



**FINTECH ASSOCIATION
OF HONG KONG**

***Response to the
consultation paper on the legislative
proposal to implement a regulatory
regime for stablecoin issuers in Hong
Kong***

February 2024

The FinTech Association of Hong Kong (FTAHK) is a **member-driven, independent, not-for-profit, & diverse organisation** that is the voice of the FinTech community in Hong Kong. It is organised and led by the community, for the community, through a series of committees and working groups.

Our objective is to promote Advocacy, Communication and Education in the wider FinTech ecosystem.

Build the community.
Be the connector.

A. FOREWORD

In December 2023, the Financial Services and the Treasury Bureau (“**FSTB**”) and the Hong Kong Monetary Authority (“**HKMA**”) released a consultation paper on the legislative proposal to implement a regulatory regime for stablecoin issuers in Hong Kong¹, inviting views from the industry and public on the implementation of a regulatory regime on the issuance of fiat-referenced stablecoins (“**FRS**”), with the aim of:

- (a) Implementing appropriate safeguards to address the potential monetary and financial stability risks posed by FRS;
- (b) Providing adequate protection to FRS users;
- (c) Maintaining Hong Kong’s status as an international financial centre by putting in place an appropriate regulatory regime for FRS issuers that is in line with international regulatory recommendations; and
- (d) Fostering sustainable and responsible development of the VA ecosystem in Hong Kong by providing legal and regulatory clarity.

The FSTB and HKMA have indicated that they have taken into account international recommendations and the characteristics of stablecoins, as well as the market and regulatory landscape, both locally and within other major financial centres. The proposed new regulatory regime will include the following major features:

- (i) A definition of an FRS as a “*cryptographically secured digital representation of value that, among other features, purports to maintain a stable value with reference to one or more fiat currencies, with the exception of items that are already covered by other regulatory regimes, such as deposits...*”;
- (ii) Requiring all FRS issuers who (i) issue an FRS in Hong Kong; (ii) issue a stablecoin that purports to maintain a stable value with reference to the value of the Hong Kong dollar (a “Hong Kong dollar-referenced stablecoin”); or (iii) actively market their issuance of FRS to the Hong Kong public should be licensed by the HKMA;
- (iii) Requiring FRS to only be offered by specified licensed entities in Hong Kong; with unlicensed entities limited to only offering such FRS to Professional Investors;
- (iv) Allowing flexibility to adjust the parameters of the types of stablecoins and types of activities that are determined in-scope of regulation; and
- (v) Establishing a transitional arrangement to allow for migration by eligible pre-existing FRS issuers to the new regulatory regime.

The FTAHK is a not-for-profit industry organisation that has over 1,100 members and is the largest independent FinTech association in Asia. Our wide-ranging membership comprises global and domestic FinTechs, financial institutions, technology service providers, consultancies, law firms, and both student and teaching members from various universities. This submission is made by the FTAHK after consultation with our member base.

The FTAHK is grateful to have the opportunity to respond to this public consultation and welcomes the opportunity to discuss any of the provided feedback in future follow-up sessions with the FSTB and the HKMA.

¹ See: <https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2023/20231227e4a1.pdf>

B. EXECUTIVE SUMMARY

The FTAHK commends the HKMA and the FSTB in their respective efforts to further the regulatory regime around the use of virtual assets in Hong and is generally supportive of the approach suggested in the proposals.

We do, however, feel that there are certain areas in which additional regulation clarity would be beneficial to the market in the move towards regulation and assist in greater adoption of regulated stablecoins by the public, including:

- whether stablecoins designed for the wholesale, corporate or trade sectors fall within the proposed scope of regulation;
- when looking at the reference asset for a stablecoin, a clearer understanding of what the HKMA and FSTB would consider an “asset” under the proposed legislation;
- in respect of the proposed licensing regime, what the expectations are of the HKMA in terms of (a) local presence; and (b) governance, knowledge, and experience, as well as generally around token management and wallet management.

Additionally, we note that the role of intermediaries has not been fully addressed by the HKMA and FSTB, and we would recommend expansion of the proposed scope to include them as an additional means of protecting the public. It is the FTAHK’s views that stablecoin transactions are more likely than not to involve intermediaries, as the issuer of a stablecoin may focus its obligations on the minting and burning of stablecoins, versus engaging directly with end-users.

The FTAHK welcomes the opportunity to engage directly with the HKMA and the FSTB in dialogue on these issues and assist in the development of a broad and cohesive regulatory framework around virtual assets.

C. RESPONSES TO QUESTIONS

C.1 Question 1

Do you agree with the proposed definition of "stablecoin" and "FRS"?

