



HONG KONG MONETARY AUTHORITY

香港金融管理局

Conclusion of Discussion Paper on Crypto-assets and Stablecoins

January 2023

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1. Executive summary

1.1. On 12 January 2022, the HKMA issued a discussion paper on crypto-assets and stablecoins¹ (the “Discussion Paper”) and invited feedback from stakeholders. The Discussion Paper outlines the HKMA’s thoughts on giving priority to the development of a regulatory framework for “payment-related stablecoins”, i.e. stablecoins that may have the potential to develop into a widely acceptable means of payments, while providing flexibility in the regime to make adjustments to the scope of stablecoins that may be subject to regulation as needed in the future.

1.2. Since then, the crypto-asset markets have continued to evolve. Of note, the stablecoin market experienced much price volatility in May 2022 subsequent to the collapse in value of TerraUSD. Some crypto exchanges also ran into trouble, e.g. FTX in November 2022. Against this backdrop, authorities have called for more comprehensive regulation of stablecoins to address the financial stability risks that they could potentially pose. The international regulatory bodies, standard-setting bodies (“SSBs”) and some major jurisdictions have responded with more specific policy recommendations and regulatory measures and/or proposals with respect to stablecoins.

1.3. It is worth noting that while the definition of stablecoins could technically capture a wide spectrum of crypto-asset structures that aim to maintain a stable value,² international regulatory bodies, SSBs and major jurisdictions have been according higher priority to those stablecoins that have a potential reach and use across multiple jurisdictions including as means of making payments and/or stores of value. Specifically, more major jurisdictions are giving priority to regulating those stablecoins that purport to reference to fiat currencies as they are more likely to be used in payments and have linkages with the traditional financial system, thereby creating higher and more imminent monetary and financial stability risks than other types of stablecoins or other crypto-assets. Major jurisdictions also note the importance of building in appropriate flexibility in the regulatory regime to adjust the regulatory scope to cope with the rapidly moving market and international regulatory developments.

1.4. By the end of the feedback period on 31 March 2022, the HKMA received 58 submissions. Respondents generally indicated their support for the HKMA’s proposal of bringing stablecoins into the regulatory perimeter. Taking into account the latest international recommendations and feedback received, the HKMA will further proceed with putting in place a regulatory regime. The proposed key parameters of such a regime are summarised as follows:

¹ The Financial Stability Board (“FSB”) defines stablecoins as a crypto-asset that aims to maintain a stable value relative to a specified asset, or a pool or basket of assets.

² For instance, based on the definition of the FSB, any crypto-asset that purports to reference its value to any kind of asset (be it fiat currencies, commodities, or another type of crypto-asset) could technically be captured under this definition.

 What to regulate	Key activities relating to stablecoins will be subject to a mandatory licensing regime. The HKMA will adopt a risk-based approach in scoping in stablecoin structures for regulation under the proposed regime. As a priority, the HKMA will start with regulating stablecoins that purport to reference to one or more fiat currencies, given the higher and more imminent monetary and financial stability risks that they may pose. Flexibility will be built in to enable the authority to scope in other stablecoin structure(s) for regulation under the proposed regime in the future.
 Key activities to be regulated³	Key activities that are related to an in-scope stablecoin, e.g.: (i) <i>Governance</i>: establishment and maintenance of the rules governing an in-scope stablecoin arrangement; (ii) <i>Issuance</i>: issuing, creation or destroying of an in-scope stablecoin; (iii) <i>Stabilisation</i>: stabilisation and reserve management arrangements of an in-scope stablecoin (whether or not such arrangements are provided by the issuer); and (iv) <i>Wallets</i>: provision of services that allow the storage of the users' cryptographic keys which enable access to the users' holdings of an in-scope stablecoin and the management of such stablecoins.
 Entities that will require a licence from the HKMA	Entities that (i) conduct a regulated activity in Hong Kong; (ii) actively market a regulated activity to the public of Hong Kong; (iii) conduct a regulated activity which concerns a stablecoin that purports to reference to the value of the Hong Kong dollar; <u>or</u> (iv) the authority is of the opinion that should be so regulated, having regard to matters of significant public interest.
 Key regulatory principles	<i>Comprehensive regulatory framework</i>: Appropriate regulatory requirements will be developed on areas such as but not limited to ownership, governance and management, financial resources requirements, risk management, anti-money laundering and counter-terrorist financing ("AML/CFT"), user protection, and regular audits and disclosure requirements. <i>Full backing and redemption at par</i>: The value of the reserve assets of a stablecoin arrangement should meet the value of the outstanding stablecoins at all times. The reserve assets should be of high quality and high liquidity. Stablecoins that derive their value based on arbitrage or algorithm will not be accepted. Stablecoin holders should be able to redeem the stablecoins into the referenced fiat currency at par within a reasonable period.

³ This list sets out the key activities for easy reference and should not be treated as an exhaustive list.

	<i>Principal business restriction:</i> ⁴ The regulated entities should not conduct activities that deviate from its principal business as permitted under their relevant licences. For example, wallet operators should not engage in lending activities.
 Target implementation date	By 2023/24.
 Legislative approach	The HKMA is weighing the pros and cons between introducing a new legislation and amending existing laws for implementation of the regulatory regime.

1.5. A more detailed consultation, with more granular information about the regulatory regime, will be conducted in due course.

1.6. As regards the wider crypto-asset space, and on the basis of the “Policy Statement on Development of Virtual Assets in Hong Kong” issued by the Hong Kong SAR Government on 31 October 2022, the HKMA will continue its ongoing discussion with other stakeholders in the Hong Kong SAR Government and financial regulators, and actively participate in relevant international fora. The HKMA embraces financial innovations and encourages institutions to explore the potential of distributed ledger technology (“DLT”) to support the responsible development of virtual asset ecosystem in Hong Kong. At the same time, we will also work with the HKSAR Government and financial regulators to prioritise regulatory efforts using a risk-based, “same activity, same regulation” approach and drawing reference from applicable international standards. Specifically, the HKMA will continue to monitor market developments and the risks that different categories of crypto-asset may pose to monetary and financial stability, as well as actively participate in the relevant international regulatory discussions, with a view to working with the HKSAR Government and financial regulators to consider the appropriate treatment for the wider crypto-asset space.

1.7. As a related matter, the HKMA notes that the activities being proposed to be regulated under the aforesaid stablecoin regime might overlap and/or have interface with other financial regulatory regimes in Hong Kong, e.g. the licensing regime for virtual asset service providers (“VASP”) to be administered by the Securities and Futures Commission (“SFC”). The HKMA will conduct further assessment and continue to work with other stakeholders in the HKSAR Government, local financial regulators as well as relevant stakeholders when formulating the details of the regime in order to avoid regulatory arbitrage, identify and address regulatory overlaps or gaps and mitigate the risks arising from different activities.

⁴ As Authorized Institutions (“AIs”) are already subject to similar or more stringent regulatory requirements with respect to their deposit-taking business, it is proposed that the principal business restriction does not apply to an AI that is in scope for the purpose of the proposed regulatory regime.

1.8. This feedback conclusion is organised as follows: Chapter 2 provides a background of the paper and Chapter 3 sets out recent notable market and regulatory developments. Chapter 4 provides a summary of major comments received in respect of the Discussion Paper and the HKMA's response to a number of key issues. Chapter 5 sets out the proposed next steps.

2. Background

2.1. In January 2022, the HKMA issued the Discussion Paper. The Paper outlined the HKMA's thoughts on the development of a regulatory framework for stablecoins while providing flexibility in the regime to make future adjustments to expand the scope of stablecoins that may be subject to such a regulatory regime, and invited feedback from stakeholders. The policy objectives are to safeguard Hong Kong's monetary and financial stability while supporting financial innovation, with a view to adopting the relevant international regulatory recommendations.

