

[By Email \(stablecoin_feedback@hkma.gov.hk\)](mailto:stablecoin_feedback@hkma.gov.hk)

29 February 2024

Digital Finance Division
Monetary Management Department
Hong Kong Monetary Authority
55/F, Two International Finance Centre
8 Finance Street, Central, Hong Kong

Dear Sir/Madam,

[RE: Consultation Paper on the Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong \(the “Consultation Paper”\)](#)

CFA Society Hong Kong (the “Society” or “we”) appreciates the opportunity to respond to the Consultation Paper jointly issued by the Financial Services and the Treasury Bureau and the Hong Kong Monetary Authority (the “MA” and together, the “Authorities”). As an organization committed to promoting fair and transparent financial markets and safeguarding investors' interests, we are pleased to provide our comments in alignment with our mission.

The legislative proposal for fiat-referenced stablecoins (“FRS”) represents a significant step forward. It aims to mitigate potential financial stability risks, ensure adequate protection for FRS users, and foster the development of the virtual assets ecosystem in Hong Kong.

The Emerging Role of Stablecoins

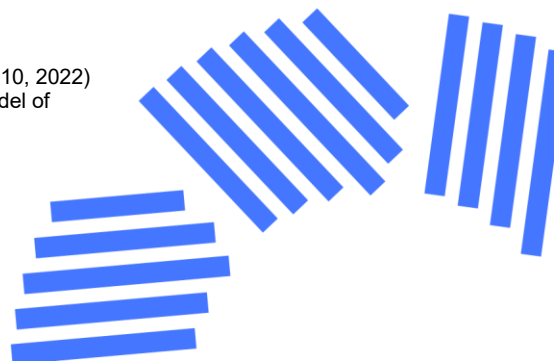
Stablecoins, particularly FRS, have become integral to the cryptocurrency market, offering cost-effective means of payment and a range of potential future applications. Although stablecoins have functional similarities to traditional payment solutions with banks, they pose new risks due to their unique technological features (Ostercamp, P., 2022)¹, and also face the risk of a run similar to a bank (Li & Mayer, 2020)². As stablecoins grow in popularity, there is a need for an insightful regulatory framework.

Insights from USDT

USDT's sustained prominence within the stablecoin market provides insights into the factors that attract users. Despite questions raised about the veracity of its underlying backing

¹ Ostercamp P, (2022), 'Stablecoin Regulation: EU, UK and US Perspectives' (January 10, 2022)

² Ye L and Simon M, (2020), 'Money Creation in Decentralised Finance: A Dynamic Model of Stablecoin and Crypto Shadow Banking', Fisher College of Business Working Paper



assets (Jamie, R., 2019)³, USDT maintains the largest market capitalization and is the most liquid stablecoin on major virtual asset exchanges⁴. The success of USDT demonstrated that the circulation of a stablecoin highly depends on virtual asset exchanges, therefore, the proposed regulatory framework should align with the VA service providers (the “VASPs”) regime (the “VASP Regime”) imposed by the Securities and Exchange Commission (the “SEC”), aiming to mitigate the phenomenon of “bad money driving out good”.

Additionally, we observe that it is not uncommon for VASPs to issue their own cryptocurrencies, for instance, iFinex Inc. issues with USDT through Tether Limited, while also operating Bitfinex, a cryptocurrency exchange. We suggest that the Authorities and the SEC consider to streamline the regulation framework for licensed VASPs that issue and market their own stablecoins. This would avoid unnecessary complexity or costs that could stifle innovation.

Challenges for virtual banking in Hong Kong

The competitive banking sector in Hong Kong serves as a cautionary landscape for the introduction of innovative solutions. Not long ago, virtual banking has been launched as an innovative and cost-effective alternative to traditional banking. However, we observe that, as the Hong Kong Economic Journal⁵ points out, virtual banks have struggled to achieve profitability and sustainable development since their launch, reflecting the challenges of achieving scale in an overbanked landscape. This competitive environment could inadvertently hinder innovation. We, therefore, encourage a regulatory approach that not only manages risks but also promotes the growth and innovation of the stablecoins ecosystem in a balanced and sustainable manner.

