

Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong

Consultation Paper

Financial Services and the Treasury Bureau

Hong Kong Monetary Authority

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Foreword

1. This consultation paper is jointly issued by the Financial Services and the Treasury Bureau (“FSTB”) and the Hong Kong Monetary Authority (“HKMA”) to seek views and comments on the proposed regulatory regime for stablecoin issuers in Hong Kong.

2. Prior to this public consultation, the HKMA issued a Discussion Paper on Crypto-assets and Stablecoins (“Discussion Paper”) to invite feedback from stakeholders in January 2022¹. The HKMA then issued the consultation conclusion to the Discussion Paper (“Conclusion Paper”) in January 2023². It set out, among other things, views received by the HKMA from a total of 58 respondents to the Discussion Paper from the industry, public bodies, business and professional organisations, and individuals, etc. Respondents generally indicated their support for the HKMA’s proposal of bringing stablecoins into the regulatory perimeter. The paper also indicated the expected regulatory scope and key regulatory requirements.

3. The FSTB and the HKMA welcome written comments on or before 29 February 2024 through any of the following channels:

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

By email to: stablecoin_feedback@hkma.gov.hk

4. The FSTB and the HKMA may, as appropriate, reproduce, quote, summarise or publish the written comments received, in whole or in part, in any form and use without seeking prior permission from the contributing parties.

5. Persons submitting comments on behalf of an organisation should provide details of the organisation whose views they represent.

¹ See “[Discussion Paper on Crypto-assets and Stablecoins](#)” published on 12 January 2022. Unless specified otherwise, the phrases “crypto-assets” and “virtual assets” are used interchangeably in this paper.

² See “[Conclusion of Discussion Paper on Crypto-assets and Stablecoins](#)” published on 31 January 2023.

6. The names of the contributing parties, their affiliation(s) and the content of their submissions may be referred to in other relevant documents we publish and disseminate through different means after the consultation. If any contributing parties do not wish their names and/or affiliations to be disclosed, they should expressly state so in their submission.

Personal Information Collection Statement

1. This Personal Information Collection Statement (“PICS”) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data³ will be used following collection, what you are agreeing to with respect to the FSTB’s and HKMA’s use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap. 486) (“PDPO”).

Purpose of collection

2. The personal data provided in your submission in response to this consultation paper may be used by the FSTB or the HKMA to seek views and comments on the proposed regulatory regime for stablecoin issuers in Hong Kong, for research and statistical purposes, or for other purposes permitted by law.

Transfer of personal data

3. Personal data may be disclosed by the FSTB and the HKMA to members of the public in Hong Kong and elsewhere as part of this public consultation. The names of persons who submit comments on this consultation paper, together with the whole or any part of their submissions, may be disclosed to members of the public. This will be done by publishing this information on the FSTB and the HKMA websites and in documents to be published by the FSTB and the HKMA during the consultation period or at its conclusion.

Access to data

4. You have the right to request access to and correction of your personal data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your personal data provided in your submission on this consultation paper. The FSTB and the HKMA have the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal data provided to the FSTB and the HKMA in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of their functions.

³ Personal data means personal information as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

Enquiries

6. Any enquiries regarding the personal data provided in your submission on this consultation paper, requests for access to personal data or correction of personal data should be addressed in writing to:

FSTB

Data Controlling Officer
Financial Services Branch
Financial Services and the Treasury Bureau
24/F, Central Government Offices
2 Tim Mei Avenue
Tamar, Hong Kong

HKMA

Personal Data Privacy Officer
Hong Kong Monetary Authority
55/F, Two International Finance
Centre
8 Finance Street
Central, Hong Kong

7. A copy of the Privacy Policy Statement adopted by the FSTB and the HKMA is available upon request.

Executive Summary

1. The rapidly evolving virtual asset (“VA”) sector is bringing new opportunities for financial innovation and inclusion while adding complexities to the financial system. A stablecoin, in particular one that purports to maintain a stable value with reference to one or more fiat currencies (i.e. fiat-referenced stablecoin, “FRS”), could potentially have broad and frequent interconnection with the mainstream financial system and day-to-day commercial, financial and economic activities, and hence pose more direct and imminent risks to the financial system. This is the view shared by key financial markets and financial regulators internationally.

2. The FSTB and the HKMA received broad support to introduce a regulatory regime in light of the risks posed by FRS. The TerraUSD collapse in 2022 highlighted the urgency to have such regime in place sooner rather than later. Against this backdrop, we propose to implement a regime for regulating issuance of FRS with the following policy objectives:

- (a) to put in place appropriate safeguards to address potential monetary and financial stability risks posed by FRS;
- (b) to provide adequate protection to FRS users;
- (c) to maintain Hong Kong’s status as an international financial centre by putting in place an appropriate regulatory regime for FRS issuers that is in line with international regulatory recommendations; and
- (d) to foster sustainable and responsible development of the VA ecosystem in Hong Kong by providing legal and regulatory clarity.

