21 December 2022

Via: https://go.gov.sg/mas-cp-dpt-services-2022
CC: capital_markets@mas.gov.sg

Comments on the Consultation for Proposed Regulatory Measures for Digital Payment Token Services

Dear Sir / Madam,

GBBC Digital Finance ("GDF") is an industry membership body that promotes the adoption of best practices for virtual assets and digital finance technologies through the development of conduct standards in a shared engagement forum with market participants, policymakers, and competent authorities. We appreciate the opportunity to submit comments in response to the MAS's consultation on the proposed regulatory measures for DIgital Payment Token Services.

Our response to the consultation is detailed on the following pages. We look forward to being part of a continued productive dialogue with the MAS and the private sector to ensure policy continues to foster responsible innovation in these quickly changing markets.

Yours faithfully,

Malcolm Wright

Director of Regulatory Affairs, APAC

GDF GBBC DIGITAL FINANCE

Areas of Focus

Question 1. MAS seeks comments on the proposed scope of “retail customer” for consumer access measures

GDF agrees with the scope of a retail customer, and that the definition of an AI remain the same for DPTSPs in accordance with existing definitions within the SFA.

GDF further agrees on the scope of consumer access measures with regards to residency / incorporation, and non-AI status.

Question 2. MAS seeks comments on the options for the treatment of DPT holdings for the purpose of determining a customer’s eligibility as an Accredited Investor (AI)

GDF agrees that it may be suitable that volatile DPTs might not make up more than 10% of an AI’s portfolio in order to be treated as an AI. However, as highlighted by the consultation, if the AI holds a larger proportion of their $2m SGD eligible assets in a fully backed non-volatile stablecoin then MAS should consider an unlimited cap. This would allow AIs to benefit from being “crypto-native” and benefit from particular investment strategies without being penalised and losing an AI status requiring them to diversify their portfolio more broadly than they may wish or may have experience with.

Question 3. MAS seeks comments on the proposal to assess the retail customer’s knowledge of the risks of DPT services, as well as the risks to be covered by the assessment. MAS also seeks comments on possible next steps for DPTSPs, should the retail customer be assessed not to have sufficient knowledge of the risks of DPT services.

GDF agrees with the risk assessment approach for retail customers, and fully supports the concepts, and the risks and mitigations presented. GDF suggests that this might be taken one step further; that in the event of a standardised template being developed by the industry, the customer can then be awarded an digital certificate of completion, perhaps in the form of an NFT, that can be presented to the platforms on which the customer wishes to transact. This would enable greater transferability for the customer without the need to retake risk assessments on each platform. Greater transferability will enable and encourage healthy competition and better market practices.

Question 4. MAS seeks comments on the proposal to restrict DPTSPs from offering incentives to retail customers.

Incentives form a key part of any business’s customer acquisition strategy, and are a bone fide and normal activity in traditional finance, even for comparatively volatile assets such as FX.. With marketing opportunities limited already, the removal of incentives completely would potentially be highly detrimental to the viability of DPTSPs and inconsistent with the risk approach taken in traditional finance. At the same time, GDF recognises the risks that MAS highlights.

Rather, GDF proposes that incentives should:

(a) Be proportionate. For example, offering $1,000SGD free trading credit after $100SGD of trading may not be considered proportionate whereas, offering $10SGD credit against $1,000SGD would be more suitable.

(b) Be accompanied with appropriate risk warnings, such as the incentive should not be seen as an inducement to trade, that the retail customer should still pass the risks assessment and make appropriate enquiries as to the risks of trading, and so forth.

(c) Potentially, include a cool-down period. That is, the incentive would not activate within, for example, 24 hours of acceptance.

Incentives could be granted for activities which are not focused on solicitation to trade, rather than solely on the use of DPT as a mode of payment method, so as to aid the introduction of DPT into the ecosystem as more than just a tool to speculate.

Question 5. MAS seeks comments on the proposed restrictions on debt-financed and leveraged DPT transactions.