International Regulatory Trend

Globally, there is a movement toward implementing new regulations for stablecoins, with strict requirements on the underlying backing assets and redemption processes. Such regulations are primarily focused on addressing financial stability risks and reinforcing market integrity and consumer protection. Considering stablecoins mainly as payment instruments rather than savings instruments, we believe that the regulatory framework for stablecoin issuers should be different from that of traditional banks. Additionally, we note that there is limited consideration of “embedded supervision”—the adoption of regulatory technology (“RegTech”) to enhance the efficiency and effectiveness of regulatory monitoring and compliance, as suggested in the Bank for International Settlements’ working paper⁶. We contend that this domain warrants more attention.

³ Jamie R. (2019), ‘Crypto Community Monitors Bitfinex Wallets and the Strange 6% BTC Premium’, Bitcoin.com

⁴ CoinMarketCap (2024), Top Stablecoin Tokens by Market Capitalization. Available at: <https://coinmarketcap.com/view/stablecoin/> (Accessed: 31 January 2024)

⁵ Hong Kong Economic Journal, (9.10.2023), ‘虛銀燒錢依賴增資, 科企股東趨審慎理, 慧配股籌 10 億, 京東再次不參與’

⁶ Douglas A., Raphael A and Jon F. (2020), ‘Stablecoins: risks, potential and regulation’, BIS Working Papers No.905

Our Perspectives

We are of the view that there is a need for a new regulatory framework specifically designed to identify and mitigate the risks associated with stablecoin-based financial activities. Additionally, it should aim to balance the interests of issuers, intermediaries, and users, whilst considering Hong Kong's unique banking environment and the available RegTech. Our detailed comments and suggestions are set out in the attached response section.

Thank you for considering our views and perspectives. We welcome and appreciate the opportunity to meet and provide more details as outlined in our letter. Should you have any questions or seek further elaboration on our responses, please contact Mr. Matthew Chan, the Managing Director of the Society at matthew.chan@cfahk.org.

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

Matthew Chan
Managing Director



**CFA Society
Hong Kong**

Response Section

Q1. Do you agree with the proposed definition of “stablecoin” and “FRS”?

a) Incorporating stabilization mechanism into the definition of “stablecoin”

While we generally concur with the proposed definition of stablecoin, to differentiate stablecoins from other cryptocurrencies, we suggest incorporating a requirement for a stabilization mechanism into the definition. We also note that the Financial Stability Board (the “FSB”) echoes this sentiment in its report on stablecoin (the “FSB Report”)⁷, recommending that stablecoins are differentiated from other crypto assets based on two key features: a stabilization mechanism and their function as a means of payment or store of value.

b) The feasibility of broadening the type of reference assets

We concur with the designation of FRS as a stablecoin with fiat currencies as its reference assets. Nevertheless, the emergence of central bank digital currencies by nations worldwide could potentially alter the dynamics of ecosystem for FRS in near future. The introduction of digital currencies may potentially reduce the appeal of FRS, while stablecoins tied to precious commodities, such as gold or silver, may gain popularity.

In light of the forementioned potential developments, and to ensure the relevance of the legislative framework, we suggest the Authorities to assess the feasibility of broadening the reference assets to include precious commodities, such that the legislative framework can be more resilient and responsive to shifts within the stablecoin ecosystem.

Q2. Do you have any comments in relation to the scope of regulated stablecoin activity?