2.2. As stated in the Discussion Paper, stablecoins, as a sub-set of crypto-assets, has been an area of regulatory concern. Among other things, stablecoins, in particular those that purport to reference to fiat currencies, have the potential to have relatively broad and frequent interconnection with the mainstream financial system and day-to-day commercial, financial and economic activities, hence posing more direct and imminent risks to the financial system. There is also concern that stablecoins backed by assets may create a channel through which risks borne by crypto-assets could spill over to the traditional financial system. In light of the monetary and financial risk considerations in relation to stablecoins, we set out in the Discussion Paper our intention to apply appropriate regulatory treatments to stablecoins, with priority to those that may be used in payments. The Discussion Paper also set out the following discussion questions and invited views from the industry and the public on the regulatory approach:

- | | |
|----|---|
| Q1 | <i>Should we regulate activities relating to all types of stablecoins or give priority to those payment-related stablecoins that pose higher risks to the monetary and financial systems while providing flexibility in the regime to make adjustments to the scope of stablecoins that may be subject to regulation as needed in the future?</i> |
| Q2 | <i>What types of stablecoin-related activities should fall under the regulatory ambit, e.g. issuance and redemption, custody and administration, reserves management?</i> |
| Q3 | <i>What kind of authorisation and regulatory requirements would be envisaged for those entities subject to the new licensing regime?</i> |
| Q4 | <i>What is the intended coverage as to who needs a licence under the intended regulatory regime?</i> |
| Q5 | <i>When will this new, risk-based regime on stablecoins be established, and would there be regulatory overlap with other financial regulatory regimes in Hong Kong, including but not limited to the SFC's VASP regime, and the stored value facility ("SVF") licensing regime of the Payment Systems and Stored Value Facilities Ordinance ("PSSVFO")?</i> |
| Q6 | <i>Stablecoins could be subject to run and become potential substitutes of bank deposits. Should the HKMA require stablecoin issuers to be AIs under the Banking Ordinance, similar to the recommendations in the Report on Stablecoins issued by the US President's Working Group on Financial Markets?</i> |

Q7 Would the HKMA also have plan to regulate unbacked crypto-assets given their growing linkage with the mainstream financial system and risk to financial stability?

Q8 For current or prospective parties and entities in the stablecoins ecosystem, what should they do before the HKMA's regulatory regime is introduced?

2.3. This paper summarises the feedback received from the respondents and provides the HKMA's corresponding responses. It also provides a summary of the latest market and policy developments which informed our consideration and the proposed next steps.

3. Developments since issuance of the Discussion Paper

Key market developments

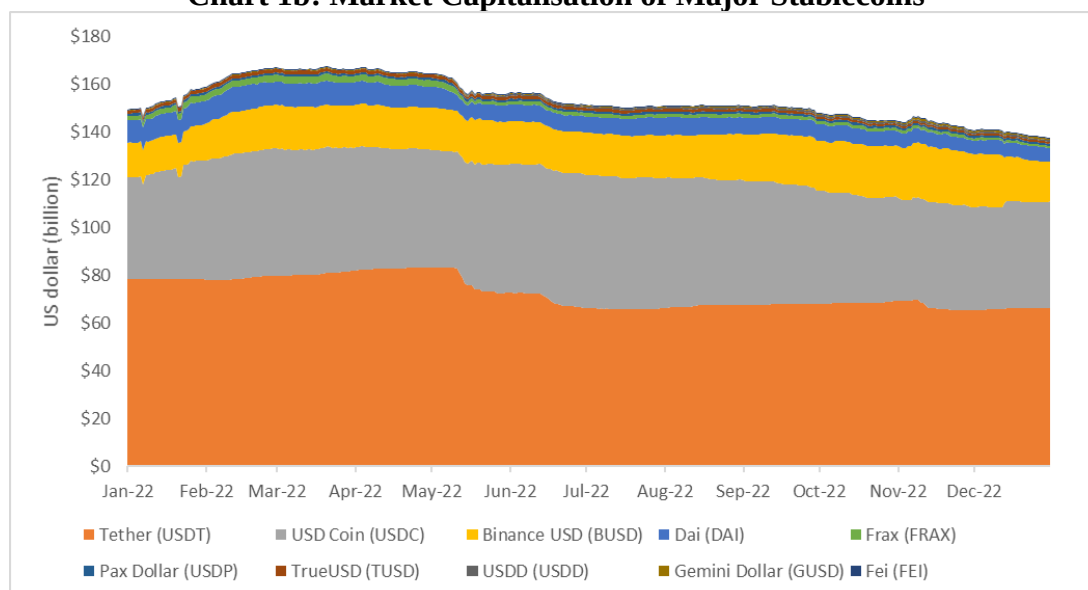
3.1. Since the issue of the Discussion Paper in January 2022, the crypto-asset market has experienced rounds of price volatility. Among others, the market capitalisation of crypto-asset has shrunk by more than half (**Chart 1a**), whereas that of stablecoin had maintained growth until April, before declining with the wider crypto-asset market in May (**Chart 1b**).

Chart 1a: Market Capitalisation of Crypto-assets (in US dollar)



Source: Coinmarketcap.com
(Data up to 31 December 2022)

Chart 1b: Market Capitalisation of Major Stablecoins



Source: *Coinmarketcap.com*

(Chart 1b shows the top 10 stablecoins based on their respective market capitalisation as at 31 December 2022)

3.2. Two notable incidents happened in the crypto-asset market in 2022. In May, TerraUSD (“UST”), the then largest algorithmic stablecoin by market capitalisation, lost its peg to the US dollar, and its stabilisation mechanism broke down. Afterwards, the value of Tether (“USDT”), the then largest stablecoin, fell to US\$0.95 before recovering the US\$1.00 peg. Subsequent to these incidents, authorities around the world have expressed renewed concerns about stablecoins.⁵ Some crypto-exchanges also ran into trouble in 2022. For example, in November, FTX, one of the major crypto-asset exchanges, suspended withdrawals and subsequently announced that it had filed for bankruptcy in the US. Its native token, i.e. the FTT, also collapsed. The knock-on effect caused by these incidents accelerated or led to the failures of other firms in the crypto-asset markets. As the situation further unfolded, there were more signs pointing towards issues about the firm’s operation and governance, e.g. allegedly improper use of customer funds to prop up another entity that was founded by the founder of FTX, misconduct and potential fraud.

3.3. While the aforementioned market incidents were not confined to stablecoins, there are lessons learnt from the stablecoin perspective. For instance, the events have revealed certain vulnerabilities or even failures in multiple aspects including governance, management, stabilisation mechanisms, transparency and disclosure to users. Another observation is that certain financial activities related to crypto-asset and/or stablecoins carry similar risks as conventional financial services. However, the fact that they were conducted in a bundled manner, e.g. by the same entity or different

⁵ On 12 May 2022, US Treasury Secretary Janet Yellen expressed that the run and decline in value of UST demonstrated the urgency of establishing a regulatory framework to cope with the financial stability risks brought by stablecoins. On 16 May 2022, Fabio Panetta, a member of the Executive Board of the European Central Bank, commented that stablecoins did not benefit from deposit insurance or have access to central bank standing facilities and were therefore vulnerable to runs.

affiliated companies of the same financial group, could give rise to significant concentration risks and conflicts of interests.

Major policy and regulatory developments

3.4. Against the above backdrop, in 2022 relevant international organisations, SSBs, and major jurisdictions made progress in attending to, and proposing ways to address risks brought by crypto-assets.

3.5. In October 2022, the FSB, in consultation with relevant international SSBs and international organisations, published a proposed framework for the international regulation of crypto-asset activities. The framework provided recommendations relating to the regulation, supervision and oversight of crypto-asset activities and markets and global stablecoin (“GSC”) arrangements. Additional clarity and guidance was provided for governance arrangements, regulation of trading platforms and other intermediaries, risk management, redemption and stabilisation mechanisms, and the applicability of the FSB recommendations.

3.6. In 2022, SSBs, such as the Basel Committee on Banking Supervision (“BCBS”), Committee on Payments and Market Infrastructures (“CPMI”), International Organization of Securities Commissions (“IOSCO”), and the Financial Action Task Force (“FATF”) also issued guidance on addressing the risks of stablecoins and/or reviewed and clarified the applicability of their existing standards and regulatory frameworks to crypto-assets and stablecoins. Many jurisdictions proposed, or recently adopted, more granular regulatory requirements to address the risks associated with stablecoin activities.

3.7. More details of the recent policy developments among international organisations and major jurisdictions are at [Annex 1](#) and [Annex 2](#), respectively.

3.8. Notwithstanding variation in progress and approaches taken by different jurisdictions in regulating stablecoins, there is a convergence of the major aspects of their regulatory remit and requirements. For example, there is general consensus to bring at least fiat-referenced stablecoins, i.e. stablecoins that purport to maintain a stable value relative to one or more fiat currencies, into the regulatory perimeter. Regulatory efforts are moving towards the direction that a stablecoin should not rely on arbitrage activities to maintain a stable value at all times and should not derive its value from algorithms.