3. Taking into account the market conditions and needs in Hong Kong, we intend to introduce a new piece of legislation to implement a licensing regime for FRS issuers with the following major features:

- (a) providing for the definition of an FRS as a cryptographically secured digital representation of value that, among other features, purports to maintain a stable value with reference to one or more fiat currencies, with the exception of items that are already covered by other regulatory regimes, such as deposits (section 4);
- (b) requiring that all FRS issuers who (i) issue an FRS in Hong Kong; (ii) issue a stablecoin that purports to maintain a stable value with reference to the value of the Hong Kong dollar (“Hong Kong dollar-

referenced stablecoin”); or (iii) actively market their issuance of FRS to the public of Hong Kong, should be licensed by the Monetary Authority (“MA”) (section 6). The licensing criteria and conditions are explained further in section 6.2;

- (c) requiring that FRS can only be offered by specified licensed entities in Hong Kong. For FRS issued by entities not licensed by the MA, our current thinking is that specified licensed entities may only offer such FRS to professional investors in view of the risks involved (section 7);
- (d) in view of the evolving landscape of VAs, flexibility will be built-in over the scope of the regulatory regime and necessary powers will be provided for the authorities to adjust the parameters of in-scope stablecoins and activities (section 8). Powers will also be provided to the MA for administering the licensing regime (section 9) and enforcing the regime (section 10). Offences, sanctions and an appeal mechanism are also proposed (sections 11 and 12); and
- (e) a transitional arrangement is proposed to allow eligible, pre-existing FRS issuers to migrate to the new regulatory regime in an orderly manner (section 13).

4. The FSTB and the HKMA would like to invite comments from the public on the proposed regulatory regime for FRS issuers as set out in this consultation document. We will take into account the comments received when finalising the regulatory regime for FRS issuers.

1. Background

1.1. As announced in the “Policy Statement on Development of Virtual Assets in Hong Kong”, the Government, in conjunction with the financial regulators, are working towards providing a facilitating environment for promoting sustainable and responsible development of the VA sector in Hong Kong⁴. To this end, as announced in the 2023-24 Budget, the Financial Secretary has established the Task Force on Promoting Web3 Development, with members from relevant policy bureaux, financial regulators, and market participants, to provide recommendations on the sustainable and responsible development of the sector⁵.

1.2. The FSTB and the HKMA note that the VA sector could bring benefits in improving the accessibility to and efficiency of the financial system, as well as unlocking new business opportunities. While acknowledging the potential benefits of financial innovation, the FSTB and the HKMA are closely monitoring the international market and regulatory developments to ensure regulatory harmony. Among other policy and regulatory initiatives, the FSTB and the HKMA, in conjunction with other stakeholders in the Government and financial regulators such as the SFC, are working towards putting in place timely and necessary guardrails, so that VA innovations can thrive in Hong Kong in a sustainable manner, while actual and potential risks from the perspectives of monetary and financial stability, consumer protection, as well as money laundering and terrorist financing, can be identified and properly addressed.

1.3. One of the key considerations from a regulatory standpoint is the apparent and rising interconnectedness between the traditional financial system and the VA markets, as well as the potential monetary and financial stability risks associated with the increased prevalence of VAs. In this context, stablecoin, in particular FRS, could become a key channel through which risks could spill over from the VA sector to the traditional financial system, and vice versa, posing monetary and financial stability concerns. Adopting a risk-based and agile approach in implementing the regulatory regime for FRS issuers would serve to mitigate the relevant risks.

1.4. International organisations (“IOs”) and standard-setting bodies (“SSBs”) have accorded considerable attention to the risks posed by VAs including stablecoins. In July 2023, the Financial Stability Board, in

⁴ See “[Policy Statement on Development of Virtual Assets in Hong Kong](#)” published on 31 October 2022.

⁵ See “[The 2023-24 Budget Speech](#)” by the Financial Secretary on 22 February 2023, at paragraph 57.

consultation with relevant SSBs, published a finalised global regulatory framework for crypto-asset activities⁶. The framework provides recommendations relating to the regulation, supervision and oversight of crypto-asset activities and markets as well as global stablecoin arrangements. Some major jurisdictions⁷ have also proposed, or recently adopted, regulatory requirements with regard to stablecoin activities.

1.5. The HKMA issued the Discussion Paper in January 2022, setting out its view that appropriate regulatory treatment should be applied to stablecoins, with priority given to those that may be used in payments. The HKMA received a total of 58 submissions in response to the Discussion Paper from the industry, public bodies, business and professional organisations, and individuals, etc. The respondents were generally supportive of the HKMA’s proposal of bringing stablecoins into the regulatory perimeter. In January 2023, the HKMA issued the Conclusion Paper, confirming that it would put in place a regulatory regime for certain key activities relating to stablecoins and indicating the expected regulatory scope and key regulatory requirements.

1.6. The proposed regulatory regime as set out in this paper aims to provide further details in relation to the features of a licensing regime for FRS issuers, having taken into account feedback received on the Discussion Paper and further engagement with market stakeholders.

2. Current Regulatory Framework in Hong Kong

2.1. With the overall coordination of the FSTB and drawing references from applicable international standards, the financial regulators, including the HKMA and the SFC, are working closely together to introduce a comprehensive framework to regulate a wide range of VA-related activities.

2.2. In line with international practices, regulatory effort is prioritised first and foremost on major on- / off-ramp⁸ destinations in the VA ecosystem. For instance, following the passage of the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 by the Legislative Council in December 2022, the new licensing regime for VA service⁹ providers (“VASPs”)

⁶ See [“FSB Global Regulatory Framework for Crypto-asset Activities”](#) published on 17 July 2023.