GDF agrees that leveraged DPT transactions may not be suitable for most retail customers. Further, GDF agrees that fiat-backed debt financing from fiat sources (i.e. credit and charge cards) may not be suitable. However, MAS should consider ensuring clarity and distinction from debit card transactions which may be funded from appropriate sources.

With regards to credit facilities in the case of DPT, GDF would like to reconfirm that over-collateralised lending is commonplace with the DeFi market. For example, a $1,000 SGD balance in USDC may be used as collateral to purchase $800 of BTC. This would present no greater risk than purchasing the BTC outright, but may allow for better capital allocation and in this regard MAS may wish to consider an amended approach for retail customers. Such an approach may be that the collateral be provided in an asset-backed stablecoin.

Question 6. MAS seeks comments on the proposed segregation measures relating to customers' assets.

GDF firmly agrees with MAS' proposals for segregation of customer assets from those of the DPTSPs.

Question 7. MAS seeks comments on whether DPTSPs should be required to appoint an independent custodian to hold customers' assets. MAS also seeks comments on other control measures that would help to minimise the risk of loss or misuse of customers' DPTs.

Given the drawbacks of such a proposal (currently a limited number of suitable custodians, limiting provider choice), GDF believes that the realisation of the proposal at this time would lead to concentration and counterparty risks with a small number of custodians, alongside increased service costs for customers due to a lack of market competition. Some DPTSPs may also seek out cheaper alternatives that whilst meeting with any regulatory guidance could nonetheless put customer assets at risk due to lower standards of care and security. It can also be noted that the model wherein venues safely provide their own custody is well established in Traditional Finance where the model is not inherently unsafe.

Additionally, such measures may hinder innovation in the custody related space. DPTSPs could be encouraged to consider custody solutions that could enable additional control and security for customers. (i.e. hybrid or fully segregated custody solutions external to the trading platform.)

As an additional control measure, MAS could consider that DTPSPs post their balances on-chain so that independent verification can be easily and cheaply achieved by any independent party.

At a future juncture, once the market matures and more custodians come to market, including regulated financial institutions, it may be more suitable to reassess this requirement at that time. This would need to bear in mind not only factors of customer asset segregation from the DPTSP but also the increased costs that will inevitably be pushed downwards to customers. An alternative approach may seek to strengthen the Technology Risk Management requirements for licensing to ensure that there are appropriate safeguards in place.

Question 8. MAS seeks comments on whether the proposed disclosure and reconciliation measures are appropriate and adequate, and whether any other disclosures would be useful.

GDF agrees with the proposed disclosure requirements. As a secondary benefit, reporting will be helpful in the context of tax planning, reconciliation, AML/KYC surveillance and provision of secondary services such asset management platforms, etc.

However, with regards to the disclosure requirements GDF notes that often such notices as proposed can be buried in terms and conditions that are only accessible from a checkbox link. GDF would propose that MAS considers appropriate wording such that any risk notices and disclosures should be written in suitably straightforward language (in English, this might be wording proposed by the Plain English Campaign - http://www.plainenglish.co.uk/), and that such notices be suitably visible.

Question 9. MAS seeks comments on the proposed risk management controls for customers' DPTs. MAS also seeks comments on any other measures to safeguard the private keys and storage of customers' DPTs.

GDF agrees with the proposed controls as outlined in the consultation document; particularly, the three principles highlighted. GDF would propose including a further measure for active monitoring and alerting of wallets with dynamic, appropriately configured parameters such that any unusual activity on any wallet is alerted early. The use of dynamic parameters that can update based on a rolling average set of behaviours will ensure that volatility of movement between wallets (such that might occur during high market demand) will not trigger false positive alerts, and will allow the DPTSP to focus on underlying unusual behaviours.

Further, DTPSPs might also be required to institute automated messaging to retail customers of changes to wallet balances, in the same way that fiat banks notify their retail clients of payments and withdrawals of their FIAT accounts. Such a requirement would greatly enhance the visibility of activity of the venues, as well as serving as a mitigant for online fraud.

Question 10. MAS seeks comments on the proposed restriction on DPTSPs not to lend out retail customers' DPTs. MAS also seeks comments on any other measures to protect customers' DPTs from the risks of unregulated borrowing and lending by DPTSPs.

