

Embracing stablecoins in Hong Kong

Five years ago, when Diem (formerly known as Libra) was announced to the market, the potential and need for a revolution in digital payments was clear. However, the readiness of central banks, regulators and regulatory framework was lacking.

Standard setters including the Financial Stability Board, Bank of International Settlements and the Financial Action Task Force have been working with regulatory bodies to consider current gaps and how regulators may need to respond. Consultations and proposals for regulatory change are now showing the likely shape that regulation will take. Both existing incumbents and a number of new entrants are now able to plot their course for adoption, and perhaps acceptance, within the regulatory perimeter.

In this briefing, we will examine the current situation in Hong Kong and how we anticipate the regime for stablecoins developing.

Hong Kong embraces stablecoins

After a two-month public consultation period which attracted more than 100 submissions, on 17 July 2024, the Financial Services and the Treasury Bureau and the Hong Kong Monetary Authority (HKMA) jointly released consultation conclusions (see details [here](#)) on the legislative proposal to implement a regulatory regime for fiat-referenced stablecoin issuers in Hong Kong (the *FRS regime*). Shortly after, the HKMA announced the first batch of participants in its stablecoin issuer sandbox (the *Sandbox*, see details [here](#)).

With greater clarity on the parameters of the FRS regime – and the HKMA’s plan to introduce a bill for the regulatory framework to the Legislative Council “later this year” – we share some observations to contextualise the FRS regime for local and overseas market participants.

We summarise the current proposed parameters of the FRS regime in the one-page fact sheet [attached](#) to this briefing.

The stablecoin issuer sandbox

Sandbox participation is not a prerequisite for the application of a stablecoin issuer licence in the future. However, participation in the Sandbox enables the HKMA to “better understand the business models of stablecoin issuers with a view to assessing their plans to start stablecoin issuance business in Hong Kong.”

Through the Sandbox, the HKMA allows institutions with plans to issue stablecoins in Hong Kong to conduct testing on their operational plans. The Sandbox also facilitates two-way communication on proposed regulatory requirements, with a view to formulating a fit-for-purpose and risk-based regulatory regime.¹ For participants, the Sandbox also offers a lower-risk regulatory environment in which they can live-test their operations to identify any potential compliance challenges.

Retail payments or institutional FX trading instrument

When formulating the regulatory intention for the consultation in 2022, the stated priority was “the development of a regulatory framework for ‘payment-related stablecoins’, ie stablecoins that may have the potential to develop into a widely acceptable means of payments”, in light of risks pertaining to financial stability, monetary stability, settlement, user protection, financial crime, cyber, and regulatory arbitrage.²

Now, the HKMA’s vision for the FRS regime is much wider: there is an expectation that Sandbox applicants – presumably each becoming a licensed stablecoin issuer applicant in the future – will “propose concrete use cases for the stablecoin to help address pain points in economic activities and create value and new opportunities for our economy and financial services”. Admittedly, the admission bar for the Sandbox and ongoing likelihood of obtaining a license is therefore “set at a reasonably high level”.³

An emphasis on use cases

The HKMA is upfront about the importance they attach to the use cases of stablecoins admitted into the Sandbox, highlighting the use cases proposed by the first batch of Sandbox participants, which include payments, supply chain management and applications in capital markets. In the payments context, the HKMA referenced [financial institutions](#), [payment services companies](#), [settlement systems](#) and the pain points regarding movement of monies that stablecoins might address.⁴

On a similar note, the HKMA has been encouraging banks “to study the potential of taking ‘tokenised’ deposits” in the context of facilitating cross-border liquidity management.⁵ Project Ensemble and a range of other initiatives are looking at how the HKMA can support the development of the tokenisation market in Hong Kong with the support of central bank digital currencies.⁶

An issuance structure bespoke to the FRS regime

In our experience, given the specific prescriptions around the safekeeping of reserves and segregation under the FRS regime, it is unlikely that existing issuance structures prevalent in the market can be folded into the FRS regime. Issuances under the FRS regime will – which should not come as a surprise – have to adopt structures tailored for the FRS regime.

With more jurisdictions releasing their own stablecoin regulatory regimes, for multijurisdictional offerings, the design of issuance structures will necessarily have to dovetail with the regulatory requirements across those jurisdictions.

Given the vision for stablecoins to play an active role in addressing pain points in cross-border digital finance, and to avoid reducing stablecoins issued under the FRS regime to having local applications only, mutual recognition or “passporting” arrangements with overseas regulated issuances will be something to expect down the line in the FRS regime’s future development.⁷

Overseas issuances and offerings

There will be an extraterritorial element in the FRS regime: it is a criminal offence where an unlicensed person: (a) actively markets a stablecoin issuance to the Hong Kong public; or (b) issues a stablecoin that references the Hong Kong dollar, even if these activities are carried on outside of Hong Kong.⁸

However, it should be possible to offer stablecoins issued by entities not licensed by the HKMA under the FRS regime to professional investors through licensed intermediaries in Hong Kong.⁹

How Freshfields can help

Whether you are (or are looking to become) a local issuer, you are considering the implications of the FRS regime for your overseas issuance, or you are looking to enhance your settlement, payments or trade systems by way of a stablecoin, we can help you navigate the nuances of the FRS regime and the long-awaited developments to revolutionise payments.

