

March 2023

HKMA's conclusion of discussion paper on crypto-assets and stablecoins



Introduction

On 12 January 2022, the Hong Kong Monetary Authority ("HKMA") issued a "[Discussion Paper on Crypto-assets and Stablecoins](#)" to invite stakeholders to give feedback on HKMA's thoughts on regulating payment-related stablecoins. The focus of the Discussion Paper was on stablecoins that have a potential reach and use across multiple jurisdictions including as means of making payments and/or stores of value, but less on other crypto-asset structures that only aim to maintain a stable value. For details, please refer to our article "[An update on the virtual asset regulatory landscape in Hong Kong](#)".

The feedback period for the Discussion Paper ended on 31 March 2022. Since then, the HKMA noted that the stablecoin market experienced price volatility due to the collapse in the value of a widely adopted stablecoin and the crypto market was shaken by the collapse of a large crypto exchange. In light of these events and after taking into consideration the feedback the HKMA has received from the public, HKMA is looking to implement a more comprehensive regulation to address the financial stability risks, and has issued the "[Conclusion of Discussion paper on Crypto-assets and Stablecoins](#)" ("**Conclusion**") to set out the approach that the HKMA intends to take.

This client alert summarises the key takeaway points in the Conclusion.

What to regulate

The HKMA will take a risk-based approach in structuring the regulation. Stablecoins that purport to reference to one or more fiat currencies will be prioritised because of the likelihood of these stablecoins being used in payments and having linkages with the traditional financial system. The underlying stabilisation mechanism and the proposed usage of the stablecoin are irrelevant when considering whether a stablecoin is in-scope.

Certain stablecoin arrangements will be excluded but details will be subject to further analysis and additional consultations to be conducted by the HKMA. Currently, it is proposed that arrangements that are already being subject to another financial regulatory regime or used within a well-confined environment outside the reach of the general public will be excluded. Also, other unbacked crypto-assets will not be the focus of the current regime, and the HKMA will consider the need to regulate them in the future.

Given the rapid market and international developments, it is also proposed that the regulatory regime will have appropriate flexibility to enable the HKMA to declare other types of stablecoin structures as in-scope from time to time.

What kind of activities will be regulated

The HKMA proposed to regulate certain critical functions in the lifecycle of a stablecoin. These will be:

- (i) Governance: establishment and maintenance of the rules governing an in-scope stablecoin arrangement;
- (ii) Issuance: issuance, creation or destruction 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, (each a "**Regulated Activity**").

The HKMA does not intend to regulate any of the following activities:

- (a) purchase or exchange of a stablecoin with fiat currency;
- (b) operation and management of centralised stablecoin lending services;
- (c) issuance of crypto-asset debit/credit cards; and
- (d) operation of crypto-asset automated teller machines or exchange shops.

Nevertheless, the regime will have appropriate flexibility to enable the HKMA to include new types of activities as a Regulated Activity in the future.

What will the authorisation and regulatory requirements be

It is proposed that each type of Regulated Activity will require its own licence, in contrast to one single type of licence covering various activities. The regulatory requirements in the licences are still being considered, but the HKMA intends to impose requirements on the following crucial elements:

- (i) Comprehensive regulatory framework: requirements such as 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: requirements that the value of the reserve assets of a stablecoin arrangement should meet the value of the outstanding stablecoins at all times, and 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.
- (iii) Principal business restriction: restrictions from carrying out activities that deviate from the principal business as permitted under the relevant licence.

Who will need a licence

Anyone who carries out any of the following activities will need to be licensed:

- (i) conducting a Regulated Activity in Hong Kong;
- (ii) actively marketing a Regulated Activity to the public of Hong Kong; and
- (iii) conducting a Regulated Activity in which the stablecoin concerned purposes to reference its value to the Hong Kong dollar, regardless of whether the relevant Regulated Activity is conducted in Hong Kong or actively marketed to the general public of Hong Kong.

Any entity that the HKMA is of the opinion that should be so regulated, having regard to matters of significant public interest, will also need to be licensed.

All licensees are also expected to be subject to a local incorporation requirement for HKMA's ease of supervision and enforcement, but this is still subject to further evaluation, and the HKMA may propose alternative options.

The HKMA will also be mindful of other existing financial regulatory regimes in Hong Kong when structuring the current regime to avoid any overlapping. Stablecoin issuers will not be required to be licensed as an authorised institution under the Banking Ordinance, but all issuers will be subject to the same regulatory requirements applicable to stablecoin. The HKMA is also considering whether the proposed regime will be implemented by amending the existing Payment System and Stored Value Facility Ordinance or by introducing a new standalone legislation.

Next steps

The HKMA will continue to monitor market developments, engage with the industry, and work with other stakeholders to prepare the details of the proposed regulatory regime. It is anticipated that there will be a more detailed consultation with the draft legislation in due course. At the moment, the HKMA envisaged that the draft legislation will set out: (i) the structures and activities that would be regulated or not; (ii) the range of effective and proportionate powers that should be granted to the HKMA; (iii) the key regulatory requirements; (iv) the range of powers that should be given to the authority; and (v) the relevant guiding factors that the authority should have regard to when exercising its power.

The HKMA will be looking to implement the new regime by 2023 or 2024.

How we can help

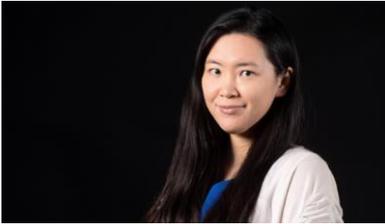
The introduction of a new regulatory regime is definitely a good sign to the market as guidance from the regulators on what activities are permitted. It also offers investors of virtual assets some comfort that their investments are handled by businesses that are required to meet a certain level of standards and expectations. Especially in light of the recent incidents in the virtual asset market that have shaken investors' confidence.

We will, together with many others in the industry, continue to monitor the development closely.

Many of our clients are intermediaries that provide virtual assets-related services. We regularly advise our clients on virtual assets-related issues and we have had numerous discussions with clients on virtual assets related-product launches.

Please get in touch if you are interested in discussing any of the above.

Contact us



Katherine Liu

Partner, Head of finance and financial services regulation
T: +852 2533 2717
E: katherine.liu@shlegal.com



Alan Wong

Associate
T: +852 2533 2719
E: alan.wong@shlegal.com



Karin Asai

Trainee solicitor
T: +852 2533 2731
E: karin.asai@shlegal.com

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