



31 March 2022

Hong Kong Monetary Authority
via: stablecoin_feedback@hkma.gov.hk

Dear Madam/Sir,

Re: EPAA's Response to HKMA Discussion Paper on Crypto-Assets & Stablecoins

Emerging Payments Association Asia (EPAA) applauds HKMA's receptivity toward stablecoins as a mode of payment. This is aligned to growing acceptance of this class of digital asset in multiple jurisdictions, and corresponding ambition to provide regulatory clarity around its use. This approach has been observed in the recent US Executive Order in this space, the European Commission's Markets in Crypto-Assets framework, and Singaporean Monetary Authority's clarifications on treatment of stablecoins.

Prior to commencing our response, EPAA would like to highlight that our approach is from the perspective of a payments industry association. There are several activities undertaken in a stablecoin arrangement, ranging from issuance, custody, exchange, distribution, and payment facilitation. Payment service providers are increasingly likely to extend their services as the fiat-crypto-asset/stablecoin bridge in these arrangements, with the purpose of facilitating the acceptance of crypto-assets as payment for goods and services or conversion back to fiat. In the language of the Discussion Paper, this would be closest to the activity of "facilitating the redemption of stablecoins".

EPAA notes the following key positions put forth by the Discussion Paper:

- Assessment that the arrangements of stablecoins, especially those that are used for payment purposes, are *somewhat* akin to a Stored Value Facility (SVF).
- To regulate a suite of stablecoin activities¹ either by expanding the scope of Payment Systems & Stored Value Ordinance (PSSVFO) or introducing a new legislation.

In relation to the first position, there is a viewpoint in some jurisdictions, including Singapore, on the equation of stablecoins to e-money and the corresponding equation of e-money to an SVF (as it would be defined in Hong Kong). An SVF is a facility which contains a digital representation of money. In a similar capacity, a stablecoin is a representation of value. However, if we consider the responsibilities for a payment service provider, these might be currently regulatory defined differently in a stablecoin versus fiat-only arrangement.

¹ Issuance, reserve asset management, validation of transactions and records, storage of private keys, redemption facilitation, transmission of funds, execution of transactions in stablecoins

The Monetary Authority of Singapore (MAS) has recently made clarifications on stablecoins², where it was determined that stablecoins are not the same as e-money in the way that e-money is a digital representation of currency. Holders of single-currency stablecoins (SCS) can often use the SCS via third party service providers or with their own private wallets, without the involvement of the SCS issuer. This is unlike e-money holders who typically have contractual relationships or accounts with the issuer and can only use e-money through the issuer. The MAS indicates that “Stablecoins may meet the definition of ‘---digital payment token’. MAS takes a technology-neutral stance and will examine the characteristics of the stablecoin to determine the appropriate regulatory treatment”.

The Discussion Paper focuses on payment-related stablecoins, with a discussion of both whether PSSVFO is an adequate framework to regulate stablecoins and whether stablecoin arrangement activities are suitable and relevant for PSSVFO, which is designed to regulate payment-related activities, and hence may need amending/expanding in scope. The Paper also at times discusses the regulation of stablecoins as an asset class versus the activity of payment using a stablecoin.

The EPAA, in line with the principle to “examine the characteristics of the stablecoin to determine the appropriate regulatory treatment”, considers a substance over ‘form’ approach, as outlined in our views below on Discussion Question 1 and note that the options in an existing regulatory regime may vary significantly between markets as to how the current substance of a financial product is currently regulated and these regulations may need expanding, amending to accommodate stablecoins.

Discussion Question 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?

As indicated above, using a guiding principle of substance over ‘form’ when considering stablecoins and in particular payment-related stablecoins, with an adjustment for the current regulatory definitions, as the Singapore example above indicates, appears to be an expedient approach.

To allow an assessment of the regulatory substance over strict ‘form’ of a stablecoin, EPAA finds it most appropriate to consider the primary ‘substance’ of a stablecoin as digital representation of a claim in a ledger (of some type which is not critical and should be technically neutral) enforceable on an entity that offers an undertaking to redeem the value of the stablecoin from their holdings of a range of backing assets, in the simplest form 1:1 backed with the currency in which denominated (e.g. USD).

The purpose to which an entity may create, hold, utilise, transfer or distribute a stablecoin would appear to be the primary guide to the appropriate regulation:

² Qu 23 -

<https://www.mas.gov.sg/-/media/MAS-Media-Library/regulation/faqs/PD/faqs-on-payment-services-act-2019/Payment-Services-Act-FAQ--7-March-2022.pdf>