The proposed scope of regulated stablecoin activity captures the necessary breadth of activities associated with stablecoins. Nevertheless, to provide clarity to the market, we suggest the following:

a) Scope out “investment”

Stablecoins are primarily designed to serve as a medium of payment with stable value. Their function is predicated on maintaining price stability rather than capital

⁷ The Financial Stability Board (2023), ‘Final Report - High-level Recommendations for the Regulation, Supervision and Oversight of Global Stablecoin Arrangements’ (July 17 2023), available at <https://www.fsb.org/2023/07/high-level-recommendations-for-the-regulation-supervision-and-oversight-of-global-stablecoin-arrangements-final-report/>

appreciation. By excluding the term “investment” in Paragraph 4(b) from the scope of activities of the user/ public, the Authorities can provide a clearer stance that stablecoins should not be misconstrued as speculative investment instruments.

b) Scope in cross-border transfers

Stablecoins, leveraging blockchain technology, are considered an optimal choice for cross-border payments because they enable timely and cost-effective transactions without the hassle of intermediate exchanges (Qing D., 2020)⁸. As a key function, we suggest the inclusion of cross-border transfers in regulated stablecoin activities and provide relevant guidance on this matter.

Q3. 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?

We agree and advocate for a standalone and technologically integrated regulatory framework that aligns with the VASP Regime.

a) International Regulatory Trend

It is a global consensus on the need to regulate FRS issuers separately to protect users and maintain financial stability in view of the unique characteristics and potential risks of FRS. Particularly, the FSB advocates for a specific regulatory regime for FRS in its FSB Report⁹ and the report of “High-level Recommendations for the Regulation, Supervision and Oversight of Crypto-Asset Activities and Markets⁹”. Additionally, Singapore¹⁰, the United Kingdom¹¹ and the European Union¹² have either adopted or expressed intentions to adopt a new piece of legislation towards FRS issuers.

b) Collaborative approach

Considering that FRS and VA exchanges are part of the same value chain yet fall under the purview of different regulatory bodies, fostering a collaborative approach is crucial.

Furthermore, with the prevalence of VASPs issuing their own cryptocurrencies, we suggest that the Authorities and the SFC work together to introduce a streamlined

⁸ Qing D. (2020), ‘Application Analysis on Blockchain Technology in Cross-border Payment’, Advances in Economics, Business and Management Research

⁹ <https://www.fsb.org/wp-content/uploads/P170723-2.pdf>

¹⁰ <https://www.mas.gov.sg/publications/consultations/2022/consultation-paper-on-proposed-regulatory-approach-for-stablecoin-related-activities>

¹¹ <https://www.fca.org.uk/publication/discussion/dp23-4.pdf>; Regulatory regime for systemic payment systems using stablecoins and related service providers | Bank of England

¹² <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023R1114>; <https://www.eba.europa.eu/publications-and-media/events/consultation-rtss-further-specifying-liquidity-requirements-reserve>

regulatory framework for relevant licensed VASPs. The objective is to protect the integrity of the market, while avoiding undue complexity or excessive costs that inhibit innovation.

c) Integration of RegTech

We suggest the Authorities to explore the integration of RegTech into the regulatory framework. This would enable more transparent and timely regulatory oversight, enhance compliance measures to respond timely to new developments in the market.

Q4. 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?

We support the proposed exclusion, and have following comments:

- a) as suggested in response to Question 3, the proposed regime for FRS issuers may be streamlined for the licensed VASPs that issue and market their own stablecoins.
- b) there is an asymmetrical regulatory requirement as compared with the VASP Regime and the Payment Services and Stored Value Facility Ordinance (PSSVFO):
 - The VASP Regime incorporates several requirements that are pertinent to FRS issuers. These include the identification of primary responsible party, insurance arrangements, cybersecurity measures, and conflict of interest management. Such requirements are not currently mirrored in the legislative proposal for FRS issuers.
 - The PSSVFO stipulates certain obligations that are relevant to FRS issuers, such as the identification of an ultimately responsible person and reputation risk management. These provisions are absent in the legislative proposal.

Q5. Do you have any comments on the proposed licensing regime for FRS issuers?

