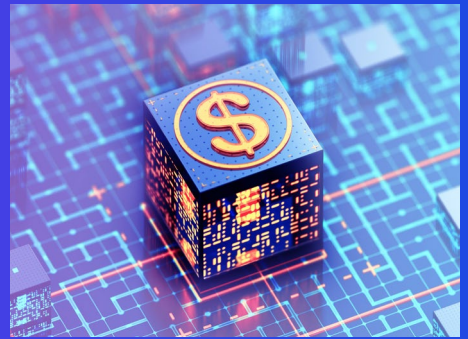


Consultation Paper on Proposed Regulatory Regime for Fiat-Referenced Stablecoin Issuers in Hong Kong

January 2024



Amid growing interest in stablecoins, regulators in Hong Kong have issued a consultation on legislation to implement a licensing regime for Fiat-Referenced Stablecoin (FRS) issuers.

Among the different types of stablecoins, FRS is viewed as having the potential to develop into a commonly acceptable means of payment. FRS therefore provides more imminent monetary and financial stability risks than other virtual assets or types of stablecoins.

On 27 December 2023, the Financial Services and the Treasury Bureau (FSTB) and the Hong Kong Monetary Authority (HKMA) jointly issued a [consultation paper](#) to seek views and comments on the proposed regulatory regime for stablecoin issuers in Hong Kong

In this brief, KPMG outlines the proposals, and the key expectations set by the regulator for stablecoin issuers in Hong Kong.

Key updates from the consultation

- Provides proposed definition of stablecoin.
- Sets out the licensing regime for FRS issuers.
- Ascertains the regulatory power of HKMA on stablecoin issuance.
- Proposes transitional arrangement



Proposed Definition of Stablecoin and FRS

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) 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.

FRS - a stablecoin where the specified asset is one or more fiat currencies.

Example of FRS – Tether (USDT), USD Coin (USDC), Binance USD (BUSD), EUROS (EURS)

Not considered stablecoin: Deposits, including in a tokenised or digitally represented form; certain securities or futures contracts; float stored in Stored Value Facilities (SVF) 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 purpose, do not fall under the definition of a “stablecoin”.

Key updates from the consultation



Licensing Regime – FRS issuers

Under the proposed licensing regime for FRS issuers, a company or person must hold an FRS issuer license granted by the HKMA if it intends to:

- (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 market its issuance of FRS to the public of Hong Kong.

HKMA has adopted a one-size-fits-all approach to the regulatory regime for FRS issuers. Regardless of the stabilisation mechanism of the FRS concerned and the underlying backing assets, all FRS issuers will be subject to the same regulatory treatment.

However, some stabilisation mechanisms by design are highly unlikely to fulfill certain licensing criteria. For example, an FRS that derives its value from **arbitrage** or an **algorithm** is **unlikely** to fulfill the requirements on reserves management and is therefore unlikely to secure a license.



Licensing Regime – Proposed Criteria and Conditions

- (a) Management of reserves and stabilisation mechanism - *the reserve assets should be sufficient and the value of FRS should be stable.*
 - i. Full backing
 - ii. Investment limitations
 - iii. Segregation and safekeeping of reserve assets
 - iv. Risk management and controls
 - v. Disclosure and reporting
 - vi. Prohibition on paying interest
 - vii. Effective stabilisation
- (b) Redemption Requirements – *FRS users should have the right to redeem FRS in a timely manner without undue cost or unreasonable restrictions. FRS issuer should have a contingency plan.*
- (c) Restrictions on business activities – *For FRS issuers, any new business needs to be approved by HKMA. Lending, financial intermediation and other regulated activities cannot be performed by FRS issuers.*
- (d) 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 management must be based in Hong Kong.*
- (e) Financial resources requirements - *The FRS issuer must have adequate financial resources for operating its FRS issuance business, including a minimum paid-up share capital of HK\$25,000,000 or 2% of the par value of FRS in circulation.*
- (f) Disclosure requirements - *The FRS issuer must publish a white paper to disclose general information about itself and key information of the FRS.*
- (g) Governance, knowledge and experience - *Controllers, chief executives and directors of an FRS issuer must be fit and proper persons. The FRS issuer must have an adequate system of control for the appointment of the senior management team and a robust corporate governance structure.*

Key updates from the consultation



Licensing Regime – Proposed Criteria and Conditions

- (a) Risk management requirements - *The FRS issuer must have appropriate risk management processes and measures for its operations and perform risk assessments at least annually.*
- (b) Audit requirements - *The FRS issuer must submit audited financial statements to the HKMA annually.*
- (c) Anti-Money Laundering and Counter-Financing of Terrorism requirements - *FRS issuers should ensure they comply with the applicable provisions of the Anti-Money Laundering Ordinance and other measures promulgated by the HKMA.*



Regulatory power of HKMA

HKMA and FTSB are proposed to be **empowered to adjust** the parameters of in-scope stablecoins.

It is also proposed that the HKMA be **empowered to intervene in the operations** of a licensee where the circumstances so warrant.

To enable the HKMA to ensure the fitness and propriety of the ownership and management of licensees, it is proposed that the HKMA's **consent** be required for the certain **changes in ownership or management**.

Other Supervisory Powers of HKMA on FRS issuers:

- Powers to gather information
- Powers to give directions
- Powers to issue guidelines
- Powers to make regulations

It is proposed that HKMA be **empowered to conduct investigations** where it has reasonable cause to believe that an offence under the intended regulatory regime may have been committed.




Transitional Arrangement

- One month upon gazettal of the proposed new ordinance (the commencement date of the regime), FRS issuers that meet the applicable conditions set out in section 6.1.1 will be required to hold a license issued by the HKMA.
- 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 **six months**, on condition that they have **submitted a license application** to the HKMA within the **first three months** of the commencement of the regulatory regime.
- Pre-existing FRS issuers that do not submit a license application to the HKMA within the first three months of the commencement of the regulatory regime will need to close down their business in an orderly manner by the end of the fourth month of the commencement of the regime.


How KPMG can help

KPMG is a market leader in supporting Licensed Corporations and Virtual Assets Companies in various capacities from Audit to Advisory. A team of seasoned experts with deep knowledge of the VA space is ready to support you on the proposed HKMA requirements.




Pre-Implementation

- Understanding the rules and managing rule ownership assignment
- Perform a gap analysis and readiness assessment of your controls and processes against requirements and industry practices
- Provide enhancement suggestions on the existing policies and procedures



Implementation Support

- Support firms in implementing the HKMA requirements listed in the proposed licensing regime
- Perform regular assessments and health checks to ensure continued compliance with licensing criteria, including AML assessment, management of reserve and redemption procedures.



Business Support

- Business roadmap support and target operating model support under the stablecoin activities.
- Stabilisation mechanism and reserves management review and assessment against business objectives.
- Notification and licensing support to the HKMA.
- IT and cybersecurity services in relation to stablecoin and other VA business.
- AML and KYC services.

Contact us



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