The FTAHK generally agrees with the approach and use of terminology in drafting the definition which mirrors the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (“AMLO”) definition of virtual asset, as this will support the creation of the wider cryptoasset ecosystem in Hong Kong by ensuring consistency in the interpretation of key, common elements.

Whilst generally supportive of the elements of the definitions of stablecoins and FRS, we note that there are areas where further clarity would assist the market in the move towards regulation, and likely assist in greater adoption of regulated stablecoins.

Specifically, in the ‘stablecoin’ definition:

- (a) Section 4.1(b): the reference to “*public*” appears to restrict stablecoins to those “*used or intended to be used...by the public*” This may exclude non-retail stablecoins, for instance those designed for wholesale, corporate or trade sectors, which the FTAHK believe should fall both within the definition and the regulation.
- (b) Section 4.1(c): (i) the meaning of “*control*” is likely to need a clearer technical definition – is this intended to reference the ability to ‘write’ or ‘append’ to the ledger (something which is solely controlled in a centralised traditional database), or is this in relation to the ability to update the software (which is likely solely controlled) or some combination? (ii) Similarly, the meaning of “*issuer*” would benefit from clarity in definition, particularly with reference to the Payment Systems and Stored Value Facilities Ordinance (“PSSVFO”), which separate the roles of ‘issuer’ from ‘facilitator’².

We note that previous consultation paper highlighted two distinct roles, i.e., (i) issuing, creating, or destroying stablecoins; and (ii) managing reserve assets to ensure stabilisation of the stablecoin value – each considered by the FTAHK to be primary roles of an FRS issuer.

- (c) Section 4.1(d): the requirement that the technology is “*not controlled solely by the issuer*” may be open to interpretation and too restrictive for some stablecoins. As an example, the JPM Coin uses the Quorum blockchain which, “*is a blockchain protocol specially designed for use in a private blockchain network, where there is **only a single member owning all the nodes** or a consortium blockchain network where multiple members each own a portion of the network.*” (emphasis added).³

² A regulated entity in the PSSVFO, Section 2B. In one of the e-cash schemes the HKMA regulated under the forerunner to the SVF regulations in the 1990s, a Mondex central originator created the e-cash and managed the assets backing the e-cash, but retail banks (in this case HSBC and Hang Seng) were the issuers of the e-cash to the public. The central originator was a facilitator under the regulation.

³ See: <https://www.kaleido.io/blockchain-platform/quorum> section ‘Benefits of Quorum’

- (d) Section 4.1(e): it would appear that commodities would be included within a general understanding of the term “asset”. The FTAHK suggests either a clear definition of what would constitute an asset within the legislation or provide HKMA guidance (for example, in the form of a non-exhaustive list) as to what would be considered an asset. Generally, it is unclear if a fully commodity backed stablecoin (e.g., fully gold backed) would meet the definition of ‘*medium of exchange*’ as provided in 4(b). A related question would be if the pool of assets backing a stablecoin included both fiat and commodity assets, would this fall under the definition of stablecoin?
- (e) Section 4.2: the exclusion from the stablecoin definition of ‘*certain digital representation of value that has a limited purpose*’ with its associated footnote 11 ‘*digital representation of value that can only be used as a means of payments of goods or services provided by the issuer*’ appears to be based on the PSSVF definition, but may require further refinement if, in fact, the service of the FRS issuers is considered to be solely that of providing a stablecoin facility.
- (f) Section 4.3: Specifically in relation to the FRS definition, it would be beneficial to clarify the expectations of avoiding FX risk from a basket of unrelated currencies supporting an FRS. The FTAHK considers the most relevant cross-currency combination is a Hong Kong dollar-denominated FRS backed by US Dollar assets, which reflects the current arrangement for Hong Kong Dollar notes and coins in issue. Even in this case, there is a question as to whether the FRS should be confined to one fiat currency only, or would the HKMA be comfortable with an FRS backed by a combination of HKD and USD assets?

Lastly, we note that it may also be worth clarifying that, for instance, an offshore USD FRS could be issued and regulated under the proposed legislation provided any applicable regulatory criteria are met by an HKMA regulated Hong Kong Issuer.

C.2 Question 2

Do you have any comments in relation to the scope of regulated stablecoin activity?

We understand that the HKMA wishes to proceed as quickly as possible in its implementation of a regulatory regime for stablecoins as a means of providing regulatory certainty to the market. As such, the FTAHK is generally supportive of the proposed scope of the regulation, though we note that there is a risk of a multi-strata approach to regulation of stablecoins, with potential difficulty on the part of the public in differentiating between those stablecoins that are HKMA regulated, and those that are not. This has already been seen within the local Virtual Asset Trading Platform (“**VATP**”) market, where some companies claim that they are regulated, or in the process of applying for regulation, when this is not the case.