GDF is in agreement with MAS that it is important to protect retail customers from harm. However, GDF does not agree with an outright ban on DPTSPs being able to mortgage, charge, pledge or hypothecate the retail customer's DPTs. To do so removes consumer choice and wealth generation opportunities that may be possible with credible strategies.

Rather, GDF recommends that all customers, retail or non-retail, be provided with detailed explanations of not only risks, but also investment strategies used by the DPTSP as well as the experience of the team managing such investments. Retail customers should be qualified as described in Question 3 to first ensure they have both the required knowledge as well as the risk tolerance to undertake such investments. If such risk disclosures are adequate, accurate and clear, then the ability for a retail customer to agree to lend its digital assets in return for a yield is not a complex product, and such a product should be available to retail customers to enjoy, and not just be for the benefit of sophisticated counterparties.

Should a retail customer not wish to participate in allowing DPTSP to use their DPTs for lending purposes. DPTSPs should then separately ring-fence such DPTs. GDF believes that the combination of education and awareness, transparency through disclosures, and voluntary assumption of risk would form sufficient safeguards.

There are already credible DPTSPs providing these types of services to retail customers with substantial experience and risk management protocols in place to prevent retail customers from harm.

Question 11. MAS seeks comments on the proposed measures to identify and mitigate conflicts of interests. MAS also seeks comments on any other measures to identify and mitigate conflicts of interest.

GDF agrees that suitable measures are required to prevent conflicts of interest, and highlights such measures should be commensurate with the risks presented and the size, nature, and complexity of the DPTSP. In any account, any potential conflicts should be clearly presented to customers to provide them with sufficient information as to making informed decisions on whether to use a trading platform.

In light of recent events, GDF would support further measures in regards to conflicts of interest on DPTs that the DPTSP might issue and that ideally, such DPTs should:

(a) Not be listed on the DPTSP's own platform, or in any event if such DPT are listed, then the DPTSP and any related entities are not permitted to trade such DPT on the DPTSP's own platform; and

(b) The DTPSP's issues DPT should not be used as collateral for any operational or strategic arrangements in which the DPTSP is involved.

(c) Require DPTSPs to maintain an internal Conflicts of Interest Register where any such potential or apparent conflict of interests are voluntarily recorded and submitted for internal review by a committee created specifically for such purpose. Any valid concern would then be addressed (reported) internally and could be reported externally to MAS if such a need arises.

Question 12. MAS seeks comments on the proposal for DPT trading platform operators to publish its policies and procedures on the process for selecting, listing, and reviewing DPTs, as well as the relevant governance policies. MAS also seeks comments on any other measures or disclosures to enhance market discipline on DPT trading platform operators, with regard to DPTs traded on their trading platforms.

GDF supports the requirement for greater transparency with regards to DPT listing on DPTSP platforms. However, GDF also notes that such policies and procedures may be time consuming, complex, and costly which would disproportionately affect smaller DPTSPs. GDF would welcome views from MAS on whether third party firms providing detailed DPT due diligence in an outsource arrangement might be able to be relied upon, under the right conditions, to support DPTSPs in assessing whether a DPT should be listed or delisted.

Further, such policies and procedures may be proprietary in nature and a requirement for public disclosure may obstruct the competitive advantage of certain DPTSPs. Such disclosures could be made solely to MAS in a confidential format and the whitepaper of the coin (published by the issuer) be made available on the website of the DPTSP.

MAS may also wish to consider whether DPTSPs should publish their listing fees for DPT listed on their platform.

Question 13. MAS seeks comments on the proposed complaints handling policies and procedures. MAS also seeks comments on any other measures or disclosures to ensure that customer complaints are dealt with in a fair and timely manner.

Ensuring that customer complaints are handled appropriately and in a timely manner is important not only for the reputation of the DPTSP but also for Singapore and MAS. GDF welcomes measures to ensure customers are treated fairly, and appropriate measures for the handling of complaints is a key aspect of operating any business, particularly a DPTSP operating in a fast moving industry.

