

What's inside?

HKMA issued consultation conclusion of discussion paper on crypto-assets and stablecoins.....	1
SFC Consultation on proposed requirements for operators of virtual asset trading platforms.....	2
HKMA: HKSAR Government's Inaugural Tokenised Green Bond Offering.....	3
ISDA: Publication of the Digital Asset Derivatives Definitions.....	3

HKMA issued consultation conclusion of discussion paper on crypto-assets and stablecoins

Simon Deane and Jennifer Lok

On 12 January 2022, the Hong Kong Monetary Authority (“**HKMA**”) issued a discussion paper on crypto-assets and stablecoins (“**Discussion Paper**”) outlining its thoughts on the development of a regulatory framework for stablecoins, and invited feedback from members of the public and the industry.

The HKMA published the consultation conclusion (“**Consultation Conclusion**”) on 31 January 2023. It summarises the feedback received on the Discussion Paper and sets out the HKMA's responses. There was a broad consensus among the respondents on regulating stablecoin based on a risk-based and agile approach.

Having considered the responses received, the latest international regulatory recommendations, standards and approaches on crypto-assets and Hong Kong's overall policy stance, the HKMA has formulated the following key parameters for the proposed regulatory regime for crypto-assets:

- The HKMA will adopt a risk-based approach by giving priority to regulating stablecoins that purport to reference to one or more fiat currencies. Appropriate flexibility will be built-in to the proposed regime to enable the HKMA to adjust the scope of regulation in the future (e.g. scope in other stablecoin structure(s)).
- A mandatory licensing regime will be introduced to regulate key activities relating to stablecoins, such as:
 - **Governance**: establishment and maintenance of rules governing an in-scope stablecoin arrangement;
 - **Issuance**: issuing, creation or destruction of in-scope stablecoins;
 - **Stabilisation**: stabilisation and reserve management arrangements of an in-scope stablecoin (whether or not such arrangements are provided by the issuer); and
 - **Wallets**: provision of services that allow the storage of users' cryptographic keys which enable access to the users' holdings of in-scope stablecoins and the management of such stablecoins.

- The licensing requirement will apply to entities which (i) conduct a regulated activity in Hong Kong concerning in-scope stablecoins (specifically, stablecoins that purport to reference the value of the Hong Kong dollar); (ii) actively market such regulated activity to the public of Hong Kong; or (iii) the HKMA is of the opinion should be so regulated, having regard to matters of significant public interest.

The HKMA will conduct a more detailed consultation in due course, with a view to implementing the stablecoin regulatory regime by 2023/24. The Consultation Conclusion can be found [here](#).

SFC Consultation on proposed requirements for operators of virtual asset trading platforms

Simon Deane and Chris Wong

The Securities and Futures Commission (“**SFC**”) launched a consultation on the regulatory requirements for virtual asset trading platforms (“**VATPs**”) in Hong Kong. As most would now know, a licensing regime for virtual asset service providers that operate centralised virtual asset trading platforms will come into operation on 1 June 2023, and the SFC is now preparing the relevant regulatory guidelines and requirements for VATPs so that they are in place once the regulatory regime comes into effect. The SFC has issued a consultation document relating to (i) the proposed regulatory requirements for VATPs, and (ii) whether retail investors should be allowed access to VATPs.

The SFC will base the requirements on the existing requirements for centralised VATPs which have “opted-in” to be regulated, and expand the requirements to take into account the changes to the industry since the implementation of the opt-in regime in 2019. The proposed guidelines have requirements in relation to (i) custody of client money and virtual assets, (ii) AML/CFT and KYC checks, (iii) conflicts of interest in relation to trading or market-making activities, (iv) criteria and procedures for admitting virtual assets for trading on the VATP, (v) policies on prevention of market manipulation and other similar activities, and (vi) standard requirements for systems of control and management, in particular accounting, auditing and risk management.

Of somewhat greater interest is the consultation in relation to whether retail investors should be permitted to access licensed VATPs. Although the SFC has in the past taken a more reserved view on the participation of retail investors in virtual assets, it has allowed limited and indirect access to retail investors to virtual assets exposures through limited regulated products. Given the changes and growing maturity in the virtual asset industry over the last few years, as well as the intentions of the HKSAR Government to develop Hong Kong into a virtual asset hub, the SFC now sees an opportunity to permit all investors to access trading services provided by licensed VATPs within limited circumstances and under proper investor protection measures. Such measures will include (i) requiring VATPs to have onboarding requirements for its clients, including the client’s risk tolerance, financial situation, etc., and (ii) requiring VATPs to establish and implement criteria in relation to what virtual assets can be admitted for trading by retail investors, taking into account factors such as the virtual asset’s background, development and management, regulatory status, supply, demand, maturity and liquidity of the virtual asset, technical aspects, market and legal risks of the virtual asset, etc.

