

December 2024

2024 end-of-year update on Fintech-related laws and regulations



Introduction

2024 had been a busy year for the financial services industry in terms of the regulatory updates that were introduced. With the development of new technology solutions such as generative artificial intelligence ("**GenAI**") and an increasing adoption of virtual assets and blockchain by the banking and securities industry, several new legislations and regulations were introduced by different regulators.

This client alert aims to give you a summary of some major regulatory updates in 2024.

Generative AI Language Models

SFC Regulations – Use of generative AI language models

In November 2024, the Securities and Futures Commission (the "**SFC**") issued a comprehensive circular outlining the expectations and guidelines for SFC licensed corporations ("**LC(s)**") regarding the responsible use of GenAI language models ("**AI LMs**"). The SFC highlighted several potential risks associated with AI LMs, such as inaccuracies, biases, inconsistencies and cyberattacks. To mitigate these risks, LCs are encouraged to adopt a risk-based approach and implement extra risk mitigation measures for high-risk use cases. The SFC also outlined several key principles that LCs should observe, including but not limited to:

- **Senior Management Responsibilities** – Senior management of LCs must ensure that effective policies, procedures and internal controls are in place throughout the lifecycle of AI LMs. This includes the design, implementation, validation, and ongoing monitoring of the AI LMs. The governance framework should encompass the identification of high-risk use cases, particularly those that could adversely impact clients if the AI LM's output is inaccurate or inappropriate.
- **AI Model Risk Management** – LCs should validate the AI LMs, conduct comprehensive end-to-end testing to assess the performance of the AI LMs, and continuously monitor their performance to ensure they remain fit for purpose. Additional risk mitigation measures should also be adopted in high-risk use cases. The appropriate measures may include having a human-in-the-loop to address hallucination risk, testing output robustness to prompt variations, and making the disclosure to the client whenever there is an interaction with the AI LMs (as opposed to making a one-off disclosure upfront). The SFC also clarified that high-risk use cases include situations where AI LMs are used for providing investment recommendations, investment advice or investment research to investors or clients.
- **Cybersecurity and Data Risk Management** – Robust measures should be implemented to protect AI LMs from adversarial attacks and LCs should ensure the quality and security of the data used. This includes encryption of non-public data and periodic adversarial testing. LCs should also be aware of the risks associated with the use of AI LM-based browser extensions and take appropriate measures to mitigate these risks. Regards must also be made to the requirements set out in the [circular on data risk management](#) published by the SFC and the [artificial intelligence: model personal data protection framework](#) published by the Office of the Privacy Commissioner for Personal Data.
- **Third-Party Provider Risk Management** – Due diligence and ongoing monitoring are essential when selecting and assessing third-party providers of the AI LMs, in order to ascertain whether the provider possesses the requisite skills, expertise, resources and controls to deliver the product or service to the standards acceptable to the LCs. LCs should assess the providers' model risk management frameworks and ensure that the AI LMs are appropriate for the specific use cases. There should also be an allocation of responsibilities between the LC and the third-party provider which should be well-defined and clearly understood.

Finally, the SFC specifies that the use of AI LMs in high-risk use cases will constitute a significant change in the nature of an LC's business and the types of services that the LC provides, and therefore the notification requirements under the Securities and Futures (Licensing and Registration) (Information) Rules (Cap. 571S) should be observed and complied with.

HKMA regulations – Consumer protection in respect of use of generative artificial intelligence

In August 2024, the Hong Kong Monetary Authority ("**HKMA**") issued new guidelines for banks on using GenAI in customer-facing applications. The guidelines set out certain key principles for banks.

- **Governance and Accountability** – The boards and senior management of banks are responsible for all decisions and processes of GenAI, and must have thoroughly considered the potential impact on customers. Banks must have proper policies and procedures for using GenAI responsibly, and have proper validation, in particular by adopting the human-in-the-loop approach.
- **Fairness** – GenAI models should produce objective, consistent, ethical and fair outcomes for customers. They must ensure that any output would not lead to unfair bias or disadvantage against any customer or group of customers. Customers should have the option to opt out of GenAI decisions and request human intervention. If opt-out is not available, then banks should provide channels for customers to request for review of the decisions generated by GenAI.
- **Transparency and Disclosure** – Banks must be transparent about their use of GenAI through proper, accurate and understandable disclosure. Customers should be informed about how and why GenAI is being used, as well as its limitations.