In addition to points (a) to (g) in 4.27, GDF highlights that any complaint process should also include a feedback loop and, in the case of repeat complaints, a process for root cause analysis and remediation to prevent similar complaints being made by the same or multiple customers.

Further, MAS could consider issuing guidelines to the industry, similar to the 2019 Guidelines for E-Payments User Protection.

Question 14. MAS seeks comments on the proposed requirements for DPTSPs to establish a high level of availability and recoverability of critical IT systems that they use to support their business and services. MAS also seeks comments on the proposed incident reporting and customer information protection requirements.

GDF is in alignment that active system infrastructure management is critical to the viability and security of DPTSP platforms.

However, GDF does not agree that the overlay of requirements for traditional financial institutions be extended to DPTSPs in the same manner. Largely, this is for two reasons:

(a) Such a policy will disproportionately negatively impact smaller DPTSPs where access to higher value or dedicated technology. data centres, and staff may be cost-prohibitive;

(b) Such a policy would not account for DPTSPs who may grow faster than their technology can keep pace, and may therefore experience temporary issues during the interim period. Whilst certainly not desired, this is a factor that affects most technology businesses, not just DPTSPs..

Rather, a policy of risk mapping and regular reviews (e.g. monthly / quarterly) to plan capacity, risks, etc. may yield more proportionate results that will yield the same outcomes without necessarily creating the unintended consequences described above.

However, as a minimum DPTSPs should establish Information and Communications Technology (ICT) business continuity as well as disaster recovery plans aimed at ensuring that in the case of an interruption to their ICT systems and procedures, essential data and functions and the maintenance of crypto asset services are preserved or timely recovered and resumed.

DPTSPs should implement rigorous cybersecurity policies and procedures based on international best practices specific to their business models.

Where possible, DPTSPs should undertake third party audits and accreditation for independent assessment of the firm's cyber risk practices.

Finally, on a separate note, paragraph 5.5 makes note of the protection of customer information. However, as has been highlighted to MAS in separate communications, the current requirements / guidance of PSN02 in relation to Travel Rule implementation (collection of beneficiary information by the originator, for supply to the originator DPTSP who in turn transmits to the beneficiary DPTSP) creates significant risks to the protection of customer information. Such risks can be mitigated through alternative approaches whilst also protecting customers against fraud.

Question 15. MAS seeks comments on effective systems, procedures and arrangements that DPT trading platform operators should implement, in order to promote fair, orderly, transparent trading of DPTs offered for sale on their trading platform.

Market Abuse is a clear risk in DPT trading. In order to have effective systems, procedures and arrangements to prohibit and detect market abuse and related behaviours, first and foremost, market abuse needs to be defined in detail.

Market abuse can be defined as a behaviour, whether by one trader or collusion of traders (here in referred to as “Traders”) which gives undue advantage to Traders as they attempt to make profits for themselves or loss to regular market participants or indulge in illicit transactions.

Market abuse further consists of following types of abusive behaviours.

Money laundering on the Trading Platform / accommodation trades - Accommodation trading is a type of trading in which one Trader accommodates another by entering into a non-competitive purchase or sale order. The instance of accommodation trades often happens when two Traders are participating in illegal trading e.g. pre-arranged trades, wash trades

Insider dealing - is a common form of Market Abuse and, if not detected and prevented, could have a damaging effect on the Trading Platform. Another term for Insider Dealing is Material Nonpublic Information ("MNPI") Insider dealing can be further drilled down to:-

Insider trading - Traders may look to profit illegally from dealing on inside information. The strategy is to take a large position or positions ahead of news being made public. A Trader can then profit in a risk-free manner from the impact of a news announcement by gaining a first mover advantage on the rest of the market. Conversely, a Trader can make use of inside information to close an existing position and thus avert losses. Insider information refers to facts including firm intentions, as yet unrealised plans and prospects.

