GLOBAL DIGITAL FINANCE

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stablecoin_feedback@hkma.gov.hk

Response to the HKMA discussion on Stablecoins

Dear Sir / Madam,

Global Digital Finance ("GDF"), an industry membership body that promotes the adoption of best practices for virtual assets and digital finance technologies through the development of conduct standards in a shared engagement forum with market participants, policymakers, and regulators, appreciates the opportunity to submit comments in response to the HKMA's discussion paper on Stablecoins.

We agree that regulation is required to drive innovation whilst maintaining trust in the associated financial stability.

However, what we can see from the questions and views from the HKMA is that the initial focus is very narrow (payment-related) but conversely the questions are at times very broad.

Given the increasing use of stablecoins and crypto assets in the financial system along with increased public appetite we recommend that this paper is too narrow and a secondary tranche of stablecoin regulation needs to be considered and timetabled.

We suggest this phase and any secondary phase will be essential to attract global issuers to Hong Kong. The wider scope of stablecoin regulations needs to be addressed in a timely manner to stimulate the demand for innovation in HK and not result in a lost opportunity. It should be noted, that the crypto asset space is moving quickly and the agreement on what "timely" equates to will be essential to avoid HK being left behind.

While the HKMA is clearly looking to drive regulations around stablecoins, we cannot lose sight that these assets are cross border by nature and it is essential that HKMA align with international standards and principles to assure alignment and consistency where appropriate.

At a more local level, the HKMA needs to make sure that any proposal works hand in hand with the pending SFC regulations on VASPs or risk confusion and potentially regulatory arbitrage.

GDF agrees that regulation needs to be risk based and therefore focuses on stablecoins that best protect the underlying investors. However, we cannot lose sight of the fact that various types of stablecoins are already sold into HK today via exchanges and regulation will eventually need to cover all items -OR- accept stablecoins activity outside of HKMA regulation -OR- enforce a ban on the stablecoins not regulated.

GDF thanks you for the opportunity to provide feedback and we are happy to be engaged in additional consultation which we recommend is required. If you would like to discuss more, please feel free to reach out to hello@gdf.io

Yours faithfully,

The GDF Board

Discussion Questions

1. Should we regulate activities relating to all types of stablecoins or give priority to those payment-related stablecoins that pose higher risks to the monetary and financial systems while providing flexibility in the regime to make adjustments to the scope of stablecoins that may be subject to regulation as needed in the future?

Stablecoins by their nature cover a very broad spectrum from various types of asset backed to algorithmic.

These various types of coins can bring different regulatory challenges and expanding this paper to consult on and cater for all potentials will be time consuming and impact the current timelines.

We therefore agree that a risk based approach is required which should focus on the more simplistic payment-related stablecoins, however this should not ignore the inclusion of additional types of stablecoins at a future date.

Customers with a nexus to HK already transact with various types of stablecoins and we believe a timetable for regulating additional forms of stablecoins (including algorithmic) is essential as the more complex coins would fall outside of the HKMA regulatory scrutiny implemented by this paper and therefore leave a gap

NOTE: For clarity, when we refer to payment-related coins, we are referring to either stores of value or true fiat only backed stablecoins such as the eYuan

2. What types of stablecoin-related activities should fall under the regulatory ambit, e.g. issuance and redemption, custody and administration, reserves management?

GDF recommends all stable coins and related activities should eventually fall under regulatory ambit, however the initial focus (as mentioned in Q1 above) should be aligned to payment-related stablecoins.

In our opinion, the PSSVFO may be expanded to cater for payment-related stablecoins that are SOVs, however that would not be fit for purpose for future stablecoins and we would recommend that new legislation will be required if the HKMA is looking to expand into the wider ecosystem of stablecoins.

As per the HKMA view, we consider the below activities all need clear regulation to protect underlying investors. However, careful consideration will be needed as we suggest some of the items below could require less focus if the 1st phase is just Payment-related stablecoins and other items could fall under other regulatory regimes.

I. issuing, creating or destroying stablecoins
II. managing reserve assets to ensure stabilisation of the stablecoin value
III. validating transactions and records
IV. storing the private keys providing access to stablecoins
V. facilitating the redemption of stablecoins
VI. transmission of funds
VII. executing transactions in stablecoins

3. What kind of authorisation and regulatory requirements would be envisaged for those entities subject to the new licensing regime?