3.9. In Hong Kong, following the issuance of the Discussion Paper, in July 2022 the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill was introduced into the Legislative Council to amend the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (“AMLO”). Among other things, it was proposed that an SFC licence will be required for the carrying on of a business of operating a virtual asset exchange, subject to the meeting of a fit and proper person test and other regulatory requirements. Virtual asset will be defined in the AMLO with reference to the key elements set out in the FATF’s definition. Moreover, given the rapid development in the virtual asset sector, the Secretary for Financial Services and the Treasury will be empowered to prescribe by notice published in the Gazette whether

a particular asset is to be considered a virtual asset under the AMLO. The Legislative Council passed the amendment bill on 7 December 2022 and the regime will take effect on 1 June 2023.

3.10. On 31 October 2022, the HKSAR Government issued the “Policy Statement on Development of Virtual Assets in Hong Kong”, setting out the policy stance and approach towards developing a vibrant sector and ecosystem for virtual assets in Hong Kong. The Policy Statement emphasises that the HKSAR Government and financial regulators will put in place timely and necessary guardrails to mitigate actual and potential risks in line with international standards, with a view to providing a facilitating environment for promoting the sustainable and responsible development of the virtual asset sector in Hong Kong.

4. Outcome of the feedback received, our response, and the proposed way forward

4.1. The consultation period of the Discussion Paper ended on 31 March 2022. We received 58 submissions from respondents of various background, including market players, public bodies, business and professional associations, and individuals. A list of the respondents is at [Annex 3](#). A summary of the major issues raised and our feedback is set out in this section.

4.2. In summarising and responding to the feedback received, we also set out the proposed direction of travel, including the key parameters that we intend to apply in implementing the proposed regulatory regime. When formulating our proposals, we have taken into account the feedback received, the recent international regulatory discussions, practices of other major jurisdictions, as well as Hong Kong’s overall policy stance.

4.3. Specifically, while the definition of stablecoins could technically capture a wide spectrum of crypto-asset structures that aim to maintain a stable value,⁶ we note that international regulatory bodies, SSBs and major jurisdictions have been according higher priority to those stablecoins that have a potential reach and use across multiple jurisdictions, including as means of making payments and/or store of value. For example, more major jurisdictions are giving priority to regulating stablecoins that purport to reference to one or more fiat currencies as they are more likely to be used in payments and have linkages with the traditional financial system, thereby creating higher and more imminent monetary and financial stability risks than other types of stablecoins and crypto-assets. The above assessment is similar to that of the HKMA, as set out in the Discussion Paper.

4.4. As such, the HKMA plans to put in place an agile and risk-based regime for regulating certain financial activities that are related to stablecoins. We propose starting with stablecoins that purport to reference to one or more fiat currencies. Also, due to

⁶ For instance, based on the definition of the FSB, any crypto-asset that purports to reference its value to any kind of asset (be it fiat currencies, commodities, or another type of crypto-asset) could technically be captured under this definition.

the rapid market and international developments, and taking an approach similar to some other jurisdictions, the HKMA considers it important for the regime to have appropriate flexibility to enable the authority to scope in other stablecoin structures and stablecoin-related financial activities into the regulatory regime as necessary in the future. We will conduct further consultation to seek market and public feedback as we develop more granular proposed regulatory parameters and arrangements.

Overview of the feedback received

4.5. Through the Discussion Paper feedback process, a number of broad themes emerged:

- (i) broad consensus that the HKMA should regulate stablecoins with a risk-based and agile approach, and the regulatory requirements should be proportionate to the risks posed by the activities undertaken by the concerned entities;
- (ii) broad agreement that the HKMA should draw reference from SSBs' work and adopt an approach that would be consistent with global standards or practices;
- (iii) varied opinion on whether the HKMA should impose a local incorporation requirement;
- (iv) a variety of views on the regulatory approach on other crypto-assets and stablecoins, with some calling for further regulation and others arguing that other crypto-assets should not be regulated given their characteristics. In respect of the former approach, most called for having a coordinated approach in respect of crypto-asset regulation by the HKSAR Government and the financial regulators, and were mindful of possible risks of regulatory arbitrage, vis-à-vis other crypto-assets and traditional finance regimes (e.g. investment funds); and
- (v) questions on the scope of the regulatory regime, e.g. what would constitute "payment-related stablecoins" and relevant activities; and the applicability of the stablecoin regime to financial institutions who are already subject to regimes in respect of carrying out similar regulated financial activities in the traditional finance space.

Summary of respondents' feedback by discussion questions⁷

Q1 from the Discussion Paper

Should we regulate activities relating to all types of stablecoins or give priority to those payment-related stablecoins that pose higher risks to the monetary and

⁷ Following the sequence as set out in the Discussion Paper

financial systems while providing flexibility in the regime to make adjustments to the scope of stablecoins that may be subject to regulation as needed in the future?

Summary of feedback

4.6. A significant number of respondents agreed that the HKMA should adopt a risk-based approach to prioritise regulatory efforts regarding crypto-assets and/or stablecoins that pose higher financial and monetary implications on Hong Kong. In particular, there was broad agreement that the HKMA should regulate stablecoins that have the potential to become a widely accepted means of payment. A number of respondents opined that the proposed regime should cover all kinds of crypto-assets as a start. Two respondents commented that the HKMA should not introduce any regulation for crypto-assets or stablecoins at this moment.

4.7. Respondents generally agreed that flexibility should be built into the regime so that regulators could adapt to market developments and allow for timely adoption of internationally agreed standards and practices where appropriate. Respondents also supported the HKMA's ongoing participation in the discussion with other international financial authorities and SSBs with a view to implementing a consistent approach.

4.8. Some respondents mentioned that a clear and robust regulatory framework would be required to ensure a level playing field and highlighted that the regulations set forth should work in tandem with the existing rules and regulations to promote innovation and should not stifle growth by over-regulating.

4.9. A few respondents were of the view that algorithm-based stablecoins should also be brought into the regulatory remit as they were more vulnerable to value manipulation and misuse for money-laundering and fraud.

4.10. Some respondents shared that central bank digital currencies, certain closed-loop limited purpose stablecoins, settlement tokens, and tokenised deposits of AIs should be excluded from the regulatory scope. A few respondents suggested that the HKMA consider whether it should cast the regulatory net over crypto-assets/stablecoins that reference other assets, such as commodities, or stablecoins that would be used predominantly for payment in crypto-asset transactions.

4.11. Some respondents sought clarification on the definition of "payment-related stablecoins" and stressed the importance of having a clear definition in order to provide legal certainty and clarity. They noted difficulty in differentiating between "payment-related stablecoins" and "non-payment related stablecoins", with some asking whether there would be a threshold for a crypto-asset/stablecoin to be considered as a widely accepted means of payment. Respondents also cited challenges in defining the regulatory scope by use purpose or scale.

4.12. Respondents recommended that the HKMA should ensure regulatory consistency with international standards and practices when considering the scope and requirement of any future regulations on stablecoins to enable cross-border collaboration across jurisdictions and avoid regulatory arbitrage.

The HKMA's response

4.13. Having considered the responses received as well as the latest international recommendations, the HKMA will take a risk-based approach by giving priority to regulating stablecoins that purport to reference to one or more fiat currencies. The reason is that these stablecoins are more likely to be used in payments and have linkages with the traditional financial system, thereby creating higher and more imminent monetary and financial stability risks than other types of stablecoins or crypto-assets. It should be noted that the focus would be on the purported reference of a stablecoin irrespective of the underlying stabilisation mechanism of that stablecoin. Hence, a stablecoin that purports to reference to fiat currencies through algorithms or arbitrage mechanisms will be scoped in.⁸ Likewise, a stablecoin that purports to reference to one or more fiat currencies would be scoped in regardless of whether the coin is predominately used for retail, wholesale, or crypto-asset transactions.

4.14. In addition, due to rapid market and international developments as well as possible, innovative ways of using stablecoins in a manner that may not be possible in traditional finance, it is important for the regime to be agile so that it could address, in a timely manner, monetary and financial stability risks that may be posed by new stablecoin structures and/or use cases. Having considered the feedback received and international practices, the HKMA proposes that the regime should have appropriate flexibility to enable the authority to declare other types of stablecoin structures (i.e. apart from those that purport to reference to fiat currencies) to be subject to the regulatory regime in the future. In this regard, the HKMA sees merits in providing some “guiding factors” in the future in respect of what the authority would have regard to in considering which particular structure should be declared as a stablecoin subject to regulation.

