PRACTICAL COMPLIANCE AND THE PAYMENT SERVICES ACT:

REQUIREMENT TO OBTAIN AN OPINION ON THE TOKENS YOUR PLATFORM SUPPORTS

3 JANUARY 2020 – HOLLAND & MARIE

*Most of the relevant forms and guidelines for the Payment Services Act (the "**PS Act**"), including the main license application form ("**Form 1**")* [1] *have now been published by the Monetary Authority of Singapore. Over the coming weeks, we intend to publish a series of articles considering various practical issues relating to applying for a license under or complying with the PS Act.*

INTRODUCTION

Digital payment token ("**DPT**") services (which consist of dealing in DPTs or facilitating the exchange of DPTs)[2] are a newly regulated activity in Singapore. In Form 1, Question 7.20 requires (the "**Assessment Requirement**") each applicant conducting DPT services to:

> "Provide a list of all tokens supported and indicate the applicant's assessment of the nature of the token. Attach a legal opinion of the applicant's assessment".

The legal opinion is required to include an opinion (the "**Assessment**") on whether the token constitutes (1) a DPT and/or (2) a capital markets product under the Securities and Futures Act (the "**SFA**"). Tokens that do not constitute a DPT or a capital markets product may constitute "e-money" under the PS Act.

A BRIEF HISTORY OF LEGAL OPINIONS ON TOKENS

During the initial coin offering ("**ICO**") boom, market practice was for a token issuer (the "**Issuer**") to receive a legal opinion that the token it was issuing was not a security under the laws of the jurisdiction of incorporation of the Issuer. For example, an Issuer incorporated in Malta would obtain a legal opinion under the laws of Malta that its token was not a security. Sometimes that legal opinion would be shared with exchanges that elected to list the token.

The deficiency in this market practice was that the legal opinion did not help you if you offered your token outside your home jurisdiction. Most countries, including Singapore, have laws regulating the offering of securities. Therefore, if a Malta Issuer offers its token in Singapore, the Malta legal opinion was not relevant to whether the Malta Issuer had breached the securities laws of Singapore. Instead, the Malta Issuer, as well as any Singapore-based exchange that listed the Malta Issuer's token, would have needed to receive Singapore legal advice.

Additional issues included:

- cryptocurrency tokens were so new that:
  - thought leadership on what they constituted under applicable securities law was constantly evolving;[3] and
  - there was no standard format or content for the legal opinion.
- the legal opinions often contained various assumptions and qualifications which may not have been followed by the Issuer and/or the features of the token could have changed, both of which could render the opinion obsolete.

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[1] See https://www.mas.gov.sg/-/media/MAS/Sectors/Forms-and-Templates/Form-1---Application-for-a-Payment-Service-Provider-Licence.pdf

[2] Question 7.19 of Form 1 also lists digital payment token custody as a DPT service. The MAS has indicated that such custody services will be licensed under the PS Act in the future.

[3] For example, the MAS published multiple editions of its "Guide to Digital Token Offerings" (the "**Guide**") including most recently on 23 December 2019. Singapore law firms generally included a reference to the latest version of the Guide any opinion given on the status of a token under Singapore law. The latest version of the Guide can be found at https://www.mas.gov.sg/-/media/MAS/Sectors/Guidance/Guide-to-Digital-Tokens-Offering---23-Dec-2019.pdf.

- the legal opinions were sometimes characterized as memorandums and given by law firms which were not licensed to practice in the relevant jurisdiction.

As a compliance advisory firm, Holland & Marie does not provide legal opinions on ICOs and will not provide the Singapore legal opinions including the Assessment. Instead, we refer such matters to Singapore law firms including WMH Law Corporation.

According to Brandon Tee, Head of the Corporate Practice at WMH Law Corporation, "The legal opinions issued on tokens to date almost never addressed whether the token was a DPT, as that status is only relevant upon effectiveness of the PS Act on 28 January 2020. In addition, many legal opinions contain confidentiality restrictions. Therefore, it is likely that none of the legal opinions issued in the context of an ICO would be sufficient for purposes of the Assessment."

HOW WILL LICENSEES RESPOND TO THE ASSESSMENT REQUIREMENT?

We anticipate that some Singapore-based DPT exchanges will delist/drop support for certain tokens rather than incur the cost of obtaining a legal opinion sufficient for PS Act licensing. Moreover, there is no guarantee that the legal opinion would conclude the token was not a capital markets product under the SFA.

Stablecoins

This lack of guarantee is particularly true for some "stablecoins" which the MAS has flagged may constitute a debenture.[4] Historically, market practice relating to the treatment of stablecoins is varied and we have seen cases where Singapore-based exchanges trade tokens that the Issuer does not offer directly in Singapore.

However, in the latest version of the Guide published on 23 December 2019, the MAS altered its guidance on a type of stablecoin that constitutes a debenture. In Case Study 11 of the Guide,[5] the MAS wrote:

> **"As Company K is under an obligation to the buy-back of Token K from the holders, Token K may constitute a debenture if Token K represents Company K's indebtedness to the holder to pay back the holder US$1 per Token K. However, if Token K falls within the definition of "e-money" under the PS Act, MAS' general regulatory stance is to not regulate Token K as a debenture."**

This represents a material change from the position descried in the April 2019 version of the Guide in which the MAS wrote:

> "Depending on the business activities of Company K and whether Token K is a debenture, Company K may require a capital markets services licence for dealing in capital markets products that are securities under the SFA, unless otherwise exempted. Holders of a capital markets services licence that carry on business in dealing in tokens that are capital markets products are required to comply with AML/CFT requirements under MAS Notice SFA04-N02."

