

January 2024

Stablecoin regulations – Consultation Paper on the proposed regulatory framework



Background

In January 2023, the Hong Kong Monetary Authority ("**HKMA**") and the Financial Services and the Treasury Bureau ("**FSTB**") jointly published the result of a discussion paper in relation to stablecoin regulations and, in light of the positive feedback received, it was concluded that there should be regulations for stablecoin-related activities. We have covered this in an earlier [client alert](#).

As a step forward in formulating such a regulatory framework, in the last week of 2023, the HKMA and the FSTB again jointly launched a [consultation paper](#) that sets out the proposed regulatory framework and invited the public to provide comments. The consultation period will end on 29 February 2024. This client alert summarises the proposed framework as set out in the consultation paper.

New legislation?

It is acknowledged that the virtual asset ("**VA**") market landscape is constantly evolving and would not be appropriate to regulate stablecoin-related activities under the existing legislations such as the Payment System and Stored-Value Facility Ordinance (Cap. 584) or the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615). It is therefore expected that a new piece of legislation would be introduced which may be further modified in the future to house different regulatory regimes for other segments of the VA market.

How will stablecoin be defined?

It is proposed that stablecoin would be defined as "a cryptographically secured digital representation of value that, among other things:

- is expressed as a unit of account or a store of economic value;
- is used, or is intended to be used, as a medium of exchange accepted by the public, for the purpose of payment for goods or services, discharge of a debt and/or investment;
- can be transferred, stored or traded electronically;
- uses a distributed ledger or similar technology that is not controlled solely by the issuer; and
- purports to maintain a stable value with reference to a specified asset, or a pool or basket of assets."

The following items are also proposed to be excluded from the definition of stablecoin as they are already covered by other existing regulatory regimes:

- deposits, including its tokenised or digitally represented form;
- certain securities or futures contracts (mainly authorised collective investment schemes and authorised structured products);
- float stored in SVFs or SVF deposits;
- digital representation of fiat currencies issued by or on behalf of central banks; and
- certain digital representation of value that has a limited purpose (such as those that can only be used as a means of payment for goods or services provided by the issuer).

Nonetheless, it is proposed that the current regulatory framework will only capture fiat-reference stablecoin, which means a stablecoin that purports to maintain a stable value with reference to one or more fiat currencies ("**FRS**"). Other stablecoin projects, despite falling under the above definition of "stablecoin", will unlikely be granted a licence since they will not meet the other licensing requirements.

What will be regulated?

It is proposed that the new legislation will specify that: "No person shall:

- issue, or hold oneself out as issuing, an FRS in Hong Kong;
- issue, or hold oneself out as, issuing a stablecoin that purports to maintain a stable value with reference to the value of the Hong Kong dollar; or
- actively market its issuance of FRS to the public of Hong Kong,

unless it is a company that holds an FRS issuer licence granted by the HKMA."

For active marketing, this would include: (1) frequently calling on members of the Hong Kong public and marketing their services; (2) running a mass media programme targeting the Hong Kong public, and (3) internet activities that target the Hong Kong public.

What are the licensing criteria and conditions?

The consultation paper sets out the proposed licensing criteria and conditions. Some of the more noteworthy requirements are summarised below:

