New Licensing Regime for Fiat-Referenced Stablecoin Issuers

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Background

Following the consultation paper jointly issued on 27 December 2023 by the Financial Services and the Treasury Bureau ("**FSTB**") and the Hong Kong Monetary Authority ("**HKMA**") to introduce a new licensing regime for fiat-referenced stablecoin issuers ("**FRS issuer**"), the consultation conclusions had finally published on 17 July 2024, indicating that a vast majority of respondents agreed that the new regime should be introduced to fill the loophole of the existing regulatory regime which mainly focus on the virtual asset trading platform and the operators thereof.

As a result, FSTB and HKMA are planning to finalize the legislative proposal and introduce a bill for implementing the new licensing regime into the Legislative Council by 2024. This explanatory note is intended to provide the readers with the key takeways of the new licensing regime for fiat-referenced stablecoin issuers.

Fiat-Referenced Stablecoin

The HKMA defines fiat-referenced stablecoin ("**FRS**") as a cryptographically secured digital representation of value that, among other things, it : -

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

(ii) 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 debt; and/or investment;

(iii) can be transferred, stored or traded electronically;

(iv) is operated on a decentralised distributed ledger or similar techonology in which no person has the unilateral authority to control or materially aler its functionality or operation; and

(v) purports to maintain a stable value with reference to a specified asset, or a pool or basket of assets.

The defintion of FRS excludes those instruments covered under the existing regulatory regimes (e.g. deposits, securities and futures contracts, float stored in stored value facilities, digital representations of fiat currencies issued by or on behalf of central banks).

By its very nature, FRS poses a higher and more imminent monetary and financial stability risk as it carries the potential to become a commonly acceptable means of payment.

Regulatory Framework for FRS Issuer

Under the proposed licensing regime, 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 which maintains a stable value with reference to the value of the Hong Kong dollars; or (iii) actively market its issuance of FRS to the public of Hong Kong, unless it obtains licence granted by the HKMA.

What will constitute the issuance activitity and fall within the regulatory perimeter will be determined by the HKMA on a case-by-case basis, taking into account specific facts and circumstances. In contrast, it is worth noting that the offering activity of FRS would not necessarily require licence but instead, only licensed FRS issuers, authorized institutions as defined in the Banking Ordinance (Cap. 155 of the Laws of Hong Kong), licensed virtual asset trading platforms and licensed corporations with relevant permission in virtual asset sector from the Securities and Futures Commission will be legally and regulatorily capable of offering licensed FRS to the public of Hong Kong.

With respect to the licensing requirements, there are 6 key requirements in front of FRS issuers. They are listed out as follows:

(i) Management of reserve assets and stabilisation mechanism: The FRS issuer must, all the times, ensure that the FRS is fully backed by reserve assets which are of high quality and high liquidity with minimal market, credit and concentration risk, and at least equal to the par value of the FRS in circulation. For meeting the redemption requests, the FRS issuers are also required to establish an appropriate management and investment policy for reserve assets and remain ultimately responsible for the management of risks associated with reserve management. In addition, the offering of marketing incentives would not be prohibited while paying interest to FRS users would not be allowed, whether through third parties or otherwise.

(ii) Redemption requirement: The FRS issuer must ensure to fulfill redemption requests within one business day in normal circumstances after the day of the receipt of the request and without imposing undue costs or unreasonable conditions.

(iii) Restrictions on business activities: The provision of ancillary activities, inlcuding but not limited to, the provision of wallet services for the FRS, will be permitted to facilitate the issuance and redemption processes of FRS. It suggests however that no lending and financial intermediation activities shall be carried out by the FRS issuers.

(iv) Physical presence in Hong Kong: The FRS issuer must be a company incorporated in Hong Kong and have a registered office in Hong Kong. The physical presence of key management personnel, including chief executive, senior management team in Hong Kong is also regarded as the essential licensing requirements.

(v) Financial resources requirement: A minimum paid-up share capital requirement of the greater of HK$25 million or 1% of the par value of FRS in circulation is required to address the relevant market risk, operational risk, technology risk and other risks associated with the business operations.

(vi) Disclosure and audit requirement: 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 and the underlying technology and the risks to the public of Hong Kong. In addition, the FRS issuer is also required to submit audited financial statements to the HKMA annually and when necessary, provide reports prepared by external independent auditors and assessors to validate the management and operational soundness of FRS issuance.

Way forward

Due to the fast-evolving market landscape in the virtual asset sector, HKMA confirms that they will closely monitor market developments and adjust the regulatory remit as and when necessary in order to address the emerging monetary and financial risk and align with the international standards in respect of the nascent nature of virtual assets.