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HKMA publishes report on first climate risk stress test (CRST) of the Hong Kong banking sector

Simon Deane and Crystal Choi

In December 2021, the Hong Kong Monetary Authority (**HKMA**) issued the results of its pilot CRST. The CRST assesses the potential impact of climate change on the Hong Kong banking sector.

The CRST results showed that the extreme climate scenarios assumed in the exercise would lead to a material reduction in the participating banks' profitability due to an upsurge in expected credit losses from their exposures directly affected by climate change, such as residential mortgages and lending to high-emitting industries. Climate change could also weaken banks' capital positions.

The HKMA will continue to engage with the industry to support the sector's capability building to manage climate risks. In particular, the HKMA intends to:

- reach out to the industry to share the lessons learnt from the CRST and provide guidance to help banks strengthen their capabilities to meet supervisory expectations on managing climate risk;
- explore possible solutions to resolve challenges, especially those that require concerted efforts of banks to improve the climate resilience of the industry as a whole;
- collect the industry's feedback and enhance the scenario specifications and develop a climate related stress test framework; and
- explore opportunities to collaborate with overseas authorities to promote greater consistency in climate related stress test practices.

The HKMA intends to undertake a second climate related stress test in two years' time.

To access the report, please see [here](#).

HKMA consultation on crypto-assets and stablecoins

Simon Deane and Jennifer Lok

On 12 January 2022, the Hong Kong Monetary Authority (**HKMA**) released a discussion paper on crypto-assets and stablecoins (the **Discussion Paper**).

The Discussion Paper considers the existing regulatory framework on crypto-assets and stablecoins in Hong Kong, taking into account, among other things, the market and regulatory landscape in Hong Kong and other major jurisdictions, the characteristics of stablecoins and the potential risks that may arise in relation to the use of stablecoins, and outlines the HKMA's views and priorities on the regulatory approach for crypto-assets.

The HKMA's proposal is to focus initially on payment-related stablecoins, in particular asset-linked stablecoins. Under the new regime, certain stablecoin-related activities will be regarded as regulated activities and need to be licensed by the HKMA.

The HKMA is inviting feedback on the scope of the regulatory regime applicable to stablecoins from members of the public and the industry by 31 March 2022. The aim is to introduce the new stablecoin regulatory regime by 2023-2024.

The Discussion Paper can be found [here](#).

Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022

Simon Deane and Jennifer Lok

In view of the recommendations of the Financial Action Task Force (**FATF**) in the Mutual Evaluation Report on Hong Kong and the latest changes to the FATF Standards introduced in 2019, the Financial Services and the Treasury Bureau has proposed to amend the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (**AMLO**) to introduce (a) a licensing regime for virtual asset services providers (**VASPs**) and (b) a two-tier registration regime for dealers in precious metals and stones (**DPMS**), along with other miscellaneous and technical amendments. Public consultation was conducted from 3 November 2020 to 31 January 2021 and the consultation conclusion was published on 21 May 2021. Key features of the current legislative proposals are set out below.

(A) Licensing Regime for VASPs

Any person seeking to engage in the regulated activity of operating a virtual asset exchange in Hong Kong will be required to obtain a VASP licence from the Securities and Futures Commission (**SFC**). Virtual asset exchange(s) that are already regulated as a licensed corporation in SFC's opt-in regime will not be required to obtain a new licence.

Licensed VASPs will be subject to the anti-money laundering and counter-terrorism financing (**AML/CTF**) requirements stipulated by AMLO as well as other regulatory requirements to be implemented by the SFC, which will include, among other things, requirements on financial resources, corporate governance, risk management policies and that the licensed VASPs may only offer services to professional investors.

(B) Two-tier Registration Regime for DPMS

Any person seeking to carry on the business of regulated activities as a DPMS for a customer in Hong Kong will have to be registered under the AMLO, and there will be two tiers of registration based on whether or not the DPMS intends to or may engage in cash transactions at or above HK\$120,000 in the course of its business (**specified cash transactions**). Applicants who intend to or may engage in any specified cash transaction in the course of their DPMS business will be subject to an additional fit and proper test and only this tier of registrants will be subject to the AML/CTF obligations under the AMLO.

Further details on the legislative proposal can be found in the [paper](#) tabled at the meeting of the Legislative Council Panel on Financial Affairs on 7 February 2022.