4.15. The HKMA is also grateful for the feedback received in respect of arrangements that might be excluded from the proposed scope of regulation, as summarised in paragraph 4.10. The HKMA agrees that there is a need to exclude certain arrangements from the definition of stablecoins for certain reasons (e.g. already being subject to another financial regulatory regime, or used within a well-confined environment outside the reach of the general public). The HKMA will conduct further analysis and additional consultation with respect to the scope of exclusions as well as the relevant approach. Among other things, deposit-taking activity is currently regulated under the Banking Ordinance in Hong Kong, and the HKMA will consider the appropriate regulatory treatment for tokenised deposits in Hong Kong.

4.16. As regards the regulation of other crypto-assets, the HKMA will continue to coordinate with other stakeholders in the HKSAR Government, participate in relevant international discussions, and take into account any applicable international standards and/or recommendations in considering the relevant regulatory treatment. In doing so, the HKMA will also have regard to the risks that other crypto-assets may pose to the monetary and financial stability in Hong Kong.

⁸ However, these kinds of stablecoins will unlikely meet the regulatory requirements which will be further discussed in later sections.

Q2 from the Discussion Paper

What types of stablecoin-related activities should fall under the regulatory ambit, e.g. issuance and redemption, custody and administration, reserves management?

Summary of feedback

4.17. Overall, the respondents supported regulating many of the activities included in the proposed list of activities to be regulated. There was broad consensus that the HKMA should regulate the activities of “issuing, creating or destroying stablecoins”, “managing reserve assets to ensure stabilisation of the stablecoin value” and “facilitating the redemption of stablecoins”. At the same time, some respondents noted challenges in regulating the activity of “issuing, creating or destroying stablecoins” and identifying the responsible party as many existing stablecoins were said to be issued by foreign online entities or, in some cases, in a decentralised manner.

4.18. A number of respondents stated that it would be more efficient for the HKMA to focus on critical links in a stablecoin arrangement rather than regulating all entities involved. Some respondents highlighted the importance of aligning the regulatory approach and timeline with other major jurisdictions.

4.19. Some respondents raised questions about the exact definitions of the proposed regulated activities involving stablecoins. There were also suggestions that some other activities should also be regulated under the regime proposed by the HKMA, e.g. purchasing or exchanging a stablecoin with fiat currency, operation and management of centralised stablecoin lending services, issuance of crypto-asset debit/credit cards, and operation of crypto-asset automated teller machines or exchange shops.

4.20. There were suggestions that the HKMA should consider the regulatory approach in the case where outsourcing of activities was involved and entities managing some functions were separate from the entities bearing the risk.

4.21. Some respondents shared that the coverage of the proposed list of activities might, depending on the circumstances, overlap with other regimes in Hong Kong, e.g. SVFs, trust and company service providers, and virtual asset service providers that would be regulated by the SFC.

The HKMA’s response

4.22. In light of the feedback received and the evolving approach adopted at the international level, the HKMA will further review the list of activities that would be brought into the regulatory perimeter. In this connection, taking a risk-based approach and referencing international recommendations and proposed way forward in other major jurisdictions, our key focus will be placed on regulating critical functions such as the following under the mandatory licensing regime:

- (i) *Governance*: establishment and maintenance of the rules governing an in-scope stablecoin arrangement;

- (ii) *Issuance*: issuing, creation or destroying of in-scope stablecoins;
- (iii) *Stabilisation*: stabilisation and reserve management arrangements of an in-scope stablecoin (whether or not such arrangements are provided by the issuer); and
- (iv) *Wallets*: provision of services that allow the storage of users' cryptographic keys which enable access to the users' holdings of an in-scope stablecoin and the management of such stablecoins.

4.23. In other words, stablecoin-related activities not listed in paragraph 4.22 – including those listed in paragraph 4.19 – may not be captured in the proposed regulatory scope at the initial stage. These activities are assessed to generally pose lower and less imminent monetary and financial stability risks. That said, we propose building in appropriate flexibility in the stablecoin regulatory regime to enable the authority to, having regard to matters of significant public interest, include new types of regulated activities in the future. This would enable the authority to readily address any risks associated with unregulated stablecoin activities when such risks become concerning from monetary and financial stability angle.

4.24. With respect to outsourcing, we expect the relevant licensed entity to retain ultimate control of the outsourced activities and obligations to its users. Drawing reference from other regulatory regimes currently administered by the HKMA, we expect to supplement the governing legislation with appropriate guidance to set out our requirements in relation to licensing and on-going supervisory matters.

Q3 from the Discussion Paper

What kind of authorisation and regulatory requirements would be envisaged for those entities subject to the new licensing regime?

Summary of feedback

4.25. Respondents overwhelmingly agreed that authorisation and regulatory requirements should be risk-based. Some respondents mentioned that a licensee could carry out one or more proposed regulated activities and different activities might generate different levels of risks and warrant different mitigating measures. One respondent commented that adopting a risk-based approach should not necessarily mean the application of the exact same rules as regulation should be made flexible to adapt as technology evolves.

4.26. There were some suggestions that the HKMA should apply an “activity-based” approach, i.e. establishing an appropriately tiered set of regulatory requirements for each type of regulated activity in a manner that is commensurate with the nature of the activity and the assessed risks. Certain regulated activities might also be bundled together so that a key entity would be responsible and held accountable for the relevant risks. Several respondents sought clarifications on whether an entity providing more

than one stablecoin-related activity would require multiple licences and whether the HKMA would require each entity to submit an individual licence application in the case where multiple entities are involved in different parts of a stablecoin arrangement.

4.27. A number of respondents opined that the proposed requirements might turn out to be similar to those currently imposed on banks, and argued that such a stringent licensing regime could deter payment service providers from conducting stablecoin-related activities in Hong Kong.

4.28. For regulatory requirements regarding maintenance and management of reserves of backing assets, a few respondents suggested that reserve assets should be subject to periodic disclosures and audits. They also proposed that backing assets should be held by AIs or banks supervised by overseas regulators, and called for measures to ensure user protection in case the stablecoin issuer were to become insolvent.

4.29. Several respondents urged the HKMA to provide best practices, standards, and guidelines on stablecoin licensing and supervision, similar to its existing practices for the regulatory regimes for AIs and SVF licensees to provide industry players with more clarity on the HKMA's regulatory expectation.

4.30. A number of respondents commented that the HKMA might need to consider cross-sectoral implications when devising the stablecoin licensing regime, such as data protection, competition and cybersecurity.

4.31. A respondent suggested that the HKMA should consider an approach between an open-end and a renewable fixed-term license mechanism, with the latter option allowing the HKMA to review thoroughly whether the licensees are still fit and proper. The respondent added that an efficient on-going monitoring system was important to ensure that the licensing regime was functional.

The HKMA's response

4.32. The HKMA will adopt a risk-based approach in formulating the regulatory requirements for stablecoins. In light of the multiple activities that may take place with respect to a stablecoin arrangement, the HKMA is more inclined to develop appropriate regulatory requirements targeting each type of activities, i.e. there would be different types of regulated activities covered by different licenses, rather than one single type of licence covering various activities.

4.33. While the HKMA will continue to formulate the exact and detailed regulatory requirements and consult the market at an appropriate juncture, as a matter of principle, the HKMA considers the following to be crucial elements of the regulatory regime:

- (i) *Comprehensive regulatory framework:* The regulatory requirements should cover a broad range of issues including but not limited to ownership, governance and management, financial resources requirements, risk management, AML/CFT, user protection, and regular audits and disclosure requirements.

- (ii) *Full backing and redemption at par*: The value of the reserve assets of a stablecoin arrangement should meet the value of the outstanding stablecoins at all times. The reserve assets should be of high quality and high liquidity. Stablecoins that derive their value based on arbitrage or algorithm will not be accepted. Stablecoin holders should be able to redeem the stablecoins into the referenced fiat currency at par within a reasonable period.
- (iii) *Principal business restriction*:⁹ The regulated entities should not conduct activities that deviate from its principal business as permitted under their relevant licence. For example, wallet operators should not engage in lending activities.

4.34. Another issue that has transpired in recent months was the risks associated with the provision of multiple or bundled financial services by affiliated entities that would generally be separated in traditional finance for conflict of interest, prudential and user protection reasons. The HKMA will consider such issues in formulating the more granular regulatory requirements, taking also into account the relevant international regulatory discussions.

Q4 from the Discussion Paper

What is the intended coverage as to who needs a licence under the intended regulatory regime?