Notwithstanding our general support, the FTAHK would recommend expansion of the proposed scope to consider the role of an “intermediary”. We note that stablecoins are likely to involve an intermediary, as the issuer of stablecoins may not deal directly with the end-users of an FRS, but rather focus on its obligations as an issuer (the creation and, where necessary, burning of any stablecoins) and deal with intermediaries regarding distribution of the same (much like HKD banknotes, which are issued by either the note issuing banks or in the case of the HKD10 banknote, the HKSAR Government, but distributed by all of the banks). We feel regulation of intermediaries is critical to protect the public as, in a redemption situation as envisaged in Section 6.2.9 and 10, it is more likely that the end-user (especially if a member of the general public) of a regulated FRS will go to an intermediary such as a fully licensed bank, for redemption at par, and not to the FRS issuer directly. The intermediary (in this case, the fully licensed bank) will need to have the obligation to redeem at par and subsequently to recover the funds from the FRS issuer, or if their licence is suspended, from the relevant trust.

We also note that under the current proposals for regulation, it is only the issuance of FRS that is deemed a regulated stablecoin activity, specifically those issuers that:

- (a) issues, or holds itself out as issuing, an FRS in Hong Kong;
- (b) issues, or holds itself out as issuing, a stablecoin that purports to maintain a stable value with reference to the value of the Hong Kong dollar; or
- (c) actively markets its issuance of FRS to the public of Hong Kong.

We wish to highlight to the HKMA and FSTB the practical reality that many of the actively traded stablecoins within Hong Kong are, in fact, issued outside of the jurisdiction (e.g., USDC and USDT). Given the nature of these assets (virtual, and traded through the internet), such stablecoins are easily accessible by the Hong Kong public through the issuer’s website or platform. Against this background, we would appreciate greater clarity on the intended meaning of “*actively markets*” so as to avoid the unintended consequences of a foreign issuer with no nexus to Hong Kong falling into regulatory scope, and vice-versa to provide clarity for those who wish to take advantage of Hong Kong as a nexus location, as well as affording protection to those based in Hong Kong to ensure they operate within the regulatory perimeter.

In comparison to the proposed scope as set out in Section 4 of the Consultation Paper, we note that within the United Kingdom (“**UK**”), the regulators are opting to first regulate issuers where the FRS is issued by a UK-based entity – these stablecoins are then permitted to be used as a means of payment within the United Kingdom. In addition, the UK regulators have left it open for future consultations on legislation to accommodate the use of foreign-issued FRS for payments in the UK⁴. We would encourage the HKMA to reference the approach taken by peer jurisdictions to encourage consistency in legislative approach across international financial centres and would be supportive of the development of a wider supervisory (and licensing regime) to include additional types of stablecoins.

Moreover, the FTAHK would welcome future expansion of scope and encouragement of more types of homegrown stablecoins from Hong Kong-based institutions and FinTechs in order to drive innovation and maintain Hong Kong’s position as an international financial centre.

⁴ See: “*Update on Plans for Regulation of Fiat-backed Stablecoins*”, paragraph 2.6, https://assets.publishing.service.gov.uk/media/653a82b7e6c968000daa9bdd/Update_on_Plans_for_Regulation_of_Fiat-backed_Stablecoins_13.10.23_FINAL.pdf

C.3 Question 3

Do you agree with the proposed approach of introducing a new piece of legislation to implement the regulatory regime for FRS issuers, and potentially cover the regulatory regime for other VA activities as appropriate in the future?

The FTAHK agrees with the proposed approach of introducing legislation to implement the regulatory regime for FRS issuers and is of the view that the regulation should address all requirements issuers of FRS must meet in order to achieve licensed status from the HKMA.

With reference to any new legislation potentially covering other VA activities (as appropriate) in the future, we would encourage the HKMA and FSTB to consider regulating non-FRS that are issued outside of Hong Kong, given the rate of adoption of such virtual assets by the wider public. Likewise, we would recommend that the regulations across virtual assets, CBDCs, and FRS be harmonised to ensure regulatory consistency to the greatest extent possible, even if enforcement is, in actuality, effected by different regulatory bodies. In respect of future regulation on other forms of VA activities, we recommend that a regulatory review of the approach taken by peer jurisdictions (as has been done in the preparation of the current proposals) be undertaken prior to the introduction of any new legislative measures and/or regulatory regime.