- **Data Privacy and Protection** – Banks must protect customer data and comply with data privacy laws, if personal data are collected and processed by GenAI. Banks must also pay due regard to the relevant recommendations and good practices issued by the Office of the Privacy Commissioner for Personal Data.

Finally, the HKMA encourages banks to explore the use of GenAI in enhancing consumer protection. In particular, to use GenAI to identify customers who are vulnerable and require more protection and education, or identify customers who may need more information or clarification to better understand product features, risks and terms and conditions.

Stablecoin Regulatory Regime

In December 2024, the Stablecoins Bill (the "**Bill**") was published in the Hong Kong Gazette. This followed the consultation conclusions on the proposed regulatory regime for fiat-referenced stablecoin ("**FRS**") issuers published by the Financial Services and the Treasury Bureau ("**FSTB**") and the HKMA and the announcement of the launch of the stablecoin issuer sandbox with the list of participants.

For our previous client alert on the consultation paper and on the discussion paper leading to the consultation, please refer to our [January 2024 client alert](#) and our [March 2023 client alert](#).

Some key takeaways of the Bill:

- **Definition and Scope** – The definition of stablecoin is similar to the one proposed in the consultation paper. For FRS, this is now referred to as "specified stablecoin" and will be defined as a stablecoin that purports to maintain a stable value with reference wholly to official currencies, or other units of accounts or stores of economic value (or a combination of the value and the official currencies) that are specified by the HKMA. Specified stablecoin will also include a digital representation of value or a digital representation of value of a class that is specified by the HKMA. Official currency is also defined as the currency issued by the government, the central bank, the monetary authority, or an authorised note-issuing bank of a jurisdiction.
- **Regulatory Framework** – The Bill will cover the following activities, and it will be an offence to carry on the following activities without the appropriate licence or in a manner not permitted under the Bill:
 - "regulated stablecoin activity", which includes the issuance of a specified stablecoin in Hong Kong in the course of business, or the issuance of a specified stablecoin outside Hong Kong in the course of business but the specified stablecoin purports to maintain a stable value with reference to Hong Kong dollars;
 - the active marketing to the public of an activity that a person carries on, or purports to carry on, and such activity, if carried on in Hong Kong, would constitute a regulated stablecoin activity;
 - the offering of a specified stablecoin, which includes the communication by one person, in the course of business, to another person with sufficient information so as to enable the latter person to decide whether to acquire the specified stablecoin from the first-mentioned person. A communication will be an offer if it includes information on the stablecoin to be offered, the terms on which the stablecoin will be offered and the channels through which the stablecoin will be offered. Unless an exemption applies, only a permitted offeror, which includes a stablecoin licensee, a virtual asset trading platform licensee, a LC or a HKMA authorised institution, can offer a specified stablecoin; and
 - the publication of an advertisement concerning a person: (a) that is carrying on a regulated stablecoin activity but such advertised person is not licensed for carrying on the regulated stablecoin activity; or (b) that is offering a specified stablecoin but such advertised person is not a permitted offeror.

The HKMA may also specify an activity as a regulated stablecoin activity if such activity is or is likely to become material to the monetary or financial stability of Hong Kong, is or is likely to become material to the functioning of Hong Kong as an international financial centre and involves matters of significant public interest.