We generally support the proposed licensing regime. Indeed, there is a worldwide accord on the importance of regulating FRS issuers which either (i) issue FRS within their respective territories or (ii) peg the FRS they issued to their local (and/or other) currencies. This practice is prevalent across various jurisdictions, including Singapore¹², the United Kingdom¹³, and the European Union¹⁴. Nevertheless, we have following suggestions:

¹³ <https://www.elegislation.gov.hk/hk/cap571!en>

¹⁴ Regulatory Framework for Supervision of Liquidity Risk (hkma.gov.hk)

a) Clarifying ‘Actively Market’ in the context of FinTech business models

Although the term ‘actively market’ is in line with the approach of the SFC under Section 115¹³ of the Securities and Futures Ordinance (Cap. 571), which restricts business in regulated activities when they are actively marketed to the public in Hong Kong, the definition is ambiguous in the context of FinTech business models. For instance, it is unclear whether “internet activities that target the Hong Kong public”, stated in footnote 14 of Paragraph 6.1.1., encompasses actions such as listing a FRS on the exchange of licensed VASPs or accepting FRS as a form of payment.

b) Who can actively market FRSs

Paragraph 6.1.1. of the Consultation Paper specifies that only FRS licensee can actively market its FRS to the public of Hong Kong. However, we note that Paragraph 7.2 seems to broaden this scope, stating that “licensed FRS issuers, authorized institutions, licensed corporations, and licensed VASPs can offer FRS in Hong Kong or actively market such offering to the public of Hong Kong.” The inconsistency may create confusion as to whether authorized institutions, licensed corporations, and licensed VASPs can actively marketing the offering of FRS. From our perspective, to prevent regulatory overlap, authorized institutions, licensed corporations, and licensed VASPs should be allowed to market licensed FRS without requiring an additional license from the MA.

Q6. *Do you have any comments on the proposed licensing criteria and conditions?*

We generally agree with the proposed licensing criteria and conditions, but suggest the Authorities clarifying the matters below.

a) Investment limitations

We suggest that the Authorities can provide guidance on the characteristics of reserve assets that are considered as high quality and high liquidity with minimal market, credit and concentration risk, such as bank deposits, or high-quality liquid assets as defined in the Regulatory Framework for Supervision of Liquidity Risk under the Supervisory Policy Manual¹⁴, along with the relevant proportions, if applicable.

Globally, we noted that other financial regulators have provided clearer provision regarding reserve assets. For instance:

- The Monetary Authority of Singapore (the “MAS”)¹⁵ has specified that reserve assets can only be held in the form of cash, cash equivalents, or debt securities

¹⁵ <https://www.mas.gov.sg/publications/consultations/2022/consultation-paper-on-proposed-regulatory-approach-for-stablecoin-related-activities>

with no more than three months residual maturity and are issued by (i) the central bank of the pegged currency; or (ii) organizations that are of both a governmental and international character with a credit rating of at least “AA-”.

- The Bank of England (the “BOE”) has proposed¹⁶ that systemic stablecoin issuers fully back the stablecoins in issue fully with central bank deposits; and the Financial Conduct Authority is considering allowing non-systemic stablecoins to be backed with short-term cash deposits (i.e. deposits with commercial banks), alongside short-term government bonds.
- The European Banking Authority (the “EBA”) has launched consultations¹⁷ to specify (i) minimum percentage rates of the reserve assets with a maturity of no longer than between 1 and 5 working days, (ii) minimum creditworthiness and liquidity soundness of credit institutions taking deposits from issuers, concentration limits to issuers’ deposits with a credit institution and over-collateralization of reserve assets; (iii) financial instruments that can be considered highly liquid and bearing minimal market risk, credit risk and concentration risk where reserve assets may be invested in etc.

b) Risk management and control

Referring to our response to Question 4 above, we suggest specific requirements on insurance arrangements, cybersecurity and reputation risk management.

c) Prohibition on paying interest

We agree that FRS should be utilized primarily as a payment method rather than an investment tool. As such, we concur with the policy of not distributing interest or any financial gains or losses from reserve assets to FRS users. For the sake of clarity, we suggest the legislative proposal also address questions such as whether FRS issuers are allowed to issue FRS at a discount, and whether intermediaries, including VASPs, are permitted to pay interest to FRS users.