C.4 Question 4

Do you agree with the proposed exclusion of issuance of FRS from certain regulatory regimes, such as those for securities and SVFs to avoid subjecting FRS issuer to multiple regulatory regimes?

The FTAHK agrees with the proposed exclusion of issuance of FRS from certain regulatory regimes, such as those for securities and SVFs, and believes that this will also serve to add clarity to the market on the regulatory position of FRS and avoid duplicative oversight. We note that the SVF regime is well-established and fit for its purpose of regulating primarily low-value retail stored value payment schemes. Further, we note that as the nature of stablecoins (FRS, or otherwise) includes high-value applications (e.g., use in wholesale, corporate payments and/or investments), we do not feel it appropriate to subject either existing or future SVFs to the stablecoin regulatory regime, or likewise, subject a stablecoin to the SVF regulatory regime.

Notwithstanding the foregoing, we would like to highlight that the exclusions may have long-term implications for FRS issuers that are looking to diversify offerings. As an example, FRS issuers looking to expand offerings into securities or SVFs may face significant barriers from transitioning between disparate frameworks, increasing compliance costs and complexity. This friction may serve to disincentivise FRS players from expanding their service offerings, potentially inhibiting innovation. We ask that the HKMA and FSTB consider a more unified approach towards the regulation of stablecoins under a single license, such as that taken by Singapore. Similar challenges arise for SVF licensees seeking to provide FRS – the additional regulatory hurdles could serve as a hindrance to potential cross-sector expansion.

With reference to a specific exclusion, we would like to understand whether the intention will also be to exclude FRS specifically from the definition of virtual asset under s53ZRA AMLO (for example by mechanism of s53ZRA (4)(b)). If an FRS also falls within the definition of a virtual asset, then we understand that any authorised institution or licensed corporation wishing to offer such FRS would only be able to do so through a partnering with a licensed VATP (as set out in the HKMA and SFC's Joint Circular on intermediaries' virtual asset-related activities). In addition, the offering of FRS by licensed VATPs will be subject to enhanced requirements when dealing with retail clients (such as the requirement to be a large-cap virtual asset).

We note that this may discourage new entrants to the market as meeting this requirement may prove challenging. As the FRS issuers and the FRS will be subject to a detailed set of prudential, business conduct and supervisory requirements, we do not think that they should then be subject to extra requirements in relation to offerings by a VATP (we contrast this with the lack of such requirements for the issuers of virtual assets), and of course the FRS issuer would not be subject to those extra requirements which would mean there is an uneven playing field. We would encourage the HKMA and FSTB to work with the SFC to ensure that FRS that are successfully licensed are able to be traded on licensed VATPs as a matter of course, i.e., without the strenuous due diligence requirements currently required by the SFC on virtual assets to be listed.

Further, notwithstanding our general agreement with the proposed exclusions, we would appreciate additional clarity on how these exclusions are to be achieved. As an example, is

the intention to amend legislation already in effect to carve out stablecoins? The FTAHK would appreciate the opportunity to comment on any specific arrangements and encourage the HKMA and FSTB engaging with market participants prior to enacting any such changes. Relatedly, we would also appreciate guidance on how the exclusions will work against the possibility of future stablecoin arrangements being brought into the proposed licensing and supervisory regime.

C.5 Question 5

Do you have any comments on the proposed licensing regime for FRS issuers?

The FTAHK refers the HKMA and FSTB to our comments in our response to Question 2 above on the role played by intermediaries.

We would suggest that the definition of “issue” of an FRS in Hong Kong be further refined, as a means of providing additional clarity to the market as to what firms are actively in-scope of the regulatory regime. An example of an area where additional guidance would be beneficial is in respect of an entity that accepts fiat currencies (Hong Kong dollar or otherwise) in exchange for FRS in Hong Kong – would this be considered an “issue”, or would the regulators look at this act of exchange as the act of an intermediary, and therefore out of scope of the proposed regulations.

We additionally would like to better understand, and would appreciate if future guidance documents and legislation could clarify, the following:

- (a) Segregation of Assets (S6.2.3): in a situation where an authorised institution (“AI”) is the FRS issuer, will such AI be able to custody the reserve assets itself in an appropriate segregated account?
- (b) Local Presence (S6.2.14): would it be possible to align the local incorporation requirement for FRS issuers to be akin to that for Ais, which include overseas companies that have a place of business in Hong Kong that are required to be registered under Part 16 of the Companies Ordinance (Cap. 622)? The requirement to have a licence under the regime will allow the HKMA to retain the right to take enforcement actions against the FRS issuer, as it will be required to comply with regulatory requirements in order to continue to issue and offer the FRS.
- (c) Governance, Knowledge & Experience (S6.2.19): We would appreciate further clarity on what the requirements will be in order to ensure that firms wishing to issue FRS have the correct personnel (finding and employing personnel in this area can require long lead-times), for example will there be specific requirements in relation to the education / professional qualifications for senior management?
- (d) Regulatory Guidance: Will there be a separate set of guidelines or guidance similar to a supervisory policy manual for FRS issuers? We would be grateful to see drafts of the proposed guidance prior to its implementation.
- (e) Requirements in relation to wallets and/or custody arrangements: It is important for the industry to understand whether there will be specific requirements in relation to the wallet/custody of the FRS themselves? The consultation sets out the current direction of travel for the preservation of the reserve assets. However, there has been less of an indication of what the proposals will be for the custody of the FRS themselves.

C.6 Question 6

Do you have any comments on the proposed licensing criteria and conditions?

Whilst generally supportive of the proposed licensing regime, the FTAHK is of the view that additional licensing criteria could be considered by the HKMA and FSTB, including around the following:

- (a) Token Management: This would address processes such as token issuance, token modification and token destruction. It is important to ensure that these processes are authorised, accurately recorded, and completed in a timely manner.
- (b) Wallet Management: This would address internal controls and governance procedures (including segregation of duties) and should be established and implemented for wallet and private key management, to ensure all cryptographic seeds and private keys are securely generated, stored and backed-up. Access to any wallet or transaction systems and key materials should be restricted to authorised individuals only.

In addition, we would appreciate additional clarification from the regulators as to whether an FRS issuer will be permitted to manage firm and client wallets, and if so, what additional licensing criteria is to be met (e.g., TCSP licence). Additionally, the expected standards of controls for wallet management by an FRS issuer should be stipulated, including whether the same (or similar standards) as that required by the SFC for VATP issuers are to be met. If, in fact, FRS issuers are not permitted to manage firm and client wallets, it would be useful to understand whether custody of an FRS through a VATP is the alternative? In this instance, guidance on the expected minimum outsourcing controls should be provided to assist with regulatory clarity.

We would also appreciate guidance as to whether the requirement for an independent assessment is a mandatory requirement for (i) the purposes of obtaining a licence; and/or (ii) the public launch of a business. Where there is a need for an independent assessment, further clarification on whether such assessment is to cover design effectiveness in addition to implementation effectiveness of the in-scope areas as proposed by the regulators is appreciated.

Turning specifically to the Licensing Criteria and Conditions as set out in Section 6.2 of the consultation paper:

- (A) **Management of reserves and stabilisation mechanism**
 - 6.2.1. Full backing: We recommend additional clarification as to whether it is permissible to pool assets for reserve backing where the FRS issuer has multiple issuances of FRS (i.e., has issued FRS under different currencies). We assume this would not be a permissible practice for HKMA-licensed FRS issuers. Similarly, additional clarification on the alternate scenario would also be useful, i.e., is it permissible for an FRS issuer to pool assets for the purposes of reserve backing, where such FRS issuer has multiple issuances of FRS in the same currency, but under a

different blockchain protocol? Our understanding is that this would be a permissible practice and welcome the HKMA and FSTB's views on the same.

6.2.3. Segregation and safekeeping of reserve assets: We agree that ensuring reserve assets are appropriately safeguarded is imperative to ensure consumer confidence, and therefore the success of a stablecoin regulatory regime. As such, we agree with the suggested approach to segregating reserve assets, in essence ensuring that reserve assets are treated akin to client assets and therefore segregated. We also note that this approach is in line with that across other financial services businesses and welcome the consistency in approach. One area for clarification is whether it is the regulators' intention that the same client asset segregation model is to be applied where the FRS issuer is also an HKMA-licensed bank or custodian – would such an institution have the option to establish their own trust, or is it the intention that FRS issuers are required to work with an established and independent third party trustee to place reserve assets? As we have stated above, we view robust internal control methods as a necessity at both the issuer and trustee level as a means of ensuring that assets reserve assets are protected from operational risks including the risk of theft or misappropriation.

6.2.4. Risk management and controls: We are of the view that the HKMA and FSTB should seek to mandate more formal risk management attestations required of management and controls reports, similar to those in place within the regulated banking sector.

6.2.7. Effective stabilisation: In respect to effective stabilisation, additional clarity as to the intentions and/or expectations of the HKMA and FSTB with regards to “effective stabilisation” and the “stabilisation mechanism” would be useful. In particular, guidance on (i) the expected types of operating models; (ii) whether the use of liquidity providers is permitted/ expected; and (iii) whether the HKMA and FSTB would be supportive of innovation in this regard.