Summary of feedback

4.35. The majority of the respondents agreed that entities conducting a stablecoin activity in Hong Kong or actively marketing such an activity to the public of Hong Kong should hold a relevant licence. One respondent expressed that stablecoin service providers which have business dealings with Hong Kong residents should also be subject to the licensing regime. One respondent also suggested that the HKMA should assess the associated monetary implications of a stablecoin that references its value to the Hong Kong dollar if they were incorporated into the mainstream financial system.

4.36. There were mixed views as to whether local incorporation requirement should be included as one of the authorisation conditions. Those supporting the local incorporation requirement were of the view that this could enable effective regulatory supervision and enforcement, which in turn would enhance user protection and market integrity. On the other hand, some respondents suggested that the HKMA should allow companies incorporated outside the HKSAR but registered under the Companies Ordinance (Cap. 622) to apply for a licence, arguing that local incorporation requirement was not imposed on all AIs carrying out traditional banking activities in the HKSAR.

⁹ As AIs are already subject to similar or more stringent regulatory requirements with respect to their deposit-taking business, it is proposed that the principal business restriction does not apply to an AI that is in scope for the purpose of the proposed regulatory regime.

4.37. A few respondents commented that the HKMA could consider imposing the local incorporation requirement only on entities that are engaged in critical activities in a stablecoin arrangement, e.g. issuing, creating and destroying stablecoins, and managing reserve assets for stabilisation of the stablecoin's value. Some respondents suggested that the HKMA could consider an entity's regulatory status in overseas jurisdictions and impose physical presence conditions, such as setting up a branch office with senior officers and sufficient base capital requirement, rather than imposing local incorporation requirement. One respondent said that an entity issuing stablecoins that would be referenced to the Hong Kong dollar should be incorporated in the HKSAR to ensure effective oversight.

4.38. Some respondents highlighted the challenge of identifying the entities that should be subject to the licensing regime if the stablecoin arrangement concerned is managed in a decentralised manner. One respondent noted that the HKMA might need to conduct screening of international platforms and websites in order to identify those that target Hong Kong residents.

4.39. One respondent stressed that it would be important to ensure consistency of the definition of "active marketing" between the HKMA and the SFC. It was suggested that the HKMA could provide further guidance on what constitutes "actively market to the public of Hong Kong" and the corresponding threshold and trigger. A number of respondents suggested that the HKMA maintain a public register of licensed stablecoin entities, which could help financial institutions conduct due diligence and risk assessment on customers and counterparties.

The HKMA's response

4.40. The HKMA is of the view that imposing a local incorporation requirement is highly conducive to enabling the HKMA to effectively supervise the licensed entities and enforce the regulatory requirements, particularly for ensuring the company's assets and liabilities will be appropriately segregated from the rest of the group and to facilitate seizure of assets where necessary for the purpose of user protection in case of failure of business. At the same time, we noted comments and suggestions during the consultation period regarding alternative approaches on the enforcement of the regulatory requirements. The HKMA will further evaluate different options, such as whether certain mitigation measures could be adopted in lieu of the local incorporation requirement while upholding the necessary level of robustness and effectiveness of the regulatory regime. We will take into account the relevant international regulatory discussions and developments as well as input of market participants.

4.41. Those conducting a regulated activity in Hong Kong concerning an in-scope stablecoin or actively marketing such activities to the public of Hong Kong should hold a relevant licence. As regards the issue of stablecoins that are referenced to the Hong Kong dollar, the HKMA is inclined to bring them into the scope of the regulatory regime. Specifically, any entity conducting a stablecoin-related activity in which the stablecoin concerned purports to reference its value to the Hong Kong dollar should need to obtain a relevant licence and be subject to the regulatory requirements, regardless of whether the relevant regulated activity is conducted in Hong Kong or actively marketed to the general public of Hong Kong. This is due to the consideration

that stablecoins that are referenced to the Hong Kong dollar would have much higher likelihood of adoption and usage by the general public in Hong Kong, hence giving rise to higher monetary and financial stability concerns and the need for enhanced user protection.

4.42. In addition, for reasons similar to paragraphs 4.14 and 4.23 above, the HKMA also proposes building appropriate flexibility in the stablecoin regulatory regime to enable the authority to scope in an entity to be subject to the stablecoin regulatory regime even if the entity may not fall under any of the three scenarios as described in paragraph 4.41 above. The HKMA will conduct further consultation with respect to the assessment criteria.

Q5 from the Discussion Paper

When will this new, risk-based regime on stablecoins be established, and would there be regulatory overlap with other financial regulatory regimes in Hong Kong, including but not limited to the SFC's VASP regime, and the SVF licensing regime of the PSSVFO?

Summary of feedback

4.43. Some respondents indicated support for the proposed timeline of introducing the new regime for stablecoins no later than 2023/24 as suggested in the Discussion Paper, with some respondents urging to have such regulation put in place earlier or as soon as possible. One respondent highlighted the importance of allowing adequate time for the industry to make necessary changes in order to adapt to the regulatory requirements.

4.44. The vast majority of respondents mentioned that there could be overlap for some of the stablecoin activities with other regulatory regimes in Hong Kong, especially the licensing regime for VASPs to be implemented by the SFC. A commonly cited example was that an exchange conducting transactions in stablecoins might be regulated by both the SFC under the VASP regime and the HKMA under the proposed stablecoin regime.

4.45. A number of respondents agreed with the HKMA that whether a stablecoin arrangement fell within the definition of an SVF has to be determined on a case-by-case basis, adding that there could be potential overlap between the stablecoin regime and the SVF licensing regime.

4.46. There was broad agreement that collaboration and coordination amongst the financial regulators and other stakeholders in the HKSAR Government would be required to avoid regulatory arbitrage. A few respondents noted that regulatory overlap or gap might be reduced so long as the HKSAR Government were to adopt a coordinated approach in crypto-asset policy formulation. Some respondents called for a clearly defined regulatory framework and clear division of labour among the regulators. They asked for guidance on which financial regulator would take the lead in the regulatory efforts and how businesses should cope with the regulatory overlap.

4.47. A number of respondents proposed to further expand the scope of the Banking Ordinance and PSSVFO, pointing to the functional similarities between stablecoins and deposits or SVFs. Some respondents were opposed to regulating stablecoins using the PSSVFO, as a stablecoin issuer would not offer any undertaking as a means of payment.

The HKMA's response

4.48. In terms of the timeline of introducing the new regulatory regime, the HKMA is reviewing its work target. Among other things, the FSB has recently reviewed its recommendations on GSCs and indicated its latest plan to review the implementation of the revised recommendations by end-2025. Other major jurisdictions are also at various stages of putting in place their regulatory regimes for stablecoins. Having considered the volatility and risks of stablecoins as well as the need to adopt the latest international recommendations and align Hong Kong's regulatory regime in stablecoins with those in other major jurisdictions, the HKMA will work towards putting in place the regulatory regime by 2023/24.

4.49. The HKMA notes that the activities proposed to be regulated under the aforesaid stablecoin regime might overlap and/or have interface with other financial regulatory regimes in Hong Kong, e.g. the licensing regime for VASPs to be administered by the SFC. The HKMA will conduct further assessment and work with other stakeholders in the HKSAR Government, local financial regulators as well as other relevant stakeholders when formulating the details of the regime, in order to avoid regulatory arbitrage, identify and address regulatory overlaps or gaps and mitigate the risks arising from different activities. As we develop the regulatory regime, the HKMA will be mindful of possible scenarios where a stablecoin that is currently captured under one regime may subsequently fall under another.

4.50. Meanwhile, the HKMA recognises the fast evolution of the broader crypto-asset market and the various stages of international discussions about different types of crypto-assets. In this regard, regulatory discussions about stablecoins are more advanced and specific. In parallel, there are ongoing discussions at different international fora, in which the HKMA actively participates, about the broader crypto-asset markets, e.g. unbacked crypto-assets and decentralised finance ("DeFi"). We also note the way services are provided in the crypto space is evolving rapidly and may be different from that of traditional finance. The HKMA will continue to monitor international recommendations and the applicable timelines. In light of the above, while the amendment of PSSVFO may serve the purpose of bringing stablecoins into the regulatory remit from the payment perspective, there may also be merits in introducing a new, stand-alone legislation that starts with the regulation of stablecoins while providing the possibility of bringing other segments of the crypto-asset market under regulation further down the road. The HKMA will further assess the pros and cons of such an approach. In doing so, the HKMA will continue to engage with other HKSAR Government stakeholders and other financial regulators, and will conduct further market consultation.

