

# New stablecoin regime in Hong Kong - towards what and where is it targeted?

## In brief

On 27 December 2023, the Financial Services and the Treasury Bureau (**FSTB**) and the Hong Kong Monetary Authority (**HKMA**) jointly announced the Consultation Paper on the **Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong (Consultation)**. The Consultation takes into account the feedback received on the HKMA **Discussion Paper on Crypto-assets and Stablecoins** dated January 2022 (**Original Consultation**) and the **Conclusion of Discussion Paper on Crypto-assets and Stablecoins** dated January 2023 (**Prior Conclusions**).

The Consultation proposes a standalone regulatory regime (**Proposed Regime**) focusing on fiat-referenced stablecoins (**FRS**). The four key policy objectives for the Proposed Regime include putting in place appropriate safeguards to address potential monetary and financial stability risks posed by FRS, providing adequate protection to FRS users, putting in place a regulatory regime that is in line with international regulatory recommendations<sup>1</sup> and fostering sustainable and responsible development of the virtual asset (VA) ecosystem in Hong Kong by providing legal and regulatory clarity. The Proposed Regime introduces a new licensing regime on FRS issuers, which represents an important extension of scope to the existing VA regulatory regime. We discuss the Consultation in more depth below.

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## Key Definitions/Concepts

The Consultation includes the following key proposed definitions and concepts:

1. **"Stablecoin"**: This refers to a cryptographically secured digital representation of value that, amongst 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.

The regulators intend to formulate a regime that can avoid regulatory arbitrage, identify and address regulatory overlaps or gaps and mitigate the risks arising from different activities. It is proposed in the Consultation that the following will be excluded from the scope of "stablecoin": deposits (including in tokenised or digitally represented form), certain securities or futures contracts (mainly authorised collective investment schemes and authorised structured products), float stored in stored value

<sup>1</sup> The HKMA and FSTB have in particular referenced the **FSB Global Regulatory Framework for Crypto-asset Activities - Financial Stability Board** published on 17 July 2023.

facilities (SVF) or SVF deposits, digital representations of fiat currencies issued by or on behalf of central banks (**CBDC**), and certain digital representations of value that has a limited purpose.<sup>2</sup>

2. **"Fiat referenced stablecoin" (FRS):** This refers to a stablecoin where the specified asset is one or more fiat currencies.
3. **"Hong Kong dollar referenced stablecoin":** This refers to a stablecoin that purports to maintain a stable value with reference to the value of the Hong Kong dollar.

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## What are the key triggers for the new regulatory regime?

The Proposed Regime essentially regulates the issuance and/or offering of FRS as follows:

1. **Licensing regime for FRS issuers.** It is proposed that no person shall: (i) issue, or hold itself out as issuing, an FRS in Hong Kong; (ii) issue, or hold itself out as issuing, Hong Kong dollar referenced stablecoin; or (iii) 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 (**FRS Licensee**). The term "actively marketing" 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.
2. **Restrictions on offering of FRS.** It is proposed that there will be restrictions for offering FRS in Hong Kong or actively marketing such offering to the public of Hong Kong. In this regard, the term "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.

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## FRS Issuers – Key Licensing Criteria and Conditions

The licensing criteria and conditions applicable to an FRS issuer under the Proposed Regime will, unless an exemption applies, include:

1. **Management of reserves and stabilisation mechanism**
  - An effective stabilisation mechanism must be implemented for the FRS consisting of reserve assets at least equal to the par value of the FRS in circulation at all times. The reserve assets should be held in the same referenced currency as the FRS and must be of high quality and high liquidity with minimal market, credit and concentration risk.
  - The assets should be subject to an effective trust arrangement to ensure segregation from the FRS issuer's other assets. FRS issuers must establish segregated accounts with licensed banks or under arrangements satisfactory to the HKMA with other asset custodians.
  - Income or loss from the reserve assets must be attributed to the FRS issuer and interest must not be paid to the FRS users.
  - The FRS issuer must have adequate policies, guidelines and controls for the proper management of all investment activities associated with the reserve assets management.
  - Regular disclosure must be made to the general public of the total amount of the FRS in circulation, the mark-to-market value of reserve assets and the composition of reserve assets. The total amount of the FRS in circulation and the value of the reserve assets must be disclosed at least daily and the composition of the reserve assets must be disclosed weekly.
  - An independent auditor must be engaged to perform regular attestation including on the composition and market value of the reserve assets, the par value of the FRS in circulation and whether the reserve assets are adequate to fully back the value of the FRS in circulation. The independent auditor's attestation must be performed at least monthly.

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<sup>2</sup> This refers to a digital representation of value that can only be used as a means of payment for goods or services provided by the issuer.