(B) Redemption requirements

In respect of redemption requirements, the FTAHK is of the view that sufficient consideration is given to the various business models/ distribution models, e.g., in an instance where an FRS issuer does not directly front with customers (instead going through via an AI or VATP), how would this situation be viewed against the stated redemption requirements?

6.2.9 provides that “direct redemption for all FRS users at par in a reasonably timely manner”. We note that this may not reflect an FRS arrangement with a hierarchy of intermediaries, e.g., a central FRS issuer that only deals with FRS end-users through wholesale arrangements with intermediaries (fully-licensed banks, for example). We would suggest modifying the concept of requiring direct redemption (as intimated through use of the phrase “*must ensure direct redemption*”) to reflect the more practical reality, i.e., issuers must ensure sufficient arrangements are in place to allow for redemption at par for all FRS users.

We also note that it is presently unclear whether regulated intermediaries should have an obligation to exchange a regulated FRS at par (6.2.8) with (i) the public, i.e. retail FRS users and/or (ii) any FRS user. It is likely that the position may vary between FRS issued to the public (who will expect redemption at par) rather than FRS offered to non-public, as this would limit secondary market trading on a wholesale basis. An example of a scenario in relation to intermediaries' obligation to redeem an FRS at par from the public may be if, per Section 6.2.1, the FRS ceased to be fully backed and suspended. As a means of avoiding a public run, we recommend implementation of regulatory requirements on intermediaries to redeem at par from the general public and allowing such intermediaries to then make claims from the FRS issuer or trust.

(D) Physical Presence in Hong Kong

We would appreciate additional details on what the HKMA and FSTB would consider maintenance of a physical presence in Hong Kong.

(E) Financial resources requirement

In setting financial resources requirements, the FTAHK urges the HKMA and FSTB to adopt a position that will not result in the creation of an uneven playing field.

(F) Disclosure requirements

The requirement for publication of a "white paper" by the FRS issuer is ambiguous. Additional guidance from the HKMA and FSTB as to the requirements and form would be appreciated. For example, is it expected that the document sets out the terms and conditions related to the FRS issuance, policies, and procedures of the issuer? Relatedly, what are the accountability standards in relation to the contents of any such document?

(G) Governance, knowledge, and experience

We agree with the requirement to ensure that controllers, chief executives, and directors are fit and proper and have appropriate skills and experience to discharge their responsibilities. In relation to management of an issuer, are the HKMA and FSTB able to provide guidance on whether it will adopt a Responsible Officer/ Senior Management regime, similar to that seen in other regulated HK businesses, to assist issuers with the selection and appointment of senior management?

(H) Risk management requirements

In respect of risk management requirements, the FTAHK would recommend additional clarity from the HKMA and FSTB on the obligations of FRS issuers toward end-users (e.g., retail customers) when there is an instance of business/ operations disruption, especially in scenarios where FRS are distributed through SFC regulated VATP. It would be useful for guidance from the HKMA and FSTB on specific scenarios under which FRS issuers would be expected to handle redemption requests from end-users under extreme conditions, and, as suggested in our answers above, the scenarios

under which an intermediary should handle end user's request for redemption under extreme conditions.

(I) Audit requirements

With respect to the required periodic attestation, we are of the view that consideration should be given to the issuance by FRS issuers of an annual report on internal controls, in a manner similar to that expected by financial/ prudential regulators across robust banking licence regimes.

We would appreciate additional guidance on the determination of what is considered "sufficiently liquid", as well as the expectations and frameworks for any smart contract audits. On this last issue, as there is currently no defined, standardised framework for auditing a smart contract, the FTAHK recommends working closely with auditing bodies, both in Hong Kong and on a global basis, to determine the requirements for any framework.

(J) Anti-Money Laundering and Counter-Financing of Terrorism requirements

The FTAHK is generally supportive of the application of the AMLO to FRS issuers and encourage the promulgation of measures applicable to the sector. We are of the view that the substantive differences in the nature of FRS business models in comparison to those of AIs and SVFs, in particular as a result of the risks and opportunities that arise from the application of distributed cryptographic technology, necessitate sector-specific guidance.

As appears to be the intent of the HKMA and FSTB, such sector-specific regulations should apply to the FRS issuers at the time of issuance and redemption. As stated above, we are of the view that the role of intermediaries does need to be considered when looking at FRS circulation. At the time of issuance and redemption of an FRS, we suggest that the responsibility of AML/ CTF monitoring lie with the FRS issuer; over the course of circulation of the FRS, the responsibility for monitoring should lie with the entity that facilitates in the circulation (whether the issuer or the intermediary). Further clarification in this regard would be helpful.