Q6 from the Discussion Paper

Stablecoins could be subject to run and become potential substitutes of bank deposits. Should the HKMA require stablecoin issuers to be AIs under the Banking Ordinance, similar to the recommendations in the Report on Stablecoins issued by the US President's Working Group on Financial Markets?

Summary of feedback

4.51. Opinions were divided on whether the HKMA should allow only AIs to issue stablecoins in Hong Kong. Respondents who thought such requirement was appropriate opined that requiring stablecoin issuers to go through the comprehensive and strict licensing process currently applicable to banks could ensure the fitness and propriety of issuers which, in turn, could help achieve user protection, combat illicit financing activities and enhance market confidence. On the other hand, some respondents found it too restrictive to require all stablecoin issuers to be AIs. One of them argued that stablecoins would serve as a means of exchange rather than a substitute for bank deposits. Hence, the risks to the financial and monetary system posed by issuers would be smaller than those posed by AIs. Two respondents mentioned that the requirements of becoming an AI in Hong Kong were strict. Imposing such requirements might prevent smaller non-bank companies and start-ups from issuing stablecoins.

4.52. A number of respondents suggested that the stablecoin-related activities should be subject to the relevant aspects of the current regulatory regimes for SVFs and payment service providers, given that stablecoins function in similar ways to SVFs and other payment solutions. One respondent opined that the HKMA should ensure that no banking risks would be built up in non-bank or less regulated sectors, and that no unregulated forms of shadow banking would be created.

4.53. Some respondents suggested applying additional prudential requirements to stablecoins which have systemic implications so as to better protect stablecoin holders. One respondent noted that the definition of “systemic” was not provided in the Discussion Paper and suggested that the criteria used in the determination of systemic stablecoin issuers should be aligned with the considerations identified by the CPMI and IOSCO.

4.54. One respondent opined that the HKMA should evaluate impacts on commercial banks, such as their ability in credit creation, if they were required to hold the reserve assets of stablecoins under a deposit backed model.

The HKMA's response

4.55. In line with international standards, the HKMA will adopt a risk-based, “same risk, same regulation” approach to regulate the relevant entities and activities. Having considered the feedback received and drawing reference from the way forward of many major jurisdictions, the HKMA is of the view that both AIs and non-AIs should be allowed to issue stablecoins as long as they could satisfy relevant licensing and

regulatory requirements. In line with the “same risk, same regulation” principle, the HKMA will calibrate the final regulatory requirements applicable to AI and non-AI issuers (i.e. whether the same or customised) based on the risks that each type of issuers presents to the financial system.¹⁰ The aforesaid approach aims to strike a reasonable balance between promoting financial innovation (e.g. by not imposing too high a bar) and maintenance of financial stability.

4.56. As regards whether we should differentiate between “systemic” and “non-systemic” stablecoins in the regulatory approach, we have made reference to the regulation of SVF issuers and considered the stage of development of the market. Instead of seeking to specify at the outset additional requirements for what may constitute “systemic” stablecoins and the corresponding additional regulatory requirements, we consider it more appropriate to take a risk-based approach, under which the HKMA will calibrate the intensity of regulation with regard to all relevant factors concerning a licensed entity and the specific stablecoin arrangements adopted.

Q7 from the Discussion Paper

Would the HKMA also have plan to regulate unbacked crypto-assets given their growing linkage with the mainstream financial system and risk to financial stability?

Summary of feedback

4.57. Many respondents called for a coordinated regulatory approach in respect of crypto-assets (including stablecoins), highlighting the importance of mitigating AML/CFT risks posed by crypto-assets, the benefits of reducing regulatory overlaps or gaps with regimes administered by other local financial regulators, and avoidance of possible regulatory arbitrage across jurisdictions. There was general support for stablecoin activities being subject to AML/CFT controls.

4.58. Respondents had diverse views as to whether the HKMA should regulate unbacked crypto-assets in the future. There was support that the HKMA should continue to closely monitor the development of crypto-assets instead of over-regulating the industry at its start in order to allow room for innovation. However, some respondents felt that the HKMA should plan for unbacked crypto-asset regulation given their growing linkage with the mainstream financial system, money laundering/terrorist financing (“ML/TF”) threats to financial systems in Hong Kong, and consumers’ lack of related knowledge.

4.59. A number of respondents expressed that crypto-assets should be regulated in accordance with the international guidance provided by the relevant SSBs. One respondent stated that whether unbacked crypto-assets should be regulated by the HKMA should depend on whether such assets were widely used in payment scenarios.

¹⁰ For avoidance of doubt, the above is not relating to the issue of AIs issuing “tokenised deposits”, of which the HKMA will further consider the appropriate regulatory treatment as mentioned in paragraph 4.15 above.

Respondents also suggested the HKMA should consult the public and the industry by way of issuing a consultation paper if it planned to regulate unbacked crypto-assets in the future.

4.60. Several respondents proposed that the HKMA could consider creating a sandbox that would enable the private sector to test innovative projects such as providing DLT-based services to financial services firms in a controlled regulatory environment.

The HKMA's response

4.61. Following consideration of the broad support from the respondents on the proposed risk-based approach and the advanced stage of international recommendations for stablecoins, the HKMA will prioritise the regulation of stablecoins at this stage and monitor the interconnectedness between other crypto-assets and the mainstream financial system. The HKMA will take the latest market situation and international discussion into account in considering whether and if so how other crypto-assets should also be regulated. In doing so, the HKMA will continue to have regard to the monetary and financial stability risks that may be posed by different categories of crypto-assets.

4.62. In this regard and as mentioned in paragraph 4.50 above, the HKMA is considering and will conduct additional consultation as to whether there would be more merits in introducing a new legislation that could be used to regulate relevant segments of the crypto-asset market, starting with stablecoins. In the process, the HKMA will maintain close dialogue with other stakeholders in the HKSAR Government and financial regulators on the need to strengthen the regulation of such assets in light of market and international regulatory developments so as to avoid regulatory arbitrage in relevant activities. The HKMA will also continue its ongoing work in implementing appropriate standards set by the SSBs.

4.63. With respect to the issue of sandbox, the HKMA has set up a Fintech Supervisory Sandbox that allows banks and their partnering technology firms to conduct pilot trials of their fintech initiatives involving a limited number of participating customers without the need to achieve full compliance with the HKMA's supervisory requirements. While developing the regulatory regime for stablecoins, we will also give thoughts to the implementation arrangements. The need for a sandbox will be considered in that context.

Q8 from the Discussion Paper

For current or prospective parties and entities in the stablecoins ecosystem, what should they do before the HKMA's regulatory regime is introduced?

Summary of feedback

4.64. A number of respondents suggested the HKMA should introduce a transitional period to provide sufficient time for existing service providers to make necessary

adjustments to their policies, procedures, systems and controls so as to comply with the new regulatory requirements. The majority of respondents suggested that existing or prospective entities in the stablecoin ecosystem could provide feedback for the HKMA's consideration and conduct internal assessment to ensure that they would be considered fit and proper before conducting regulated activities under the new regulatory regime. Some respondents suggested industry players join or establish industry associations to exchange intelligence and learn about the best practices.

4.65. Respondents generally appreciated the HKMA's effort in communicating with relevant stakeholders, and suggested such efforts be continued to gather more feedback on the practicalities and challenges of the proposed regulation.

The HKMA's response

4.66. The HKMA will continue to engage industry participants and other stakeholders in the HKSAR Government and financial regulators as relevant work advances. We will further consult the industry before introducing legislation to set out the regulatory framework. The avoidance of regulatory arbitrage will be addressed during the formulation of legislation and the implementation details.

Other issues

4.67. Respondents also provided feedback on other issues.

4.68. Due to stablecoins' cross-border nature, a number of respondents suggested that the HKMA could consider putting in place supervisory and regulatory arrangements with authorities in other jurisdictions, e.g. by having regard to the home regulatory framework when processing licence application of foreign entities, and adopting a simplified licensing process for foreign companies that were approved as being suitable to conduct stablecoin-related activities by a competent foreign financial regulator.

4.69. Respondents also raised stablecoin-related concerns that cut across different sectors. For example, a number of respondents highlighted that authorities should provide guidance in respect of accounting and tax treatments of stablecoin-related activities. In relation to user protection, it was suggested that the HKMA should take into account the deposit protection scheme as part of the overall stablecoin regime. A few respondents also urged the HKMA to launch public education campaigns in respect of the risks associated with stablecoins and publish consumer alerts with other related parties (e.g. the Consumer Council) to help prevent scams.