ISDA whitepapers on environmental, social and governance issues

Simon Deane and Ruby Hui

ISDA released two whitepapers on environmental, social and government (**ESG**) on 1 December 2021.

The first whitepaper discusses the legal implications of voluntary carbon credits (**VCC**) and divides them into the following main sections:

1. Legal nature of VCCs including whether VCC could be classified as an intangible asset and possible legal treatment of VCC in different jurisdictions.
2. Analysis of major legal issues including ownership and fungibility, security of transfer, intermediation and conflicts of laws, netting and security arrangements following an insolvency.

Recommendations to enhance legal certainty including publishing a legal statement, introducing legislative amendments and guidelines, and launching global standards. For more information, please see [here](#).

The second whitepaper analyses sustainability-linked derivatives (SLD) from a regulatory perspective. To summarise, the paper covers the following issues:

1. Whether SLD could be categorised as swaps under the relevant regulations in the US, EU and/or UK, and the possible exemptions available if so.
2. Significance of Category 2 SLDs on the underlying transactions.
3. Compliance considerations for market participants.

For more information, please see [here](#).

Launch of cross-border fintech pilot trial facility

Simon Deane and James Tong

The Hong Kong Monetary Authority (**HKMA**) announced in February 2022 the launch of the Greater Bay Area (**GBA**) fintech pilot trial facility and that it was prepared to process applications from financial institutions and technology firms for access to this cross-border facility. The announcement came after the signing of the “Memorandum of Understanding on Fintech Innovation Supervisory Cooperation in the Guangdong-Hong Kong-Macao Greater Bay Area” by the HKMA and the People’s Bank of China (**PBOC**) in October 2021 in which the two authorities aimed to provide a “one-stop platform” to allow eligible financial institutions and technology firms to conduct pilot trials of cross-border fintech initiatives.

To get ready for processing applications for accessing the facility, the HKMA and the PBOC jointly developed a set of operational procedures for the facility.

Further details can be found in the [circular](#) issued by the HKMA. A notice (in Chinese only) similar to the circular was also issued by the PBOC.

PRC's 14th Five Year Plan makes plans for the digital economy

Simon Deane and Chris Wong

In the latest Five Year Plan (outlines of which can be found [here](#) in English, and [here](#) in Chinese), the policymakers of China set out China's course for economic and social development. Amongst the many areas covered, the plan also sets out Chinese policy in relation the financial industry.

Some points of note include:-

- The Five Year Plan notes China's intention to develop financial technology and accelerate the digital transformation of financial institutions. In particular, financial institutions are encouraged to use technology throughout their services, including for regulatory matters, risk assessment, and others. The Five Year Plan also seeks to encourage innovation across all sectors, to be supported by all sectors, including the financial sector through the development of new fintech products, and establishing pilot projects by financial institutions.
- To help ensure that China remains competitive and is ready for the new digital age, measures will be introduced to encourage the development of key digital technologies and industries, including technologies that have an application in the world of finance, such as big data, artificial intelligence, blockchain, and cloud computing.
- Integrating digital technologies into the daily lives of the citizens of China is also a focus, with plans to develop platforms and technology to digitise many aspects of life and government services. This is can be seen in the development and promotion of China's digital currency – reference in the Five Year Plan is made to the fact that policymakers will continue to encourage this development.
- The Five Year Plan also makes references to a desire to improve on many aspects of the banking and financial industry, including plans to improve the governance structures and corporate governance of financial institutions generally (including strengthening oversight of shareholders' equity and related party transactions), reforming state-owned banks, regulating the development of non-banking financial institutions, and enhancing the inclusiveness of financial services. Other stated intentions include improving on the capital markets of China (including developing institutional investors, fully implementing registration-based IPO systems, and improving the quality of listed companies), improving the market-based bond issuance mechanism, improving on consumer and investor protection systems (including deposit insurance) and so forth.
- China's intention to participate in the development of international rules and standards on digital technologies, including digital currencies and digital taxes, is also noted in the Five Year Plan – this may mean that Chinese innovations and standards have a greater impact on the developments of similar technologies around the world.
- For Hong Kong, the Five Year Plan outlines China's support of the city's status as an international financial and trade centre. The Five Year Plan dedicates sections on encouraging Hong Kong's continued efforts to building itself as a centre for finance, legal services, technology and innovation, and the mechanisms by which Hong Kong will be integrated into the overall development of its immediate region (the Greater Bay Area) and the Chinese economy as a whole.

Want to know more?

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