduce a number of measures for retail investors who trade in Payment Token Derivatives offered or distributed by financial institutions regulated by MAS<sup>7</sup>. We expect these measures to be in place by 30 June 2020. Investors should be aware that these mitigating measures will not apply if they deal with an entity which is not regulated by MAS.

4.3 To reduce the amplification of losses experienced by retail investors, 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<sup>8</sup> ("1.5x margin requirement"), subject to a floor of 50% (see illustrative examples below). The 1.5x margin requirement applies to both listed<sup>9</sup> and over-the-counter<sup>10</sup> Payment Token Derivatives. The margin requirement will be supplemented with other measures such as tailored risk warnings and restrictions on advertising. These measures also serve to discourage retail investors from trading in these highly risky products.

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<sup>7</sup> Including Approved Exchanges, capital markets services licence holders, banks, merchant banks, and finance companies conducting regulated activities under the SFA.

<sup>8</sup> The margin requirements for contracts traded on Approved Exchanges are set by their Approved Clearing Houses.

<sup>9</sup> Prior to an Approved Exchange listing Payment Token Derivatives, the Approved Clearing House clearing such contracts for the Approved Exchange is expected to have rules providing for the 1.5x margin requirement.

<sup>10</sup> Financial institutions offering over-the-counter Payment Token Derivatives will thus have to set their minimum margins by reference to the standard margin requirements of the Approved Exchanges.

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**Illustrative Examples of Margins (in % and \$)<sup>11</sup> to be Collected from Retail Investors**

*Assuming contract size of 1 bitcoin with notional value of \$10,000.*

	<u>Example 1</u>		<u>Example 2</u>	
<b>(a) Margin required for Payment Token Derivatives offered by Approved Exchange</b>	40% (4,000/10,000)	\$4,000	20% (2,000/10,000)	\$2,000
<b>(b) 1.5 times of (a)</b>	60% (6,000/10,000)	\$6,000	30% (3,000/10,000)	\$3,000
<b>(c) Margin required from retail investors for listed or over-the-counter Payment Token Derivatives: (b) or 50%, whichever is higher</b>	60% (6,000/10,000)	\$6,000	50% (5,000/10,000)	\$5,000

4.4 The measures that will be introduced for retail investors will also be extended to cover 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.

4.5 **Notwithstanding these measures, retail investors are strongly advised not to trade in Payment Token Derivatives, and even if they choose to do so, should exercise utmost caution.**

## **5 Amendments to Subsidiary Legislation**

5.1 To reflect the intended regulatory scope of Payment Token Derivatives under the SFA discussed in section 3, MAS proposes to amend the Securities and Futures (Prescribed Underlying Thing) Regulations 2018 ("SF(PUT)R"). The draft amendments are enclosed as **Annex B**.

**Question 1.** MAS seeks comments on the draft amendments to the SF(PUT)R to categorically include Payment Token Derivatives offered by Approved Exchanges within the scope of the SFA.

<sup>11</sup> Margin requirement expressed as a percentage of notional value of the contract and in absolute dollars.

**Annex A**

**LIST OF QUESTIONS**

- Question 1.** MAS seeks comments on the draft amendments to the SF(PUT)R to categorically include Payment Token Derivatives offered by Approved Exchanges within the scope of the SFA..... 9



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