We understand that it is open to the regulators to require FRS issuers to implement compliance-enhancing functionality in the design and functionality of their products and services e.g., inclusion of functionality in FRS smart contracts to facilitate the freezing of tokens involved in illicit activity where determined necessary by relevant authorities, or in the case of ancillary services offered by FRS issuers, ensuring that such products do not afford undue levels of anonymity to users of wallets provided by issuers.

C.7 Question 7

Do you have any comments on the proposed power given to the MA to impose additional licensing conditions?

The FTAHK notes that the proposed power to impose additional licensing conditions are limited to the current scope of the consultation, i.e., additional licensing conditions would be for FRS issuers. We believe that additional regulatory clarity is desired by market participants that will engage with stablecoins (e.g., intermediaries such as AIs, VATPs or custodians), and as such, the licensing regime should be wider in scope to address:

- (a) the issuance and offer of digital assets in general, as well as specifically, issuers of asset-referenced tokens and issuers of e-money tokens;
- (b) admission of digital assets to trading platforms; and
- (c) provision of digital asset services (which may include provision of custody and administration of digital assets; operation of trading platforms, order management and execution and portfolio management as well as advisory services) and protection of clients of those digital asset service providers.

The FTAHK is supportive of greater regulatory clarity on issues such as:

- (i) terms of definition of relevant digital asset products and services;
- (ii) how those products and services are accommodated within either existing or new frameworks of law, regulation, and licensing regimes; and
- (iii) the allocation of authority and responsibility for financial regulatory oversight (which is likely to be derived from the definition and classification of products and services, which will determine which body of law or regulation applies, and therefore which supervisory powers are enabled to act).

We would welcome the opportunity to engage with the HKMA and other regulators in dialogue on the above and assist in the development of a broader regulatory framework around virtual assets.

C.8 Question 8

Do you have any view on the proposed arrangements for the offering of FRS?

The FTAHK regards the emphasis on user protection (through the proposal that only HKMA licensed issuers can offer FRS to the general public) as a positive step in mitigating risks associated with unlicensed entities. We also note that those FRS issued by non-HKMA regulated entities are still able to be offered to Professional Investors in recognition of the diverse needs and risk profiles of different investor groups.

In respect of the public offering of FRS, detailed guidance on the offering arrangements would be required, and such guidance should cover the following:

- (a) minimum content requirements for the offering terms, e.g. the specific information of
- (b) the reserve assets, valuation and stabilisation mechanism, risk disclosures and dealing arrangements etc.;
- (c) redemption process;
- (d) custody arrangements (including identity of the custodian); and
- (e) liquidation of the FRS issuer.

Our understanding is that the consultation envisages AIs and licensed corporations to be a mainstream distribution channel for FRS in Hong Kong. As referenced in our answers on the proposed scope of the legislation, the FTAHK is of the view that the intended distribution channels be widened to capture the role played in distribution by intermediaries. That being said, we are of the view that it would be useful for market participants if the HKMA (together with the SFC, if need be) formulate specific conduct guidelines to ensure regulatory alignment on offering activities, e.g., if an FRS is to be offered by an AI (regulated by the HKMA) and also by a VATP (an intermediary, regulated by the SFC).

Relatedly, as the inclusion of FRS will be an expansion of the product range for AIs and licensed corporations, our understanding is that the relevant conduct guidelines will likely expand the Hong Kong Regulated Entities' existing regulatory obligations with respect of selling or distributing products and would appreciate if additional consultation on any such changes to these conduct guidelines could be undertaken.

We also note that in relation to OTC operators, once an HKMA regulated stablecoin is available in Hong Kong, it would seem that providers of OTC crypto services would no longer be considered as solely dealing in commodities, and therefore outside of the scope of the Money Service Operators (“MSO”) Ordinance and Licensing Regime. We would recommend coordinating to amend the MSO Ordinance and/or Licensing Regime as appropriate to reflect

the monetary nature of an HKMA regulated FRS in parallel with any proposed legislation to regulate stablecoins⁵.

On the matter of who an offering of FRS can be made to, the consultation sets out that under the FRS regime, only those FRS issued by HKMA-licensed FRS issuers are able to be distributed to retail investors. To distribute or actively market an FRS, an entity must be any one of (i) the FRS issuer of that particular FRS, an AI, an SFC licensed corporation or licensed VATP, and (ii) must have a licence to carry out active marketing. FRS not issued by an HKMA-licensed issuer may only be distributed to Professional Investors.