- **Licensing and Oversight** – A person must obtain a license from the HKMA if it intends to carry on a regulated stablecoin activity. Only a company (as defined under the Companies Ordinance (Cap. 622)) or an authorised institution incorporated outside Hong Kong can apply for such licence. A person must also not become a controller of a licensee unless consent is obtained from the HKMA. HKMA may also attach conditions to a person before such person can become a controller of a licensee, but there will first be a process where the HKMA discusses with the proposed controller on whether a condition should be attached.
- **Governance** – A licensee must appoint a person as the chief executive and at least one person to be an alternate chief executive. The HKMA's consent is required before a person is appointed as a chief executive, a director or a stablecoin manager (which a licensee must have) of a licensee. Same as a controller, the HKMA may attach conditions to a person for granting any consent for such person to become a chief executive or a director of a licensee. Other positions of a licensee, including managers (which is specifically defined) and employees, are also subject to certain requirements under the Bill.
- **Minimum criteria** – A licensee must: (a) have adequate financial resources and liquid assets to meet its obligations (whether actual or contingent) as they will or may fall due; and (b) have a paid-up share capital of no less than HK\$25,000,000 (or in an equivalent amount in another currency that is freely convertible into Hong Kong dollars or is approved by the HKMA), or other financial resources as approved by the HKMA.
- **Reserve assets** – A licensee must maintain a pool of reserve asset pool for each type of specified stablecoins issued by the licensee, which must be segregated from other pools of reserve assets maintained by the licensee. The value of the specified reserve assets pool for a type of specified stablecoins must also be at least equal to the par value of the outstanding specified stablecoins of the type in circulation at all times. A licensee must also have in place and implement adequate and appropriate risk management policies and procedures, and systems of control in relation to the reserve assets. Disclosure, in relation to the licensee's reserve assets management policy, risk assessment, composition and market value of the reserve assets, and the results of regular independent attestation and audit of its reserve assets, must also be made to the public in an adequate and timely manner.
- **User Protection** – A holder of the specified stablecoin must be able to redeem a specified stablecoin, and no burdensome conditions and unreasonable fees can be attached or charged against the holder.

Public Consultation on VA OTC Trading Regulation

In February 2024, the FSTB launched a public consultation on the legislative proposals to regulate the over-the-counter (OTC) trading of virtual assets (VA). Under the proposed regulations, any person wishing to operate a VA OTC business in Hong Kong must obtain a license. The regulations intended to cover the provision of spot trading services of any VA, where the transaction involves exchanging VA for any money but not for another VA, regardless of whether the service is provided through a physical outlet or other platforms. For more details regarding the consultation, please refer to our earlier [client alert](#).

Provision of custodial services for digital assets and the sale and distribution of tokenised products by authorised institutions

In February 2024, the HKMA published two circulars to highlight the supervisory standards expected of authorised institutions if they wish to sell and distribute tokenised products or provide custodial services for digital assets. In particular:

- for the sale and distribution of tokenised products, an authorised institution is expected to carry out adequate due diligence against a tokenised product before the authorized institution can sell and distribute the product; and
- for providing custodial services for digital assets, an authorised institution is expected to observe the 8 areas of concern set out by the HKMA in the circular, including but not limited to the safeguarding of client digital assets, delegation and outsourcing and disclosure.

For more details regarding the consultation, please refer to our earlier [client alert](#).

Phase 2 of e-HKD Pilot Programme

In September 2024, the HKMA commenced Phase 2 of the e-HKD Pilot Programme, which expanded the scope of the phase 1 programme to explore innovative use cases for digital money, including e-HKD and tokenised deposits. The e-HKD project was also renamed to e-HKD+ to reflect its expanded scope. In phase 2 of the programme, 11 groups of firms will be participating to explore innovative use cases. The outcome of the programme will help the HKMA in understanding the practical issues that may be faced in designing, implementing and operating a digital money ecosystem that comprises both publicly and privately issued digital moneys.

Project Ensemble Sandbox

In August 2024, the HKMA launched the Project Ensemble Sandbox, a new initiative aimed at exploring the use of tokenisation in the financial sector. Tokenisation is the process of converting assets into digital tokens so that they can be easily traded and settled.

The sandbox will focus on four main themes for its initial experiments:

- **Fixed Income and Investment Funds** - Exploring how tokenisation can improve the trading and settlement of bonds and investment funds.
- **Liquidity Management** - Investigating ways to enhance the management of financial resources through tokenised assets.
- **Green and Sustainable Finance** - Promoting environmentally friendly investments by making it easier to trade green assets.
- **Trade and Supply Chain Finance** - Streamlining the financing of trade and supply chains using digital tokens.

How we can help

In light of the changes that took place this year, we have received many enquiries from various clients who were looking to expand their businesses or implement new technology into the services and/or products that they offered, such as LCs, HKMA authorised institutions, payment companies that operate under a pure digital model, licensed custodians, or other non-regulated entities who are looking to carry on a regulated business. Please get in touch if you are interested in discussing any of the above.

Contact us



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