

**By email (stablecoin\_feedback@hkma.gov.hk)**

30 March 2022

Hong Kong Monetary Authority  
55/F Two International Finance Centre  
8 Finance Street  
Central  
Hong Kong

Dear Sir,

**DISCUSSION PAPER ON CRYPTO-ASSETS AND STABLECOINS**

The CFA Society Hong Kong has reviewed the abovenamed discussion paper and we have summarized our comments on the discussion paper in the appendix to this letter for your reference.

Should you have any questions, please do not hesitate to contact the undersigned at [eric.chiang@cfahk.org](mailto:eric.chiang@cfahk.org) or 2530 9200.

Yours faithfully,  
For and on behalf of CFA Society Hong Kong

Eric Chiang  
Managing Director

Encl.



**1. Should we regulate activities relating to all type 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?**

We agree that activities relating to stablecoins and other type of virtual assets (VA) should be regulated for the good of the Hong Kong citizens. As revealed in Annex A of the discussion paper, stablecoins are members of the VA family.

While this discussion paper talks about licensing of intermediaries which engage in the regulated activities, we are of the view that the government should take a more holistic approach in regulating activities of VA in Hong Kong. We understand that the Financial Services and Treasury Bureau (FSTB) launched a public consultation in 2020/21 on a licensing regime on virtual asset service provider (VASP).

Based on the consultation conclusion published on 21 May 2021 (consultation conclusion), respondents to the consultation were supportive to the proposed licensing framework which include:

- i. Designate the business of operating VA exchange as a “regulated VA activity” under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO) (Cap. 615) and require any person seeking to operate a VA exchange in Hong Kong to apply for a licence from the Securities and Futures Commission (SFC) as a licensed VASP under the AMLO;
- ii. Locally incorporated companies and companies incorporated elsewhere but registered in Hong Kong under the Companies Ordinance (Cap. 622) with a permanent place of business in Hong Kong will be considered for the granting of VASP licenses;
- iii. To ensure the integrity of the management of a licensed VASP, it was proposed that an applicant has to pass a fit-and-proper test to be considered for the granting of a VASP license;
- iv. Licensed VASPs will be subject to the AML/CTF requirements (notably customer due diligence (CDD) and record-keeping requirements) stipulated in Schedule 2 to the AMLO, as well as other regulatory requirements for investor protection purposes;
- v. The VASP will be granted an open-ended licence, i.e., it will remain valid until the licensed VASP is revoked by the SFC; and,
- vi. VASP will be subject to the SFC’s close and ongoing supervision in respect of conduct and operation, and the SFC will have the power to review and revoke a licence as need be notwithstanding the open-ended nature of the licence. The SFC will also have the power to take disciplinary actions, including suspension or revocation of licence, against VASPs which are found guilty of misconduct or not fit and proper.

We appreciate that the definition of stablecoin stated in Annex A of the discussion paper is not an universal one. Paragraph 2.8 of the consultation conclusion stated clearly that *“The definition of VA applies equally to virtual coins*

*that are stable (i.e. the so-called “stablecoins”) or not and irrespective of the purported from the underlying assets”.*

While we envisage that the above proposed framework for VASP is largely for compliance with the relevant recommendations of Financial Action Task Force (FATF), point (iv) above clearly spells out that investor protection is also important.

Moreover, some stablecoins may be backed by a basket of currencies and/or short term investments not dissimilar to a money market fund. Globally there was a review of regulations and policy proposals around money market funds following the liquidity crunch and volatility in the short term funding markets in March 2020 which exposed vulnerabilities of money market funds.

In view of the above, there could be overlap or gap in the proposed regulatory regime if we are not taking a holistic and co-ordinated approach in building up the regulatory framework for VA. And we agree that Hong Kong should follow the relevant FATF recommendations in deploying a risk-based approach in setting up the regulatory framework. Yet, it is equally important that the general investor protection protocols be observed.