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¹ 18 July 2024 inSight article by Darryl Chan, Deputy Chief Executive of the HKMA (<https://www.hkma.gov.hk/eng/news-and-media/insight/2024/07/20240718/>)

² January 2022 Discussion Paper on Crypto-assets and Stablecoins (<https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2022/20220112e3a1.pdf>) and January 2023 Conclusion of Discussion Paper on Crypto-assets and Stablecoins (<https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2023/20230131e9a1.pdf>)

³ 18 July 2024 inSight article by Darryl Chan, Deputy Chief Executive of the HKMA

⁴ 18 July 2024 inSight article by Darryl Chan, Deputy Chief Executive of the HKMA

⁵ 16 April 2024 circular (<https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2024/20240416e1.pdf>) and 11 April 2024 Keynote Speech at the International Conference on Central Bank Digital Currencies and Payment Systems by Eddie Yue, Chief Executive of HKMA (<https://www.hkma.gov.hk/eng/news-and-media/speeches/2024/04/20240411-1/>)

⁶ 7 March 2024 – HKMA press release (<https://www.hkma.gov.hk/eng/news-and-media/press-releases/2024/03/20240307-5/>)

⁷ Paragraph 4.8 of July 2024 consultation conclusions on the Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong (<https://www.hkma.gov.hk/eng/news-and-media/press-releases/2024/07/20240717-3/>)

⁸ Paragraph 3.1 of July 2024 consultation conclusions

⁹ Paragraph 7.2 of December 2023 consultation paper on the Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong (<https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2023/20231227e4a1.pdf>)

Stablecoins in Hong Kong: regulated products and activities

Product	What product is in scope? A fiat-referenced stablecoin (FRS). This captures an FRS that either: a. derives its value from arbitrage or algorithm; or b. references a single currency or multiple currencies. The proposal currently does not capture commodity-linked or precious metal-linked stablecoins.	What is a “stablecoin”? 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. operates on a decentralised distributed ledger (i.e. a distributed ledger in which no person has the unilateral authority to control or materially alter its functionality or operation) or similar technology; and e. purports to maintain a stable value with reference to a specified asset, or a pool or basket of assets.	
Regulated activities	Regulated activities Licensing is triggered where a person: a. issues, or holds oneself out as issuing, an FRS in Hong Kong; b. issues, or holds oneself out as issuing, a stablecoin that purports to maintain a stable value with reference to the value of the Hong Kong dollar; or c. actively markets its issuance of FRS to the public of Hong Kong. Extraterritoriality application: under both (b) and (c), even if carried on outside of Hong Kong.	Offering regime Only licensed FRS issuers, licensed banks, and corporations and virtual asset trading platforms licensed with the Securities and Futures Commission (SFC) can offer FRS in Hong Kong or actively market such offerings to the Hong Kong public. FRS issued by entities not licensed by the HKMA may only be offered to professional investors by licensed banks, and corporations and virtual asset trading platforms licensed with the SFC.	What does “actively market” mean? The HKMA references the approach adopted by the SFC under the securities regulatory regime and will take into account factors that include: a. the language used in the marketing messages, whether the message is targeted at a group of people that resides in Hong Kong; and b. whether a Hong Kong domain name is used for its website.

Licensed issuers

Operations	Restrictions on business activities The HKMA’s approval is required before an FRS issuer commences any new lines of business. An FRS issuer must not engage in lending or financial intermediation activities.	Localisation requirement An FRS issuer must be a company incorporated in Hong Kong and have a registered office in Hong Kong. Key management personnel must be based in Hong Kong.	Financial resources requirement A minimum paid-up share capital requirement of HKD25 million or 1% of the par value of FRS in circulation, whichever is higher.
Reserves management	Requirements on reserves The amount of FRS issued must always be fully backed by reserve assets held with licensed banks in Hong Kong at any given point in time (see Safekeeping requirements below). Given the absence of any backing assets with inherent value, issuers of FRS that derive its value from arbitrage or algorithm will not be granted a licence under the FRS regime.	Investment limitations The reserve assets must be of high quality and high liquidity with minimal market, credit and concentration risk. FRS issuers must demonstrate to the HKMA that their investment policies and liquidity management policies are commensurate with the size and complexity of the FRS issuers’ businesses. The HKMA will adopt a risk-based regulatory approach.	What constitutes “high-quality and high-liquidity reserve assets”? They may include: a. coins and banknotes; b. deposits placed with licensed banks; c. marketable securities representing claims on or guaranteed by governments, central banks or qualified international organisations with high credit quality; d. overnight reverse repurchase agreements with minimal counterparty risk backed by these securities; and e. tokenised versions of the above assets.
	Segregation requirements Reserve assets must be segregated from the FRS issuer’s own assets.	Safekeeping requirements FRS issuers must justify to the HKMA if reserve assets are not placed with licensed banks in Hong Kong. There must be in place an effective trust arrangement that provides FRS users with legal rights and priority claims on the reserve assets in the event of the FRS issuer’s failure.	Currency requirements Reserve assets must be held in the same currency as that referenced by the FRS, otherwise the HKMA’s approval is required. For HKD-referenced stablecoins, FRS issuers may have the flexibility to include USD-denominated reserve assets.
	Redemption requirements FRS issuers must fulfil redemption requests within one business day in normal circumstances after the day on which a redemption request is received.	Restrictions on profit distribution 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.	Disclosure There must be monthly attestation on reserve assets conducted by a qualified and independent auditor.