We are unclear as to whether it is the intention of the HKMA and FSTB to create a regime where marketing to Professional Investors only will not amount to “active marketing”. We have had discussions with members as to whether it would be possible to actively market an FRS whose issuer is not HKMA-licensed if the marketing is to Professional Investors only, and if so, what the requirements would be, e.g., will this marketing be covered by the proposed new regulation, or by another piece of regulation? It would appear that unlicensed FRS issuers cannot offer an FRS to Professional Investors themselves, but confirmation of this point would be helpful to the market. Relatedly, we would also like to understand what approach will be taken in relation to stablecoins that do not fall under the proposed regime at all.

As a final comment, although not touched on directly in the consultation paper, in relation to custody, the FTAHK recommends that any guidelines in relation to custody/ treasury of stablecoins follow the same technical requirements for virtual asset custody as required of VATP operators, including guidelines on how cryptographic keys are to be secured and stored, policies and enforcement rules on who has the authority to mint and burn FRS, and requiring that back-ups of private keys and seeds are situated within Hong Kong.

⁵ We note that the consultation paper (https://www.fstb.gov.hk/fsb/en/publication/consult/doc/VAOTC_consultation_paper_en.pdf) issued by the FSTB proposing legislation on over-the-counter trading of virtual assets addresses this and will provide substantive comments to the FSTB on this issue in our submission to that paper.

C.9 Question 9

Do you support granting the authorities necessary powers to adjust the parameters of in-scope stablecoins and activities, similar to the VASP regime?

The FTAHK is generally supportive of granting the authorities the necessary powers to adjust the parameters of in-scope stablecoins and activities, similar to the powers accorded to the SFC under the VASP regime. Where there is to be any such adjustment, we would recommend that the HKMA consult with the industry prior to any adjustment being enacted, as a means of ascertaining market impact of any such change. In addition, a period of transition would be advisable, to allow market players sufficient time to bring operations in-scope of any adjustments to parameters.

We have two specific comments in relation to Section 9 of the consultation:

- (a) Section 9.1.1: the phrase “... *users or its creditors*” as used in (ii) may benefit from being rephrased as “*users or its other creditors*”, as the FRS users are primarily the creditors of the FRS issuer; and
- (b) Section 9.1.2: with respect to the consent of the HKMA for changes in management, we would recommend clear guidance being provided to the market as to what information and supporting documentation will be required from licensees as a means of ensuring regulatory clarity and ensuring efficiency in the system.

C.10 Question 10

Do you consider the proposed criteria and factors relevant and appropriate for the authorities to take into account when exercising such powers?

In relation to the proposed criteria and factors to be considered when adjusting the parameters of in-scope stablecoins and activities, the FTAHK suggests the following:

- (a) when looking at the number and value of transactions (S8.2(b)), to also consider the nature of transactions, as this may perform a critical role in a wholesale market;
- (b) rather than general market share, consider looking at the “relevant” market share (S8.2(e)) as related to the nature of transactions under consideration.

We would also recommend that it would be helpful to have regard to the type of activity of the particular stablecoin or issuing entity, e.g., is the FRS being used for payments, cross-border payments, investment purposes, etc., when assessing whether they would be usefully regulated through any new legislation.

C.11 Question 11

Do you have any comments on the proposed supervisory powers of the MA on licensed FRS issuers?

We have no comments on the proposed supervisory powers of the HKMA on licensed FRS issuers.

C.12 Question 12

Do you have any comments on the proposed investigative powers of the MA in respect of licensed FRS issuers?

We have no comments on the proposed investigatory powers of the HKMA in respect of licensed FRS issuers.

C.13 Question 13

Do you have any comments on the proposed offence and sanction provisions, in particular the sanctions and pecuniary penalty proposed, as well as the special arrangements?

We have no comments on the proposed offence and sanction provisions as set out in the consultation paper.

C.14 Question 14

Do you have any comments on the proposed transitional arrangement?

The transitional arrangements as referenced in the Consultation Paper show a rather limited timeline for application. Based on other HKMA requirements and the requirements of the SFC's VATP regime, we assume that the application requirements will be quite detailed.

In light of this, it is likely that FRS issuers will need to make fundamental changes in their operations, to capture any governance and/ or business requirements, in addition to necessary staffing changes; this will take time to implement. We believe that the sandbox will assist with the application process, as it should allow for an exchange of views and provide accelerated feedback to the HKMA. However, we note that even with this assistance, the proposed timeframe is quite tight.

As a final comment, we would appreciate additional clarity from the HKMA as to which applicants will go into the sandbox – is there a selection process, or will all FRS applicants be admitted to the sandbox, pending registration?

FTAHK

29th February 2024

<https://ftahk.org>