4.70. Some respondents commented that it would be important for the HKMA to introduce regulations to manage associated risks without incurring too much compliance cost on industry players, which might inhibit the development of the stablecoin ecosystem in Hong Kong. Respondents also suggested that the HKMA assist crypto-asset companies in obtaining banking services.

4.71. Several respondents mentioned that the HKMA should consider the interoperability of payment systems, including digital money, both locally and internationally. It was also suggested that the HKMA should consider the relationship

between stablecoins and central bank digital currencies and how the interaction between the two might have implications on cross-border payments in the future.

The HKMA's response

4.72. The HKMA welcomes the comments submitted by respondents to which we would give due consideration when considering our regulatory framework and policy.

4.73. Among other things, the HKMA agrees that having regard to the possible cross-border use cases of stablecoins, there should be efficient and effective cooperation and coordination among relevant financial regulators. The HKMA will continue to participate in the relevant international discussions and make contributions with a view to incorporating a suitable cooperation and coordination arrangement in the future regulatory regime. As regards the issue of providing arrangement similar to the deposit protection scheme, the HKMA will continue to monitor relevant international developments and consider whether the same protection outcome may already be delivered through other means (e.g. reserve assets should be at least equal to the amount of outstanding stablecoins in circulation).

5. Next steps

5.1. Following the broad agreement for the proposed approach, the HKMA intends to develop an agile, risk-based regulatory regime for stablecoins with requirements to be applied in a proportionate manner. This will help ensure monetary and financial stability, protect users, and minimise risks of regulatory arbitrage.

5.2. The HKMA will take into account the responses received and draw reference from the relevant international discussions in coming up with the details of the regulatory regime. We will also continue to monitor market developments, engage with the industry along the way, and work with other stakeholders in the HKSAR Government and other financial regulators.

5.3. A more detailed consultation, with more granular information about the regulatory regime, will be conducted in due course with a view to hammering out the major parameters that will be covered in the draft legislation. Among other things, we stated in Chapter 4 above that the HKMA will conduct further assessments in respect of certain issues, e.g. whether to introduce a new legislation or amend existing laws to implement the proposed regulatory regime, how to minimise possible regulatory overlaps, addressing risks that may be posed by provision of multiple or bundled financial services by affiliated entities, and the local incorporation requirement. It is our plan to set out the assessment outcomes and proposed way forward in the more detailed consultation.

5.4. In parallel, the HKMA will also work closely with other stakeholders to implement the regulatory regime through an appropriate legislative exercise. It is envisaged that the draft legislation will set out key issues such as (i) defining the structures and activities that would be regulated or not regulated (e.g. the latter through exclusions or carve out) under the legislation; (ii) the range of effective and proportionate powers that should be granted to the HKMA to implement the regulatory

regime; (iii) the key regulatory requirements; (iv) the range of powers (as well as the relevant framework) that should be given to the authority to allow for the timely update of the regulatory regime to scope in additional structures or activities; and (v) the relevant guiding factors that the authority should have regard to in exercising the powers relating to point (iv) above.

Annex 1 – Recent policy developments among international organisations¹¹

FSB

1. In October 2022, the FSB, in consultation with relevant international SSBs and international organisations, published a proposed framework for the international regulation of crypto-asset activities. The core components of this framework are:

- (i) development of a set of nine high-level recommendations that promote the consistency and comprehensiveness of regulatory, supervisory and oversight approaches to crypto-asset activities and markets and strengthen international cooperation, coordination and information sharing; and
- (ii) revised ten high-level recommendations for the regulation, supervision, and oversight of GSC arrangements to address associated financial stability risks more effectively.

The two sets of recommendations are closely interrelated, reflecting the interlinkages between stablecoins and the broader crypto-asset ecosystem. They have been developed as stand-alone documents but are intended to work together in light of these interlinkages and to be consistent where they cover the same issues and risks.

2. From the review of the FSB’s high-level recommendations for the regulation, supervision, and oversight of GSC arrangements, the FSB proposed to revise the high-level recommendations, with additional clarity and guidance provided on matters such as:

- (i) Governance: The ownership structure, governance and operation should not impede the effective application of relevant regulations and standards. Authorities should require that GSC issuance be governed and operated by one or more identifiable and responsible legal entities or individuals. The governance structure should allow for timely human intervention, as and when needed or appropriate.
- (ii) Trading platforms and other intermediaries: Where a GSC arrangement relies on trading platforms or other intermediaries to perform critical functions, authorities should require those intermediaries fall within the regulatory, supervisory and oversight perimeter wherever possible.
- (iii) Risk management: GSC arrangements should comply with the FATF “travel rule”, and they should have comprehensive liquidity risk management practices and contingency funding plans for addressing large number of redemptions.

¹¹ Mainly sourced from the FSB Report (2022), taking also into account additional information available in the public domain.

- (iv) Redemption and stabilisation mechanisms: GSC arrangements should provide a robust legal claim to all users against the issuer and/or the underlying reserve assets and guarantee timely redemption. For GSCs referenced to a single fiat currency, redemption should be at par into fiat currency. Authorities should require GSC to have an effective method to maintain a stable value at all times, which should include reserve assets that are conservative, high quality and highly liquid, and at least equal the amount of outstanding stablecoins in circulation at all times unless that GSC is subject to prudential requirements and safeguards equivalent to those applicable to commercial money subject to the BCBS standards. A GSC should not rely on arbitrage activities to maintain a stable value and it should not derive its value from algorithms.
 - (v) Applicability of the FSB recommendations: While focusing on GSC arrangements, authorities may choose to apply relevant FSB high-level recommendations as appropriate to stablecoin arrangements more widely, taking into account the size, complexity and risks of those stablecoins.
3. The FSB sought the public's view on the proposals to revise the high-level recommendations. The public consultation ended on 15 December 2022. The FSB aims to finalise the updated high-level recommendations by July 2023 reflecting comments received through public consultation.

BCBS

4. Following two rounds of public consultation, the BCBS published its final standard on the “Prudential treatment of cryptoasset exposures” in December 2022. It categorises crypto-assets into two broad groups to determine their minimum capital requirements for credit and market risk:
- (i) Group 1 crypto-assets are those crypto-assets that meet a set of classification conditions. Group 1 crypto-assets will generally be subject to risk-based capital requirements based on the risk weights of underlying exposures as set out in the existing Basel capital framework.
 - (ii) Group 2 crypto-assets are those crypto-assets that fail to meet any of the classification conditions. As a result, they pose additional and higher risks compared with Group 1 crypto-assets and consequently will be subject to a newly prescribed conservative capital treatment.
5. In addition to the capital requirements for credit and market risks, the consultation provided guidance on the application of other aspects of the Basel Framework to crypto-assets, such as liquidity requirements, operational risk, the leverage ratio and large exposures. The liquidity requirements have been expanded to more fully address the risks posed by crypto-liabilities that may arise in the context of banks issuing stablecoins or other tokenised claims.
6. The BCBS has indicated that some areas, such as permissionless blockchains and additional statistical tests to identify low risk stablecoins, will remain subject to monitoring and further review.

CPMI-IOSCO

7. In July 2022, CPMI and IOSCO published guidance on the Application of the Principles for Financial Market Infrastructures (“PFMI”) to stablecoin arrangements in applying “same risk, same regulation” to systemically important stablecoin arrangements that are used for payments.

8. The guidance, which follows the consultative report of October 2021, reconfirmed the preliminary results from the analysis conducted by the CPMI-IOSCO as part of the FSB’s 2020 report on Regulation, Supervision and Oversight of “Global Stablecoin” Arrangements: if a stablecoin arrangement performs a transfer function and is determined by authorities to be systemically important, the stablecoin arrangement as a whole is expected to observe all relevant principles of the PFMI.

9. A notable feature of the guidance is that it provided expectations for a stablecoin used by a systemically important stablecoin arrangement as a settlement asset to have little or no credit or liquidity risk.

10. The CPMI and IOSCO continue to examine regulatory, supervisory and oversight issues associated with the stablecoin arrangements and coordinate with other SSBs.

IOSCO

11. In March 2022, the IOSCO published its “Decentralized Finance Report” which, among other things, noted that stablecoins are a key feature of the DeFi ecosystem. The report highlighted numerous risks to participants, investors and markets arising from the DeFi including the failure of a stablecoin issuer involved in a particular stablecoin arrangement. Such failure could give rise to significant volatility in the crypto-asset market.