**2. Redemption requirements**

- FRS redemptions should, amongst other requirements, be at par value in the fiat currency(ies) referenced by the subject FRS and processed without undue costs on a timely basis. The redemptions must not be subject to unreasonable redemption conditions.

**3. Restrictions on business activities (not applicable to AIs)**

- The FRS issuer must seek the HKMA's approval before commencing any new lines of business.
- The FRS issuer will be permitted to conduct activities that are ancillary or incidental to the issuance of FRS (such as providing wallet services for the FRS it issues).
- The FRS issuer should not carry on lending, financial intermediation or other regulated activities such as those under the Securities and Futures Ordinance, the Mandatory Provident Fund Schemes Ordinance or the Insurance Ordinance.

**4. Physical presence in Hong Kong (not applicable to AIs)**

- The FRS issuer must be a company incorporated in Hong Kong, with a registered office in Hong Kong.
- The chief executive, senior management and key personnel (including the functional heads of operations, IT systems, financial management, control and risk management, compliance and internal audit) must be based in Hong Kong and exercise effective management and control over its FRS issuance and related activities.

**5. Financial resources requirements (not applicable to AIs)**

- The FRS issuer must have a minimum paid-up share capital of either HKD25,000,000 or a fixed percentage (currently proposed to be 2%) of the par value of the FRS in circulation, whichever is higher.

**6. Disclosure requirements**

- The FRS issuer must publish a white paper disclosing general information about itself, the rights and obligations of the FRS users, the FRS stabilisation mechanism, reserve management arrangements, underlying technology and the risks. The HKMA must be notified in advance of publication of the white paper and other relevant publications. The redemption policies defining the redemption process, timeframe, applicable fees and rights must also be disclosed.

**7. Governance, knowledge and experience**

- Controllers, chief executives and directors of an FRS issuer must be fit and proper persons and their appointment, changes in ownership or management of the FRS issuer will require prior consent from the HKMA. There must be adequate controls for appointment of the senior management team and the corporate governance structure must be staffed by personnel with necessary knowledge and experience to effectively discharge their responsibilities.

**8. Risk Management requirements**

- Appropriate risk management processes and measures must be in place for the operations of the FRS issuer that are commensurate with the scale and complexity of its business, including data and system safety and integrity controls, fraud monitoring measures, contingency arrangements to deal with operational disruptions and technology risk management measures. Risk assessments on the adequacy and effectiveness should be performed sufficiently frequently (at least annually).

**9. Audit requirements**

- Audited financial statements must be submitted to the HKMA annually. The FRS issuer may also be required by the HKMA to submit external auditor and assessor reports validating the management and operational soundness of the FRS issuance, including the integrity of the "smart contracts".

**10. Anti-Money Laundering and Counter-Financing of Terrorism requirements**

- The FRS issuer must have in place adequate and appropriate systems of control for preventing or combating possible money laundering and terrorist financing.

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## FRS Offering Restrictions

It is proposed that only FRS Licensees (which would only be able to offer FRS that they issue), AIs, SFC licensed corporations (LCs) (which must hold a licence for Type 1 regulated activity (dealing in securities) and be permitted by the SFC to carry out dealing in VA) and SFC licensed virtual asset trading platforms (VATPs)<sup>3</sup> can offer FRS in Hong Kong or actively market such an offering to the public of Hong Kong.

In respect of FRS which is not issued by an FRS Licensee, these can only be offered to professional investors (as defined in Part 1 of Schedule 1 to the SFO).

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## Proposed implementation/Transition arrangements

The FRS issuer licensing regime will commence 1 month from the gazettal of the proposed new ordinance. The other provisions on offering of FRS, restrictions relating to advertisements and other provisions will also take effect at the same time. Pre-existing FRS issuers with a meaningful and substantial presence in Hong Kong prior to the commencement of the Proposed Regime will be able to continue to operate under a non-contravention period of 6 months, provided they have submitted a licence application to the HKMA within the first 3 months from the commencement of the Proposed Regime. Pre-existing FRS issuers that do not submit a licence application by the deadline will need to conduct an orderly closure of business by the end of the 4th month from the commencement of the Proposed Regime.

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## Consultation Deadline

The deadline for submissions in response to the Consultation is on or before 29 February 2024.

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## Going Forward

The Consultation represents an important opportunity to help shape the stablecoin regulatory framework going forward. If you have any questions on how the proposed changes may impact your business and activities, or in the event that you would like to discuss a potential submission, please liaise with your usual contact at Baker McKenzie or the lawyers listed in this client alert.



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<sup>3</sup> Under the Securities and Futures Ordinance (Cap. 571) (SFO) or the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (AMLO).

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