⁷ Such as the European Union, Japan, Singapore and the United Kingdom.

⁸ “On- / off-ramp” refers to the process of exchanging fiat currencies for VAs / exchanging VAs for fiat currencies.

⁹ Under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (“AMLO”), “VA service” is defined to mean the services specified in Schedule 3B to that Ordinance, and at present operating a VA exchange is the only service so specified. The Secretary for Financial Services and the Treasury may amend Schedule 3B by notice published in the Gazette.

under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (“AMLO”) came into effect on 1 June 2023. Under the new regime, centralised VA exchanges operating in Hong Kong are required to be licensed and regulated by the SFC. The FSTB, the HKMA and the SFC will continue to collaborate with stakeholders in enhancing the VA regulatory landscape in Hong Kong, including carefully considering the need and options for bringing other VA-related activities under the regulatory remit as appropriate.

2.3. As mentioned in the Conclusion Paper, a number of respondents commented that there could be overlap between some of the stablecoin activities and other regulatory regimes in Hong Kong, especially: (i) the licensing regime for VASPs overseen by the SFC under the AMLO; and (ii) the licensing regime for stored value facilities (“SVF”) overseen by the HKMA under the Payment Systems and Stored Value Facilities Ordinance (Cap. 584) (“PSSVFO”)¹⁰.

2.4. In respect of the licensing regime for VASPs, the FSTB and the HKMA have been working with the SFC and other stakeholders to formulate the details of the regulatory regime for FRS issuers, in order to avoid regulatory arbitrage, identify and address regulatory overlaps or gaps and mitigate the risks arising from different activities. In respect of the licensing regime for SVFs, we are aware that certain stablecoin arrangements, especially those that are used for payment purposes, may to some extent be similar to an SVF. To provide the needed clarity, we have proposed (in section 4) that the definition of FRS will explicitly exclude float stored in SVFs or SVF deposit, though we note that in some cases, whether a digital representation of value or its issuance constitutes an SVF under the PSSVFO may still have to be determined on a case-by-case basis having regard to relevant factors such as the structure, relationship of the relevant parties and operations of the entity or product concerned.

2.5. Another matter explored in the previous consultation was whether the proposed regulatory regime should be covered under existing legislation (e.g. PSSVFO considering some of the similarities between FRS and SVF) or a dedicated new ordinance. In view of the evolving nature and complexity of the VA market landscape, it is considered sensible to introduce new, stand-alone legislation that focuses on the regulation of FRS issuers. Such legislation may also house the regulatory regime for other segments of the VA market as appropriate in the future (further details are provided in section 5).

¹⁰ Under the PSSVFO, the MA is responsible for: (i) licensing and supervision of SVFs, such as e-wallets and prepaid cards; and (ii) the designation and oversight of clearing and settlement systems, and retail payment systems in Hong Kong.

3. Policy Objectives and Guiding Principles of the Proposed Regulatory Regime

3.1. The key policy objectives are as follows:

- (a) to put in place appropriate safeguards to address potential monetary and financial stability risks posed by FRS;
- (b) to provide adequate protection to FRS users;
- (c) to maintain Hong Kong’s status as an international financial centre by putting in place an appropriate regulatory regime for FRS issuers that is in line with international regulatory recommendations; and
- (d) to foster sustainable and responsible development of the VA ecosystem in Hong Kong by providing legal and regulatory clarity.

3.2. In drawing up the legislative proposals, we will follow the guiding principle of “same activity, same risk, same regulation”. Also, the proposed regulatory regime would:

- (a) be risk-based, giving priority to areas that pose a higher degree of actual, perceived or potential risks;
- (b) be ready to address evolving market developments and relevant international discussions;
- (c) be proportionate, i.e. not imposing a regulatory burden on regulated entities that is disproportionate to the risks; and
- (d) ensure a level playing field and address possible regulatory arbitrage.

4. Scope and Coverage

4.1. Drawing reference from the definitions currently adopted by IOs and SSBs and making reference to mainstream terminology adopted in the VA market, we propose to define a “stablecoin” as a cryptographically secured digital representation of value that, among other things, —

- (a) is expressed as a unit of account or a store of economic value;

- (b) 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;
- (c) can be transferred, stored or traded electronically;
- (d) uses a distributed ledger or similar technology that is not controlled solely by the issuer; and
- (e) purports to maintain a stable value with reference to a specified asset, or a pool or basket of assets.

4.2. With reference to the coverage of relevant existing regulatory regimes, it is proposed that 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 deposit; digital representations of fiat currencies issued by or on behalf of central banks; and certain digital representation of value that has a limited purpose¹¹, do not fall under the definition of a “stablecoin”.

4.3. For FRS specifically, it will be defined as a stablecoin where the specified asset is one or more fiat currencies. Since an FRS could potentially be developed into a commonly acceptable means of payment, thus posing more imminent monetary and financial stability risks as compared to other VAs or other types of stablecoins, such as commodity-referenced stablecoins. As such, the FSTB and the HKMA propose that the issuance of an FRS would be a regulated stablecoin activity under the proposed new legislation. The conditions with which FRS issuers will require a licence from the MA are provided in section 6.1.