We consider that it would be preferable to have wider coverage to cover algorithm-based stablecoins and VA in the regulatory regime for better investor protection. Despite this, we do not have objection to give priority to certain stablecoins for regulation. We believe that stablecoins that have potential for mass adoption as means of payment should be given priority to be regulated. And the government should keep monitoring the market development and make adjustments to the scope of supervision of stablecoins in future. This is because:

- The market is dynamic. Algorithm-based stablecoins may gain popularity over time and become a commonly-used means of payment;
- Algorithm-based stablecoins may pose higher risk to investors as compared with asset-linked stablecoins as algorithm-based stablecoins appear to be more dependent on the integrity of the issuer and are more complex in terms of business models; and,
- The structure of stablecoins will evolve over time. There may be hybrid versions of stablecoin (i.e., algorithm-based coins with asset-backed features), and therefore regulation should evolve in time.

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

We are of the view that entities involved in the critical business processes should be subject to the licensing requirement. For instance, the following could be considered as critical business processes for stablecoins:

- The central developer or governance body of the stablecoins. In general, financial institutions (e.g., as a business involved in the “issuing and managing means of payment”) or VASP (e.g., as a business involved in

the “participation in and provision of financial services related to an issuer’s offer and/or sale of a VA”);

- Entities that operate the stabilization and transfer mechanism, and act as the user interface (e.g., by offering custodial wallet and exchange and transfer services); and,
- Entities engage in custody services, administration and reserve management of stablecoins.

And we agree that the activities listed out by HKMA in Question 2 of the discussion paper should be subject to the proposed licensing requirements.

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

We agree that there is a need to regulate the activities of the intermediaries of stablecoins and the proposed licensing regime could be a solution. We, in principle, agree to the views expressed by HKMA in the discussion paper on the direction of supervision. However, we would like to supplement with the following:

- *Sanctions*

It is not uncommon for the regulator to impose sanctions on the market participants for non-compliance of the regulations of the licensing regimes. However, there is no indication in the discussion paper what penalties would be imposed on the market participants on their non-compliance behaviours.

Sanctions serve as efficient means to deter market participants from performing non-compliant acts. Despite this, sanction level should be commensurate with the damages caused by the non-compliant activities such that the sanction itself would not become a deterrent for the interested intermediaries to enter into the market.

Moreover, the sanction level should be fair and equitable to all the market players. Noting in question 4 that it is the intention of HKMA to require all intermediaries which engage in the regulated activities to be Hong Kong incorporated companies and it does not seem that financial institutions (FI) would enjoy exemption from the licensing requirements. We note that FIs may be subject to significantly higher penalty ceiling as compared to Designated Non-Financial Business and Professions (DNFBP) in AMLO. To make it fair and equitable to all the market players, the penalty ceiling for the same regulated activities should be the same but the regulator can juggle around the penalty loading within the same penalty ceiling based on the knowledge on the subject matters of the market participants

- *Licensing and on-going monitoring*

In the proposed licensing regime for VASP, SFC will grant open-end licenses and the licensed VASP will be subject to on-going monitoring and supervision by SFC.

Given that the stablecoins that HKMA intends to regulate are those with potential for mass adoption as means of payments, it is worth discussing if an open-end license mechanism should be adopted for the stablecoin licensing regime. Besides, it is debatable whether we should rely solely on the on-going monitoring mechanism to identify the non-compliant activities in a risk-based supervisory approach when the general public is the potential participants in the ecosystem of the stablecoins that HKMA intends to regulate.

Given that the fast pace of the development of the stablecoin sector, shall we consider requiring the licensees to apply for license renewal in regular intervals (e.g. once every two to three years) so that HKMA would have a chance to review thoroughly whether the licensees are still fit and proper to be stablecoin intermediaries? Despite this, we consider an efficient on-going monitoring system is important to make the licensing regime functional.

- *Legal backing for the licensing regime*

As indicated in point 5.3 of the discussion paper, we need to review whether a new legislation or amendments to the existing legislation(s) is/are needed to back up the licensing regime.

We are of the view that appropriate legal backing is important to make the licensing regime functional and credible. Otherwise, the regulator may become toothless in conducting the regulatory actions.

- *Transitional arrangement*

Considering that it will be a new licensing regime, intermediaries which are engaged in the regulated activities should be given sufficient time to comply with the new licensing requirements. The final decision on the duration of the transitional period should consider the feedback from the survey to be conducted by the HKMA on the market topography.

