Segregation and custody of customers' tokens

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The segregation regime is the single most important change to DPT regulation since the Act commenced. MAS consulted on it in October 2022 after the collapse of Three Arrows Capital, Terraform and Hodlnaut, and published its first response on 3 July 2023.[1] The response announced four measures. Customer assets were to be held under a statutory trust. Providers were to carry out daily reconciliation and keep proper books and records. Access and operational controls over customers' tokens were to be maintained in Singapore. The custody function was to be operationally independent from other business units. It also announced the restriction on lending and staking of retail customers' tokens discussed in Chapter VIII. The amendments to the Payment Services Regulations that implement the measures were finalised in a response of 2 April 2024. The regulations came into effect together with the commencement of the Payment Services (Amendment) Act 2021, with a later compliance deadline for existing licensees.[2]

The content of the regime is as follows. A DPT service provider that holds customers' tokens must hold them on trust for the customers in a trust account, which the regulations name as such, separate from the provider's own assets. The provider must keep records that allow it to identify each customer's entitlement and

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must reconcile its records with the on-chain position daily. At least 90 per cent of customers' tokens must be held in cold storage, meaning systems that are not connected to the internet. The keys or key shards enabling control over the tokens must be held in Singapore under controls accessible to MAS.[3] The custody function must have reporting lines to a senior manager resident in Singapore, must be operationally independent of trading and treasury, and must be governed by a written conflicts of interest policy.

Three further rules address what happens when things go wrong. The provider must disclose in writing to customers how it will treat losses caused by its own fraud or negligence. It must send customers statements of account at least monthly. Where the provider uses a third-party custodian, that custodian may assert a lien, right of retention or right of sale over customers' tokens only on two conditions. The customer must have consented in writing, and the provider must have notified the custodian of that consent in writing. Retail customers' tokens may not be mortgaged, charged, pledged, hypothecated, lent or staked by the provider.[4]

The legal effect of the trust is the point on which Singapore has gone further than Switzerland. Under Swiss law the segregation of crypto assets in the insolvency of a custodian depends on Art. 242a DEBA and on whether the assets are individually allocated or collectively held and readily attributable (see Part D, Chapter IV). Singapore has imposed a statutory trust as a regulatory condition. The customer is a beneficiary and the tokens are outside the provider's estate, provided the trust was properly constituted and the records allow the trust property to be identified. The certainty of subject matter problem that arose in the Hong Kong Gatecoin case, discussed in Part J, Chapter II, is addressed by the record-keeping and daily reconciliation requirements. It is not eliminated. A provider that fails to keep adequate records may leave its customers with a trust that cannot be traced to any identifiable tokens, since the regulatory breach will not by itself create property rights.

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Example

A licensed Singapore exchange holds 12,000 ETH for 4,000 customers in an omnibus cold wallet and 1,200 ETH in a hot wallet for withdrawals. Its records show each customer's balance and the records are reconciled against the chain each morning. The exchange fails after an exploit drains the hot wallet. Under the 2024 regime the cold wallet holdings are trust property and are returned to customers in proportion to their recorded entitlements. The hot wallet loss is a loss of trust property, and whether customers or the exchange's general creditors bear it depends on the written loss-treatment disclosure the exchange was required to make and on the general law of trusts. If the exchange had disclosed that it would make good losses caused by its own negligence, the customers hold an unsecured claim against the estate for the shortfall in addition to their proprietary claim to the cold wallet tokens. The 90 per cent cold storage rule limits the exposure to the hot wallet by design.

Notes

1. MAS, Media Release "MAS publishes investor protection measures for digital payment token services", 3 July 2023: DPT service providers to safekeep customer assets under a statutory trust, conduct daily reconciliation, maintain access and operational controls in Singapore, and keep the custody function operationally independent. ↩
2. Ocorian, "MAS finalises crypto segregation and custody regulations", 17 April 2024, recording the MAS Response to Feedback Received on Proposed Amendments to the Payment Services Regulations of 2 April 2024 and the requirements described in this section. ↩
3. Payment Services Regulations 2019, as amended in 2024, provisions on the trust account, daily reconciliation and the requirement that at least 90 per cent of customers' DPTs be held in systems not connected to the internet; MAS Response of 2 April 2024. ↩

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4. Payment Services Regulations 2019, as amended in 2024: disclosure of loss treatment, monthly statements, limits on safeguarding persons' liens, and the prohibition on encumbering or lending retail customers' DPTs. ↩

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