4.4. Under the proposed regulatory regime, all FRS issuers will be subject to the same regulatory treatment, regardless of the stabilisation mechanism of the FRS concerned and the underlying backing assets. For instance, an issuer of an FRS that derives its value from arbitrage or algorithm will fall under the scope of the regulatory regime, but it will be highly unlikely that such issuer will meet the proposed licensing criteria, especially on reserves management (section 6.2(a)), and be able to obtain a licence¹².

4.5. Due to the fast-changing market and regulatory environment in the VA sector, there is a need on a timely basis to address the emerging monetary

¹¹ This refers to digital representation of value that can only be used as a means of payment for goods or services provided by the issuer.

¹² The arrangement for FRS issued by such entities is set out in section 7.

and financial stability risks and adhere to relevant international standards. The FSTB and the HKMA intend to provide the authorities with the necessary powers to adjust the parameters of in-scope stablecoins and activities. More details on the proposed powers are provided in section 8.

Consultation questions:

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

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

5. Legislative Approach

5.1. Having considered the options of amending the AMLO, the PSSVFO, and introducing a new piece of legislation to give effect to the proposed regulatory regime, the FSTB and the HKMA propose that a new piece of legislation be introduced, based on the following grounds:

- (a) stablecoins and SVFs may have different features¹³. It would be more appropriate for the new regulatory regime for FRS issuers to be established by a new piece of legislation rather than be incorporated into the PSSVFO; and
- (b) a new ordinance seems more suitable for addressing a rather nascent area like stablecoins. It could also serve as the foundation for extension of the local regulatory regime for other VA-related activities as necessary and appropriate in the future.

5.2. It is proposed that, as a first step, FRS issuers be brought within the regulatory remit of the MA. As the market and international regulatory discussions continue to evolve, the Government and financial regulators will continue to work together to assess the risks of other VAs and their activities and keep in view the need to bring them under regulation.

5.3. The FSTB and the HKMA also note that the FRS issuance activity to be regulated under the proposed regulatory regime may overlap with other financial regulatory regimes in Hong Kong. To avoid subjecting an FRS issuer

¹³ For example, a stablecoin could generally be transferable without the involvement of the issuer, whereas an SVF would entail the SVF licensee (i.e. issuer) giving relevant undertakings relating to making payments using the value stored under the SVF concerned.

to multiple regulatory regimes, it is proposed that the issuance of an FRS by a FRS licensee be excluded from certain regulatory regimes such as those applicable to securities (including collective investment schemes) and SVFs.

Consultation questions:

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?

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?

6. Regulatory Framework for FRS Issuers

6.1 Licensing regime for FRS issuers

6.1.1. Under the proposed licensing regime for FRS issuers, no person shall:

- (i) issue, or hold oneself out as issuing, an FRS in Hong Kong;
- (ii) 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
- (iii) actively market¹⁴ its issuance of FRS to the public of Hong Kong;

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

6.2 Licensing criteria and conditions

(a) *Management of reserves and stabilisation mechanism*

6.2.1. **Full backing:** The FRS issuer must ensure that the value of the reserve assets backing an FRS is at least equal to the par value of the FRS in circulation at all times. Considering the inherent difficulty of maintaining a robust stabilisation mechanism in the absence of any backing assets with inherent

¹⁴ This may include: (i) frequently calling on members of the Hong Kong public and marketing their services; (ii) running a mass media programme targeting the Hong Kong public; and (iii) Internet activities that target the Hong Kong public.

value, issuers of FRS that derive its value from arbitrage or algorithm will not be granted a licence.

6.2.2. **Investment limitations:** The reserve assets must be of high quality and high liquidity with minimal market, credit and concentration risk. Reserve assets should be held in the referenced currency, with flexibility allowed on a case-by-case basis, subject to approval by the MA. In determining the composition of reserve assets, the FRS issuer should take into account the liquidity requirements of the FRS concerned and how the reserve assets will be managed and invested to meet such requirements. The MA will need to be satisfied that the types of investment the FRS issuer proposes to hold are appropriate. In this regard, the FRS issuer should put in place an investment policy for reserve assets that is reviewed for suitability on a sufficiently frequent basis as the FRS business develops.

6.2.3. **Segregation and safekeeping of reserve assets:** The FRS issuer should put in place an effective trust arrangement to ensure that the reserve assets of the FRS are segregated from its other assets, and available to satisfy FRS holders' redemption, as well as their legal right and priority claim of the reserve assets in the event of an insolvency of the issuer. The FRS issuer must establish segregated accounts for reserve assets with licensed banks or, under arrangements satisfactory to the MA¹⁵, with other asset custodians. As part of the FRS issuer's internal control system, the issuer must put in place effective internal control measures and procedures to protect the reserve assets from operational risks, including the risk of theft, fraud and misappropriation.

6.2.4. **Risk management and controls:** The FRS issuer must have adequate policies, guidelines and controls for the proper management of all investment activities associated with the management of the reserve assets to ensure that there will be sufficient funds and liquid assets for the redemption of FRS in circulation. The FRS issuer must have comprehensive liquidity risk management practices that clearly set out the strategy and tools for addressing large scale redemptions, i.e. run scenarios or scenarios of liquidity stress. The issuer will be expected to conduct periodic stress testing to monitor the adequacy and the liquidity of the reserve assets.