d) Redemption requirements

We suggest that the Authorities could offer more specific guidance on the timeliness of processing redemption requirements. Globally, the MAS has stipulated that a redemption request must be processed no later than five business days from the legitimate redemption request date. The BOE further proposes that systemic stablecoin issuers should process redemption requests by the end of the day on which a valid redemption request is made, and in real time wherever possible. The

¹⁶ Regulatory regime for systemic payment systems using stablecoins and related service providers | Bank of England

¹⁷ <https://www.eba.europa.eu/publications-and-media/events/consultation-rts-further-specifying-liquidity-requirements-reserve>

EBA has drafted guidance stating that an issuer is required to redeem the asset-referenced tokens at any time, upon request by the holders of the asset-referenced tokens.

e) Physical presence in Hong Kong

Market concerns have been raised on the requirement for licensed FRS issuers to be incorporated in Hong Kong and to have their senior personnel based there. This could pose challenges for issuers that currently operate on a global scale.

However, we believe that this requirement is common in financial services regulations in Hong Kong. From an investor protection standpoint, having issuers based in the same jurisdiction as the regulatory authority allows for more effective supervision and enforcement of rules. This approach helps prevent fraud, safeguards investors, and maintains market integrity, thereby contributing to a safer investment environment.

f) Restrictions on business activities

Paragraph 6.2.13 specifies that an FRS issuer should not engage in other regulated activities, such as those governed by the SFO. The legislative proposal appears to prohibit FRS issuers from operating VA exchanges. However, considering that the issuance of cryptocurrencies and the operation of VA exchanges belong to the same value chain, and it is fairly common for VASPs to issue their own cryptocurrencies, we suggest that the Authorities provide clarity regarding their regulatory concerns and objectives in this domain.

Q7. Do you have any comments on the proposed power given to the MA to impose additional licensing conditions?

We agree. We believe that this measure will enhance market flexibility by allowing the MA to respond swiftly and effectively to evolving market conditions. However, we recommend that any additional licensing conditions be implemented in a transparent and consultative manner to ensure the continued growth and innovation in the FRS market.

Q8. Do you have any view on the proposed arrangements for the offering of FRS?

We generally agree with the proposed arrangements. Additionally, in the interest of protecting retail users and managing the exposure of FRS or specific FRS issuers, we suggest that the Authorities consider reserving the option to introduce a monetary cap on the maximum stored value for retail users, similar to the cap imposed on e-money like the Octopus Card.

- Q9. Do you support granting the authorities necessary powers to adjust the parameters of in-scope stablecoins and activities, similar to the VASP regime?**
- Q10. Do you consider the proposed criteria and factors relevant and appropriate for the authorities to take into account when exercising such powers?**
- Q11. Do you have any comments on the proposed supervisory powers of the MA on licensed FRS issuers?**
- Q12. Do you have any comments on the proposed investigation powers of the MA in respect of licensed FRS issuers?**
- Q13. Do you have any comments on the proposed offence and sanction provisions, in particular the sanctions and pecuniary penalty proposed, as well as the appeal arrangements?**

We support the proposed measures, including granting the Authorities the necessary powers to adjust the parameters of in-scope stablecoins and activities, similar to the VASP regime. The proposed criteria and factors are relevant and appropriate for the Authorities to consider when exercising such powers.

The proposed supervisory and investigation powers of the MA on licensed FRS issuers are necessary steps to ensure the stability and integrity of the market.

The proposed offence and sanction provisions, including the sanctions and pecuniary penalty proposed, as well as the appeal arrangements, will help maintain a fair and transparent market environment.

In summary, these proposals are well-considered and promote a robust and resilient FRS ecosystem, aligning with the current MA and SFC regulatory regime.

- Q14. Do you have any comments on the proposed transitional arrangement?**

We believe the proposed timeline is appropriate. It allows the stakeholders to prepare and adjust, ensuring compliance and minimizing disruptions to the market. We value the Authorities' balanced approach between regulation and market growth.