- **Full backing:** A FRS issuer must ensure the value of the reserve assets backing the FRS is at least equal to the par value of the FRS in circulation at all times.
- **Investment limitations:** The reserve assets must be of high quality and high liquidity with minimal market, credit and concentration risk. Investments with the reserve assets would be allowed but only with HKMA's approval, which would only be granted if the HKMA is satisfied that the types of investment the FRS issuer proposes to hold are appropriate.
- **Segregation and safekeeping:** There should be an effective trust arrangement to ensure the segregation of assets, and the arrangement must be available to meet redemption requests, or the FRS users' legal rights and priority claim of the reserve in the event of insolvency of the FRS issuer. Segregated accounts must be held with a licensed bank, or other arrangements satisfactory to the HKMA.
- **Disclosure and reporting:** Information regarding: (1) the total amount of FRS circulation (which should be disclosed at least daily), (2) the market-to-market value of the reserve (which should be disclosed at least daily), and (3) the composition of the reserve assets (which should be disclosed at least weekly), must be disclosed regularly to the general public. There must also be a qualified and independent auditor (the HKMA must be consulted regarding such auditor's appointment) to perform regular attestation on various items (which should be done monthly).
- **Paying interest:** Any income or loss from the reserve must be attributed to the FRS issuer. The FRS issuers must not pay interest to FRS users.
- **Effective stabilisation:** The FRS issuer must ensure the effective functioning of the stabilisation mechanism, and be ultimately responsible for any third parties engaged.
- **Redemption-specific requirements:** The FRS users must have the right to redeem the FRS at par value, and be granted the right to claim against the reserve assets or the FRS issuer. Redemptions should also be done on a timely basis, without undue costs and not have unreasonable conditions. A FRS issuer must also form a contingency plan to cover circumstances when redemption requests cannot be met.
- **Restriction on business (not applicable to authorised institutions ("AI")):** The FRS issuer must seek the HKMA's approval before developing any new line of business, and ensure there will be adequate resources to ensure the new business will not adversely affect the FRS. However, a FRS issuer will be permitted to carry out activities that are ancillary or incidental to the issuance of the FRS, such as the provision of wallet services. A FRS issuer will be prohibited from lending or providing financial intermediation, and carrying out other regulated activities.
- **Physical presence in Hong Kong (not applicable to AI):** A FRS issuer must be a company incorporated in Hong Kong and have a registered office in Hong Kong. All chief executives, senior management team members and key personnel must be based in Hong Kong.
- **Financial resources (not applicable to AI):** A FRS issuer must have a minimum paid up share capital of at least HK\$25mil or of a fixed percentage of the par value of FRS in circulation (proposed to be 2%), whichever is higher.
- **Disclosure requirements:** There must be a white paper to disclose general information about the FRS issuer, the rights and obligations of the FRS users, the FRS stabilisation mechanism, reserves

management arrangement, the redemption procedure and details, the underlying technology and the risks. The HKMA's approval is required before the white paper can be published.

- Governance, knowledge and experience: All controllers, chief executives and directors of an FRS issuer must be fit and proper, and the HKMA's prior consent must be obtained before their appointments. Staff must also possess the necessary knowledge and experience to manage the FRS.

Other issues

It is also proposed that:

- HKMA would be empowered to impose licensing conditions from time to time.
- A licensee will require HKMA's approval before issuing any new FRS.
- The licence will be an open-ended licence, meaning it will remain valid until the licence is revoked by the HKMA.
- Only licensed FRS issuers, AIs, SFC-licensed corporations and licensed virtual asset trading platform operators can offer FRS in Hong Kong. If a FRS is not issued by a licensed FRS issuer, then the AIs, SFC-licensed corporations and the licensed virtual asset trading platform operators can only offer the FRS to professional investors as defined under the Securities and Futures Ordinance.

Supervisory power of the HKMA and offences

As the HKMA will be the primary regulating authority, it is proposed that the new legislation will grant the HKMA various supervisory powers to the HKMA, including requiring a licensee to do any act relating to the affairs, businesses or properties of the licensee, giving directors to a licensee to engage a HKMA-appointed manager to manage its business. A licensee must also obtain the HKMA's consent before any amalgamation, agreement for the sale or disposal of all or part of its business, and any sale of shares by controllers of the licensee. The HKMA will also be granted various investigation power.

It is also proposed that the carrying out of regulated activities without a licence will be a criminal offence, and may also be subject to other civil and supervisory sanctions.

Transitional period

It is proposed that the new regulatory regime will become effective after one month of the new legislation being gazetted. For FRS issuers who are already in operation before that, they must apply for the licence within three months, and they will be granted a six months' non-contravention period until the licence is granted.

If the FRS issuers do not apply for the licence within the first three months, then they must cease business by the end of the fourth month.

Sandbox

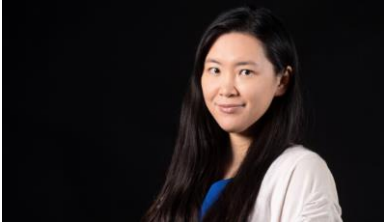
Finally, in an accompanying press release, the HKMA indicated that they will introduce a sandbox arrangement for businesses who are interested in being a licensed FRS issuer to participate. Sandbox participants will be able to communicate supervisory expectations and receive guidance on compliance. They may also provide feedback to the HKMA on the proposed regulatory regime. More details will be made available.

How can we help?

Stablecoin plays an important role in the VA market as it permits investors to participate and withdraw from the VA market quickly. It is also gaining a lot of interests amongst local payment companies who are constantly seeking to expand the scope of their services.

We advise many clients in respect of virtual asset regulations, including assisting clients in structuring and launching their stablecoin projects. Please get in touch if you are interested in discussing any of the above.

Contact us



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