6.2.5. **Disclosure and reporting:** The total amount of the FRS in circulation, the mark-to-market value of reserve assets and the composition of reserve assets must be disclosed regularly to the general public. The issuer, in consultation with the MA, must engage a qualified and independent auditor to perform regular

¹⁵ The FRS issuer is expected to demonstrate to the MA that the asset custodian is qualified for such role, and has in place robust mechanisms for the safekeeping of reserve assets.

attestation, including on: (i) the composition and market value of the reserve assets, (ii) the par value of FRS in circulation, (iii) whether the reserve assets are adequate to fully back the value of FRS in circulation, and are sufficiently liquid, as of the last business day of the period covered by the attestation; and (iv) whether the conditions on the reserves management as imposed by the MA have all been fulfilled. It is proposed that the total amount of FRS in circulation and the value of reserve assets be disclosed at least daily, the composition of reserve assets be disclosed at least weekly, and attestation by the independent auditor be performed at least monthly¹⁶.

6.2.6. **Prohibition on paying interest:** Any income or loss from the reserve assets, including but not limited to interest payments, dividends or capital gains or losses, must be attributed to the FRS issuer. In line with the international regulatory practices, FRS issuers must not pay interest to FRS users.

6.2.7. **Effective stabilisation:** The FRS issuer must be ultimately responsible for ensuring the effective functioning of the stabilisation mechanism of the FRS it issues, even if third parties are engaged by it to carry out the stabilisation activities.

(b) *Redemption requirements*

6.2.8. FRS users should have the right to redeem their FRS at par value with the FRS issuer and have a claim on the reserve assets (and in respect of the issuer when the issuer is not able to meet redemption obligations). Redemption requests must be processed without undue costs on a timely basis. The FRS issuer must not impose unreasonable conditions on redemption (e.g. a very high minimum threshold amount). Any fees for redemption must be clearly communicated to users and should be proportionate, and not be set at such a high level that effectively deters redemption. The FRS issuer must meet the redemption request at par value by paying in the fiat currency/currencies as referenced by the FRS concerned.

6.2.9. In particular, where channels for FRS users to exchange their FRS into fiat currency/currencies become unavailable (e.g. in the case of disruption to an intermediary or infrastructure), the FRS issuer must ensure direct redemption for all FRS users at par in a reasonably timely manner.

6.2.10. The FRS issuer must draw up and maintain a contingency plan to enable orderly redemption of FRS by FRS users when the FRS issuer is unable

¹⁶ The disclosure requirement is consistent with the classification conditions for Group 1 cryptoassets as set out by the Basel Committee on Banking Supervision.

to meet redemption requests, including in the case of a suspension or revocation of the issuer's licence.

(c) *Restrictions on business activities*¹⁷

6.2.11. The FRS issuer must seek the MA's approval before it commences any new lines of business. The FRS issuer should conduct a risk assessment and also demonstrate that adequate resources are dedicated to the issuance and maintenance of FRS, the new business will not introduce significant risks to itself and there is proper risk control in place to ensure the new business activities will not impair its ability to perform its functions as an FRS issuer.

6.2.12. The FRS issuer will be permitted to conduct activities that are ancillary or incidental to its issuance of FRS, such as providing wallet services for the FRS it issues to facilitate the issuance and redemption processes. In providing such wallet services, among other things, the FRS issuer should have adequate policies and procedures for the segregation and safekeeping of users' FRS and handling of users' deposit and withdrawal requests for its FRS.

6.2.13. For the avoidance of doubt, the FRS issuer should not carry on lending and financial intermediation and should not conduct other regulated activities such as those under the Securities and Futures Ordinance ("SFO") (Cap. 571), the Mandatory Provident Fund Schemes Ordinance (Cap. 485) or the Insurance Ordinance (Cap. 41).

(d) *Physical presence in Hong Kong*¹⁸

6.2.14. The FRS issuer must be a company incorporated in Hong Kong and have a registered office in Hong Kong. Its chief executive, senior management team and key personnel¹⁹ must be based in Hong Kong and exercise effective management and control of its FRS issuance and related activities. This requirement will allow the MA to exercise effective supervision on such entities.

¹⁷ Licensing criterion (c) does not apply to FRS issuers which are authorized institutions (section 6.3.2).

¹⁸ Licensing criterion (d) does not apply to FRS issuers which are authorized institutions (section 6.3.2).

¹⁹ Key personnel include the functional heads of operations, IT systems, financial management, control and risk management, compliance and internal audit.

(e) *Financial resources requirements*²⁰

6.2.15. The FRS issuer must have adequate financial resources for operating its FRS issuance business, including a minimum paid-up share capital. The intention is to ensure that adequate financial resources are available to sustain the issuer's operations and absorb any losses. Drawing reference from international practices, it is proposed that the minimum paid-up share capital will be either HKD25,000,000 or a fixed percentage of the par value of FRS in circulation, whichever is higher. It is proposed that the fixed percentage be set at 2%.

6.2.16. The MA may also impose a higher level of paid-up share capital requirement on the FRS issuer as a licensing condition under the regime, if the MA considers it appropriate.