#### **4. What is the intended coverage as to who needs license under the intended regulatory regime?**

We are of the view that individuals and entities which carry out the regulated activities discussed in question 2 should be subject to the licensing requirements. However, we have reservation on the exclusion of non-Hong Kong incorporated companies from applying for the licences as proposed by HKMA.

While some may argue that limiting Hong Kong incorporated companies to apply for the licenses would make the administration and supervision easier, it is likely that substantial part of the stablecoin activities can be processed by servers which could be located outside Hong Kong. The proposed licensing limitation does not appear to be in line with the international practice.

As revealed in the consultation conclusion, many respondents had reservation on the then proposed prohibition of non-Hong Kong incorporated companies to

apply for the VASP licenses. As a result, the qualifying condition was adjusted to Hong Kong incorporated companies or branches of foreign companies which had been properly registered under the Companies Ordinance. This is something worth exploring to make Hong Kong competitive in the international market landscape.

As a separate note, per FATF's Recommendation 15 and its interpretative note, "A country need not impose a separate licensing or registration system with respect to natural or legal persons already licensed or registered as financial institutions (as defined by the FATF Recommendations) within that country, which, under such license or registration, are permitted to perform VASP activities and which are already subject to the full range of applicable under the FATF Recommendations." It would be helpful if HKMA can clarify whether Hong Kong wants to set up the regulatory regime stricter than the FATF recommendations by requiring all intermediaries, including FIs, to get licenses.

**5. 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?**

The pace for VA development is fast and there are VA, including stablecoin, activities in the market nowadays. Protection to the market participants are limited for the time being. Therefore, it would be preferable to implement a functional and efficient licensing regime as soon as possible.

We do not have any specific comment on the potential regulatory overlap. However, as per our comments on Question 1, if the government can take a more holistic approach in policy formulation for VA, we can potentially reduce the chance of regulatory overlap or gap.

For instance, peer-to-peer transactions form part of the stablecoin ecosystem. However, there is no coverage on peer-to-peer transactions in the views shared by HKMA for Question 4 which may leave uncertainty on whether peer-to-peer transactions will be disallowed in Hong Kong going forward or this represents a gap in the regulatory regime.

**6. Stablecoins could be subject to run and become potential substitutes of bank deposits. Should 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?**

As stated in the blog of the Secretary of FSTB dated 17 March 2022, "*the virtual asset (VA) industry has flourished across the globe in recent years, with a substantial increase in market capitalisation as well as a growing number of participating institutions and investors. As an international financial centre, Hong Kong has attracted a wealth of talent and a great many start-ups in the VA sector. VAs and their underlying technologies (including Blockchain) are capable of bringing numerous opportunities for financial innovation. That said, for this emerging industry, it is important to put in place a comprehensive regulatory*

*system to build up market confidence, and hence provide a pathway to its sustainable development.”*

As revealed in section 3.1 of the discussion paper, there are a few policy options. The extreme option would be “*blanket ban*” and the main characteristic of this option is “*eliminate new risks to the maximum extent possible*” and the possible downside is “*possible challenges to financial innovation*”. And the risk-based regime as proposed in the discussion paper is in the middle of the spectrum.

Requiring stablecoin issuers to be AIs under the banking ordinance would help develop the market integrity and market confidence as the barrier of entry on becoming an AI is high. And arguably requiring issuers to be AIs would also help build a pathway to the sustainable development of the stablecoin market in Hong Kong. However, we should be cautious not to over-regulate the market because it may deter the potential participants from entering into the market.

**7. 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?**

We, in principle, agree to the views expressed by HKMA in the discussion paper. To position Hong Kong ahead of the peer international or regional financial centres, we also believe that unbacked cryptos should also be monitored for their development and evolvement as the market of unbacked cryptos is also growing fast and getting sizeable.

Investors, especially the unsophisticated retail investors, often find it difficult to differentiate the nature of the backed and unbacked cryptos. While we acknowledge the diversified nature of unbacked cryptos which renders it difficult to classify in the precise regulatory regime in Hong Kong now, we see a potential risk of undue generalization by the investors and stakeholders in or interested in the crypto market if only backed ones are regulated. This could lead to loopholes causing material market failures one day as we saw in various structured products defaults or scams in Hong Kong. As such, a proactive approach to regulate the unbacked cryptos would be desirable.

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

We, in principle, agree to the views expressed by HKMA in the discussion paper.