- if the issuer or parties utilising an issued stablecoin are primarily intending or the actual usage of the stablecoin is that of a stored value facility utilised in payment for a product/service/asset (for example, crypto assets) and the funds are primarily to maintain the nominal value of the float, the substance would appear to be that of a Stored Value Facility, although risk based adjustments would be needed (especially to reflect the value of the amounts being used and to reflect the pseudo-anonymous 'bearer' features of common solutions and how the risks of these are managed).
- if the issuer or parties utilising an issued stablecoin are primarily intending the stablecoin or the actual usage of the stablecoin is that of a form of e-money (to the extent that a jurisdiction's regulations have a separate regulation focus on this service), similar assessment and adjustment of a regulatory regime maybe an appropriate approach.
- if the issuer is an entity primarily intending or the actual usage of the stablecoin is that of an alternative to deposits as a form of providing funds to support a fractional lending business, the full banking licensing regime appears more appropriate.
- if the issuer, or the parties utilising an issued stablecoin, is intending or the actual usage is for high-value real-time settlement with finality for crypto asset exchanges, considering whether the substance would be that of a Designated Clearing & Settlement System. Similarly, (although currently less likely) if the intent was for low value retail payments, the substance would be of a Retail Payment System.
- if the issuer, or the parties utilising an issued stablecoin, is intending or the actual usage is on exchanges as part of the trading activity, exchange related regulation as appropriate in the jurisdiction, noting that there are a number of approaches, with the Securities and Futures Commission ('SFC') appearing to take the lead in Hong Kong.
- at a minimum it would appear that any parties utilising payment-related stablecoins in their business for purposes that would fall under an amended or expanded Money Service Operators License, e.g. for over-the-counter exchanges or remittances, if not already falling under the other supervision (thereby exempting them), would need to follow the licensing rules of this type of activity and the relevant international anti-money laundering/terrorist financing requirements.

Discussion question 2

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

The HKMA has listed a comprehensive suite of activities intended to be brought under regulatory ambit for payment-related stablecoins. A clear distinction between activities associated with payments versus activities associated with issuing and maintenance of the stablecoin would be beneficial. For instance where stablecoin issuers could be viewed as substitutes of bank deposits, by no means does this activity fit into the regulatory parameters of the PSSVFO and as indicated above would on a substance over 'form' approach equate with banking activities.

Hence, following our recommendation above of considering substance over form, once the substance of the use of stablecoin by an entity is established, existing regulations specify the areas that are considered, for example if the substance is established as a SVF, then the areas to be covered are detailed in the Guideline on the Supervision of SVF Licensees³ and the Explanatory Note on Licensing for SVF⁴. Whilst sections of these guidelines and notes may need adjustment to reflect the particular technology involved, the market offering of features such as the pseudo-anonymous ‘bearer’ transfer between parties, the responsibilities of the regulated entity would remain the same whether undertaken directly, reliant on others (reliance would need to fit-for-purpose risk assessed) or outsourced (with existing material outsourcing responsibilities already defined).

Considering SVF as an example, the areas (i) to (vii) noted in the Discussion Paper would appear to fall within the the responsibilities of the regulated entity and whilst amendments and scope may be needed, the risk based responsibilities appear familiar:

	Discussion paper activity for payment-related stablecoins	Appears existing or amended/expanded scope of:
(i)	issuing, creating or destroying stablecoins - the activity of the issuer minting and burning of stablecoins	Issuer or Facilitator under the SFV (see Guideline) ¹
(ii)	managing reserve assets to ensure stabilisation of the stablecoin value - the activity of managing the reserve assets that are backing the value of the stablecoins and providing custody/trust for these assets	Section 6.4 Management of Float and SVF Deposits - Guideline...SFV Licencees ¹
(iii)	validating transactions and records - the activity of authorising or verifying the validity of transactions and records	Section 5.3 Record keeping - Guideline..SFV Licencees
(iv)	storing the private keys providing access to stablecoins - the activity of safe-keeping of keys used to digitally sign transaction instructions on behalf of stablecoin holders	7.2 Technology risk management - Guideline..SFV Licensees
(v)	facilitating the redemption of stablecoins - the activity of facilitating the stablecoin holders to redeem stablecoins for fiat currencies or other assets	Section 24 Redemption of outstanding stored value - Explanatory Note on Licensing for Stored Value Facilities
(vi)	transmission of funds - the activity of ensuring the correct and final settlement of transactions to minimise default risk of counterparties	Section 27 Operating Rules - Explanatory note on Licensing for Stored Value Facilities. It is expected that the operating rules cover the complete chain of an SVF’s operation including account opening, pre-transaction and authorization to clearing and settlement

³ https://www.hkma.gov.hk/media/eng/doc/key-functions/financial-infrastructure/Guidelines-on-supervision-of-SVF-licensees_Eng.pdf

⁴ https://www.hkma.gov.hk/media/eng/doc/key-functions/financial-infrastructure/infrastructure/retail-payment-initiatives/Explanatory_note_on_licensing_for_SVF.pdf

		and post-transaction processes”
(vii)	executing transactions in stablecoins - the activity of conducting transactions on behalf of others	See general comment on ‘form’ under response to question 1 - would depend on the regulations of the form of the entity transaction - at a minimum a Money Service Operator or potentially if an agent of an Authorised Institution, a Money Broker.