(f) *Disclosure requirements*

6.2.17. The FRS issuer must publish a white paper to disclose general information about itself, the rights and obligations of the FRS users, the FRS stabilisation mechanism, reserves management arrangements, the underlying technology and the risks. The FRS issuer must notify the MA prior to the publication of the white paper and other relevant publications.

6.2.18. The FRS issuer must disclose the redemption policies that clearly define the redemption process, the timeframe for such redemption, the applicable fees and the right of FRS users to redemption.

(g) *Governance, knowledge and experience*

6.2.19. Controllers, chief executives and directors of an FRS issuer must be fit and proper persons, and their appointment, together with any changes in ownership or management of the FRS issuer, would require the prior consent of the MA. The FRS issuer must have an adequate system of control for the appointment of the senior management team and a robust corporate governance structure staffed by personnel with the necessary knowledge and experience to enable the effective discharge of responsibilities.

²⁰ Licensing criterion (e) does not apply to FRS issuers which are authorized institutions (section 6.3.2).

(h) *Risk management requirements*

6.2.20. The FRS issuer must have in place appropriate risk management processes and measures for its operations. These should include, among other things, adequate security and internal controls to ensure the safety and integrity of data and systems; effective fraud monitoring and detection measures; technology risk management measures; robust contingency arrangements to address operational disruptions; and other operational and security safeguards which are commensurate with the scale and complexity of the business. The FRS issuer should also perform risk assessments on a sufficiently frequent basis (at least annually) to ensure the adequacy and effectiveness of its internal controls, risk management and governance processes.

(i) *Audit requirements*

6.2.21. The FRS issuer must submit audited financial statements to the MA on an annual basis. As and when required by the MA, the FRS issuer must submit reports prepared by external independent auditors and assessors to validate the management and operational soundness of FRS issuance, such as whether the FRS issuer has adequate systems of control for the management of reserve assets, cybersecurity and the integrity of the “smart contracts”²¹.

(j) *Anti-Money Laundering and Counter-Financing of Terrorism requirements*

6.2.22. The FRS issuer must ensure that the design and implementation of its issuance business have in place adequate and appropriate systems of control for preventing or combating possible money laundering and terrorist financing. It must have in place adequate and appropriate systems of control to ensure that it complies with the applicable provisions of the AMLO; any measures promulgated by the MA, whether in the form of rules, regulations, guidelines or otherwise, to prevent, combat or detect money laundering or terrorist financing. These would include but not be limited to adequate customer due diligence measures in relation to the FRS issuance and redemption, transaction monitoring and wire transfer (“travel rule”) requirements in line with the standards set by the Financial Action Task Force and requirements under the AMLO.

²¹ Smart contracts are self-executing computer programs stored on a blockchain that run when predetermined conditions are met.

6.3 Other licensing matters

(a) Eligibility for a licence

6.3.1. All entities would be eligible to apply for an FRS issuer licence as long as they could satisfy the same set of licensing and regulatory requirements. Subject to a robust approval process for their issuance of FRS, applicants are required to demonstrate that they meet the applicable licensing criteria, including but not limited to the ones proposed under section 6.2.

6.3.2. Considering that authorized institutions are already subject to stringent prudential requirements and ongoing holistic supervision by the MA, it is proposed that the licensing criteria (c) restrictions on business activities, (d) physical presence in Hong Kong and (e) financial resources requirements do not apply to FRS issuers which are authorized institutions, given that they are already subject to relevant regulatory requirements under banking regulation.

(b) Ongoing licensing conditions

6.3.3. In addition to setting licensing criteria, it is proposed that the MA be empowered to impose, amend and cancel ongoing licensing conditions on an FRS issuer. The MA will impose such conditions as the MA considers necessary. Such conditions may include, for example, requirements on reserve assets and restrictions on the types of services that could be undertaken by the FRS issuer.

(c) Issuing more than one FRS

6.3.4. It is proposed that the FRS issuer will be required to obtain consent from the MA before it issues any new FRS under its licence. The purpose of this requirement is to ensure that the new FRS will not jeopardise the operation of the existing FRS.

(d) Open-ended licence

6.3.5. It is proposed that the FRS issuer will be granted an open-ended licence, i.e. it will remain valid until the licence is revoked by the MA, for example, due to non-compliance or if the FRS issuer ceases its operation.

(e) Register of licensees and licensing fee

6.3.6. It is proposed that the FRS issuer must have its licence number displayed on any advertising materials and consumer facing interface of any software applications offered by it, so that the public would be made aware of its

licensing status. The MA will maintain a central register of all licensees that will be accessible by the general public.

6.3.7. It is proposed that the MA be empowered to levy licence fees on the FRS issuers (including licensees who are authorized institutions) on an annual basis.

Consultation questions:

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

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

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

7. Custody and offering of FRS

7.1. Stakeholders have expressed views on the need for regulating VA custody and offering services under dedicated guardrails. The FSTB, the HKMA and the SFC will work closely to examine the appropriate regulatory approach for such activities.

7.2. On offering of FRS²², we are of the view that FRS issued by entities not licensed by the MA is not suitable for use by the general public given the opaqueness of the risks involved. To ensure protection to FRS users, it is proposed that only licensed FRS issuers²³, authorized institutions²⁴, licensed corporations²⁵ and licensed VATPs can offer FRS in Hong Kong or actively market such offering to the public of Hong Kong. Authorized institutions, licensed corporations and licensed VATPs can offer FRS issued by entities not

²² “Offer” refers to the act, as a principal or an agent, of providing a channel for a person to acquire FRS, which includes but is not limited to distribution, providing trading or brokerage services for acquiring FRS, etc.