Frontrunning - Front-running is defined as the behaviour of a Trader trading in a particular asset based on inside information which is generally identified when proprietary trading accounts or employee accounts send orders in the moments before customer orders in the same assets. The recent scandal of fall out of a big exchange clearly involved front running where in the trading arm of the exchange was front running native tokens

Surveillance of native tokens - A big risk of native tokens is that the issuing DPTSP is in possession of the tokens before the tokens are rolled out for trading. This may lead the DPTSP to keep a big portion with itself or its trading desk. This can easily lead to abusive behaviour such as front running or pump and dump. Impetus needs to be there to report to regulators the top five Traders trading on native tokens.

Market manipulation - Any act that is a deliberate attempt to interfere with the fair and orderly operation of a marketplace and create a false or misleading appearance of trading activity. Traders undertake orders or trades in order to :-
1. Gives, or likely to give, false impression about demand or supply of an asset
2. Secure prices of an asset which are artificially high or low

Market Manipulation consists of (but not limited to) the following types of behaviours:-

1. Concentration / cornering
2. Duplicate orders / trades
3. Large orders / trades
4. Marking the close / open
5. Painting the tape
6. Pinging orders
7. Quote stuffing
8. Spoofing and layering
9. Price move / unlikely priced orders
10. Wash trades
11. Manipulation of funding rates (perpetual contracts)
12. Manipulation of insurance fund (derivatives)

Dissemination of false and misleading information - This behaviour is an extension of Market Manipulation. In traditional markets, this is considered part of market manipulation. However, in crypto assets trading, its advisable to keep this as another form of Market Abuse, since the prices of crypto assets are susceptible to big price movements due to any news on electronic or traditional media.The act consists of the dissemination of information by any means which gives, or is likely to give, a false or misleading impression as to the supply of, demand for, or price or value of a Relevant Product by a Trader who knew or ought to have known that the information was false or misleading.

Typical behaviours are:-

- Pump and Dump / Trash and Cash
- Momentum Ignition

In building a robust response to the above, a DPTSP needs to consider:

Surveillance Systems - A critical part of Market Surveillance is having a robust surveillance system. There are several vendors that offer sophisticated surveillance tools. It is advisable to select a third party vendor rather than develop a tool inhouse. These third party tools are developed keeping the volume and volatility of crypto assets in mind. These tools provide both real time as well as T+1 data.

Surveillance Professionals - DPTSPs should invest in hiring personnel who have considerable experience in market surveillance in crypto assets. These are specialised roles and availability of professionals with crypto experience is limited.

Procedures - Once the above are fulfilled, development of clear procedures for market surveillance become a critical component. Each DPTSP should have their own procedures, however, special attention needs to be given to the escalation process i.e. once an abusive behaviour is established, what the escalation process should be. Surveillance process should be independent so that escalations can be addressed relatively quickly.

Fines and Penalties- If any DPTSP fails to have an effective surveillance system or does not maintain an effective surveillance system (post licensing), MAS should impose appropriate fines and penalties to deter poor practices within the sector..

GDF highlights, although MAS will be aware, that some customers on DPTSP are unaware of behaviours that constitute market abuse. The efficacy of any system may also therefore warrant educational courses for customers on the prohibited behaviours that go beyond simple disclosures and rules.

Question 16. MAS seeks comments on effective measures, including the implementation of market surveillance mechanisms, to detect and deter unfair trading practices.

As mentioned earlier, the major prerequisites for effective implementation are:

1. Definition of Market Abuse
2. Surveillance tools
3. Surveillance professionals
4. Procedures
5. Fines / penalties

MAS should have clear sight of how market surveillance has been implemented by the DPTSP. A few suggested measures include:

1. Demo of the end to end surveillance system and procedures
2. Reviewing the surveillance professionals qualifications based on their skills and knowledge
3. Reviewing internal and customer training practices on acceptable / unacceptable behaviours.
4. Regular reporting to MAS on positive cases of market abuse identified, and / or STR's filed in relation to such activities

Question 17. MAS seeks comments on the proposed transition period of 6-9 months. MAS also seeks other comments to facilitate the transition towards the implementation of the regulatory measures.

GDF appreciates that MAS seeks to reinforce resilience in this sector. However, 6-9 months may be too fast to adopt some changes; particularly if there are substantial changes to custodial arrangements or disclosures. Therefore a longer transitional arrangement is recommended towards 1 year to 18 months.

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