Note where the stablecoin creator is separate from the entity managing the issuing of the stored value facility for payment purposes, the existing regulations do include a role of ‘facilitator’ which, as the Explanatory Note on Licensing for SVF² describes in footnote 1 on page 4⁵

Discussion question 3

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

As per the response under Question 1, subject to the intended use of the stablecoin and the proposed activities of the stablecoin participant, it would seem that the relevant current regulations and authorisations could be brought into action and/or be modified to ensure that the relevant regulations and authorisation processes capture the new activities and participants.

Consideration may need to be given to the type of assets permitted to back a stablecoin, for example an approved list of assets with real monetary value. If not already adequately covered by existing regulation and authorisation processes, the custodians of these stablecoin assets and their activities and legal standing also need to be considered.

Discussion question 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?

Generally there are a number of regulatory entities within Hong Kong’s regulatory landscape for crypto-assets and payments, creating a degree of complexity when parties are navigating. It may be beneficial to take an overarching view on crypto-assets and expand the current coordination of a harmonized approach, as indicated by the joint SFC and HKMA positioning around VASPs.

⁵ Footnote on page 4 of Explanatory note see above) Facilitation of the issue of SVF is also subject to the same requirements under the licensing regime. Under section 2B of the Ordinance, a facilitator is defined as a person who facilitates the issue of an SVF by providing the issuer with valuable consideration the value of which determines, whether in whole or in part, the extent to which the issuer may give an undertaking that falls within the description of section 2A(2) or (3) of the Ordinance in respect of the facility

In the Appendix there is reference to our understanding of the licensing regimes and the multiple regulatory parties involved in payments licensing in Hong Kong from the perspective of a new entrant to the Hong Kong market wishing to perform cross-border payment activities.

Discussion question 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?

With reference to the substance over 'form' approach, unbacked crypto assets are a completely different form of property/holding (whether commodity, security, utility token etc.) to a payment-related stablecoin.

Whereas a payment-related stablecoin is expected to be backed by assets with the intent to maintain a fixed 1:1 exchange, unbacked crypto assets are "intangible" and whose value cannot be related to well known and developed asset classes, except via exchange rates to fiat currencies quoted by Crypto Exchanges. To the extent that a stablecoin is backed, but by a basket or other commodities with a market value (for example, multiple currencies, gold), in substance this would appear to be a 'structured financial product', which in Hong Kong would fall under the Securities and Futures Ordinance and would have higher degrees of risk relative to a well regulated/operated 1:1 fiat backed payment-related stablecoin.

Similar to structure products and previous challenges (Lehman minibonds), the concern around unbacked or basket backed crypto-assets is the financial risks that they pose to retail customers, many of whom do not understand the complex exposures that they are open to when they purchase these products, hence the current restrictions in some markets to limit these to professional investors.

Thank you again for the opportunity to respond to the Discussion Paper. If you have any questions or wish to discuss further, please feel free to contact us.

Yours sincerely,

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encl: Appendix

Appendix - Primary regimes with potential oversight of Payment-related Stablecoins from perspective of a new entrant to the Hong Kong market in Cross-Border Payments

a) Money Service Operator License

For a new entrant performing basic remittance payments, companies are required to secure an MSO License under AMLO. This is administered by Hong Kong's Customs and Excise Department.

b) SVF License

For a new entrant wishing to offer an expanded range of payment services, the next natural step would be to seek an SVF License under PSSVFO. This is administered by the Hong Kong Monetary Authority.

Throughout the Discussion Paper, stablecoin arrangements are proposed to be integrated with the current PSSVFO licensing regime or an amended version thereof. This may present a streamlined opportunity for new entrant payments companies to obtain requisite step-up permissions to expand beyond the current suite of services offered under the MSO regime.

To the extent that the approach taken has been to regulate stablecoins as a class of digital asset, an expansive range of stablecoin activities appear to be proposed for regulation under the PSSVFO, which was originally intended for activities such as e-wallet and prepaid card issuance, aligned with facilitating payments.

From the perspective of a new entrant, the PSSVFO may also present a number of current administrative challenges. The potential amendment of the PSSVFO to accommodate payment-related stablecoins may provide an opportunity for streamlining.

c) VASP Regime

Virtual asset exchanges are licensed and regulated by the Securities and Futures Commission. Whilst we note that the proposed definition of VA does not cover stored value facilities, which are separately regulated under PSSVFO, there are potential overlapping activities intended for regulation under SVF to the extent that exchanges may issue or use payment-related stablecoins.

A new entrant would seek clarity and ideally a single regulator, either the SFC or the HKMA under a VASP regime or the PSSVFO. This would ideally lead to the clarity that a contractual arrangement between a VASP and SVF licensee is permissible, with no further licensing obligations required from the other regulating entity. At a detailed level, clarity on the specific activities of the usage of a stablecoin arrangement that should reasonably come under the regulatory ambit of PSSVFO would be beneficial in removing uncertainty.