²³ A licensed FRS issuer could only offer FRS that it issues.

²⁴ An authorized institution means a licensed bank, a restricted licence bank or a deposit-taking company under the Banking Ordinance (Cap. 155).

²⁵ A licensed corporation means a corporation (that is not an authorized institution) which is granted a licence to carry on one or more regulated activities under sections 116 and 117 of the SFO. When offering FRS, licensed corporations must hold a licence for Type 1 regulated activity (dealing in securities) and be permitted by the SFC to carry out dealing in virtual assets.

licensed by the MA only to professional investors²⁶, and must indicate clearly such FRS is not issued by a licensed FRS issuer.

Consultation questions:

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

8. The authorities' power to modify the regime

8.1. Due to the fast evolving nature of the industry, it is proposed that the regime should provide for appropriate flexibility to address emerging risks arising from emerging types of stablecoins, activities or entities. Referencing the experience of the VASP regime, it is proposed that the authorities be empowered to adjust the parameters of in-scope stablecoins and activities.

8.2. It is proposed that the authorities exercise such powers having regard to, for example: (i) the risks posed to the monetary and financial stability of Hong Kong; (ii) the risk posed to the functioning of Hong Kong as an international financial centre; and (iii) matters of significant public interest. In determining the materiality of the case or the level of risks involved, the authorities may take into account factors such as:

- (a) the number and type of users;
- (b) the number and value of transactions;
- (c) the size and type of reserve assets;
- (d) the value in circulation;
- (e) the market share;
- (f) the interconnectedness with the financial systems; and/or
- (g) the business, structural and operational complexity.

²⁶ Professional investor is defined in Part 1 of Schedule 1 to the SFO.

Consultation questions:

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?

9. Supervisory Powers of the MA

9.1 Powers over Management of Licensee

9.1.1. Considering the potential impact of a default / failure of an FRS issuer on the financial system, it is proposed that the MA be empowered to intervene in the operations of a licensee where the circumstances so warrant. Drawing reference from similar powers under the Banking Ordinance (Cap. 155) (“BO”) and the PSSVFO, it is proposed that where the MA, in consultation with the Financial Secretary, is of the opinion that the licensee: (i) has become or is likely to become insolvent or unable to meet its obligations; (ii) is carrying on its business in a manner detrimental to the interests of its users or its creditors; or (iii) has contravened any of its licensing conditions or provisions of the proposed regulatory regime, the MA may:

- (a) require a licensee to do any act relating to a licensee’s affairs, business or property that the MA considers necessary, including restricting the licensees’ business of issuing FRS under the licence;
- (b) give directions to a licensee to seek advice on the management of its affairs, business and property from an advisor appointed by the MA; and
- (c) give directions that a licensee’s affairs, business and property must be managed by a manager appointed by the MA.

9.1.2. To enable the MA to ensure the fitness and propriety of the ownership and management of licensees, it is proposed that the MA’s consent be required for the following changes in ownership or management:

- (a) amalgamation, including any arrangement or agreement for the sale or disposal of all or part of the business of the FRS issuers;

- (b) persons becoming or being “controllers” (majority shareholder controller, minority shareholder controller, and indirect controller) and sale of shares; and
- (c) appointment of chief executives and directors.

9.1.3. As authorized institutions in Hong Kong are subject to the MA’s supervisory powers under the BO, it is proposed that the MA’s powers over the management of a licensee under the proposed regulatory regime would, in general, not be applicable to licensees that are authorized institutions in Hong Kong.

9.2 Other Supervisory Powers

9.2.1. To ensure that licensees will continuously meet the statutory requirements including the minimum licensing criteria and any licensing conditions specified for them in relation to their FRS issuance business, it is necessary that the MA be vested with the appropriate supervisory powers. Drawing reference from similar empowering provisions under the BO and the PSSVFO, the following are a non-exhaustive list of such powers.

Powers to gather information

9.2.2. It is proposed that the MA be empowered to request information or documents, including but not limited to reports prepared by internal and external auditors and books, accounts and transactions of a licensee or its subsidiaries, to be furnished to the MA by licensees on a periodic basis or at any time as the MA thinks fit. The MA will also be empowered to conduct on-site examinations at the premises of licensees for the purpose of collecting information to enable the MA to effectively monitor the compliance of licensees with the requirements of the proposed regulatory regime.

Powers to give directions

9.2.3. It is proposed that the MA be empowered to direct licensees to take such action as the MA considers necessary to bring the licensee into compliance with the statutory obligation to ensure the protection of the FRS users.

Powers to make regulations

9.2.4. It is proposed that the MA be empowered to make regulations under the proposed legislative framework to operationalise the regime effectively. The

regulations, for example, could provide for specific requirements in relation to issuance and redemption, reserves management and risk management.

Powers to issue guidelines

9.2.5. It is proposed that the MA be empowered to issue guidelines regarding the manner in which the MA would expect to perform its functions under the proposed new ordinance, provide guidance on licensees' compliance with the proposed regulatory regime, and to provide practical guidance to assist licensees in complying with the statutory requirements.