Brandon adds:

> "The fact that the MAS's 'general regulatory stance' is not to regulate Token K as a debenture under the SFA does not mean that (1) all stablecoins will not be regulated as a debenture or (2) a token with the features of Token K would never be regulated as a debenture. For

[4] For example, see Case Studies 10 and 11 of the Guide.

[5] Case study 11 provides the following fact pattern: "Company K intends to offer digital tokens ("**Token K**") to any person globally, including in Singapore, for US$1 per Token K. Company K aims to achieve a relatively constant price for Token K by pegging its value to the US dollar. To do so, Company K will only accept payments for Tokens K in the form of electronic deposits of US dollars into its US-dollar denominated bank account. These deposits will serve as a fiat currency reserve to back the purported US$1 value of each Token K in circulation. Holders of Tokens K will have the right to exchange Tokens K with Company K for US$1 per Token K. Company K will not have any rights to cancel or redeem Token K from token holders. Company K may consider future tie-ups with retail shops to enable Token K to be used to pay for purchases.

circumstances in which the MAS did choose to regulate a stablecoin as a debenture, the MAS' earlier analysis of Token K set forth in the April 2019 version of the Guide would apply. Meanwhile, the MAS is in the midst of a consultation on the scope of e-money and digital payment tokens, which includes questions about how stablecoins should be regulated.[6] Therefore, the MAS regulatory stance on stablecoins may evolve further."

PRACTICAL RECOMMENDATIONS

For those DPT service providers which intend to obtain a legal opinion to satisfy the Assessment requirement, we offer the following recommendations:

- **Ask the Issuer to obtain the legal opinion.** This practice has economies of scale as the Issuer can share it with all the exchanges and custodial wallets that support the token. However, the DPT service provider should make sure that it is entitled to rely on any legal opinion obtained by the Issuer.
- **Require Issuers to give (1) a warranty and/or indemnity regarding the status of their token under Singapore law and (2) an undertaking to update you on any material changes to the token's features.**
    - The warranty provides an additional measure of diligence. The warranty should also be relatively easy for the Issuer to give.
    - The update is necessary because if the features to the token change then the token's legal status may change. We believe DPT service providers will be expected to know the status of the tokens they support at all times.
    - Regardless of these measures, DPT service providers will remain liable for any regulatory breaches. However, these are reasonable diligence measures and provide some economic protection.
- **Work with other industry players to agree on the general form and substance of the legal opinion.** All DPT service providers are in the same boat and we believe it would be beneficial for the industry to reach as much consensus as possible.
- **Consider where regulation is going in the other jurisdictions where you operate.** Regulation is increasing across industries, but nowhere more than the cryptocurrency industry. Now may be the time to explore how you can rationalize your legal and compliance function and approach across the jurisdictions in which you operate. Going forward, we expect DPT service providers to require licenses in every jurisdiction where they have operations or a significant number of customers. You may wish to consider what legal opinions you need in other jurisdictions before you ask an Issuer to pay for the legal opinion for Singapore.
- **Remember that if you do not conduct DPT services, then you are not required to obtain the legal opinion containing the Assessment.** The Assessment Requirement only applies to DPT service providers. If you only interact with tokens that constitute e-money, Question 7.20 of Form 1 does not apply.

CONCLUSION

The Assessment Requirement is one part of the robust legal and compliance framework that DPT service providers will be required to have.[7] Given our team's experience managing and advising licensed financial institutions, Holland & Marie is well positioned to advise DPT service providers with their compliance framework and/or provide outsourced compliance. However, we do not provide Singapore legal opinions and instead work with Singapore law firms like WMH Law Corporation which have the requisite standing and expertise.

[6] See https://www.mas.gov.sg/-/media/MAS/resource/publications/consult_papers/2019/Consultation-on-the-Payment-Services-Act-2019---Scope-of-E-money-and-Digital-Payment-Tokens/Consultation-on-the-Payment-Services-Act-2019---Scope-of-Emoney-and-Digital-Payment-Tokens-MAS.pdf

[7] See the Guidelines on Licensing for Payment Service Providers at https://www.mas.gov.sg/-/media/MAS/Sectors/Guidance/Guidelines-on-Licensing-for-Payment-Service-Providers.pdf

We look forward to publishing additional articles on similar compliance topics in the near future. If you can't wait until then, we would love to buy you a coffee sometime to explore how we can help.

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About Holland & Marie
Holland & Marie is a compliance, C-Suite and legal solutions firm based in Singapore. We have extensive experience in resolving typical compliance issues including regulatory inspections, satisfying regulatory requirements and maintaining best practices in corporate governance to navigate the rapidly changing regulatory landscape.

About WMH Law Corporation
WMH is an award-winning medium sized boutique law firm founded by a group of enterprising next-generation lawyers who were previously from a Big 4 Singapore law firm with the goal of delivering big firm quality legal work in a cost-effective manner. WMH's corporate law practice advises on a range of specialised and general corporate law matters, including, without limitation, (a) capital markets, (b) mergers and acquisitions, (c) regulatory compliance, (d) fintech and blockchain, (e) fund formation and management, (f) banking and finance, (g) startup fundraising, and (h) commercial and general corporate. Owing to their differentiated backgrounds, WMH's corporate advisers are able to combine solid legal know-how with business acumen to help clients navigate the regulatory landscape while also achieving their commercial goals.