Specifically in relation to trading by retail investors, the SFC intends only to allow “eligible large-cap virtual assets” to be traded by them. An eligible large-cap virtual asset refers to a virtual assets that is included in at least two acceptable indices (an index that has a clearly defined objective to measure the performance of the largest virtual assets and is investible, objective, possessing necessary expertise and well documented methodology) issued by at least two independent index providers (independent meaning not within the same group or belonging to the same entity as the VATP). The SFC is also proposing to introduce additional due diligence requirements for VATPs on virtual assets proposed to be traded by retail investors, including (i) ensuring that the VATP’s own systems of control are sufficient, (ii) conducting a smart contract audit for virtual assets based on blockchains with a smart contract layer, and (iii) obtaining a legal opinion to be provided to the SFC to the effect that the virtual asset in question does not fall within the definition of securities under the Securities and Futures Ordinance (Cap. 571).

Other matters subject to the consultation include requirements on disclosure of information relating to the virtual assets to be traded on the VATP, insurance and compensation arrangements, whether virtual asset derivatives should be permitted in the future (noting that they are not currently allowed), and requirements on AML/CTF measures. Transitional arrangements are also outlined in the consultation paper.

The willingness of the SFC to consider opening the possibility of investing and trading in virtual assets to retail investors is a welcome move, and the tumult in the virtual asset industry in 2022 (including the collapse of the Terra stablecoin, several large players in the industry, and the then-second largest virtual asset exchange in FTX)

emphasises the need for stringent and robust regulatory requirements to protect all investors, and in particular the ordinary retail investor. The proposals strike a balance between these necessary protections and the aim to encourage the growth of the virtual asset industry in Hong Kong.

The deadline for submission of comments to the consultation closes on 31 March 2023. For more details, please see the [link](#) to the consultation paper, and the [link](#) to the press release announcing the consultation.

HKMA: HKSAR Government's Inaugural Tokenised Green Bond Offering

Simon Deane and Natalie Chan

On 16 February 2023, with assistance from the HKMA, the Hong Kong Government offered HK\$800 million of tokenised green bonds in Hong Kong. It was also the world's first tokenised green bond issued by a government.

Tokenising a bond involves recording the beneficial interests in a bond using distributed ledger technology, as opposed to traditional computerised book entries. This does not only change the format of securities bookkeeping, but also facilitates the trading of the bonds on a single digital platform at a lower cost. Put simply, selling tokenised bonds now only involves moving the bond and cash tokens between the e-wallets of buyers and sellers on a single platform instantly without any settlement delay and other risks associated with traditional settlement methods.

As the first tokenised bond is governed by Hong Kong law, the offering demonstrates that Hong Kong's legal and regulatory environment is capable of accommodating innovative forms of bond issuances. To encourage wider adoption of tokenisation in the Hong Kong market, the HKMA will soon issue a whitepaper to summarise the experience gained from this issuance, set out the next steps and provide a blueprint for issuing other tokenised bonds in Hong Kong.

For more detail, please see [link](#).

ISDA: Publication of the Digital Asset Derivatives Definitions

Simon Deane and Crystal Choi

The International Swaps and Derivatives Association ("ISDA") has released new standard documentation for the trading of digital asset derivatives, along with a whitepaper that tackles legal concerns raised by the recent bankruptcies of major crypto exchanges and market participants.

The main objective of the ISDA Digital Asset Derivatives Definitions is to bring greater clarity to this nascent asset class. It does this by creating an unambiguous contractual framework for digital asset derivatives under the umbrella of the ISDA Master Agreement, so as to reduce credit and market risk by setting clear provisions for execution and settlement.

The ISDA Digital Asset Derivatives Definitions initially cover non-deliverable forwards and options on Bitcoin and Ether, but there are plans to broaden the scope to cover other product types such as tokenized securities and other digital assets executed on distributed ledger technology.

The definitions are available [here](#).

Want to know more?

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