Consultation question:

Q11. Do you have any comments on the proposed supervisory powers of the MA on licensed FRS issuers?

10. Investigation Powers of the MA

10.1. Non-compliance with the proposed statutory requirements or improper operation of an FRS may cause losses to users and disruption to the financial stability of Hong Kong as a whole. The overall objective of the MA's enforcement functions would be to identify non-compliance efficiently and at an early stage. For this purpose, and with reference to similar powers in the PSSVFO, the SFO and the AMLO, it is proposed that the MA be empowered to conduct investigations where it has reasonable cause to believe that an offence under the intended regulatory regime may have been committed. The proposed powers include the following:

- (a) the MA may direct an investigator to conduct investigation;
- (b) the investigator may compel provision of evidence from persons relevant to the suspected contravention, including production of any record or document. The MA may require such persons to explain particulars in respect of any record or document; to attend before it to answer questions pertaining to the matters under investigation; and to render assistance in connection with the investigation, etc. The investigator may also inspect records or documents taken in possession for the purpose of investigation; and
- (c) the MA may apply to a Magistrate for search warrants and seizures when necessary.

Consultation question:

Q12. Do you have any comments on the proposed investigation powers of the MA in respect of licensed FRS issuers?

11. Offences and Sanctions

11.1 Criminal Offences and Sanctions

11.1.1. The proposed criminal sanctions on offenders would deter industry participants from committing similar offences. Offences include issuing an FRS in Hong Kong, issuing a Hong Kong dollar-referenced stablecoin or actively marketing one's own issuance of FRS to the public of Hong Kong without a licence, advertising the issuance of FRS of an unlicensed issuer, failure to produce documents as required by the MA, giving false information to the MA or making false entries in documents, contravention of other conditions required by the MA in relation to the licensing regime. With the current thinking that only the licenced entities set out in section 7 will be allowed to offer FRS in Hong Kong, it will be an offence to offer FRS in Hong Kong unless it is carried out by a licensed entity as set out in section 7, or to advertise a person's offering of FRS unless the person is a licensed entity specified in section 7. In determining the level of fines and length of imprisonment applicable to offences under the proposed regulatory regime, reference will be drawn from the relevant provisions of the AMLO, the BO, the PSSVFO and the SFO.

11.2 Civil and Supervisory Sanctions

11.2.1. In addition to the above, it will be appropriate to empower the MA to impose a range of civil and supervisory sanctions, which will take into account the severity, circumstances, or duration of a contravention under the proposed regulatory regime. The proposed civil and supervisory sanctions in this respect include the following:

- (a) issuing a caution, warning, reprimand, order to take specified action(s); and supervisory sanctions including temporary suspension, suspension or revocation of licence, or a combination of the above;
- (b) a pecuniary penalty not exceeding HKD10,000,000 or 3 times the amount of profit gained or loss avoided as a result of the contravention, whichever is higher; or
- (c) any combination of the above.

12. Appeals

12.1. To ensure that the exercise of the MA's power under the proposed legislation is subject to checks and balances, it is proposed that an appeal tribunal mechanism be set up to cater for appeals against the MA's decisions in relation to the implementation of the licensing and supervisory requirements under the proposed regulatory regime. Appealable decisions will include the MA's decisions in relation to, among others, the following: refusal to grant licences for FRS issuance; attachment of conditions to licences; attachment of conditions to an exemption granted to an issuer; revocation and suspension of licences; objection to controllers, directors and key personnel of licensees (e.g. the chief executive); and imposition of civil and supervisory sanctions, etc. A person who is dissatisfied with a decision of the Tribunal may appeal to the Court of Appeal against the determination on a point of law.

Consultation questions:

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?

13. Transitional Arrangement

13.1. With effect from the commencement date of the regime, which we propose to be 1 month upon gazettal of the proposed new ordinance, FRS issuers that meet the applicable conditions set out in section 6.1.1 will require a licence issued by the MA. The provisions on offering of FRS, the restrictions relating to issuing advertisements²⁷, as well as other provisions would also be effective at the same time.

13.2. To facilitate smooth transition of pre-existing FRS issuers into the regime, pre-existing FRS issuers that are conducting FRS issuance activities with meaningful and substantial presence in Hong Kong prior to the commencement date of the regime may continue to operate under a non-contravention period of 6 months, on condition that they have submitted a licence application to the MA within the first 3 months of the commencement of the regulatory regime.

²⁷ This refers to the offence of advertising (i) a person's issuance of FRS unless the person is licensed by the MA, or (ii) a person's offering of FRS unless the person is a licensed entity specified in section 7. For details, please refer to section 11.1.1.

13.3. Pre-existing FRS issuers that do not submit a licence application to the MA within the first 3 months of the commencement of the regulatory regime will need to close down its business in an orderly manner by the end of the 4th month of the commencement of the regime.

13.4. In evaluating whether the FRS issuer has a meaningful and substantial operations in Hong Kong, factors that the MA will take into consideration will include, for example, whether the entity operating the FRS issuance is incorporated in Hong Kong, whether it has a physical office in Hong Kong with staff exercising central management and control over the FRS issuance and whether the FRS it issues has been circulated to independent FRS users (i.e. not limited to its own associated entities.)

Consultation questions:

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

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