12. With the rapid advancements in the fintech space and the rapid growth of the crypto-asset market, the IOSCO saw the need to establish a Board-level Fintech Task Force to prioritise policy work. The Fintech Task Force is tasked with developing, overseeing, delivering, and implementing the IOSCO’s regulatory agenda with respect to fintech and crypto-assets. It aims to publish a report with policy recommendations by end-2023.

FATF

13. In June 2022, the FATF produced a targeted update on implementation of its “Standards on Virtual Assets and Virtual Asset Service Providers”, which outlined the state of implementation of the FATF’s Recommendation 15 and its Interpretative Note (R.15/INR.15) with a focus on the FATF’s Travel Rule. The Travel Rule (Recommendation 16) is a key AML/CFT compliance measure, which mandates that virtual asset service providers obtain, hold and exchange information about the originators and beneficiaries of virtual asset transfers.

14. On stablecoins, the targeted update found that the usage and liquidity of stablecoins were increasing in parallel with the growth of the DeFi market, as

stablecoins were often used to facilitate trading or serve as collateral in the DeFi protocols. The FATF will continue to monitor market trends related to stablecoins and associated ML/TF risks and will work to facilitate discussion among jurisdictions and other SSBs.

Annex 2 – Recent policy developments among major jurisdictions¹²

1. Recent policy developments in the European Union (“EU”), Japan, Singapore, the United Kingdom (“UK”), and the United States (“US”) are summarised below.

The EU

2. In June 2022, the EU reached political agreement on legislation establishing a framework for Markets in Crypto-Assets, which among other objectives strengthens the regulatory framework for the so-called stablecoins which are classified either as e-money tokens (single currency tokens) or as asset-referenced tokens (multiple currency and other asset referenced tokens). In October, the Permanent Representative Committee of the EU endorsed the revised legal text with a view to agreement. The legislation is intended to implement the FSB High-level Recommendations, and is expected to apply as of 2024, subject to formal finalisation of the adoption procedure. Until that time, existing rules including in particular national legislation implementing the e-Money directive, apply.

Japan

3. In June 2022, Japan passed legislation that defines the legal status of stablecoins and introduces a regulatory framework for them by amending the Payment Services Act and other relevant laws to promote financial innovation and to ensure user protection and AML/CFT compliance. This new regulatory framework will come into force by June 2023.

4. The new regulatory framework defines “digital-money type stablecoins” to be stablecoins that are linked to one or more fiat currencies and whose issuers promise redemption at par. These stablecoins are required to meet higher standards of regulatory requirements so that user protection is ensured and risks to financial stability are fully addressed. To this end, issuers of digital-money type stablecoins are restricted to banks, fund transfer service providers, and trust companies as these institutions are under stringent regulations. As the regime covers stablecoins that are linked to fiat currencies and whose issuers promise redemption at par, they do not cover all types of stablecoins, e.g. those stablecoins that are referenced to commodities or other crypto-assets.

Singapore

5. In October 2022, the Monetary Authority of Singapore (“MAS”) issued a paper to set out its proposed framework to regulate stablecoin issuers and intermediaries. The consultation document sets out, among others, the scope of activities that would be regulated and the key requirements for issuers. The MAS also announced that the measures would be part of Singapore’s Payment Services Act (“PSA”). The MAS invited comments from banks, licensees and regulated entities under the PSA, other financial institutions and interested parties by 21 December 2022. As the regime covers

¹² Mainly sourced from the FSB Report (2022), taking also into account additional information available in the public domain.

stablecoins that are linked to a single fiat currency, they do not cover all types of stablecoins, e.g. those stablecoins that are referenced to commodities or other crypto-assets.

The UK

6. In July 2022, the UK introduced legislation into the Parliament to bring stablecoins, where used as a means of payment, within the regulatory perimeter given their potential for widespread use and potential financial stability implications. It will ensure that stablecoins which reference their value from fiat currency are subject to the same regulatory oversight as similar payment methods, such as e-money. This means that issuers of, and payment service providers using, stablecoins will need to be authorised by the Financial Conduct Authority (“FCA”), and meet FCA conduct and prudential requirements. The Bank of England will also be able to regulate and supervise systemically important stablecoin payment systems and related service providers, subject to the HM Treasury’s recognition. Similarly, the Payment Systems Regulator will be able to regulate and supervise stablecoin payment systems and participants to promote effective competition and innovation, subject to the HM Treasury’s designation. Secondary legislation will create an FCA authorisation and supervision regime, and set out the mechanism for managing co-responsibility for regulation for systemic stablecoin providers.

7. The UK is also currently considering responses to a consultation on its proposal to apply the Financial Markets Infrastructure Special Administration Regime, a bespoke insolvency framework for systemic payment and settlement systems, in amended form, to systemic stablecoin firms to ensure appropriate tools are in place to mitigate the risks to financial stability associated with the failure of a systemic stablecoin firm.

The US

8. In March 2022, the US President Joe Biden signed an Executive Order on Ensuring Responsible Development of Digital Assets, which outlined a whole-of-government approach to addressing the risks and harnessing the potential benefits of digital assets and their underlying technology.

9. In response to President Biden’s Executive Order, the US Department of the Treasury published a report in September 2022, in which it expressed its commitment to work with interagency partners and the Congress to implement recommendations stemming from the President’s Working Group on Financial Markets on Stablecoins.

10. The Financial Stability Oversight Council (“FSOC”) published a report on digital asset financial stability risks and regulation in October 2022, recommending that the Congress pass legislation that would create a comprehensive federal prudential framework for stablecoin issuers that also addresses the associated market integrity, investor and consumer protection, and payment system risks, including for entities that perform services critical to the functioning of the stablecoin arrangement. The FSOC also recommended that federal and state regulators coordinate on the supervision of stablecoin issuers as appropriate. The FSOC stated that it remained prepared to

consider steps available to it to address such risks related to stablecoins in the event comprehensive legislation is not enacted.

11. As of December 2022, the Congress was considering various legislative proposals that encompass stablecoins. For example, Senator Pat Toomey released a draft bill in April 2022 on the establishment of a new regulatory framework for payment stablecoins and the subsequent full bill in December 2022. In accordance with the bill, the regime covers stablecoins that are linked to fiat currencies, and does not cover all types of stablecoins, e.g. those stablecoins that are referenced to commodities or other crypto-assets. And in June 2022, Senators Kirsten Gillibrand and Cynthia Lummis introduced the Responsible Financial Innovation Act that would create a comprehensive regulatory framework for digital assets that encourages responsible financial innovation, flexibility, transparency and robust consumer protections while integrating digital assets into existing law.

Annex 3 – List of respondents

1. Aimichia Technology Co., Ltd.
2. Alipay Financial Services (HK) Limited
3. Animoca Brands and Symphony Digital
4. Arcartera
5. Arta Techfin Corporation Limited
6. Asia Securities Industry and Financial Markets Association
7. Baker McKenzie
8. BC Technology Group Limited
9. Binance
10. BitMint
11. Bitquant Digital Services
12. CFA Society Hong Kong
13. Christopher Sin
14. Circle
15. Consumer Council
16. Deloitte Touche Tohmatsu
17. Doris Keung Yuen-ting
18. Emerging Payments Association Asia
19. Ernst & Young
20. Eversheds Sutherland
21. Financial Intelligence & Investigation Bureau (Hong Kong Police)
22. FinStep Asia Limited
23. Fintech Association of Hong Kong
24. Gilbert Ng
25. Global Digital Finance
26. Henry Yu & Associates
27. HKT Payment Limited
28. Hong Kong Financial Settlement Limited
29. HSBC
30. Imperium Technology Group Limited and Imperium Financial Group Limited
31. Institute of Financial Planners of Hong Kong
32. Institute of Financial Technologists of Asia
33. K.S. Li
34. Lee Kin Ying, Esmond
35. MasterCard
36. Matrixport
37. Mr. Li
38. PwC
39. QReg Advisory Limited
40. R3
41. Ripple Labs Inc.
42. Savio Hui
43. Stephen Yip
44. Stevenson, Wong & Co.
45. Talk+
46. The Hong Kong Association of Banks
47. The Hong Kong Chartered Governance Institute

- 48. V Systems
- 49. Visa
- 50. WeChat Pay Hong Kong
- 51. ZA Bank Limited
- 52. 火幣科技控股有限公司
- 53. 香港南雅貨幣交易所
- 54. 羅智豪
- 55-58. Four respondents requested not to be named

Note: Some of the feedback reached the HKMA after the feedback period closed on 31 March 2022.