We agree in principle with the view put forward by the HKMA, however (as mentioned by the HKMA), one size does not fit all and therefore for payment-related stablecoins some of the suggested regulations may not be essential for the 1st phase.

I. Authorisation requirements
II. Prudential requirements, including adequate financial resources and liquidity requirements
III. Fit and proper requirements on management and ownership
IV. Maintenance and management of reserves of backing assets
V. Systems, controls, governance and risk management requirements
VI. AML/CFT requirements
VII. Redemption requirements
VIII. Financial reporting and disclosure
IX. Safety, efficiency and security requirements. Requirements relating to safeguards against cyber-security, operational and business continuity risks etc.
X. Settlement finality

It must be noted that multiple entities can be involved in the facilitation of stablecoin transactions, so not all of the above will be appropriate to all parties in the chain and that differentiation must be made clear in any stablecoin regulation and guidance.

Some of the items above, such as AML/CFT controls, will be covered by the complementary regulations around VASPs and the travel rule, so working through those and agreeing the VENN diagram with other regulations will be key to avoid conflicting direction and gaps in the requirements.

4. What is the intended coverage as to who needs a licence under the intended regulatory regime?

Even though the HKMA views have merit, we believe the requirement for local incorporation will restrict the appetite for stablecoins issuers and by association reduce HKs ability to be competitive and innovative in this space.

We therefore suggest there is a reconsideration of this item to attract global players, whilst maintain local confidence.

If HK cannot attract issuers then there may be implications for exchanges already offering the various types of stable coins into HK and the implications of that need to be careful thought through as part of broader regulation.

5. When will this new, risk-based regime on stablecoins be established, and would there be regulatory overlap with other financial regulatory regimes in Hong Kong, including but not limited to the SFC's VASP regime, and the SVF licensing regime of the PSSVFO?

As mentioned several times in this response, there is undoubtedly a risk of overlap between this paper and the VASP regulations as being defined by the SFC. To avoid confusion any overlaps must be addressed to mitigate a position of breaches under one regulator but not under another.

We would recommend a consultation process is established between the SFC, the HKMA and contributors to this paper so that very clear demarcations can be drawn.

For the 1st phase, which we have assumed is 100% fiat backed or SOV, we believe the PSSVFO regime could be extended to accommodate the associated stablecoins for SOV with limited changes. However the biggest change may be the ceiling regarding dollar values within the PSSVFO as they are currently low.

6. Stablecoins could be subject to run and become potential substitutes of bank deposits. Should the HKMA require stablecoin issuers to be AIs under the Banking Ordinance, similar to the recommendations in the Report on Stablecoins issued by the US President's Working Group on Financial Markets?

GDF recommends that stablecoin issuers should not be limited to authorised institutions. The requirement to be an AI does not appear to be in place elsewhere. The US stablecoin regulation appears to focus more on reserve requirements to insure controls and mitigate any adverse runs. The HKMA regulations will need to consider the level of risk associated with each offering and associated issuer to make sure the controls are calibrated to a level to mitigate any risk (even if that would lead to blacklisting of certain stablecoins outside of HKMAs risk appetite).

7. Would the HKMA also have plan to regulate unbacked crypto-assets given their growing linkage with the mainstream financial system and risk to financial stability?

We do not consider that unbacked crypto assets are at a level of maturity in the financial system to create a risk to financial stability today. However, despite this area being nascent, we believe the HKMA must keep a close eye on this item as unbacked stablecoins may grow in popularity and be sold into HK.

The challenge (as mentioned previously) is that this type of stablecoin could be available to HK residents whilst being outside of any clear regulatory ambit and therefore unbacked stablecoins will need to be regulated or specifically excluded.

8. For current or prospective parties and entities in the stablecoins ecosystem, what should they do before the HKMA's regulatory regime is introduced?

GDF recommends that the HKMA should give heads up on the expected requirement ASAP so that the entities can conduct a gap analysis between the "as is" model they have around stablecoins vs the "to be" model as defined by this paper.

Guidance on matters such as tax, accounting and prudential treatment from supervisors will be helpful to expedite supervisory dialogue on new projects, particularly on expectations for risk assessment processes and subsequent approaches to risk management and consumer protection.

An indication of any grace period, will help entities prepare for any procedure changes and instigate any remediations required.

Additionally GDF recommends that forums are made available across the industry to gather feedback on the practicalities and challenges of any expected regulations.